



U. S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278 0068

MEMORANDUM NO: 2010-NY-1806

September 22, 2010

MEMORANDUM FOR: Vicki Bott, Deputy Assistant Secretary for Single Family
Housing, HU

Dane M. Narode, Associate General Counsel for Program
Enforcement, CACC

Edgar Moore

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

SUBJECT: Security Atlantic Mortgage Company, Inc., Edison, NJ, Did Not Properly
Underwrite a Selection of FHA Loans

INTRODUCTION

We conducted a review of Federal Housing Administration (FHA) loans underwritten by Security Atlantic Mortgage Company, Inc. (Security Atlantic), an FHA direct endorsement lender. This review was conducted as part of the Office of Inspector General's (OIG) Operation Watchdog initiative to review the underwriting of 15 direct endorsement lenders at the suggestion of the FHA Commissioner. The Commissioner expressed concern regarding the increasing claim rates against the FHA insurance fund for failed loans. The objective of the review was to determine whether Security Atlantic underwrote 20 loans in accordance with U.S. Department of Housing and Urban Development (HUD)/FHA requirements.

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

The draft memorandum report was provided to Security Atlantic officials on August 12, 2010 and Security Atlantic officials provided a written response on August 26, 2010. Security Atlantic officials generally disagreed with our findings and recommendations. The complete text of Security Atlantic officials' response, along with our evaluation of that response, can be found in appendix C of this memorandum, except for the exhibits, which were too voluminous to be included within the report. Adjustments were made to the report in some areas as a result of documentation and comments provided in Security Atlantic's written response.

METHODOLOGY AND SCOPE

Security Atlantic is 1 of 15 direct endorsement lenders we selected from HUD's publicly available Neighborhood Watch¹ system for a review of underwriting quality. These direct endorsement lenders all had a compare ratio² in excess of 200 percent of the national average as listed in the system for loans endorsed between November 1, 2007, and October 31, 2009. We selected loans that had gone into claim status. We selected loans for Security Atlantic that defaulted within the first 30 months and were (1) not streamlined refinanced, (2) not electronically underwritten by Fannie Mae or Freddie Mac, and (3) associated with an underwriter (usually an individual) with a high number of claims. The sample of loans consisted of 20 purchases. To accomplish our objectives, we reviewed applicable HUD handbooks, mortgagee letters, and reports from HUD's Quality Assurance Division.

We performed our work from March through June 2010. We conducted our work in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information systems controls of Security Atlantic, consider the results of previous audits, or communicate with Security Atlantic's management in advance. We did not follow standards in these areas because our goal was to aid HUD in identifying material underwriting deficiencies and/or potential wrongdoing on the part of poor performing lenders that contributed to a high rate of default and claim against the FHA insurance fund. To meet our objectives, it was not necessary to fully comply with standards, nor did our approach negatively affect our review results.

BACKGROUND

Security Atlantic was a HUD-approved Title II non-supervised³ direct endorsement lender located in Edison, NJ. It became a direct endorsement lender on June 30, 1993, and voluntarily withdrew from the direct endorsement program on May 25, 2010. Under the direct endorsement program, lenders are allowed to underwrite FHA-insured single-family mortgages without prior review, but FHA lenders are responsible for complying with all applicable HUD regulations and are required to evaluate the borrower's ability and willingness to repay the mortgage debt. Lenders are protected against default by FHA's Mutual Mortgage Insurance Fund, which is sustained by borrower premiums. Security Atlantic endorsed 99 percent of its loans through the Lender's Insurance (LI) program in 2007 and 2008 and endorsed 96 percent of its loans in 2009. The LI program enables high-performing lenders, pursuant to section 256 of the National

¹ Neighborhood Watch is a Web-based data processing, automated query, reporting, and analysis system designed to highlight exceptions to lending practices to high-risk mortgages so that potential problems are readily identifiable.

² HUD defines "compare ratio" as a value that reveals the largest discrepancies between the direct endorser's default and claim percentage and the default and claim percentage to which it is being compared. FHA policy establishes a compare ratio of more than 200 percent as a warning sign of a lender's performance.

³ A non-supervised lender is a HUD/FHA-approved lending institution that has as its principal activity the lending or investment of funds in real estate mortgages and may be approved to originate, sell, purchase, hold, and/or service HUD/FHA-insured mortgages, depending upon its wishes and qualifications.

Housing Act, to endorse FHA mortgage loans without a pre-endorsement review⁴ being conducted by FHA. Under the LI program, the LI-approved lender performs its own pre-endorsement review and provides mortgage loan level data to FHA via the FHA Connection.⁵ The FHA Connection performs an automated verification process to check the data for accuracy and completeness, and the lender then will be able to endorse the mortgage loan automatically. Security Atlantic was removed from the LI program on December 1, 2009. HUD's Quality Assurance Division conducted its last review of Security Atlantic on August 13, 2007. Security Atlantic did business as Security American Mortgage Company.

The goal of Operation Watchdog is to determine why the selected lenders had such a high rate of defaults and claims as compared to the national average. We selected up to 20 loans in claim status from each of the 15 lenders. The 15 lenders selected for Operation Watchdog endorsed 183,278 loans valued at \$31.3 billion during the period January 2005 to December 2009. These same lenders also submitted 6,560 FHA insurance claims with an estimated value of \$794.3 million from November 2007 through December 2009. During this period, Security Atlantic endorsed 34,278 loans valued at more than \$6.7 billion and submitted 348 claims worth more than \$62.3 million.

The objective of this review was to determine whether Security Atlantic underwrote the 20 selected loans in accordance with HUD/FHA requirements, and if not, whether patterns of underwriting deficiencies reflected systemic problems.

RESULTS OF REVIEW

Security Atlantic officials did not underwrite 6 of 20 loans reviewed in accordance with HUD/FHA regulations. As a result, the FHA insurance fund suffered actual losses of \$452,217 on five loans and faces a potential loss of \$101,513 on one loan for a total of \$553,730 as shown in the table below.

FHA/loan number	Closing date	Number of payments before first default	Acquisition cost	Unpaid balance	Original mortgage amount	Actual loss to HUD ⁶	Estimated loss to HUD (60% of unpaid balance)	Total actual and potential loss to HUD
011-5621419	6/12/07	7	\$ 90,000	\$ 87,909	\$ 89,294	\$ 80,326		\$ 80,326
011-5865507	4/24/08	3	80,000	77,852	78,764	68,556		68,556
095-0567977	2/29/08	2	175,000	169,188	172,296		\$101,513	101,513
105-3100085	11/14/07	0	201,185	196,580	198,076	130,843		130,843
421-4296353	11/1/07	1	169,200	164,656	166,585	60,694		60,694
441-8065074	12/12/07	4	158,000	154,089	156,761	111,798		111,798
					\$861,776	\$452,217	\$101,513	\$553,730

⁴ A pre-endorsement review is conducted by HUD's Homeownership Center staff on the FHA case binder to ensure that FHA documentation requirements have been met, forms and certifications are properly executed, and FHA Connection and Automated Underwriting System data have integrity.

⁵ FHA Connection is an interactive system available through the Internet that gives approved FHA lenders real-time access to FHA systems for the purpose of conducting official FHA business in an electronic fashion.

⁶ The loss amount was obtained from HUD's Single Family Acquired Asset Management System (SAMS). SAMS tracks properties from acquisition to final sale closing and maintains all accounting data associated with the case records.

The table below summarizes the material underwriting deficiencies that we identified in the six loans.

Area in which underwriting deficiencies were found	Number of loans⁷
Income	1
Liabilities	3
Assets	1
Gift documentation	3
Credit-related deficiencies	2
Rental history	1
Borrower investment in property not verified	4

Appendix A of this report shows a summary schedule of material deficiencies in each of the six loans, and appendix B provides a detailed description of all loans with material underwriting deficiencies noted in this report.

Specific examples of these underwriting deficiencies follow.

Unsupported Rental Income

For loan number 441-8065074, Security Atlantic officials included monthly rental income of \$595 as the borrower's other earnings on the mortgage credit analysis worksheet without verifying this rental income. The appraisal report estimated income from the unit that would not be occupied by the borrower to be \$700; therefore, Security Atlantic officials applied the Philadelphia Homeownership Center's vacancy rate of 15 percent to the \$700 to arrive at monthly rental income of \$595. However, neither Security Atlantic's file nor the FHA case binder contained a current signed lease or other rental agreement verifying the rental income used to qualify. Without this monthly rental income, the borrower's front ratio⁸ increases from 33 to 38.15 percent and the back ratio increases from 43.53 to 50.33 percent, requiring compensating factors, which were not presented or documented in the file. The remarks section of the mortgage credit analysis worksheet only documented that purchase income was base plus rent from the second unit as a compensating factor; however, this is not an acceptable compensating factor.

Underreported Liabilities

Security Atlantic officials underreported liabilities for three loans. For example, for loan number 105-3100085, Security Atlantic officials incorrectly calculated the borrower's back ratio because it underreported the borrower's liabilities by \$1,171 by excluding the borrower's monthly

⁷ The deficiencies noted are not independent of one another, as one loan may have contained more than one deficiency.

⁸ Mortgage Letter 2005-16 defines the front ratio as the mortgage payment-to-income ratio and the back ratio as the fixed payment-to-income ratio and set HUD's benchmarks for the front and back ratio as 31 and 43 percent, respectively.

mortgage payments on rental property. The mortgage credit analysis worksheet listed the borrower's total monthly payments as \$1,756 and a back ratio of 36.88 percent. However, the borrower's credit report in Security Atlantic's file showed that the borrower had an outstanding real estate loan with a balance of \$124,375 and monthly payments of \$1,171, which was not included in the back ratio. Including this monthly mortgage payment for the borrower's rental property increases the back ratio to 49.59 percent, requiring significant compensating factors. The mortgage credit analysis worksheet listed job stability as a compensating factor, however, stability of income/employment is a requirement for mortgage approval and is not one of HUD's acceptable compensating factors to justify approving the mortgage with ratios above HUD's benchmarks.

Unsupported Assets

Security Atlantic officials did not adequately verify borrower assets for one loan. Specifically, for loan number 095-0567977, Security Atlantic officials did not adequately document and verify the borrowers' earnest money deposit of \$3,000 and cash to close totaling \$3,205; therefore, the borrower's investment in the property was not verified. The HUD-1 settlement statement, dated February 29, 2008, showed that the borrowers made an earnest money deposit of \$3,000 and needed \$3,205 in cash to close. Security Atlantic's file had a letter from the real estate company stating that \$3,000 was being held in its escrow account. The file also had copies of the front and back of three checks for the borrowers' earnest money deposit; however, these checks were not in sequential order and were faxed from an unknown source. Additionally, the file did not contain documentation to support the source of the \$3,000 in funds. The file only contained copies of the borrowers' bank statements that were more than 120 days old and a verification of the borrowers' bank balance, which was faxed from an unknown source and not the bank providing the verification. As a result, the lender did not document or verify the borrowers' earnest money deposit, cash to close, or investment in the property.

Insufficient Gift Documentation

Security Atlantic officials did not properly document gift funds for three loans. For loan number 421-4296353, Security Atlantic officials did not adequately verify the transfer of a \$7,500 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet showed that the borrower's statutory cash investment requirement was \$5,076 and listed gift funds of \$8,000. Security Atlantic's file contained a gift letter signed by a nonprofit and the borrower, stating that a gift of \$7,500 was being provided to purchase the home and the gift funds would be transferred to settlement personnel on or before the closing date. The HUD-1 settlement statement, dated November 1, 2007, listed \$7,500 in gift funds; however, Security Atlantic's file did not contain documentation verifying that the closing agent received these gift funds. Without documentation verifying that the closing agent received these funds, Security Atlantic officials did not verify and document the borrower's gift and investment in the property.

Significant Credit-Related Deficiencies

Security Atlantic officials approved two loans with material credit-related deficiencies. Specifically, for loan number 421-4296353, Security Atlantic officials did not adequately

analyze the borrower's credit because a liability listed on the borrower's credit report was excluded from the back ratio and the borrower's explanation for derogatory accounts demonstrated the borrower's disregard for their financial obligations. The borrower's credit report listed a conventional real estate loan with an outstanding balance of \$15,078 and monthly payments of \$465, which was not included in the fixed payment-to-income ratio (back ratio). Security Atlantic's file did not contain documentation showing a valid reason for excluding this mortgage debt from the borrower's back ratio. Including this debt increases the back ratio from 27.78 to 35.87 percent. Additionally, the borrower's credit report showed six collection accounts totaling \$3,338. Although FHA does not require that collection accounts be paid off as a condition of mortgage approval; the lender did not document its reasons for approving a mortgage when the borrower had collection accounts or judgments, which is indicative of the borrower's disregard for his financial obligations. This disregard was further supported by the fact that the borrower defaulted on this loan after making only one payment.

Rental Payment History Not Analyzed

Security Atlantic officials did not analyze the borrower's rental payment history for one loan. Specifically, for loan number 441-8065074, Security Atlantic's file did not contain a verification of rent or other documentation to support the borrower's rental payment history. Without documentation verifying the borrower's rental payment history, Security Atlantic officials did not analyze the borrower's ability to make the monthly mortgage payments, and this borrower defaulted after only making four mortgage payments.

Borrower Investment in Property Not Verified

Security Atlantic officials did not verify the borrower's investment in the property for four loans. For three of the four loans (FHA numbers 011-5621419, 421-4296353, and 441-8065074), Security Atlantic officials did not adequately verify and document gift funds; therefore, the borrowers' investment in the property was not verified. For the remaining loan, FHA number 095-0567977, Security Atlantic officials did not verify the borrowers' assets; therefore, the borrowers' investment in the property was not verified.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certification for the six loans with material underwriting deficiencies for accuracy. Security Atlantic's direct endorsement underwriters incorrectly certified that due diligence was used in underwriting these six loans. When underwriting a loan manually, HUD requires a direct endorsement lender to certify that it used due diligence and reviewed all associated documents during the underwriting of a loan.

Applicable Statutes

The Program Fraud Civil Remedies Act of 1986 (31 U.S.C. (United States Code) 3801-3812) and 24 CFR (Code of Federal Regulations) Part 28 provide Federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy (1) to recompense such agencies for losses resulting from such claims and statements; (2) to

permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and (3) to deter the making, presenting, and submitting of such claims and statements in the future—up to \$7,500 for each violation and double the amount of paid claims (recovery limited to claims of \$150,000 or less).

Regulations at 24 CFR 30.35 provide that the Mortgagee Review Board may initiate a civil money penalty action against any lender who knowingly violates any of the listed 14 different violations—up to \$7,500 for each violation but not to exceed \$1.375 million.

RECOMMENDATIONS

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

- 1A. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act (31 U.S.C 3801-3812) and/or civil money penalties (24 CFR 30.35) against Security Atlantic and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of six loans that resulted in actual losses of \$452,217 on five loans and the potential loss of \$101,513 on one loan, which could result in affirmative civil enforcement action of approximately \$1,152,460.⁹

We also recommend that HUD’s Deputy Assistant Secretary for Single Family

- 1B. Take appropriate administrative action against Security Atlantic and/or its principals for the material underwriting deficiencies cited in this report once the affirmative civil enforcement action cited in recommendation 1A is completed.

SCHEDULE OF INELIGIBLE COSTS

Recommendation number	Ineligible 1/
1A	\$553,730
Totals	\$553,730

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. The amount shown represents the actual loss HUD incurred when it sold 5 properties (\$452,217) and potential loss related to 1 property (\$101,513).

⁹ Double damages for actual loss amounts related to five loans (\$452,217) and the potential loss (\$101,513) related to one loan (\$553,730 x 2 = \$1,107,460) plus \$45,000, which is a \$7,500 fine for each of the six loans with material underwriting deficiencies.

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Unsupported rental income	Underreported liabilities	Unsupported assets	Insufficient gift documentation	Significant credit-related deficiencies	Rental payment history not analyzed	Borrower investment in property not verified
011-5621419*				X			X
011-5865507*		X					
095-0567977*		X	X				X
105-3100085*		X					
421-4296353*				X	X		X
441-8065074*	X			X	X	X	X
Totals	1	3	1	3	2	1	4

* Loan was originated under the LI program; therefore, the lender self-insures the FHA loan and only submits those case binders (paper or electronic) when requested for review by HUD.

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 011-5621419

Mortgage amount: \$89,294

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 12, 2007

Status as of June 30, 2010: Claim

Payments before first default reported: Seven

Loss to HUD: \$ 80,326

Summary:

We found a material underwriting deficiency relating to gift funds, and the borrower's investment.

Inadequate Verification of Transfer of Gift Funds **Borrower Investment in Property Not Verified**

Security Atlantic officials did not adequately verify the transfer of a \$2,700 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet showed that the borrower's statutory cash investment requirement was \$2,700 and Security Atlantic's file contained a gift letter, dated June 7, 2007, from a public charity for a \$2,700 gift to the borrower to assist with the property purchase. The gift approval letter stated that \$2,700 in gift funds would be wired from the nonprofit to the closing attorney. However, neither the FHA case binder nor Security Atlantic's file contained documentation verifying that the closing agent received these gift funds. The HUD-1 settlement statement showed that this loan closed on June 12, 2007; however, there was no documentation to verify that these gift funds were received by the closing agent. Without documentation verifying that the closing agent received these funds, Security Atlantic officials did not verify and document the borrower's investment in the property.

HUD/FHA Requirements:

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

Paragraph 2-10 C of HUD Handbook 4155.1, REV-5 states that 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, telephone number and states the nature of the donor's relationship to the borrower. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received the funds from the donor for the amount of the purported gift and that those funds came from an acceptable source. 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.

Loan number: 011-5865507

Mortgage amount: \$78,764

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: April 24, 2008

Status as of June 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: \$68,556

Summary:

We found a material underwriting deficiency relating to underreported liabilities, resulting in excessive ratios.

Incorrectly Calculated Ratio Due to Underreported liabilities, resulting in Excessive Ratios

Security Atlantic officials incorrectly calculated the fixed payment-to-income ratio (back ratio) because liabilities were underreported. Specifically, one revolving account and four past-due accounts shown on the borrower's credit report, dated April 9, 2008, were not included on the mortgage credit analysis worksheet. The borrower's credit report listed a revolving account with an outstanding balance totaling \$796 with monthly payments of \$24; however, the mortgage credit analysis worksheet did not list any recurring expenses. Additionally, the borrower's credit report listed four past-due accounts with past-due amounts totaling \$1,374, which were not included in the mortgage credit analysis worksheet. The four past-due accounts consisted of a telephone collection account for \$492, child support placed for collection for \$375, checking account for \$305, and another checking account for \$202. The file contained a letter of explanation from the borrower, dated April 9, 2008, stating that he and his wife were back together, the wife was working, and they had made arrangements to clear up all outstanding balances. The borrower's wife was not a co-borrower on this loan, nor was there documentation in the file regarding the wife's income. Security Atlantic's file did not include bank statements or documentation indicating that the borrower had cash assets available after loan closing. Also, Security Atlantic officials did not document the reasons for excluding the revolving debt or the past-due amounts from the borrower's back ratio, and the borrower acknowledged that arrangements had been made to pay off the outstanding balances for this accounts; therefore, these accounts should have been included in the borrower's back ratio. If we accept the borrower's written explanation that he and his wife were back together and exclude the \$375 for child support, the lender still should have included recurring debt totaling \$1,023 in the back ratio, which increases the back ratio from 23.47 to 59.95 percent, requiring significant

compensating factors. The mortgage credit analysis worksheet only documented the purchase as a compensating factor, and it is not an acceptable compensating factor.

HUD/FHA Requirements:

Paragraph 2-11A (1) of HUD Handbook 4155.1, REV-5, states that for revolving accounts, 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).

Paragraph 2-11 A of HUD Handbook 4155.1, REV-5, states that the borrower's liabilities include all installment loans, revolving charge accounts, child support, and other continuing obligations and in computing the debt-to-income ratios, 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.

Mortgagee Letter 2005-16 dated April 13, 2005 states that for manually underwritten mortgages, the qualifying ratios are raised to 31% and 43% and if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Paragraph 2-13 of HUD Handbook 4155.1, REV-5, provides that compensating factors may be used to justify approval of mortgage loans with ratios that exceed HUD benchmark guidelines; however, underwriters must note in the "remarks" section of the mortgage credit analysis worksheet any compensating factor used and provide supporting documentation.

Loan number: 095-0567977

Mortgage amount: \$172,296

Section of Housing Act: 234 (c)

Loan purpose: Purchase

Date of loan closing: February 29, 2008

Status as of June 30, 2010: Claim

Payments before first default reported: Two

Potential Loss to HUD: \$101,513

Summary:

We found material underwriting deficiencies relating to underreported liabilities, assets, and borrowers' investment.

Underreported Liabilities

Security Atlantic officials underreported the borrower's liabilities. Specifically, the mortgage credit analysis worksheet showed the borrower's total monthly payment as \$424; however, the borrower's credit report showed monthly installment payments of \$378 and monthly revolving payments of \$116 (\$131 less \$15 for an account reported twice), representing total monthly recurring debt of \$494. The difference of \$70 relates to a revolving account for a credit card with an outstanding balance of \$916, a monthly payment amount of \$70, and a past-due amount of \$372, which is shown on the credit report but not included in the borrower's back ratio. Including this debt, increases the borrower's back ratio from 43.73 percent to 45.25 percent.

HUD/FHA Requirements:

Paragraph 2-11 A (1) of HUD Handbook 4155.1, REV-5, states that for revolving accounts, 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).

Assets Not Documented or Verified
Borrower Investment in Property Not Verified

Security Atlantic officials did not adequately document and verify the borrowers' earnest money deposit of \$3,000 and cash to close totaling \$3,204.55; therefore, the borrowers' investment in the property was not verified. The mortgage credit analysis worksheet showed the borrowers'

statutory investment requirement as \$5,250, and the HUD-1 settlement statement, dated February 29, 2008, showed that the borrowers' made an earnest money deposit of \$3,000 and needed \$3,204.55 in cash to close. Security Atlantic's file had a letter from the real estate company stating that \$3,000 was being held in its escrow account. The file also had copies of the front and back of three checks for the borrowers' checking account for the borrowers' earnest money deposit; however, these checks were not in sequential order and were faxed from an unknown source. Additionally, the file did not contain documentation to support the source of the \$3,000 in funds. The file only contained copies of the borrowers' bank statements from February 27 through April 26, 2007, that were more than 120 days old and a verification of the borrowers' bank balance, which was documented with an undated letter stating that the borrower had a checking account with a current balance of \$2,499.66. This letter was faxed from an unknown source and not the bank providing the verification. As a result, the lender did not document or verify the borrowers' earnest money deposit, cash to close, or investment in the property.

HUD/FHA Requirements:

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

Paragraph 2-10 A of HUD Handbook 4155.1, REV-5 states that the earnest money deposit must be verified with documentation, which includes a copy of the borrower's cancelled check, a certification from the deposit holder acknowledging receipt of funds, or separate evidence of the source of funds. A verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts.

Paragraph 3-1 of HUD Handbook 4155.1, REV-5, states that the verification of deposit may be faxed documents if it clearly identifies the source (e.g., contains the names of the borrower's employer or depository/investment firm), the bank statements may not be more than 120 days old when the loan closes, and no document used in the processing or underwriting of a loan may be handled or transmitted by or through an interested third party to the transaction.

Loan number: 105-3100085

Mortgage amount: \$198,076

Section of Housing Act: 203 (b)

Loan purpose: Purchase

Date of loan closing: November 14, 2007

Status as of June 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$130,843

Summary:

We found a material underwriting deficiency relating to underreported liabilities.

Incorrectly Calculated Ratio Due to Underreported Liabilities

Security Atlantic officials incorrectly calculated the borrower's back ratio because it underreported the borrower's liabilities by \$1,171 by excluding the borrower's monthly mortgage payments on rental property. The mortgage credit analysis worksheet listed the borrower's total monthly payments as \$1,756 and a back ratio of 36.88 percent. However, the borrower's credit report in Security Atlantic's file showed that the borrower had an outstanding real estate loan with a balance of \$124,375 and monthly payments of \$1,171, which was not included in the back ratio. Including this monthly mortgage payment for the borrower's rental property increases the back ratio to 49.59 percent, requiring significant compensating factors. The mortgage credit analysis worksheet listed job stability as a compensating factor, however, stability of income/employment is a requirement for mortgage approval and is not one of HUD's acceptable compensating factors to justify approving the mortgage with ratios above HUD's benchmarks.

HUD/FHA Requirements:

Paragraph 2-11 A of HUD Handbook 4155.1, REV-5, states that the lender must include the borrower's liabilities, including all installment loans, revolving charge accounts, real estate loans, alimony, child support, and other continuing obligations, in computing the debt-to-income ratios.

Paragraph 2-6 of HUD Handbook 4155.1, REV-5; entitled "Stability of Income," states that the lender must verify the borrower's employment for the most recent 2 full years.

Mortgagee Letter 2005-16 dated April 13, 2005 states that for manually underwritten mortgages, the qualifying ratios are raised to 31% and 43% and if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Paragraph 2-13 of HUD Handbook 4155.1, REV-5, provides that compensating factors may be used to justify approval of mortgage loans with ratios that exceed HUD benchmark guidelines; however, underwriters must note in the “remarks” section of the mortgage credit analysis worksheet any compensating factor used and provide supporting documentation.

Loan number: 421-4296353

Mortgage amount: \$166,585

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 1, 2007

Status as of June 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: \$60,694

Summary:

We found material underwriting deficiencies relating to credit, gift funds, the borrower's investment in the property, and inadequate documentation of self-employment.

Inadequate Analysis of Borrower Credit

Security Atlantic officials did not adequately analyze the borrower's credit because a liability listed on the borrower's credit report was excluded from the back ratio and the borrower's explanation for derogatory accounts demonstrates the borrower's disregard of their financial obligations. The borrower's credit report listed a conventional real estate loan with an outstanding balance of \$15,078 and monthly payments of \$465, which was not included in the fixed payment-to-income ratio (back ratio). The borrower's credit report listed this real estate loan as a joint account, and there was a handwritten note on the credit report stating that it was a house for the daughter. However, Security Atlantic's file did not contain documentation showing that this mortgage debt was being paid by the daughter or document a valid reason for excluding this mortgage debt from the borrower's back ratio. Including this debt increases the back ratio from 27.78 to 35.87 percent. Additionally, the borrower's credit report showed six collection accounts totaling \$3,338, and the borrower's explanation for these collection accounts indicated a disregard for credit obligations. The borrower explained that she "gives tons of money to her family and financial fear or my net worth had nothing to do with being late." Although FHA does not require that collection accounts be paid off as a condition of mortgage approval, collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness, with the lender documenting its reasons for approving a mortgage when the borrower has collection accounts or judgments. The mortgage credit analysis worksheet noted that the borrower provided an excellent signed explanation for credit. However, the explanation provided by the borrower was indicative of her disregard for her financial obligations, which was further supported by the fact that the borrower defaulted on this loan after making only one payment.

HUD/FHA Requirements:

Paragraph 2-11 A of HUD Handbook 4155.1, REV-5; provides that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and other continuing obligations.

Paragraph 2-3 of HUD Handbook 4155.1, REV-5, states that major indications of derogatory credit—including judgments, collections, and other recent credit problems—require sufficient written explanation from the borrower and the explanation must make sense and be consistent with other credit information in the file.

Inadequate Verification of Transfer of Gift Funds Borrower Investment Not Verified

Security Atlantic officials did not adequately verify the transfer of a \$7,500 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet showed that the borrower's statutory cash investment requirement was \$5,076 and listed gift funds of \$8,000. Security Atlantic's file contained a gift letter signed by a nonprofit and the borrower, stating that a gift of \$7,500 was being provided to purchase the home and the gift funds would be transferred to settlement personnel on or before the closing date. The HUD-1 settlement statement, dated November 1, 2007, listed \$7,500 in gift funds; however, Security Atlantic's file did not contain documentation verifying that the closing agent received these gift funds. Without documentation verifying that the closing agent received these funds, Security Atlantic officials did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

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

Paragraph 2-10 C of HUD Handbook 4155.1, REV-5 states that 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, telephone number and states the nature of the donor's relationship to the borrower. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received the funds from the donor for the amount of the purported gift and that those funds came from an acceptable source. 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.

Inadequate Documentation of Borrower Self-Employment

Security Atlantic officials did not obtain signed and dated individual tax returns for the self-employed borrower. Security Atlantic's file contained unsigned individual tax returns for 2005 and 2006 for the self-employed borrower.

HUD/FHA Requirements:

Paragraph 2-9 B of HUD Handbook 4155.1, REV-5; provides that signed and dated individual tax returns, plus all applicable schedules for the most recent 2 years are required from self-employed borrowers.

Loan number: 441-8065074

Mortgage amount: \$156,761

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: December 12, 2007

Status as of June 30, 2010: Claim

Payments before first default reported: Four

Loss to HUD: \$111,798

Summary:

We found material underwriting deficiencies relating to unsupported rental income, resulting in excessive ratios, credit, rental payment history, gift funds, and the borrower's investment.

Unsupported Rental Income Used To Qualify, Resulting in Excessive Ratios

Security Atlantic officials included monthly rental income of \$595 as the borrower's other earnings on the mortgage credit analysis worksheet without verifying this rental income. The appraisal report estimated income from the unit that would not be occupied by the borrower to be \$700; therefore, Security Atlantic officials applied the Philadelphia Homeownership Center's vacancy rate of 15 percent to the \$700 to arrive at monthly rental income of \$595. However, neither the Security Atlantic file nor the FHA case binder contained a current signed lease or other rental agreement verifying the rental income used to qualify. Without this monthly rental income, the borrower's front ratio increases from 33 to 38.15 percent and the back ratio increases from 43.53 to 50.33 percent, requiring compensating factors, which were not presented or documented in the file. The mortgage credit analysis worksheet only documented that purchase income was base plus rent from the second unit as a compensating factor; however, this is not an acceptable compensating factor.

HUD/FHA Requirements:

Paragraph 2-7M of HUD Handbook 4155.1, REV-5, states that if the borrower resides in one or more units of a multiple-unit property and charges rent to tenants of other units, that rent may be used for qualifying purposes only after deducting the Homeownership Center's vacancy and maintenance factor, and a current signed lease or other rental agreement must be provided to verify the rental income.

Mortgagee Letter 2005-16 dated April 13, 2005 states that for manually underwritten mortgages, the qualifying ratios are raised to 31% and 43% and if either or both ratios are exceeded on a

manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Paragraph 2-13 of HUD Handbook 4155.1, REV-5, provides that compensating factors may be used to justify approval of mortgage loans with ratios that exceed HUD benchmark guidelines; however, underwriters must note in the “remarks” section of the mortgage credit analysis worksheet any compensating factor used and provide supporting documentation.

Inadequate Analysis of Borrower Credit

The borrower’s credit report shows 12 collection accounts totaling \$3,323; however, the borrower’s written explanation for these collection accounts was not sufficient. Specifically, the borrower explained that she did not receive the bills because they were sent to her mother’s home and she was not on speaking terms with her mother. However, this is not a valid explanation because the borrower could have notified the U.S Postal Service of the change in address, and should have known that her bills were due. Additionally, although FHA does not require that collection accounts be paid off as a condition of mortgage approval, collections and judgments indicate a borrower’s regard for credit obligations and must be considered in the analysis of creditworthiness, with the lender documenting its reasons for approving a mortgage when the borrower has collection accounts or judgments. There was no documentation in either Security Atlantic’s file or the FHA case binder to indicate that the lender considered these collection accounts in its analysis of creditworthiness.

HUD/FHA Requirements:

Paragraph 2-3 of HUD Handbook 4155.1, REV-5, states that major indications of derogatory credit—including judgments, collections, and other recent credit problems—require sufficient written explanation from the borrower and the explanation must make sense and be consistent with other credit information in the file.

Rental Payment History Not Analyzed

Security Atlantic’s file did not contain a verification of rent or other documentation to support the borrower’s rental payment history. Without documentation verifying the borrower’s rental payment history, Security Atlantic officials did not analyze the borrower’s ability to make the monthly mortgage payments, and this borrower defaulted after only making four mortgage payments.

HUD/FHA Requirements:

Paragraph 2-3 A of HUD Handbook 4155.1, REV-5, states that the payment history of the borrower’s housing obligations holds significant importance in evaluating credit and the lender must determine the borrower’s payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity of interest with the borrower) or the mortgage servicer, or canceled checks covering the most recent 12-month period.

Inadequate Verification of Transfer of Gift Funds
Borrower Investment Not Verified

Security Atlantic officials did not adequately verify the transfer of a \$5,000 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet showed that the borrower's statutory cash investment requirement was \$4,740 but did not list gift funds. Security Atlantic's file contained a gift letter from the borrower's brother for a \$5,000 gift to the borrower to be used for the home purchase; however, Security Atlantic's file did not contain a withdrawal document showing that the withdrawal was from the donor's account. Without this documentation, Security Atlantic officials did not verify and document the gift funds or the borrower's investment in the property.

HUD/FHA Requirements:

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

Paragraph 2-10 C of HUD Handbook 4155.1, REV-5 states that 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, 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. 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 shows the deposit is also required. 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.

APPENDIX C

LENDER COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation

Lender Comments

Security Atlantic Mortgage Co., Inc.

P.O. Box 229

Iselin, NJ 08830

August 23, 2010

VIA FEDERAL EXPRESS

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

**RE: Security Atlantic Mortgage Co., Inc.
HUD OIG Draft Memorandum Report 2010-NY-180X**

Dear Mr. Moore:

Security Atlantic Mortgage Co. Inc. ("SAMCO" or "Company") is in receipt of the revised Draft Memorandum Report ("Report"), dated August 12, 2010, from the U.S. Department of Housing and Urban Development's ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of twenty Federal Housing Administration ("FHA") insured loans selected as part of HUD and the OIG's "Operation Watchdog" initiative to examine the underwriting of fifteen lenders at the suggestion of the FHA Commissioner. The twenty loans were endorsed for FHA insurance and defaulted within the first 30 months, and have since gone into claim status.

The Report states that its objective was to determine whether the Company underwrote the twenty selected loans in accordance with FHA requirements and, if not, whether the underwriting reflected systemic problems. The Report's "Results of Review" allege that eight of the twenty loans contained underwriting deficiencies and, in each of these eight cases, the underwriters incorrectly certified that due diligence was used in underwriting the loans. Based on these assertions, the Report recommends that HUD: (1) take appropriate administrative action with regard to the underwriting deficiencies; and (2) in connection with the underwriting certifications, determine the

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legal sufficiency and, if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801 et seq. ("PFCRA") and/or civil money penalties under HUD regulations.

The OIG provided SAMCO with an opportunity to submit written comments for inclusion in the final report. This response summarizes SAMCO's history and operations and addresses the individual findings cited in the Report. We believe that this response and accompanying exhibits demonstrate that the Report's recommendations in connection with the cited loans are unwarranted. We appreciate this opportunity to comment on the OIG's findings and recommendations. That said, we understand that final reports routinely include auditors' comments about the lender's written response, but that the lender is not provided an opportunity to respond to these additional comments. Often, these comments include substantive allegations or statements that were not a part of the draft report provided to the company. To the extent that the OIG makes such additional substantive comments in this instance, we respectfully request an opportunity to respond to these additional statements to ensure that a full picture of the issues is presented in the final report.

I. BACKGROUND

A. SECURITY ATLANTIC MORTGAGE COMPANY

SAMCO received approval as a non-supervised mortgagee in June of 1993. The Company was a dedicated FHA mortgagee until recently, when, as discussed below, it was forced to cease originating loans due to the downturn in the economy, as well as outside pressures from warehouse lenders and investors as a result of the Department's "probe." SAMCO was headquartered in Edison, New Jersey and employed approximately 220 individuals. SAMCO sold all loans that it originated into the secondary market on a servicing-released basis, and its primary investors included Bank of America and Wells Fargo Home Mortgage. At all times during its active operations, SAMCO's employees consistently strived to produce high quality loans in compliance with HUD/FHA standards.

Before the Company ceased all business operations, FHA lending constituted approximately 99% of SAMCO's business operations. Because FHA lending represented a substantial portion of SAMCO's overall production, the Company has consistently taken its responsibilities under the FHA Program seriously. We have always strived to comply with applicable rules and regulations and are committed to educating and training our employees on issues of FHA compliance. Throughout our existence, we endeavored to provide dependable and professional service and repeatedly demonstrated our commitment to borrowers and allegiance to the FHA Program. For example, the Company held monthly underwriting meetings and

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conducted regular training sessions to keep employees abreast of new and existing FHA policies. The Company had also tightened its underwriting procedures to ensure the quality and performance of its FHA-insured loans. SAMCO stopped accepting FHA loan applications involving downpayment assistance grants approximately five months before this practice was discontinued by an act of Congress. The Company had also increased its pre-closing file reviews, including ordering an IRS Transcript Form 4506 for each borrower prior to closing, to verify the borrower's income and qualifications for FHA financing. These procedures assisted the Company in originating quality FHA-insured loans to borrowers who were able and willing to make timely payments. To that end, we also note that, as indicated in the Report, the fifteen lenders identified in the "Operation Watchdog" probe had 183,278 loans endorsed by HUD between January of 2005 and December of 2009, and 6,560, or 3.5%, resulted in FHA insurance claims. By comparison, SAMCO had 34,278 loans endorsed during that period, of which only 348, or approximately 1%, involved FHA insurance claims.

Finally, we note that the review covered loans originated by the Company between June 12, 2007 and February 29, 2008. As you know, during and immediately following this period, the United States experienced a dramatic financial crisis that resulted in record-breaking unemployment, and loan default and foreclosure activity. Many of the borrowers in the cases at issue defaulted after making multiple mortgage payments. This payment activity suggests that these borrowers defaulted as a result of unforeseen economic or personal setbacks as a result of this crisis, rather than because of poor origination or underwriting decisions. In fact, loan servicing data for the eight loans at issue demonstrates that five of these borrowers reported curtailment of income or illness, which often results in income loss, as the reason for the default.

B. THE "OPERATION WATCHDOG" REVIEW

As an initial matter, we would like to take this opportunity to point out that this review was not conducted in the typical manner in which the OIG Audit Division performs audits. As acknowledged in the Report, the OIG did not follow its standard procedures of considering the Company's internal or information systems controls or the results of previous audits, and did not communicate with SAMCO's management in advance of issuing the Report. Moreover, instead of reviewing a statistically random sample of loans originated by SAMCO during the review period, the OIG examined loan files for an adverse sample of 20 loans in which the borrowers had defaulted and the lenders had made a claim to HUD for FHA insurance benefits. Rather than request that the Company provide information and loan files in the cases reviewed, which SAMCO would have promptly supplied, the OIG subpoenaed loan file documentation simultaneously from fifteen FHA-approved lenders, including SAMCO, in connection with the "Operation Watchdog" probe. While HUD and the OIG expressly stated that

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the review "was not based upon any evidence of wrongdoing" on the part of SAMCO or the other lenders subjected to this probe (**Exhibit A-1**), the Department and OIG nevertheless issued a press release announcing the "probe" before reviewing any of the loan files at issue in this matter (**Exhibit A-2**). Typically, HUD and the OIG refuse to disclose the names of entities subject to ongoing reviews by the Department; however, in this instance, the press release included the names of the fifteen lenders, including SAMCO, subject to this particular review (**Exhibit A-2**).

Although the OIG acknowledged in the press release that it had no evidence of wrongdoing by the Company at that time, by stating that the Department would "aggressively pursue indicators of fraud," the announcement gave the public the impression that the subject lenders had engaged in misconduct or otherwise posed some risk to the FHA Insurance Fund. Given the scrutiny by warehouse lenders and investors of originating lenders in this market, these companies immediately chose to take action against the fifteen lenders subjected to the "probe," rather than wait for the results of the Department's review. Consequently, many of the fifteen lenders involved in this matter, including SAMCO, lost their investors, warehouse lines, and customer base upon issuance of the press release announcing the review. SAMCO is one of several of the subject lenders that have been forced to cease loan originations and close their doors as a result of this review.

In February of 2010, SAMCO ceased all business operations as an independent mortgage company. The Company has terminated its relationships with its investors and surrendered its state licenses. On May 25, 2010, SAMCO voluntarily relinquished its FHA approvals. Nevertheless, throughout its existence, SAMCO was committed to complying with HUD requirements and originating quality FHA-insured loans. Therefore, upon receiving the draft Report, we conducted a thorough review of the loan file documentation in light of the issues raised. We address the individual concerns identified in the Report below.

II. RESPONSE TO RESULTS OF REVIEW

As previously noted, the Report alleges noncompliance with HUD requirements in eight loans and recommends action by HUD and the Departmental Enforcement Center regarding these assertions. Based on our review, SAMCO strongly objects to both the recommendation for administrative action and PFCRA penalties in the cited loans. Our review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate SAMCO's

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general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report, evidence our adherence to FHA requirements in connection with several cited loans, and set forth our opposition to the to the OIG's recommendations regarding action under PFCRA.

A. SAMCO GENERALLY COMPLIED WITH HUD's UNDERWRITING GUIDELINES

In the "Results of the Review" and Appendix B, the Report alleges that SAMCO did not underwrite eight of the twenty FHA loans reviewed in compliance with HUD requirements. Specifically, the Report asserts that these loans involved deficiencies in: (1) rental income documentation; (2) assessment of borrower liabilities; (3) documenting borrower assets; (4) documenting the source of gift funds; (5) insufficient credit explanations or rental history analysis; and (6) documenting the source of funds to close. We address each of these individual allegations in turn below.

1. Rental Income Documentation

In one loan, [REDACTED] **FHA Case No. 441-8065074**, the Report asserts that the monthly rental income of \$595 included in the borrower's qualifying income was not supported, as the loan file did not contain a current signed lease or other rental agreement verifying that the borrower was receiving rental income for the second unit of the two-family property the borrower was purchasing. Without such income, the Report alleges that the borrower's qualifying ratios would have increased above HUD's benchmark guidelines without adequate compensating factors.

SAMCO understands and appreciates that, when a borrower receives rent for a property he or she owns at the time of closing, HUD guidelines require the FHA-approved lender to obtain a lease to verify any rent received that is used to qualify the borrower for FHA financing. See HUD Handbook 4155.1 REV-5, ¶ 2-7(M).¹ If, however, the borrower is purchasing a multi-unit property and intends to reside in one unit and rent the additional units, HUD guidelines expressly state that "the rent may be used for qualifying purposes. However, projected rent of additional units only and not the owner-occupied unit(s) may be considered gross income only after deducting the HOC's vacancy and maintenance factor." *Id.* (emphasis added). When a borrower purchases a multi-unit property the borrower does not yet have title to the property at the time of underwriting and, thus, cannot enter into lease agreements with tenants prior

¹ While the Department has issued a new online version of Mortgage Credit Analysis Handbook, 4155.1, the new Handbook became effective for loans originated on or after May 11, 2009, after the loans cited in the Report were originated and closed. We therefore rely on the prior Handbook, 4155.1 REV-5, and accompanying Mortgagee Letters throughout this response.

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to closing. HUD understands this and, for that reason, its guidelines expressly state that lenders should use projected rent of additional units to determine the monthly income the borrower will earn once taking title to the property and renting the units, and that such income can be included in the borrower's qualifying earnings.

SAMCO adhered to HUD requirements regarding rental income from the multi-unit subject property in the [REDACTED] loan. As acknowledged in the Report, the Company obtained an appraisal of the subject property, which confirmed that the property was a two-unit residence and that the borrower would occupy Unit #2 (**Exhibit B-1**). The appraisal states that the market rent for Unit #1 was \$700 (**Exhibit B-1**). Utilizing this amount, as acknowledged in the Report, the underwriter properly calculated the projected rent for Unit #1 by deducting the Philadelphia Homeownership Center's vacancy and maintenance factor of 15%, which resulted in projected rent of \$595. In compliance with HUD guidelines, the underwriter included this projected rent in the borrower's gross monthly income on the Mortgage Credit Analysis Worksheet ("MCAW") (**Exhibit B-2**). As the borrower did not have title to the property during the underwriting of this loan, the underwriter did not require the borrower to provide a lease regarding Unit #1. That said, we note that the appraisal stated that Unit #1 was occupied at the time of the appraisal (**Exhibit B-1**), which suggests that the borrower would have an immediate tenant to occupy the property upon closing of this loan.

The above discussion and attached documentation demonstrates that SAMCO strictly adhered to HUD guidelines to calculate and document the borrower's projected rent for the multi-unit property securing the FHA loan at issue. Therefore, this allegation should be removed from the final report.

2. Assessment of Liabilities

In four loans, the Report contends that the Company did not properly assess the borrowers' liabilities, as debts reflected on the credit reports or in file documentation were not included in the calculation of the borrowers' qualifying ratios. We address each of these four cases in turn below.

a. [REDACTED] – FHA Case No. 011-5621419

In the [REDACTED] case, the Report alleges that the credit report listed 15 revolving accounts with balances totaling \$13,006; however, the borrower's minimum payments in these accounts were not included in the calculation of the qualifying ratios.

With regard to liabilities, SAMCO understands and appreciates that, in calculating a borrower's qualifying ratios, FHA-approved lenders must include all installment loans, revolving charge accounts, real estate loans, alimony, child support,

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and all other continuing obligations extending ten months or more. See HUD Handbook 4155.1 REV-5, ¶ 2-11(A). It was SAMCO's policy and practice to do so in each FHA-insured loan it originated, and the Company maintains that it did so in the [REDACTED] loan. The fifteen accounts referenced in the Report are not revolving accounts that the Company was required to include in the qualifying ratios. Rather, the credit report clearly reflects that these accounts were delinquent collection accounts, almost all of which were medical in nature (**Exhibit C-1**). As you know, while the lender must consider all open collection accounts, such accounts need not be satisfied prior to closing. See id. at ¶ 2-3(C). In compliance with HUD guidelines, the underwriter obtained two letters of explanation from the borrower, in which she explained that the medical collection accounts resulted from a robbery of her employer while she was working, during which she was assaulted and which resulted in the premature birth of her child (**Exhibit C-2**). As a result of this event, and the fact that she was uninsured during that time, the borrower was unable to continue working and experienced significant medical bills (**Exhibit C-2**). The underwriter reasonably concluded that events outside the borrower's control, and not a lack of responsibility for credit obligations, led to the collection accounts reflected on the credit report. In addition, the borrower was working to pay off those accounts, as evidenced by at least one letter from a medical creditor contained in the loan file (**Exhibit C-3**). The loan file also demonstrated that the borrower was making timely payments on her revolving accounts (**Exhibit C-1**), which the underwriter properly included on the MCAW (**Exhibit C-4**), and had an excellent rental payment history (**Exhibit C-5**).

The above discussion and attached documentation demonstrates that the underwriter complied with HUD guidelines by including all of the borrower's revolving credit account payments in the borrower's qualifying ratios and properly analyzing the borrower's additional collection accounts. The underwriter reasonably determined, based on this analysis, that the borrower qualified for the FHA-insured loan at issue. For this reason, administrative action would be unwarranted. We therefore request that this finding be removed from the final report.

b. [REDACTED] – FHA Case No. 011-5865507

Comment 5

Here, the Report asserts that the borrower's qualifying ratios were calculated without including one revolving loan account with a minimum monthly payment of \$24 and three past due accounts with total balances of \$999.

As discussed above, SAMCO understands and appreciates that, in calculating a borrower's qualifying ratios, FHA-approved lenders must include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations extending ten months or more. See HUD Handbook 4155.1 REV-5, ¶ 2-11(A). It was SAMCO's policy and practice to do so in each FHA-insured

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loan it originated. That said, the Company acknowledges that the borrower's revolving credit account with Applied Bank should have been included in the borrower's qualifying ratios (**Exhibit D-1**). It appears that the underwriter inadvertently omitted this debt because it was listed on the credit report under "Collection Accounts," rather than under the borrower's current credit accounts (**Exhibit D-1**). Nevertheless, any oversight with regard to this debt constituted, at worst, harmless error. Including the \$24 monthly payment for this account in the borrower's qualifying ratios would have increased the borrower's back-end ratio to 24.32% (**Exhibit D-2**), which was well within HUD's benchmark guideline. See HUD Handbook 4155.1 REV-5, ¶ 2-12. Thus, even considering this debt, the borrower would have qualified for the FHA-insured loan.

With regard to the remaining three accounts, contrary to the allegation in the Report, these debts were not revolving accounts that the Company was required to include in the qualifying ratios. Rather, the credit report clearly reflects that these accounts were collection accounts (**Exhibit D-1**). As discussed above, while the lender must consider all open collection accounts, the Department does not require that such accounts be satisfied prior to closing. See *id.* at ¶ 2-3(C). In compliance with this HUD guideline, the underwriter obtained a letter of explanation from the borrower, in which he explained that the collection accounts resulted from his separation from his wife and his attempts to maintain two households (**Exhibit D-3**). The borrower also stated that he and his wife were no longer separated and that they were working to resolve the outstanding collection obligations. The underwriter reasonably concluded that events outside the borrower's control, and not his lack of responsibility for credit obligations, led to the collection accounts reflected on the credit report. In addition, the borrower had indicated that the reason for the debts had been resolved and that he was taking responsibility for satisfying his outstanding obligations. The loan file also demonstrated that the borrower had made timely payments on prior automobile loans and had no outstanding credit accounts other than the Applied Bank account and the collection accounts (**Exhibit D-1**). Finally, the loan file documented the borrower's excellent rental payment history (**Exhibit D-4**).

The above discussion and attached documentation demonstrates that inclusion of the borrower's small balance revolving account would not have affected the borrower's eligibility for FHA financing, and that the underwriter properly analyzed the borrower's additional collection accounts and made a reasonable determination that the borrower qualified for the loan at issue. Thus, administrative action in this case would be inappropriate and we request that this finding be removed from the final report.

c. [REDACTED] – FHA Case No. 095-0567977

Comment 6

In this loan, the Report alleges that the borrowers' qualifying ratios did not include a revolving credit account with a monthly payment of \$70 and the loan file did

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not include an explanation regarding the eleven collection accounts referenced on the borrowers' credit report.

With regard to the revolving credit account, as discussed above, it was SAMCO's policy and practice to include all installment loans, revolving charge accounts, and other continuing obligations extending ten months or more in the borrower's qualifying ratios. See HUD Handbook 4155.1 REV-5, ¶ 2-11(A). With regard to the borrowers' Bank of America credit account (**Exhibit E-1**), although it appears that the underwriter omitted this debt because the borrowers were contesting it (**Exhibit E-2**), we appreciate that it should have been used in the calculation of the borrowers' qualifying ratios. Nevertheless, any oversight with regard to this debt constituted, at worst, harmless error. Including the \$70 monthly payment for this account in the borrowers' qualifying ratios would have minimally increased the back-end ratio from 43.73% to 45.25% (**Exhibit E-3**). While this ratio would have slightly exceeded HUD's benchmark guideline, see HUD Handbook 4155.1 REV-5, ¶ 2-12 and Mortgagee Letter 2005-16, the loan file documented compensating factors that would have offset this slightly higher-than-average ratio. For example, the loan file documented that the borrowers had made timely rental payments for the twelve months prior to closing (**Exhibit E-4**), and the borrowers' housing payment was only increasing by \$234 (**Exhibit E-3**). HUD guidelines expressly recognize that timely payments of housing obligation and a minimal increase in housing expense are compensating factors. See HUD Handbook 4155.1 REV-5, ¶ 2-13(A), (F). Thus, even considering this debt, the borrower would have qualified for the FHA-insured loan.

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With regard to the collection accounts, contrary to the assertion in the Report, the underwriter did obtain a letter of explanation regarding these accounts at the time of closing. This document was inadvertently placed in another file and, therefore, was not included in the loan file provided to the OIG. This explanation letter is attached as **Exhibit E-2**. As indicated on the credit report, most of the borrowers' collection accounts were medical in nature (**Exhibit E-1**). The borrower stated in the explanation letter that the collection accounts had resulted from medical bills incurred by his wife for which he co-signed in certain instances (**Exhibit E-2**). Based on this explanation, the underwriter reasonably concluded that events outside the borrowers' control, and not their lack of responsibility for credit obligations, led to the collection accounts reflected on the credit report. As indicated above, the loan file also demonstrated that the borrowers had made timely rental payments for the past year (**Exhibit E-4**).

The above discussion and attached documentation demonstrates that inclusion of the borrower's small balance revolving account would not have affected the borrower's eligibility for FHA financing, and that the underwriter properly obtained a credit explanation letter regarding delinquent accounts. Administrative action in this

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case would be inappropriate. Therefore, we request that this finding be removed from the final report.

d. ██████████ – FHA Case No. 105-3100085

Finally, in the ██████████ case, the Report contends that the borrower's liabilities were underreported, as a \$1,171 monthly mortgage payment on an outstanding loan was not included in the borrower's qualifying ratios, and inclusion of this debt would have increased the borrower's back end ratio to 49.59% without adequate compensating factors.

As discussed above, SAMCO understands and appreciates that, in calculating a borrower's qualifying ratios, FHA-approved lenders must include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations extending ten months or more. See HUD Handbook 4155.1 REV-5, ¶ 2-11(A). It was SAMCO's policy and practice to do so in each FHA-insured loan it originated. That said, the Company acknowledges that the borrower's mortgage payment on the outstanding real estate loan should have been included in the borrower's qualifying ratios (Exhibit F-1). It appears that the underwriter inadvertently omitted this debt because the loan file contained evidence that the borrower had rented the property, and was collecting \$1,550 per month pursuant to a two-year lease (Exhibit F-1), which was more than the borrower's \$1,171 monthly mortgage payment (Exhibit F-2).

Nevertheless, any oversight with regard to this debt constituted, at worst, harmless error. While the borrower's back-end ratio would have exceeded HUD's benchmark guideline after including this debt, contrary to the Report's allegation, the loan file documented significant compensating factors that would have offset the higher-than-average ratio in this case. As acknowledged in the Report, the underwriter noted on the MCAW that the borrower had excellent job stability in both his full-time and part-time employment, as the loan file documented that the borrower had been employed in his full-time position for nine years (Exhibit F-3), and in his part-time position for three years (Exhibit F-4). While SAMCO appreciates that, as noted in the Report, HUD guidelines require job stability, lenders are required to document a borrower's employment for only two years prior to closing, and do not require that a borrower hold the same position for that two-year period. See HUD Handbook 4155.1 REV-5, ¶ 2-6. Based on these guidelines, a nine-year history with the same employer, and a three-year job history with a second part-time employer, demonstrates job stability above and beyond what is required by the Department's guidelines, and does compensate for higher-than-average ratios.

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In addition to the compensating factor noted on the MCAW, the loan file also documented that the borrower had substantial cash reserves of \$34,104 in a retirement account (**Exhibit F-5**), which the underwriter identified as assets on Line 12(j) of the MCAW (**Exhibit F-6**). The borrower's paycheck also demonstrated that he continued to make regular contributions to this account, which documented his ability to save (**Exhibit F-7**). HUD guidelines expressly state that significant reserves after closing and a borrower's ability to save compensate for higher qualifying ratios. See HUD Handbook 4155.1 REV-5, ¶ 2-13(C), (G). The borrower's credit report also documented his excellent payment history on his prior mortgage (**Exhibit F-1**), which HUD guidelines also recognize as a compensating factor. *Id.* ¶ 2-13(A). Finally, as noted above, while the borrower would be responsible for two mortgage loans after closing in this case, the borrower had rented his prior residence before closing for at least a two-year period, and was receiving income from that rental that exceeded his monthly mortgage payment on the loan securing that property (**Exhibits F-1, F-2**).

The above discussion and attached documents demonstrate that, even considering the borrower's \$1,171 mortgage payment, the borrower would have qualified for the FHA-insured loan, as the loan file and MCAW documented significant compensating factors to offset the higher back-end ratio. For these reasons, administrative action in this case is unwarranted and this allegation should be removed from the final report.

3. Documentation of Assets

In one loan, [REDACTED] – FHA Case No. 095-0567977, the Report alleges that the loan file did not adequately document the source of the funds used for the borrowers' \$3,000 earnest money deposit ("EMD") or the \$3,204.55 needed to close the loan. SAMCO respectfully disagrees with these assertions.

a. Earnest Money Deposit

With regard to the EMD, SAMCO understands and appreciates that, if the amount of the EMD exceeds two percent of the sales price, the lender must verify the deposit amount and the source of the funds. See HUD Handbook 4155.1 REV-5, ¶ 2-10(A). In this case, the sales price was \$175,000 and the borrowers made an EMD of \$3,000 (**Exhibit G-1**). As the EMD was less than two percent of the sales price, SAMCO was not required to document the source of the EMD. To document that the borrowers made the EMD, the loan file contained copies of three cancelled checks for \$1,000, each issued from the borrower's Bank Atlantic account, [REDACTED] (**Exhibit G-2**), and a letter from the settlement agent, dated February 14, 2008, indicating that he was holding \$3,000 for the borrower, referencing each of the three checks, and stating that each check had cleared (**Exhibit G-3**).

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While the Report takes issue with the fact that these checks were not in sequential order and were faxed from an unidentified source, neither of these facts should have raised concerns with the underwriter. As clearly evidenced on the face of the checks, the borrower issued these checks on three different dates, ranging from January 2, 2008 to February 5, 2008 (**Exhibit G-2**), from his personal checking account. Thus, it was not unusual for the checks to be out of sequential order, as the borrower likely wrote several checks from that account during that month. Moreover, SAMCO understands and appreciates that "[l]enders may not accept or use documents relating to the credit, employment or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment." HUD Handbook 4155.1 REV-5, ¶ 3-1; see also HUD Handbook 4000.2 REV-3, ¶ 3-5. It was the Company's policy and practice to obtain credit reports and income verifications directly from the providers of these documents and to ensure that faxed documentation was accurate and complete. Moreover, with regard to income and deposit documents that would be in the borrower's possession, such as the cancelled EMD checks at issue, it was SAMCO's policy and practice to obtain such documentation from the borrower. As was the case here, borrowers often utilize the fax machines of their real estate agents or mortgage representatives to transmit such documents. Nevertheless, in the case at issue, the underwriter obtained sufficient documentation to evidence that the borrower in fact made the \$3,000 EMD.

b. Source of Assets to Close

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With regard to the remaining \$3,204 needed to close (**Exhibit G-1**), the Report acknowledges that the loan file contained a copy of a letter to the borrower from Bank Atlantic stating that, as of February 22, 2008, the borrower had \$2,499.86 in available funds in his Bank Atlantic account (**Exhibit G-4**). We note that this letter was issued eight days after the settlement agent's February 14, 2008 letter indicating that all of the borrower's EMD checks drawn from that account had cleared (**Exhibit G-3**). While this letter was faxed from an unidentified fax machine, the letter was clearly issued to the borrower and would have been provided to the underwriter by that individual, rather than the bank. We also note that the fax number is the same number the borrower used to fax copies of the cancelled EMD checks, which clearly would have been in the borrowers' possession (**Exhibits G-2, G-4**). This letter evidenced that the borrowers had all but \$704 needed to close the loan in their Bank Atlantic account. The loan file also documented that the borrowers had an account with Wachovia bank, to which the borrowers made payroll deposits (**Exhibit E-4**). While the copies of the Wachovia bank account statements were more than 120 days old, these statements were obtained to document past rental payments. That said, the borrowers clearly had another bank account, in addition to the Bank Atlantic account holding \$2,500 in verified funds, into which they made regular payroll deposits (**Exhibit E-4**). The loan file demonstrated that

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both borrowers were employed (**Exhibit G-5**) and receiving income in addition to the funds deposited in the Bank Atlantic account. Based on this information, the borrowers would have received additional pay checks before loan closing on February 29, 2008 (**Exhibit G-1**). The borrowers easily could have used a portion of their earnings to satisfy the \$704 in remaining funds needed to close the loan.

In summary, the loan file contained sufficient documentation to evidence the receipt of the EMD and the Company was not required to document the source of those funds. Moreover, the loan file contained documentation to evidence that the borrowers had sufficient funds to close the loan in this case. For these reasons, administrative action in connection with this loan would be inappropriate and we request that these allegations be removed from the final report.

4. Gift Fund Documentation

In seven cases, the Report asserts that the loan files did not contain proper verification that gift funds had been provided by the borrowers to the closing agents. Six of the loans at issue involved funds from non-profit downpayment assistance organizations, and one loan involved gift funds provided by a relative. We address each of these cases in turn below.

a. Gifts from Downpayment Assistance Organizations

As you know, FHA guidelines require a lender to verify and document the transfer of gift funds used by a borrower. See HUD Handbook 4155.1 REV-5, ¶ 2-10(C). In six of the seven cases referenced in this sub-finding, the borrowers obtained "gifts" in the form of downpayment assistance. While the Department no longer permits such assistance in FHA-insured loans, see P. Law 110-289, Section 2113, at the time the loans at issue were originated HUD permitted borrowers to obtain gift funds from non-profit entities providing downpayment assistance. Until 2004, Page 2-11 of HUD's Single Family Reference Guide ("Guide") expressly stated that, with respect to gifts provided by a nonprofit or municipality through a downpayment assistance program, "[e]vidence of the actual transfer of funds can be shown as a transaction on the HUD-1." In each of the loans cited in the Report in which downpayment assistance was provided, the HUD-1 Settlement Statement ("HUD-1") documents the transfer of the funds, and the settlement agents certified to the accuracy of the information reflected on the HUD-1. It was not until HUD issued Mortgagee Letter 2004-28 that the Department's guidelines expressly required lenders to obtain and keep the documentation of the wire transfer in its mortgage loan application binder in connection with downpayment assistance gift transfers. After issuance of Mortgagee Letter 2004-28, it was SAMCO's policy and procedure to obtain evidence of the wire transfer of gift funds provided by

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downpayment assistance companies in all FHA-insured loans involving such assistance.

At the time the six loans at issue were originated, SAMCO understands and appreciates that it was required to obtain and retain evidence of the wire transfer of gift funds from the downpayment assistance provider in its loan file. While this documentation was inadvertently omitted from the loan files in these cases, in preparation of this response, the Company contacted each settlement agent and, in all but one case, obtained evidence that the funds identified on the HUD-1s were in fact transferred by the non-profit assistance provider to the agent at settlement. In the [REDACTED] loan, **FHA Case No. 011-5621419**, the settlement agent was unable to locate the file before this response was due. That said, we are confident that the gift funds were provided, as the file contained a gift letter from the downpayment assistance provider (**Exhibit H-1**), and the HUD-1, which the settlement agent certified was a true and accurate representation of this transaction, evidenced that the funds were in fact received (**Exhibit H-2**). To document the borrowers' receipt of downpayment assistance in the remaining cases, we have attached: (1) the gift letter from the downpayment assistance organization²; (2) the HUD-1 evidencing the gift funds; and (3) the wire transfer documentation confirming that the settlement agent received these funds at or before closing. This documentation is attached as follows:

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<u>Borrower</u>	<u>FHA Case No.</u>	<u>Gift Letter and HUD-1</u>	<u>Wire Transfer Confirmation</u>
[REDACTED]	011-5758688	I-1	I-2
[REDACTED]	011-5865507	J-1	J-2
[REDACTED]	105-3100085	K-1 ³	K-2
[REDACTED]	105-3315364	L-1	L-2
[REDACTED]	421-4296353	M-1	M-2

² Please note that, in one loan, [REDACTED] – FHA Case No. 011-5865507, the Company was unable to locate a copy of the gift letter in the loan file. That said, the attached HUD-1 and wire transfer documentation demonstrate that the funds were in fact provided by the downpayment assistance provider in this case.

³ Please note that, although the gift letter from AmeriDream referenced a \$7,200 gift (**Exhibit K-1**), the downpayment assistance provider in fact gave the borrower a total of \$10,800 in grant funds. The \$10,800 gift is accurately reflected on the HUD-1 (**Exhibit K-1**), as well as on the two wire transfer documents attached (**Exhibit K-2**).

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The attached documentation demonstrates, in addition to the HUD-1 reference to the gift funds, that each of these borrowers in fact received the downpayment assistance gift from the nonprofit provider. While the wire transfer documentation was inadvertently omitted from the loan files in these cases, any oversight constituted, at worst, harmless error. The attached documents evidence that the borrowers in all six of the cited cases received the downpayment assistance funds at the time of closing and qualified for FHA financing. For these reasons, this allegation and any requests for administrative action in connection with these cases should be removed from the final report.

b. Gift Funds from Relatives

In one loan, [REDACTED] – FHA Case No. 441-8065074, the Report alleges that the loan file did not document a \$5,000 gift the borrower received from his brother, as the file did not contain documentation of the withdrawal of funds from the donor's account.

With regard to gift funds obtained from a relative, HUD guidelines require a lender to obtain: (1) a gift letter specifying, among other items, the dollar amount given, the donor's name, address, telephone number, and relationship to the borrower, and stating that no repayment is required; (2) evidence of the withdrawal from the donor's personal account; and (3) evidence that funds have been deposited into a borrower's account before closing or a verification of receipt of the funds from the settlement agent. See HUD Handbook 4155.1, REV-5, ¶2-10(C); Mortgage Letter 00-28. As stated in the Report, the borrower received a \$5,000 gift to cover the funds needed to close this loan from her brother. To evidence the gift, SAMCO obtained a gift letter dated November 27, 2007 from the borrower's brother in which he indicated his intent to provide a \$5,000 gift to the borrower (**Exhibit N-1**). Contrary to the Report's allegation, the loan file also contained a copy of a withdrawal slip from the donor's Wachovia account, [REDACTED], evidencing his withdrawal of \$5,000 (**Exhibit N-2**), as well as a certification from the donor, dated November 27, 2007, stating that he had in fact withdrawn \$5,000 and provided the funds to the borrower (**Exhibit N-3**). The loan file also contained a copy of the deposit slip evidencing that the borrower deposited \$5,000 into her Wachovia account, [REDACTED] on November 27, 2007 (**Exhibit N-4**). Moreover, the loan file contained a copy of the borrower's Wachovia account statement verifying the \$5,000 deposit (**Exhibit N-5**), as well as a Verification of Deposit evidencing that the borrower had \$5,171 in her account as of November 29, 2007 (**Exhibit N-6**).

The attached documentation demonstrates that SAMCO properly evidenced the source of the borrower's gift funds in this case, and that the borrower had more than sufficient funds available to cover the \$4,740 needed to close on December 12, 2007 (**Exhibit N-7**). SAMCO adhered to FHA requirements in documenting the gift funds in this loan and, as a result, this assertion should be removed from the final report.

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5. Credit Analysis

In two loans, the Report takes issue with the Company's evaluation of the borrowers' creditworthiness, asserting that the borrowers' credit histories involved collections, judgments, and/or delinquent accounts without adequate explanation from the borrowers.

SAMCO respects the importance of analyzing a borrower's credit performance and examining his or her attitude toward credit obligations. During the Company's existence, it was SAMCO's policy and practice, with respect to every FHA applicant, to scrutinize the applicant's credit record and reasonably determine the potential borrower's creditworthiness. Given the potential risks not only to the Department, but to the Company, of making a poor credit decision, the Company's management endeavored to monitor underwriting performance and provided ongoing training to employees on the issue of credit analysis.

That being said, we note that HUD delegated to FHA lenders the responsibility for analyzing a borrower's credit and determining an individual's creditworthiness. See HUD Handbook 4155.1 REV-5, ¶ 2-3. While HUD has established specific guidelines, credit analysis remains largely subjective. For example, where derogatory credit items are present, lenders have discretion to consider the borrower's unique circumstances and determine whether financing is appropriate. The Department has recognized that underwriting is more of an art than a science and requires the careful weighing of the circumstances in each individual case. Thus, it was SAMCO's policy to carefully scrutinize a borrower's credit history to obtain any documentation or explanation necessary to assess a borrower's credit risk. See Mortgage Letters 00-24 and 95-07; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. While two underwriters may make different decisions about a borrower's credit in the same case, both underwriters may have complied with FHA requirements and made reasonable underwriting decisions. The standard for compliance with FHA requirements is not whether another underwriter or the OIG would have made a different underwriting determination. The standard is whether the Company's underwriter made a reasonable underwriting decision in light of the facts in each case. At all times during its existence, SAMCO took its underwriting responsibility seriously and would never knowingly have approved a loan to an unqualified borrower.

In the cases cited in the Report, SAMCO complied with FHA guidelines by examining the borrowers' overall pattern of credit behavior and reasonably determining that the borrowers qualified for FHA financing. The Company properly considered each borrower's previous housing obligations, recent and/or undisclosed debts, collections, judgments, and bankruptcies, and SAMCO's underwriters reasonably determined that past derogatory items did not reflect a current disregard for financial obligations. The

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loan files contain required documentation and SAMCO prudently exercised the discretion granted to it by the FHA. As discussed below, the borrowers in these cases generally were hard-working individuals who took responsibility for their financial obligations. As a result, SAMCO adhered to FHA requirements by reasonably determining that the borrowers were creditworthy and qualified for FHA loans. We address each of the cited loans below.

a. [REDACTED] – FHA Case No. 421-4296353

In this case, the Report asserts that the borrower's qualifying ratios were calculated without including a joint conventional real estate loan with a monthly payment of \$465 and that the loan file did not include an adequate explanation regarding six collection accounts referenced on the borrowers' credit report. The Report also asserts that the borrower's early default on this FHA-insured loan further supported her disregard for financial obligations.⁴

As discussed above, SAMCO understands and appreciates that, in calculating a borrower's qualifying ratios, FHA-approved lenders must include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations extending ten months or more. See HUD Handbook 4155.1 REV-5, ¶ 2-11(A). It was SAMCO's policy and practice to do so in each FHA-insured loan it originated. That said, the Company acknowledges that the \$465 conventional real estate loan payment reflected on the credit report should have been included in the borrower's qualifying ratios (**Exhibit O-1**). It appears that the underwriter omitted this debt because this joint mortgage account was secured by a property in which the borrower's daughter was residing and it was likely that the daughter was making the mortgage payment (**Exhibit O-1**). Nevertheless, any oversight with regard to this debt constituted, at worst, harmless error. As acknowledged in the Report, including the \$465 monthly payment for this account in the borrower's qualifying ratios would have increased the borrower's back-end ratio to 35.87% (**Exhibit O-2**), which was well within HUD's benchmark guideline. See HUD Handbook 4155.1 REV-5, ¶ 2-12. Thus, even considering this debt, the borrower would have qualified for the FHA-insured loan.

With regard to the collection accounts, contrary to the assertion in the Report, the borrower's explanation adequately explained the six collection accounts and evidenced her responsibility for her credit obligations (**Exhibit O-3**). As indicated on the credit

⁴ The Report also points out that the loan file contained unsigned versions of the borrower's tax returns. At all times during SAMCO's loan operations, it was the Company's policy and practice to obtain signed copies of the borrower's tax returns when such documentation was required. While we acknowledge that signed versions of these documents were inadvertently omitted from the loan file in this instance, this was an isolated incident and did not affect the insurability of the loan.

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report, all six of the borrower's collection accounts were medical in nature (**Exhibit O-1**). The borrower stated in the explanation letter that, in the past, her mother had radiation treatments and needed medical care during her fight with cancer and, in providing that care, the borrower had incurred certain medical debts (**Exhibit O-3**). Based on this explanation, the underwriter reasonably concluded that events outside the borrowers' control, and not her lack of responsibility for credit obligations, led to the medical collection accounts reflected on the credit report. While the borrower acknowledges in her letter that, in the past, she has provided financial assistance to her family, the borrower clearly states that she has learned to put her own credit profile first and engages in responsible credit practices, such as automatic debiting of savings (**Exhibit O-3**). The underwriter in this case reasonably interpreted the borrower's statements in this letter to evidence that she had taken responsibility for her credit obligations and was a reasonable credit risk.

This determination was supported by additional loan file documentation that showed the borrower's more recent responsible use of credit. For example, her credit report reflected that she was currently a minimal user of credit, with only \$113 in monthly payments on credit accounts other than the joint mortgage loan discussed above (**Exhibits O-1, O-2**). Moreover, the loan file documented that the borrower had an excellent rental history for over twelve years prior to closing (**Exhibit O-4**). These factors confirmed the borrower's statements that she had taken control of her finances and was responsibly using credit at the time the loan closed.

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Finally, with regard to the Report's reference to the borrower's early default in the FHA-insured loan at issue, we strongly oppose the inclusion of this language in the Report. HUD guidelines require lenders to analyze a borrower's income and credit situation at the time of closing, and do not hold lenders responsible for a borrower's future actions that are unforeseeable at the time of origination. In this instance, the borrower demonstrated sufficient income to meet HUD guidelines for this FHA-insured loan, and the underwriter reasonably determined in compliance with HUD guidelines that the borrower constituted an acceptable credit risk. To the extent that the borrower did not meet her credit obligations after closing, SAMCO could not have known or predicted this circumstance at the time of closing based on information available during the origination of this loan. For these reasons, it is inappropriate to use her early default to justify a recommendation for administrative action in this case. As such, this language should be removed from the final report.

In summary, the above discussion and attached documentation demonstrates that inclusion of the joint conventional real estate loan payment would not have affected the borrower's eligibility for FHA financing, and that the underwriter properly obtained a credit explanation letter that adequately explained the borrower's collection accounts

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and demonstrated that she was an acceptable credit risk. This borrower qualified for the FHA-insured loan at issue and, therefore, administrative action in this case would be inappropriate. We request that this finding be removed from the final report.

b. [REDACTED] – FHA Case No. 441-8065074

In this case, the Report asserts that the credit report reflected twelve collection accounts; however, the borrower's explanation regarding these accounts was insufficient and the loan file did not indicate that the underwriter considered these accounts in the determination of the borrower's creditworthiness. The Report also asserts that the loan file did not contain a verification of rent or other documentation regarding the borrower's rental history.

With regard to the rental history, SAMCO understands and appreciates that a lender is required to determine the borrower's payment history of housing obligations through verification of rent, cancelled checks, or a mortgage servicer's payment history. See HUD Handbook 4155.1 REV-5, ¶ 2-3(A). It was SAMCO's policy and practice to obtain such and to analyze that documentation to ensure that the borrower paid housing obligations in a responsible manner in each FHA-insured loan it originated. We are confident that, at the time of closing in the [REDACTED] loan, the underwriter had obtained and reviewed the borrower's rental payment history. Without such review, the underwriter would not have approved, and HUD would not have insured, this loan. Nevertheless, it appears that the Company inadvertently did not retain a copy of the rent verification in the loan file in this case. Any oversight in this case constitutes an isolated incident, and we are confident that this document was reviewed by the underwriter prior to closing and was provided to HUD in the case binder.

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With regard to the collection accounts, SAMCO respectfully disagrees with the assertion that the Company did not consider these accounts in its analysis of the borrower's creditworthiness in this case. As discussed above, with regard to analyzing a potential borrower's credit, SAMCO understands and appreciates that it must obtain a written explanation from the borrower regarding all delinquent inquiries shown on a credit report obtained prior to closing. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3(B). The Report acknowledges that, while the lender must consider all open collection accounts, such accounts need not be satisfied prior to closing. See *id.* at ¶ 2-3(C). In this case, the credit report reflected that several of the borrower's open collection accounts were medical in nature (**Exhibit P-1**). With regard to the student loan debts, the borrower provided an explanation letter indicating that these delinquencies occurred as a result of her misunderstanding of the beginning of collections on such loans and the fact that these bills were sent to an address at which she no longer resided (**Exhibit P-2**). While the Report suggests that the borrower should have updated her address with her collectors, the borrower's letter clearly states that she misunderstood how

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student debts would be collected and was unaware of the collection attempts until she later re-applied for additional student loan funding. Based on this explanation, the underwriter reasonably concluded that medical events outside of the borrower's control and a misunderstanding, rather than a disregard for her credit obligations, caused the borrower's past delinquencies.

Moreover, the credit report evidenced that the borrower had an excellent payment history on her current revolving accounts, which further evidenced her ability and willingness to make timely payments on her credit obligations (**Exhibit P-1**). The MCAW also noted that the borrower had cash reserves after closing (**Exhibit B-2**). The underwriter properly considered all aspects of the borrower's credit profile, including the circumstances underlying the referenced collection accounts, in analyzing the borrower's creditworthiness. As the derogatory accounts were medical in nature or caused by her prior misunderstanding of student loan debt collection, and as the remainder of the borrower's credit history evidenced timely payments, the underwriter reasonably determined that the borrower was an acceptable credit risk. For this reason, we believe that administrative action is inappropriate and request that this recommendation be removed from the final report.

6. Source of Funds to Close

Comment 19

Finally, in all eight cases cited in the Report, the Report asserts that the borrowers' source of funds to close the loans was not verified, as the loan files did not contain gift fund documentation in seven cases, or did not document the source of the borrower's assets used to close one loan.

In all eight of the cases cited in this sub-finding,⁵ rather than cite new allegations regarding the source of the borrowers funds to close, the Report merely repeats the assertions made in the sections regarding gift fund documentation and borrower assets, and concludes that, without proper documentation of the transfer of gift funds or the source of assets, SAMCO did not verify the borrowers' investment in the property.

SAMCO strongly objects to the inclusion of these allegations in the final report. The assertions made in this section of the Report merely reiterate allegations already made in the Report's sub-findings regarding gift fund and asset source documentation. As you know, HUD guidelines at the time these loans were originated set forth the information the Department requires to document the source of funds used for the

⁵ These eight cases are: (1) ██████ – FHA Case No. 011-5621419; (2) ██████ – FHA Case No. 011-5758688; (3) ██████ – FHA Case No. 011-5865507; (4) ██████ – FHA Case No. 095-0567977; (5) ██████ – FHA Case No. 105-3100085; (6) ██████ – FHA Case No. 105-3315364; (7) ██████ – FHA Case No. 421-4296353; and (8) ██████ – FHA Case No. 441-8065074.

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borrower's investment in the property in Section 2-10(C) of HUD Handbook 4155.1 REV-5. The Report cites the same section of the same provision in both its allegations regarding gift fund and asset documentation and verification of the borrowers' investment in the properties at issue. These are not separate allegations, but merely a different way of stating the same alleged deficiency in each of these eight cases. Thus, this section of the Report is unnecessarily repetitive and needlessly inflammatory. It appears that inclusion of such repetitive and inflammatory claims in the final report serves only as an attempt to justify the "Operation Watchdog probe."

Moreover, as demonstrated above, the Company obtained sufficient documentation, either at the time of loan closing or in preparation of this response, to document the borrowers' investments in these properties through the use of either gift funds from relatives or downpayment assistance organizations or their own documented assets. SAMCO maintains that it substantially conformed to HUD requirements in these cases and that the attached documentation evidences that the borrowers met their required investment, as evidenced on the HUD-1s. Each of these eight borrowers qualified for the FHA-insured loan. For these reasons, these repetitive and unnecessary allegations are unwarranted and should be removed from the final report.

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B. SAMCO STRONGLY OPPOSES THE RECOMMENDATION THAT PFCRA PENALTIES ARE APPROPRIATE IN THIS CASE

1. SAMCO Exercised Due Diligence in Underwriting the Loans at Issue

In addition to the underwriting deficiencies discussed above, the Report asserts that, in the eight loans at issue, the underwriter's certification on page 3 of the Addendum to the Uniform Residential Loan Application ("URLA"), Form HUD-92900-A ("Addendum") was incorrect, as the underwriter certified to using due diligence in underwriting these cases but did not do so. We understand that this allegation is predicated on the OIG's determination that these eight cases contained underwriting deficiencies. The Report alleges that these underlying oversights demonstrate that the underwriter did not exercise due diligence in examining the loan file and, as a result, the certification on the Addendum in these cases was incorrectly signed. The Report recommends in connection with these allegations that HUD's Associate General Counsel for Program Enforcement determine the legal sufficiency of and, if sufficient, pursue civil money penalties and/or remedies under the PFCRA for the inaccurate certifications in these cases. As discussed in detail above, SAMCO takes exception to the allegations that these loans contained underlying origination deficiencies, as well as the inflammatory recommendation to impose PFCRA penalties made in connection with this finding.

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HUD is authorized to impose civil penalties under PFCRA against persons who "make, submit, or present, or cause to be made, submitted, or presented, false, fictitious, or fraudulent claims or written statements to Federal authorities or to their agents." 24 C.F.R. § 28.1. The Report suggests that, because the OIG identified underwriting deficiencies in these eight cases, the underwriters' certifications that due diligence was used in underwriting these loans are inaccurate. As demonstrated in the above discussion, however, in the eight cases cited, SAMCO substantially complied with HUD requirements and the underwriter made a reasonable decision to approve the loans after exercising due diligence in examining each of the files at issue. For these reasons, SAMCO disagrees with the recommendation of any penalty in connection with these loans, let alone the harsh sanctions of civil money or PFCRA penalties recommended in the Report.

Additionally, the Report does not allege, and there is no evidence to suggest, that SAMCO or its employees intended to circumvent HUD underwriting guidelines in these cases. Rather, the certifications in these eight cases were executed by the underwriters after diligent review of the loan files in which these individuals made every effort to comply with FHA requirements. The certifications in these cases were executed in the belief that the borrowers qualified for FHA financing, which in fact they did in each case, rather than in an attempt to mislead the Department. The Report does not allege that SAMCO or its underwriters knowingly misrepresented facts to the Department or intentionally provided false information in the cases at issue. Before imposing penalties on FHA-approved lenders, HUD weighs a number of factors. While intentional violations or a disregard for HUD requirements can lead to severe sanction, such as PFCRA penalties, HUD traditionally imposes less severe consequences for deficiencies caused by unintentional error. Additionally, SAMCO maintains that the borrowers in the cited cases qualified for FHA financing. At worst, certain of these loans contained minor errors that did not affect the insurability of the loans. As indicated above, SAMCO believes that the final report should omit recommendations of administrative action in connection with many of these cases, making the recommendation of PFCRA penalties all the more severe under these circumstances.

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We also note that, rather than cite new allegations, the PFCRA recommendation appears to be an attempt to pile on the allegations made against SAMCO's underwriting practices in this Report. Typically, OIG audit reports allege certain deficiencies in a company's FHA operations, and the company is given an opportunity to address the materiality and accuracy of the allegations. By also adding an incorrect certification allegation to these underwriting assertions, the OIG has created a situation where every misunderstanding of FHA requirements or oversight of a detail or document in a FHA loan could give rise to allegations of a false certification claim. Considering the sensationalizing of the "Operation Watchdog" probe, and the devastating effects this

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matter has and will continue to have on the targeted lenders, such actions will create a chilling effect on lenders who want to participate in the FHA Program. Enforcement actions are meant to reinforce HUD's rules and regulations, rather than discourage broad participation in FHA lending. For the sake of the Program, therefore, we believe the OIG should reconsider its approach to alleging false certifications and focus on the compliance with FHA rules and regulations.

2. The PFCRA Allegations Constitute a Recommendation to HUD, Rather than a Final Action By the Department

As noted above, the Report merely recommends that the Department determine the legal sufficiency of pursuing PFCRA remedies and/or civil money penalties in the cited cases. Upon receiving the final report, the Department will have an opportunity to independently examine the review findings and make an independent determination of whether such penalties are appropriate in these eight cases. As discussed at length earlier in this response, SAMCO disagrees that the Report's assertions warrant administrative action, civil money penalties, or PFCRA remedies. HUD may also disagree with the Report's assertions and decide not to pursue PFCRA or civil money penalties in this instance.

In addition, while the review process is still ongoing at the time the OIG issues its "final" report, the Report and the OIG's recommendations typically are made public on the OIG website. As a result, a lender's investors and peers are able to access the preliminary recommendations of the OIG before a final assessment as to their merit can be made by the Department. These entities often misinterpret the OIG's recommendations to be final actions by the Department. Under these circumstances, making these preliminary recommendations public and including inflammatory allegation that HUD pursue PFCRA remedies with the suggestion that the loans identified involve misrepresentations would be especially detrimental, as the public nature of the "Operation Watchdog" probe has already resulted in the loss of investors and customers to the point where SAMCO was forced to cease loan originations and close its doors.

If the OIG's goal is to present the reader with a full and accurate disclosure of this review and its implications to the Company, the Report should include the following disclosure on the first page in bold, capitalized lettering:

THE REPORT FINDINGS REFLECT THE VIEWS OF THE OFFICE OF INSPECTOR GENERAL AND DO NOT CONSTITUTE A FINAL DETERMINATION OF THE MATTERS RAISED HEREIN BY THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. THE FINAL DETERMINATION IN THIS MATTER WILL BE MADE BY THE REPORT'S ADDRESSEE, THE HUD ASSISTANT SECRETARY FOR HOUSING – FEDERAL HOUSING COMMISSIONER, WHO WILL ULTIMATELY

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DECIDE WHETHER TO ACCEPT THE REPORT'S RECOMMENDATIONS IN WHOLE OR IN PART OR REJECT THEM.

Such a disclosure would more accurately convey the status of the OIG's "final" report to the Company's investors, customers, and the public.

III. CONCLUSION

SAMCO takes the matters raised in the draft Report seriously. Because FHA lending comprised a significant portion of SAMCO's overall business operations throughout its existence, the Company was committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. Although the publication of the Department's scrutiny of the Company in the press release announcing the "Operation Watchdog" probe has effectively put the Company out of business, SAMCO nevertheless has conducted a thorough review of the issues identified in the Report. As discussed above, SAMCO's review indicated that the Report's findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of SAMCO, or do not affect the underlying loans' insurability. The Company substantially complied with FHA underwriting requirements in several of the loans identified in the Report and made loans to qualified FHA borrowers. Accordingly, we respectfully request that the OIG revise the allegations cited in the Report based on the information and documentation provided in this response and remove allegations for which SAMCO has demonstrated its compliance with HUD requirements.

Finally, SAMCO believes that the recommendations involving PFCRA penalties are unwarranted, as they suggest an intent to circumvent HUD requirements when the OIG knows full well that no such intention existed in these cases. SAMCO values its relationship with the Department and did not, in any manner, seek to misrepresent any information to HUD. SAMCO believes that the various remedies available to HUD, short of the severe sanctions under PFCRA, are commensurate to resolve any deficiency identified in the Report. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate that including these recommendations in the Report is unnecessary, inappropriate, and will further damage SAMCO's reputation, which has already suffered as a result of the public nature of the

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"Operation Watchdog" probe. We respectfully request that the OIG revise its recommendations to fit the facts of this case.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip Schulman, at (202) 778-9027.

Thank you for your kind consideration.

Sincerely,



Samuel P. Lamparello

Attachments

cc: Phillip L. Schulman, Esq., K&L Gates LLP

OIG's Evaluation of Lender Comments

- Comment 1** Security Atlantic officials question the methodology used to select the 20 loan files reviewed. However, we want to point out that the loan sample was not intended to be statistical or random. The sample was the result of targeted analysis to specifically identify loans that had gone into claim status. Further, the review does not project results to Security Atlantic's universe of FHA loans, and the conclusions only relate to the now six FHA loans identified as having material underwriting deficiencies.
- Comment 2** Security Atlantic officials have taken issue with the press release announcing OIG's Operation Watchdog initiative; however, the January 12, 2010 HUD press release does not make any accusations or presumptions of fraud. The goal of the initiative was to determine why there was such a high rate of defaults and claims with the 15 companies and whether there may have been wrongdoing involved. The detection and investigation of fraud is the responsibility of the Office of Inspector General in each of its audits and reviews. As such, the reviews are proactive in trying to identify systemic problems that HUD needs to address.
- Comment 3** For loan number 441-8065074, Security Atlantic officials contend that the borrower could not enter into a lease agreement with tenants prior to closing; therefore, no verification of the projected rental income was necessary. We disagree because although HUD Handbook 4155.1 REV-5 allows projected rental income from additional units to be used to qualify, all rental income must be verified either with a current signed lease or other rental agreement. In this case, the borrower could have entered into an agreement to lease with the tenant currently occupying the unit to verify the \$595 in rental income that was used to qualify. As such, this case will remain in the report.
- Comment 4** For loan number 011-5621419, Security Atlantic official's response stated that the revolving accounts were delinquent collection accounts that were medical in nature and not revolving charge accounts; therefore, the accounts were not required to be paid off or included in the borrower's back ratio. In addition, the underwriter obtained two written letters of explanation for these collection accounts, which were provided. As a result, since the accounts were not revolving charge accounts; but were collections related to medical expenses incurred by the borrower while uninsured, we have removed the material deficiency related to underreported liabilities.
- Comment 5** For loan number 011-5865507, Security Atlantic officials agree that the revolving account with an outstanding balance of \$796 and monthly payments of \$24 should have been included in the borrower's back ratio; however, Security Atlantic officials disagree that the 3 collection accounts with a balance of \$999 should have been included. It is our position that the outstanding balances for these 3 collection accounts should have been included in the borrower's back ratio because the borrower acknowledged that arrangements had been made to pay this

outstanding balance and Security Atlantic officials did not document that the borrower had sufficient cash assets after closing to pay this \$999 outstanding balance. Including this \$999 increases the back ratio to 59.95 percent requiring significant compensating factors, which were not documented. Further the borrower defaulted on this loan after making only three payments and the reason for default was unknown, as Neighborhood Watch listed “unable to contact borrower”. Therefore, this case will remain in the report.

Comment 6 For loan number 095-0567977, Security Atlantic officials agree that the revolving account with an outstanding balance of \$916 and monthly payments of \$70 should have been included in the borrower’s back ratio. Additionally, in their response, Security Atlantic officials provided a copy of the borrower’s letter of explanation for derogatory accounts, which officials state was inadvertently placed in another file and was not previously provided to us. Therefore, the deficiency related to no letter of explanation for derogatory accounts has been removed from the report; however, the deficiency related to underreported liabilities remains in the report.

Comment 7 For loan number 105-3100085, Security Atlantic officials agree that the borrower’s back ratio was incorrectly calculated because mortgage payments totaling \$1,171 on the borrower’s rental property was excluded; however, officials contend that significant compensating factors were documented in the loan file. In their response, Security Atlantic again presented job stability as well as additional compensating factors of substantial cash reserves of \$34,104 in a retirement account, and excellent payment history on prior mortgage. Regarding job stability, this is a requirement for mortgage approval and is not one of HUD’s acceptable compensating factors to justify approving the mortgage with ratios above HUD’s benchmarks. Regarding cash reserves, Paragraphs 2-10 K and 2-13 G of HUD Handbook 4155.1 REV-5, states that only 60 percent of the value can be used in underwriting and the lender must judge whether or not the asset is liquid or readily convertible to cash and can be done so absent retirement or job termination. Security Atlantic officials documented that the borrower had funds in a retirement account; however, Security Atlantic officials did not provide any documentation showing that these retirement funds could be readily converted to cash without the borrower retiring. Regarding excellent payment history on prior mortgage, this is not a valid compensating factor because the borrower’s credit report only documented a 4 month payment history and not the required 12 month payment history and the mortgage relates to the borrower’s rental property, which was excluded from the borrower’s back ratio. Therefore, the deficiency related to underreported liabilities remains in the report because significant compensating factors were not presented and the borrower made no payments on this mortgage.

Comment 8 For loan number 095-0567977, Security Atlantic officials contend that the borrower’s earnest money deposit did not exceed 2 percent of the sales price; therefore, they were not required to document the source of the funds. However, we disagree because Paragraph 2-10 of HUD Handbook 4155.1, REV-5, pertaining to the borrower investment states that all funds for the borrower’s

investment in the property must be verified and documented. The borrowers' investment for this purchase was \$5,250; therefore, Security Atlantic officials were required to verify and document the source of funds. Security Atlantic officials contend that the file contains a letter from the settlement agent indicating that he was holding \$3,000 for the borrowers; however, this is incorrect and the letter is in fact from the seller's real estate broker. Additionally, Security Atlantic officials state that it is not unusual for checks to be out of sequential order and would not raise concerns with the underwriter. We disagree because the file documents that the borrowers provided three separate checks of \$1,000 consisting of check number 107 dated 01/02/2008, check number 105 dated 01/10/2008, and check number 135 dated 2/5/2008 and the underwriter should have questioned how check 107 was issued before check 105 and why there is such a significant gap between checks issued in January and early February. Also, Security Atlantic officials agree that the borrower's bank statements were more than 120 days old; however, officials contend that the borrowers had all but \$704 needed to close and could have used a portion of their pay checks to satisfy this. We disagree because Security Atlantic officials did not document the borrowers' savings pattern and only presented a savings bank balance of \$2,499.86 with no savings history documented and a checking account statement for May 30, 2007 to June 27, 2007 with an ending balance of only \$127.89. Therefore, this material deficiency remains in the report.

- Comment 9** For FHA number 011-5621419, Security Atlantic officials stated that the settlement agent was unable to locate the file before the response was due and did not provide us with any documentation verifying that the settlement agent received the gift funds. Therefore, the material deficiency remains in the report.
- Comment 10** For FHA number 011-5758688, Security Atlantic officials provided the wire transfer showing that the gift funds were received by the closing agent; therefore, the material deficiency and the loan has been removed from the report.
- Comment 11** For FHA number 011-5865507, Security Atlantic officials provided the wire transfer showing that the gift funds were received by the closing agent; therefore, the material deficiency has been removed from the report.
- Comment 12** For FHA number 105-3100085, Security Atlantic officials provided the wire transfer showing that the gift funds were received by the closing agent; therefore, the material deficiency has been removed from the report.
- Comment 13** For FHA number 105-3315364, Security Atlantic officials provided the wire transfer showing that the gift funds were received by the closing agent; therefore, the material deficiency and the loan has been removed from the report.
- Comment 14** For FHA number 421-4296353, Security Atlantic officials provided a copy of the settlement agent's disbursement worksheet, which listed \$7,500 in gift funds; however, Security Atlantic did not provide any documentation showing that the

settlement agent received the gift funds. Without evidence that the settlement agent received the gift funds, Security Atlantic officials did not verify the gift funds or the borrower's investment in the property. Therefore, the material deficiency and the loan remain in the report.

Comment 15 For FHA number 441-8065074, Security Atlantic officials provided a copy of the donor's withdrawal document and the borrower's bank statement showing that the \$5,000 gift was deposited into the borrower's account. However, the donor's withdrawal document did not show a beginning or ending balance for the donor's account. Without evidence of the donor's beginning or ending balances, there is no documentation showing that the funds were the donor's, and that the funds did not come from an unacceptable source. Therefore, the material deficiency and the loan remain in the report.

Comment 16 For FHA number 421-4296353, Security Atlantic officials agree that the \$465 real estate loan should have been included in the borrower's back ratio; however, they disagreed that the borrower's explanation for collection accounts indicated a disregard for credit obligations. Officials also agree that the borrower's signed tax return that indicated self employment income was not included in the files. Further they state that they could not have known or predicted the borrower's inability to meet obligations after loan closing. It is our position that the borrower's explanation did indicate a disregard for credit obligations because Paragraph 2-3 of HUD Handbook 4155.1 REV-5 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. In this instance, the borrower's past credit history indicated that this borrower's disregard for financial obligations would most likely continue and it did as the borrower made only one mortgage payment before defaulting. Further, Officials should have considered the unsigned tax return more closely because the inadequate documentation of the borrower's self employment income may have been a contributing factor in that the reason for loan default was curtailment of borrower income. Therefore; the material deficiency and this loan will remain in the report.

Comment 17 For loan number 441-8065074, Security Atlantic officials agreed that its loan file did not contain a verification of rent; however, they contend that the underwriter obtained a verification of rent and it was reviewed by the underwriter and provided in the case binder. Our review of the FHA case binder did not find a verification of rent; therefore, this deficiency and the loan will remain in the report.

Comment 18 For loan number 441-8065074, Security Atlantic officials state that the borrower's collection accounts were considered in its analysis of creditworthiness and the underwriter concluded that the collection accounts resulted from medical events outside the borrower's control and a misunderstanding of when student loans were to be repaid. We disagree because the student loan collections did not result from a misunderstanding, but from the fact that the borrower was not

having her mail forwarded from her mother's residence to her residence. Additionally, this borrower defaulted on the mortgage after only making four payments and the reason for default was excessive obligations.

Comment 19 At the cornerstone of FHA is the 3 percent minimum required cash investment to be made by borrowers. While FHA allows the entire 3 percent investment to come from gift funds, it is imperative that the lender document that the gift funds were actually received, were from an acceptable source, and the borrower's investment in the property is verified and documented (see Chapters 1-7 and 2-10 of HUD Handbook 4155.1 REV-5). Based on the gift documentation provided in Security Atlantic's response, we removed the borrower's investment deficiency for four of the eight loans and removed two loans from the report.

Further, Security Atlantic officials state that rather than cite new allegations regarding the borrower's source of funds to close, the report merely repeats the assertion made regarding gift funds and borrower assets. However, the report states that the borrowers' investment in the property was not verified or documented. The loan files indicated that the gift funds and/or borrower assets would be provided as part of the borrower's investment in the property. Nevertheless, if the gift funds and/or borrower assets were not adequately verified, then Security Atlantic officials did not verify the gift (for 3 loans), assets (for 1 loan), or the borrower's investment in the property (for 4 loans). Thus, this is not a repeat allegation, nor is it inflammatory to report that these are dual violations of HUD/FHA regulations.

Comment 20 Security Atlantic officials believe that the recommendations for remedies under Program Fraud Civil Remedies Act, Civil Money Penalties, and/or administrative action are not appropriate and should be removed from the report. However, we did not change the recommendations because violations of FHA rules are subject to civil and administrative action. Nevertheless, the report does recommend that HUD make determinations of the legal sufficiency of the deficiencies cited and pursue remedies under the Program Fraud Civil Remedies Act, Civil Money Penalties, and/or administrative actions, if necessary.