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-1808

September 29, 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: Pine State Mortgage Corporation**,** Atlanta, GA, Did Not Properly Underwrite a Selection of FHA Loans

INTRODUCTION

We conducted a review of 20 Federal Housing Administration (FHA)-insured loans underwritten by Pine State Mortgage Corporation (Pine State), an FHA direct endorsement lender. This review was conducted as part of our 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 Pine State underwrote the 20 loans reviewed 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 mailed to Pine State officials on August 24, 2010; however, it was returned as undeliverable on September 7, 2010. We telephoned Pine State officials on several occasions; however, they did not return our calls. During the audit resolution process HUD officials will attempt to establish contact with Pine State officials to give them an opportunity to address the issues in this report.

METHODOLOGY AND SCOPE

Pine State is 1 of 15 direct endorsement lenders we selected from HUD's publicly available Neighborhood Watch[1] system for a review of underwriting quality. These direct endorsement lenders all had a compare ratio[2] 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 underwritten by Pine State that had gone into claim status within 30 months. The selected loans consisted of 20 purchases and were (1) not streamline 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. To accomplish our objectives, we reviewed applicable HUD handbooks, mortgagee letters, and reports from HUD's Quality Assurance Division.

This review was performed from January through July 2010. We conducted our review in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information systems controls of Pine State, consider the results of previous audits, or communicate with Pine State's management in advance. We did not follow standards in these areas because our overall goal was to aid HUD in identifying material underwriting deficiencies and/or potential wrongdoing on the part of poorly performing lenders that contributed to a high rate of defaults and claims 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

Pine State is a HUD-approved Title II nonsupervised[3] direct endorsement lender located in Atlanta, GA. It became a direct endorsement lender on February 11, 1993. Under the direct endorsement program, lenders are allowed to underwrite FHA-insured single-family mortgages without prior HUD 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.

The goal of Operation Watchdog is to determine why the selected lenders had such a high rate of defaults and claims. 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

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[1] Neighborhood Watch is a Web-based data processing, automated query, reporting, and analysis system designed to highlight exceptions to lending practices of high-risk lenders 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 nonsupervised 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.

December 2009. During these periods, respectively, Pine State endorsed 6,054 loans valued at more than $946 million and submitted 732 claims valued at more than $99.4 million.

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

RESULTS OF REVIEW

Pine State officials did not underwrite 14 of 20 loans reviewed in accordance with HUD/FHA regulations. As a result, the FHA insurance fund suffered actual losses of $1,030,786 on 13 loans and faces a potential loss of $64,416 on 1 loan for a total of $1,095,202 as shown in the table below.

FHA case number	Closing date	Number of payments before 1st default	Original mortgage amount	Unpaid balance	Actual loss to HUD[@]	Potential loss[±]	Total actual & potential loss to HUD
105-2427729	08/09/05	1	$98,658	95,761	$55,774		$55,774
105-2541058	12/21/05	2	$202,340	195,750	$161,736		$161,736
105-2632402	03/17/06	13	$199,295	192,891	$82,525		$82,525
105-2721400	06/16/06	3	$128,245	125,803	$66,849		$66,849
105-2903785	01/29/07	2	$125,308	124,028	$38,625		$38,625
105-2926206	02/12/07	4	$127,853	126,547	$28,103		$28,103
105-2957702	06/11/07	6	$166,561	162,022	$99,662		$99,662
105-2978097	03/27/07	16	$110,132	107,360		$64,416	$64,416
105-3008866	08/31/07	7	$148,240	145,886	$86,179		$86,179
105-3011817	05/02/07	1	$122,962	121,021	$57,306		$57,306
105-3033155	05/24/07	3	$182,174	178,624	$108,421		$108,421
105-3123930	07/26/07	5	$139,410	137,446	$67,619		$67,619
105-3129145	07/30/07	6	$167,509	163,981	$106,003		$106,003
105-3121214	07/30/07	11	$83,905	81,785	$71,984		$71,984
		Total	**$2,002,592**	**1,958,905**	**$1,030,786**	**$64,416**	**$1,095,202**

[±] The potential loss represents 60% of the unpaid balance. This loss percentage is based on the actuarial review of the FHA Insurance Mutual Mortgage Fund for fiscal year 2009.

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

The below table summarizes the material underwriting deficiencies that were identified in the 14 loans.

Areas in which underwriting deficiencies were found	Number of loans*
Income	4
Liabilites	1
Ratios	1
Credit	5
Gift	13
Statutory Minimum Investment	13

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

Appendix A of this report shows a summary schedule of material deficiencies in each of the 14 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.

Inadequate Verification of Income

Pine State officials approved four loans without adequately verifying the borrower's income. For example, for loan number 105-3011817, Pine State officials failed to address a discrepancy in the borrower's employment income. While the FHA file contained a verification of employment that reported an average weekly income of $650, which was used to calculate ratios, the average weekly income reported on the borrower's pay stubs was $526. In addition, Pine State officials did not verify two full years of employment as required, thus failing to ensure that the borrower had income stability. These deficiencies are important because the reported cause of default, which occurred after one payment, was a curtailment of income.

Excessive Ratios Without Adequate Compensating Factors
Underreported Liabilities

Pine State officials approved one loan that had underreported liabilities and excessive ratios without adequate compensating factors. For loan number 105-3033155, the mortgage credit analysis worksheet noted a fixed payment-to-income ratio of 47.42 percent with the following compensating factors: home-buyer counseling, minimal use of revolving credit, overtime for borrower not considered, and FICO (credit score) 570, 548, none of which is a valid compensating factor. Home-buyer counseling does not increase the borrower's ability to pay the mortgage, minimal use of revolving credit alone is not a compensating factor because the borrower must also show an ability to accumulate savings, and the low FICO scores are not compensating factors. Further, FHA regulations would prohibit considering overtime because the underwriter did not demonstrate that the overtime income was likely to continue and that it had been received for the past two years. In addition, the lender incorrectly calculated the debt-to-income ratio because a monthly liability relating to a student loan of $251 was not considered. Although the credit report indicated that the student loan could be deferred, the file did not have an independent confirmation that the loan was deferred. Including the $251 in liabilities would raise the debt-to-income ratio to 52.50 percent, which would require significant compensating factors.

Credit-Related Deficiencies

Pine State officials approved five loans that had significant credit-related deficiencies. For loan number 105-2541058, Pine State officials did not adequately assess the borrower's credit history. The HUD-1 settlement statement reported four collection items totaling $878. While the borrower provided a letter of explanation for these items stating that she fell behind on her bills when she became unemployed on February 1, 2003, these items had gone into collection two to three years before the unemployment occurred; therefore, the borrower's explanation was inadequate. The assessment of her creditworthiness is important because the borrower defaulted with only two payments made and the cause of default was reported as excessive obligations. In addition, while the HUD-1 noted that the seller was going to pay these collection items in advance, there was no evidence that the items were paid.

Insufficient Gift Documentation
Statutory Minimum Investment Not Verified

Pine State officials approved 13 loans that had inadequate verification of the transfer of gift funds, which also resulted in the statutory minimum investment not being verified. For loan number 105-2541058, the loan file lacked adequate documentation to verify the transfer of a $6,118 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet reported the borrower's statutory cash investment requirement as $6,118, and the FHA case binder contained a gift letter, dated December 7, 2005, from a nonprofit for a $6,118 gift. The gift letter stated that the funds, to be applied toward the property purchase, would be wired to the closing attorney one day before the day of closing on or about December 19, 2005. Although the loan closed on December 21, 2005, there was no documentation to verify that the gift funds were provided to the closing agent. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, Pine State officials verified neither receipt of the gift funds nor that the borrower met the statutory minimum investment as required.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the 14 loans with material underwriting deficiencies for accuracy. Pine State's direct endorsement underwriters incorrectly certified that due diligence was used in underwriting these 14 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 to (1) recompense such agencies for losses resulting from such claims and statements; (2) permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and (3) 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 that 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 Pine State and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of 14 loans that resulted in actual losses of $1,030,786 on 13 loans and potential losses of $64,416 on one loan, for a total loss of $1,095,202, which could result in affirmative civil enforcement action of approximately $2,295,404.[4]

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

1B. Take appropriate administrative action against Pine State 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 COST

Recommendation number	Ineligible 1/
1A	$1,095,202
Total	**$1,095,202**

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 13 properties ($1,030,786) and the potential loss related to 1 property ($64,416).

[4] Double damages for actual loss amounts related to 13 loans and potential loss related to 1 loan ($1,030,786 + $64,416 = $1,095,202) plus fines of $7,500 each for the 14 loans with material underwriting deficiencies. ($1,095,202 x 2) + ($7,500 x 14) = $2,295,404.

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Inadequate verification of income/employment	Underreported liabilities	Excessive ratios without adequate compensating factors	Significant credit- related deficiencies	Insufficient gift documentation	Statutory minimum investment not verified
105-2427729					X	X
105-2541058				X	X	X
105-2632402					X	X
105-2721400	X			X	X	X
105-2903785					X	X
105-2926206					X	X
105-2957702				X	X	X
105-2978097				X	X	X
105-3008866				X	X	X
105-3011817	X					
105-3033155		X	X		X	X
105-3123930	X				X	X
105-3129145					X	X
105-3121214	X				X	X
	4	1	1	5	13	13

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number	105-2427729
Mortgage amount:	$98,658
Section of Housing Act:	203(b)
Loan purpose:	Purchase
Date of loan closing:	August 9, 2005
Status as of July 31, 2010:	Claim
Payments before first default reported:	One
Loss to HUD:	$55,774

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds and inadequate verification of statutory minimum investment.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

There was inadequate documentation showing that the receipt of two gifts of $2,984 and $500 had been verified. While the file contained a gift letter for $2,984 from a nonprofit stating that the gift would be wired to the closing attorney before closing, there was no documentation to verify receipt of the gift funds. Since the source of the borrower's statutory minimum cash investment was the gift, the lender failed to verify that the borrower made the minimum required statutory cash investment. In addition, the file contained a signed affidavit for a $500 gift and a faxed bank statement printout reporting the deposit of a $500 donor's check into the seller's real estate broker's account; however, there was no evidence that the lender verified that the $500 gift was the donor's own funds. Thus, the lender did not verify that the gift did not ultimately come from an unacceptable source. It is important to note that the loan defaulted after the first month's payment and these gift funds represented the borrower's earnest money deposit.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5 paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, provides that the borrower must make a 3 percent minimum cash investment in the property and borrower-paid closing costs may be used to meet the cash investment requirements.

Loan number: 105-2541058

Mortgage amount: $202,340

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: December 21, 2005

Status as of July 31, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $161,736

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, and inadequate evaluation of credit history.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The loan files lacked adequate documentation to verify the transfer of a $6,118 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet reported the borrower's statutory cash investment requirement as $6,118, and the FHA case binder contained a gift letter, dated December 7, 2005, from a nonprofit for a $6,118 gift. The gift letter stated that the funds, to be applied toward the property purchase, would be wired to the closing attorney one day before the day of closing on or about December 19, 2005. Although the loan closed on December 21, 2005, there was no documentation to verify that the gift funds were provided to the closing agent. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify the receipt of the gift funds or that the borrower met the statutory minimum investment as required.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, provides that the borrower must make a 3 percent minimum cash investment in the property.

C. Inadequate Evaluation of Credit History

The lender did not adequately evaluate the borrower's credit history. The HUD-1 settlement statement reported four collection items totaling $878. While the borrower provided a letter of explanation for these items stating that she fell behind on her bills when she became unemployed on February 1, 2003, these items had gone into collection two to three years before the unemployment occurred; therefore, the borrower's explanation was inadequate. The assessment of her creditworthiness is important because the borrower defaulted with only two payments made and the cause of default was reported as excessive obligations. In addition, while the HUD-1 noted that the seller was going to pay these collection items in advance, there was no evidence that the items were paid.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, provides that while minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit–including judgments, collections, and other recent credit problems–require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

Loan number 105-2632402

Mortgage amount: $199,295

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: March 17, 2006

Status as of July 31, 2010: Claim

Payments before first default reported: 13

Loss to HUD: $82,525

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds and inadequate verification of statutory minimum investment.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The loan files lacked adequate documentation to verify the transfer of a $6,073 gift; therefore, the borrower's investment in the property was not verified. The mortgage credit analysis worksheet reported the borrower's statutory cash investment requirement as $6,073, and the FHA case binder contained a gift letter, dated March 16, 2006, from a nonprofit for a $6,073 gift. The gift letter stated that the funds would be wired to the closing attorney one day before the day of closing on or about March 17, 2006. The HUD-1 settlement statement reported that the loan closed on March 17, 2006; however, there was no documentation to verify that the gift funds were provided to the closing agent. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender verified neither receipt of the gift funds nor that the borrower met the statutory minimum investment as required.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, provides that the borrower must make a 3 percent minimum cash investment in the property.

Loan number | 105-2721400

Mortgage amount: | $128,245

Loan number	105-2721400
Mortgage amount:	$128,245
Section of Housing Act:	203(b)
Loan purpose:	Purchase
Date of loan closing:	June 16, 2006
Status as of July 31, 2010:	Claim
Payments before first default reported:	Three
Loss to HUD:	$66,849

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, inadequate verification of employment, and inadequate evaluation of creditworthiness.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The loan file lacked adequate documentation to verify the transfer of two gifts; therefore, neither the borrower's gift nor investment in the property were verified. The mortgage credit analysis worksheet reported that the borrower's statutory cash investment requirement was $3,878, and the FHA case binder contained a gift letter for the borrower in the amount of $3,878, dated June 6, 2006, from a nonprofit. The gift letter stated that the funds would be wired to the closing attorney one day before the day of closing on or about June 16, 2006. While the HUD-1 settlement statement reported that the loan closed on June 16, 2006, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the receipt of gift funds and borrower's investment in the property. In addition, the loan file lacked adequate documentation to verify the transfer of a $500 gift from the borrower's mother, which was to be used as part of the earnest money deposit. While the file contained copies of the mother's bank statements showing two $500 transactions (a deposit on June 1, 2006, and a withdrawal on June 5, 2006), the lender did not verify that the funds were not from an interested third party. Therefore, in this instance, the lender did not verify the borrower's gift and earnest money deposit.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, provides that the borrower must make a 3 percent minimum cash investment in the property.

C. Inadequate Verification of Employment

The lender failed to obtain an adequate alternative verification of employment for the borrower. The borrower provided two pay stubs for the period ending March 5 and 19, 2006, which did not represent the most recent 30-day period since the closing date was June 16, 2006. Further, the lender only obtained 1 year's Internal Revenue Service (IRS) W-2 form, not the required 2 years, and the tax transcripts provided were faxed from an unknown source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), provides that as an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 forms from the previous 2 years. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. The lender also must verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified. The lender also may use an electronic retrieval service for obtaining W-2 and tax return information.

HUD Handbook 4155.1, REV-5, paragraph 3-1, also provides that the verification of deposit and verification of employment may be faxed documents or printed pages from the Internet if they clearly identify their sources (e.g., contain the names of the borrower's employer or depository/investment firm). The lender is accountable for determining the authenticity of the document by examining information included in a document's headers and footers. The lender should verify the authenticity of printed Web pages by examining the pages for similar information. A printed Web page also must show its uniform resource locator (URL) address, as well as the date and time the document was printed.

D. Inadequate Evaluation of Creditworthiness

The lender did not adequately evaluate the borrower's creditworthiness. The borrower's credit report showed a $2,436 paid collection in January 2006 related to an apartment complex. However, the lender did not obtain an explanation for this collection, which indicated the borrower's failure to meet housing obligations. The rental payments related to the collection started in December 2004, and the last activity was in January 2006. Although, the lender obtained a verification of rent reporting that the borrower had been residing at the same location for the past 32 years and was currently paying $250 per month for rent, the verification was not from an acceptable source. There was an identity of interest because the verification was from the borrower's mother. In addition, page one of the loan application noted that the borrower lived rent free at her present address, while page two noted that she paid $250 per month for rent; however there was no explanation for this discrepancy. These deficiencies are particularly important because the borrower defaulted after making only three payments and the reason for default was excessive obligations.

HUD/FHA Requirements:

HUD Handbook 4155.1 REV-5, paragraph 2-3 provides that while minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit-including judgments, collections, and other recent credit problems-require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

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

Loan number	105-2903785
Mortgage amount:	$125,308
Section of Housing Act:	203(b)
Loan purpose:	Purchase
Date of loan closing:	January 29, 2007
Status as of July 31, 2010:	Claim
Payments before first default reported:	Two
Loss to HUD:	$38,625

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds and inadequate verification of statutory minimum investment.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $3,818 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 $3,818, and the FHA case binder contained a gift letter, dated January 29, 2007, from a nonprofit for a $3,818 gift to the borrower to be applied toward the property purchase. The loan closed on January 29, 2007, and neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, provides that the borrower must make a 3 percent minimum cash investment in the property and borrower-paid closing costs may be used to meet the cash investment requirements.

Loan number: 105-2926206

Mortgage amount: $127,853

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: February 12, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Four

Loss to HUD: $28,103

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds and inadequate verification of statutory minimum investment.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a of $3,866 gift; therefore, the borrower's required minimum investment in the property was not verified. The minimum investment required was $3,866, which the borrower was to have received as a gift from a nonprofit. Although a gift letter was in the file, there was no documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

Loan number 105-2957702

Mortgage amount: $166,561

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 11, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Six

Loss to HUD: $99,662

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, and inadequate evaluation of credit history.

A. Inadequate Verification of Gift
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a of $5,075 gift; therefore, the borrower's required minimum investment in the property was not verified. The minimum investment required was $5,075, which the borrower was to have received as a gift from a nonprofit. Although a gift letter was in the file, there was no documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation showing that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

C. Inadequate Evaluation of Credit History

The lender failed to adequately evaluate the borrower's credit history. The borrower's credit report disclosed three accounts that were 30 days past due. Moreover, the borrower had an account for $853 that had been under collection since August 2006. Nevertheless, the lender failed to obtain an explanation for these delinquencies.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, provides that while minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit–including judgments, collections, and other recent credit problems–require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

Loan number: 105-2978097

Mortgage amount: $110,132

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: March 27, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: 16

Potential Loss to HUD: $64,416

Summary:

We found material underwriting deficiencies relating to inadequate evaluation of credit history, inadequate verification of transfer of gift funds, and inadequate verification of statutory minimum investment.

A. Inadequate Evaluation of Credit History

The lender did not adequately evaluate the borrower's credit history. The borrower had eight accounts that went into collection totaling $1,581. The borrower submitted a letter of explanation stating that "he was not smart enough to handle his finances and when he got angry, he did not pay his bills." However, this is an inadequate explanation that does not provide assurance of the borrower's capacity to meet obligations. In addition, the lender did not confirm whether the borrower had satisfied these accounts.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, provides that while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit–including judgments, collections, and any other recent credit problems–require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

B. Inadequate Verification of Transfer of Gift Funds
C. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $3,356 gift; therefore, the borrower's required minimum investment in the property was not verified. The mortgage credit analysis worksheet showed that the borrower's statutory cash investment requirement was $3,356, and the FHA case binder contained a gift letter, dated March 26, 2007, from a nonprofit for a $3,356 gift to the borrower to be applied toward the property purchase. The loan closed on March 27, 2007, and neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

<u>HUD/FHA Requirements</u>:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

Loan number: 105-3008866

Mortgage amount: $148,240

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 31, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Seven

Loss to HUD: $86,179

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, and inadequate evaluation of credit history.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $4,714 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 $4,518, and the FHA case binder contained a gift letter, dated August 31, 2007, from a nonprofit for a $4,714 gift to the borrower to be applied toward the property purchase. While the loan closed on August 31, 2007, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property. In addition, the gift letter shows a different address than that of the subject property and there is no documentation that the lender resolved this discrepancy.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

C. Inadequate Evaluation of Credit History

The files inadequately documented explanations for derogatory credit. The credit report had eight accounts totaling $5,383 that went into collection from July 2001 through December 2005. The file contained two letters explaining that this situation was due to the job loss of the coborrower and taking custody of two siblings. However, documentation in the file indicated that these accounts went into collection prior to the period that the coborrower became unemployed. The coborrower was unemployed for four months from September through December 2005, and for two weeks at the beginning of June 2006. Therefore, the explanation was not consistent with the facts, and there was no other documentation to verify that the borrowers had custody of two siblings.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, provides that while minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit–including judgments, collections, and other recent credit problems–require sufficient written explanation from the borrower. The borrower’s explanation must make sense and be consistent with other credit information in the file.

Loan number:	105-3011817
Mortgage amount:	$122,962
Section of Housing Act:	203(b)
Loan purpose:	Purchase
Date of loan closing:	May 2, 2007
Status as of July 31, 2010:	Claim
Payments before first default reported:	One
Loss to HUD:	$57,306

Summary:

We found a material underwriting deficiency relating to inadequate verification of income/employment.

A. Inadequate Verification of Income/Employment

The lender failed to address an unexplained discrepancy in the borrower's income. While the FHA file contained a verification of employment that reported an average weekly income of $650, which was used to calculate ratios, the average weekly income reported on the borrower's pay stubs was $526. In addition, the lender failed to verify two full years of employment as required, thus failing to ensure that the borrower had income stability. These discrepancies are important because the reported cause of default, which occurred after one payment, was a curtailment of income.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), provides that verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 forms from the previous 2 years. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. The lender also must verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified. The lender also may use an electronic retrieval service for obtaining W-2 and tax return information. If the employer will not give telephone confirmation of employment or if the IRS W-2 form indicates inconsistencies (e.g., FICA (Federal Insurance Contributions Act) payments not reflecting earnings), standard employment documentation must be used.

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

HUD Handbook 4155.1, REV-5, provides that the lender must establish that the borrower has the ability and willingness to repay the mortgage debt. This decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout HUD Handbook 4155.1, REV-5, and must be supported by sufficient documentation. Lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA.

Loan number: 105-3033155

Mortgage amount: $182,174

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: May 24, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Three

Loan Amount $108,421

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, excessive ratios with insufficient compensating factors, and underreported liabilities.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $5,551 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 $5,551, and the FHA case binder contained a gift letter, dated May 15, 2007, from a nonprofit for a $5,551 gift to the borrower to be applied toward the property purchase. While the loan closed on May 24, 2007, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

C. Excessive Ratios With Insufficient Compensating Factors
D. Underreported Liabilities

The lender approved the loan with excessive ratios and insufficient compensating factors. The mortgage credit analysis worksheet noted a fixed payment-to-income ratio of 47.42 percent with the following compensating factors: home-buyer counseling, minimal use of revolving credit, overtime for borrower not considered, and FICO (credit score) 570, 548, none of which is a valid compensating factor. Home-buyer counseling does not increase the borrower's ability to pay the mortgage, minimal use of revolving credit alone is not a compensating factor because the borrower must also show an ability to accumulate savings, and the low FICO scores are not compensating factors. Further, FHA regulations would prohibit considering overtime because the underwriter did not demonstrate that the overtime income was likely to continue and that it had been received for the past two years. In addition, the lender incorrectly calculated the debt-to-income ratio because a monthly liability relating to a student loan of $251 was not considered. Although the credit report indicated that the student loan could be deferred, the file did not have an independent confirmation that the loan was deferred. Including the $251 in liabilities would raise the debt-to-income ratio from 47.42 to 52.50 percent, which would require significant compensating factors.

HUD/FHA Requirements:

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.

HUD Handbook 4155.1, REV-5, paragraph 2-13, provides that compensating factors may be used to justify approval of mortgage loans with ratios that exceed HUD benchmark guidelines; however, underwriters must record in the "remarks" section of the mortgage credit analysis worksheet the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-11(A), provides that in computing the debt-to-income ratios, the lender must include the monthly housing expense and all other recurring charges extending 10 months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts, alimony, etc.

HUD Handbook 4155.1, REV-5, paragraph 2-7(A), provides that both overtime and bonus income may be used to qualify a borrower if such income was received for the past 2 years and is likely to continue. The lender must develop an average of bonus or overtime income for the past 2 years, and the employment verification must not state that such income is unlikely to continue. Periods of less than 2 years may be acceptable provided the lender justifies and documents the reason for using the income for qualifying purposes.

Loan number: 105-3123930

Mortgage amount: $139,410

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 26, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Five

Loss to HUD: $67,619

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, inadequate verification of statutory minimum investment, and improper verification of income.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $4,248 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 $4,248, and the FHA case binder contained a gift letter, dated July 5, 2007, from a nonprofit for a $4,248 gift to the borrower to be applied toward the property purchase. While the loan closed on July 26, 2007, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

C. Improper Verification of Income

The lender failed to properly verify income because it did not document that overtime income was received for the past two years, nor provide an explanation for why overtime income of less than two years was used to calculate income. As a result, the lender overstated income by improperly calculating overtime. The lender calculated that borrower income was $2,598, which included $2,144 in base income and $454 in overtime income. The borrower's verification of employment reported overtime or $5,447; $2,834 for 5.5 months in calendar year 2006 and $2,613 for 6.5 months year-to-date through July 17, 2007 for a total of one year. Thus, in calculating allowable overtime, the lender only documented one year's worth of overtime. The lender should have also documented an explanation for why overtime income less than two years was used. As a result, since the borrower did not have two years' worth of overtime and the verification of employment did not state that overtime was likely to continue, overtime income should not have been factored into the debt-to-income ratio. Without the overtime, the fixed payment to income (back) ratio would have increased from 43.58 percent to an unacceptable 52.80 percent.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-7(A), provides that both overtime and bonus income may be used to qualify a borrower if such income was received for the past 2 years and is likely to continue. The lender must develop an average of bonus or overtime income for the past 2 years, and the employment verification must not state that such income is unlikely to continue. Periods of less than 2 years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

Mortgagee Letter 2005-16 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.

Loan number: 105-3129145

Mortgage amount: $167,509

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 30, 2007

Status as of July 31, 2010: Claim

Payments before first default reported: Six

Loss to HUD: $106,003

Summary:

We found material underwriting deficiencies relating to inadequate verification of transfer of gift funds, and inadequate verification of statutory minimum investment.

A. Inadequate Verification of Transfer of Gift Funds
B. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $5,104 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 $5,104, and the FHA case binder contained a gift letter, dated July 23, 2007, from a nonprofit for a $5,104 gift to the borrower to be applied toward the property purchase. While the loan closed on July 30, 2007, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, provides that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, requires that the borrower make a 3 percent minimum cash investment in the property.

Loan number:	105-3121214
Mortgage amount:	$83,905
Section of Housing Act:	203(b)
Loan purpose:	Purchase
Date of loan closing:	July 30, 2007
Status as of July 31, 2010:	Claim
Payments before first default reported	11
Loss Amount	$71,984

Summary:

We found material underwriting deficiencies relating to inadequate verification of employment, transfer of gift funds, and statutory minimum investment.

A. Inadequate Verification of Employment

The lender failed to adequately verify the borrower's employment. The borrower had eight different employers and many employment gaps for the last two years. The lender obtained seven verbal verifications of intermittent employment for the period May 2005 through January 2007, and one employer refused to give out employment information. The borrower's explanation for the many employers and employment gaps was that he worked for a union as an independent contractor, which gave him different jobs for short periods of time. Since the work was sporadic and did not cover a full two years, the lender should have used alternative procedures to determine stability of income. The lender also failed to obtain two year's worth of IRS W-2 forms or tax transcripts. The loan closed in July of 2007; therefore, the lender should have obtained W-2 forms or tax transcripts for 2005 and 2006. Instead, the lender obtained documentation for the years 2004 and 2005; therefore, employment and income stability was not verified. This matter is significant because the cause of default after 11 payments was unemployment.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-6, provides that the borrower must explain gaps in employment spanning 1 month or more. To analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, and previous training and education and the employer's confirmation of continued employment. A borrower who changes jobs frequently within the same line of work but continues to advance in income or benefits should be considered favorably. In this analysis, income stability takes precedence over job stability.

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), provides that as an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 forms from the previous 2 years. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. Any copies of the W-2 form not submitted with the borrower's income tax returns are considered "original" W-2s. (These original documents may be photocopied and returned to the borrower.) The lender also must verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified. For all loans processed in this manner, the lender also must obtain a signed copy of Form IRS-4506, Request for Copy of Tax Form; Form IRS-8821; or a document that is appropriate for obtaining tax returns directly from the IRS. The lender also may use an electronic retrieval service for obtaining W-2 and tax return information.

B. Inadequate Verification of Transfer of Gift Funds
C. Inadequate Verification of Statutory Minimum Investment

The lender did not adequately verify the transfer of a $2,484 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 $2,557, and the FHA case binder contained a gift letter, dated July 19, 2007, from a nonprofit for a $2,484 gift to the borrower to be applied toward the property purchase. While the loan closed July 30, 2007, neither the FHA case binder nor the lender's file contained documentation verifying that the closing agent received these gift funds. Further, the lender did not verify that the gift did not ultimately come from an unacceptable source. Without documentation verifying that the closing agent received these funds, the lender did not verify and document the borrower's gift and investment in the property.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented and the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

HUD Handbook 4155.1, REV-5, paragraph 1-7, states that the borrower must make a 3 percent minimum cash investment in the property and borrower-paid closing costs may be used to meet the cash investment requirements.