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

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

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

SUBJECT: Americare Investment Group, Arlington, TX, Did Not Properly Underwrite a Selection of FHA Loans

INTRODUCTION

We reviewed 19 Federal Housing Administration (FHA) loans Americare Investment Group (Americare) underwrote as an FHA direct endorsement lender. Our review objective was to determine whether Americare underwrote the 19 loans in accordance with FHA requirements. This review is part of Operation Watchdog, an Office of Inspector General (OIG) 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.

For each recommendation without a management decision, please respond and provide status reports in accordance with U.S. Department of Housing and Urban Development (HUD) Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

We provided our discussion draft memorandum report to Americare's president on July 14, 2010, and requested written comments July 29, 2010. Americare did not respond. It will have an additional opportunity to respond and provide documentation during the audit resolution process.

SCOPE AND METHODOLOGY

Americare is 1 of 15 direct endorsement lenders that we selected from HUD's publicly available Neighborhood Watch[1] system (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 that had gone into a claim status. We selected loans for Americare that defaulted within the first 30 months 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.

BACKGROUND

Americare is a nonsupervised direct endorsement lender based in Arlington, TX. FHA approved Americare as a direct endorsement lender in April, 2005. The Mortgagee Review Board[3] terminated Americare as an FHA lender involuntarily on January 26, 2010. FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers that might not be able to meet conventional underwriting requirements by protecting the lender against default. The direct endorsement program simplifies the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. 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 there is 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 our review 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, Americare endorsed 2,180 loans valued at more than $250 million and submitted 73 claims worth more than $7.7 million.

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[1] Neighborhood Watch is a system that aids HUD/FHA staff in monitoring lenders and FHA programs. This system allows staff to oversee lender origination activities for FHA-insured loans and tracks mortgage defaults and claims.

[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] The Mortgagee Review Board was established pursuant to the HUD Reform Act of 1989 to partly oversee administrative sanctions including reprimand, probation, suspension, withdrawal of approval, cease-and-desist orders, and civil money penalties against HUD/FHA-approved lenders that knowingly and materially violate HUD/FHA program statutes.

Our objective was to determine whether the 19[4] selected loans were properly underwritten and if not, whether the underwriting reflected systemic problems.

We performed our work from January through April 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 Americare, consider the results of previous audits, or communicate with Americare management in advance. We did not follow standards in these areas because our objective was to aid HUD in identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing in poorly performing lenders that led to a high rate of defaults and claims against the FHA insurance fund. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

RESULTS OF REVIEW

Americare did not properly underwrite 12 of the 19 loans reviewed because its underwriters did not follow FHA's requirements. As a result, FHA's insurance fund suffered actual losses of $741,498, as shown in the following table.

FHA/loan number	*Closing date*	*Number of payments before first default*	*Original mortgage amount*	*Actual loss to HUD*
491-8965784	6/9/2007	9	$107,245.00	$80,345
491-8985262	8/4/2007	1	167,373.00	102,402
492-7660621	7/28/2006	3	84,454.00	52,068
492-7667490	7/28/2006	9	93,972.00	47,710
492-7697201	8/25/2006	7	91,563.00	50,255
492-7703727	9/27/2006	17	86,138.00	54,157
492-7738863	1/12/2007	8	104,607.00	74,078
492-7739636	12/22/2006	6	86,809.00	-0-
492-7790183	4/30/2007	4	122,084.00	94,143
493-8109055	11/28/2005	6	101,279	73,459
493-8201387	6/29/2006	11	36,083.00	13,578
493-8357125	6/28/2006	3	174,443.00	99,303
	Totals		$1,256,050	$741,498

[4] We were unable to locate the FHA or lender file for one additional loan that was selected.

The following table summarizes the material deficiencies that we identified in the 12 loans.

Area of noncompliance	*Number of loans*
Income	7
Liabilities	1
Excessive ratios	2
Gift	2
Credit report	10

Appendix A shows a schedule of material deficiencies in each of the 12 loans. Appendix B provides a detailed description of all loans with material underwriting deficiencies noted in this report.

Income

Americare did not properly verify the borrowers' income or determine income stability for seven loans. HUD does not allow income to be used in calculating a borrower's income ratios if it cannot be verified, is not stable, or will not continue. Americare is required to analyze whether income is reasonably expected to continue through at least the first 3 years of the mortgage loan (see appendix B for detailed requirements).

For example, for loan number 492-7697201, Americare used the coborrower's current pay rate. However, the coborrower had only worked for 2 days at her current employment and had held three different jobs and worked a total of only 6 months in the past 2 years.

For loan number 492-7660621, the underwriter included the borrower's mother's Social Security benefits in the borrower's income. The borrower had a financial power of attorney for his mother, but she was not a party to the mortgage.

Liabilities

Americare did not properly assess the borrowers' financial obligations for one loan. HUD requires lenders to consider debts if the amount of the debts affects the borrower's ability to make the mortgage payment during the months immediately after loan closing (see appendix B for detailed requirements).

For loan number 491-8985262, Americare did not consider a debt shown on the credit report with a balance of $3,520 and monthly payment of $200. Including this payment caused the borrower's debt-to-income ratio to increase from 42 to 46 percent.

Excessive Ratios

Americare improperly approved two loans for which the borrower's qualifying ratios exceeded FHA's guidelines without identifying strong compensating factors. Effective April 13, 2005, the fixed payment-to-income and debt-to-income ratios were increased to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval (see appendix B for detailed requirements).

For example, Americare improperly approved loan number 492-7738863 when the borrowers' debt-to-income ratio of 45 percent exceeded FHA's 43 percent guideline without providing compensating factors. In addition, Americare included ineligible income from two grown children receiving Social Security benefits when calculating the qualifying ratios. Using only the borrower's income, the payment-to-income and debt-to-income ratios increased to 58 and 90 percent, respectively.

Gift Funds

Americare improperly approved two loans for which the transfer of gift funds from the nonprofit donor to the settlement agent was not properly documented. HUD requires a lender to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

For example, Americare improperly approved loan number 492-7790183, when the actual transfer of gift funds by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source. In addition, Americare did not verify that the organization was a nonprofit.

Credit Report

Americare did not properly evaluate the borrowers' credit histories for 10 loans. HUD requires the lender to document its reasons for approving a mortgage for which the borrower has collection accounts or judgments. Major indications of derogatory credit require sufficient written explanation from the borrower. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan (see appendix B for detailed requirements).

For example, for loan number 492-7739636, the credit reports showed 50 collection accounts from 1995 through 2006 totaling $23,570. About half of the collection accounts were recent, but the loan file did not include letters of explanation for past-due accounts or evidence of payoff for collection accounts concerning the nonoccupying coborrower. In addition, Americare did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the 12 loans with material underwriting deficiencies for accuracy. Americare's direct endorsement underwriter incorrectly certified that due diligence was used in underwriting the 12 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.

Requirements at 231 U.S.C. (United States Code) 3801, "Program Fraud Civil Remedies Act of 1986," provide Federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to recompense such agencies for losses resulting from such claims and statements; to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and to deter the making, presenting, and submitting of such claims and statements in the future.

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 against Americare and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of 12 loans that resulted in losses to HUD totaling $741,498, which could result in affirmative civil enforcement action of approximately $1,572,996.[5]

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

1B. Take appropriate administrative action against Americare 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 1/

Recommendation number	Amount
1A	$741,498
Total	$741,498

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 the affected properties.

[5] Double damages plus a $7,500 fine for each of the 12 incorrect certifications.

APPENDIXES

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Unsupported income or questionable employment history	Underreported liabilities	Excessive debt-to-income ratio	Unsupported assets	Insufficient gift documentation	Significant credit-related deficiencies or no credit
491-8965784						X
491-8985262		X				X
492-7660621	X					
492-7667490	X					
492-7697201	X					X
492-7703727						X
492-7738863	X		X			X
492-7739636	X				X	X
492-7790183	X				X	X
493-8109055						X
493-8201387						X
493-8357125	X		X			X

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 491-8965784

Mortgage amount: $107,245

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 9, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Nine

Loss to HUD: $80,345

Summary:

We found material underwriting deficiencies relating to the borrowers' credit history.

Credit:

Americare did not adequately evaluate the borrowers' credit histories. Americare did not (1) document the reason(s) for not considering the borrowers' collection, charge-off, and repossession accounts; (2) document strong compensating factors to justify accepting the derogatory credit history; and (3) document borrower explanations for all of the collection and charge-off accounts.

A review of the borrowers' credit reports disclosed 55 collection accounts, one charge-off account, and one repossession from 2001 through 2007 totaling $4,604. In addition, the loan file did not address payment of the outstanding collections as identified as a condition to close by the underwriter. One of the collection accounts was for unpaid rent at a prior address.

Americare did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. Americare did not document the borrowers' explanations for the collection and charge-off accounts. In addition, it did not identify strong compensating factors to justify accepting borrowers' derogatory credit history.

The borrowers’ housing expense increased 125 percent from $400 to $900. Since the borrower had shown the inability to manage debt, a 125 percent increase in housing expense is considered significant.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they had not paid the collections at the time of the loan application but were willing to accept a significant ($500) increase in monthly housing expenses.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 491-8985262

Mortgage amount: $167,373

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 4, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: $102,402

Summary:

We found material underwriting deficiencies relating to the borrowers' liabilities and credit history.

Liabilities:

Americare did not adequately evaluate the borrowers' liabilities. It did not include a $200 monthly obligation with a total liability of $3,520 in the borrowers' qualifying ratios calculation. This payment increased the total monthly liabilities from $514 to $714 and the debt-to-income ratio from 42 to 46 percent. The 46 percent was above HUD's guideline of 43 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-11, states that the borrower's liabilities include all installment loans, revolving charge accounts, and other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other recurring charges extending 10 months or more. 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, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

Credit:

Americare did not adequately evaluate the borrowers' credit histories. It did not document the reason(s) for not considering the borrowers' collection and charge-off accounts, nor did it document strong compensating factors to justify accepting the derogatory credit history.

A review of the borrowers' combined credit report disclosed 25 collection accounts and 6 charge-off accounts totaling $5,997. In addition, Americare did not ensure that outstanding collections identified as a condition to close were paid. It did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Americare did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history. We analyzed the compensating factors in the mortgage credit analysis worksheet as follows:

Build on own land and land equity – These are not HUD-allowable compensating factors.

Downpayment assistance of $3,800 – This is not a HUD-allowable compensating factor.

Borrower's income greater than qualifying income – The additional income shown was from overtime and other pay and can be an allowable compensating factor. However, the additional income was documented for only 5½ months, and the overtime portion was not confirmed by the employer as likely to continue. As a result, this income was not considered a strong compensating factor.

Coborrower receives $109 per month in pension benefits – This is a HUD-allowable compensating factor, but it was not considered strong enough to justify accepting the borrowers' derogatory credit history that showed an inability to manage debt. We noted that the borrowers' housing cost increased from $250 to $1,468 monthly (487 percent), and the borrowers did not have documented cash reserves after closing.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they had not paid the collections at the time of the loan application but were willing to accept a significant ($1,218) increase in monthly housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, identifies the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 492-7660621

Mortgage amount: $84,454

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 28, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: $52,068

Summary:

We found material underwriting deficiencies relating to the borrower's income.

Income

Americare used ineligible income to approve the loan. It included Social Security income received by the borrower's 84-year- old mother when she was not a party to the mortgage transaction. The borrower's total income was reported as $3,601 per month, including $1,728 (48 percent) from the mother's Supplemental Security Income (SSI) benefits.

The borrower provided a power of attorney letter, which appointed the borrower to manage his mother's financial, banking, and other transactions. The underwriter contacted HUD regarding the letter, and an e-mailed reply stated, "power of attorney's letters can be written in all different ways…normally her awards letter would need to be written in his name (borrower's) for her benefit …you either need to document her as a borrower or get an attorney's opinion about the power of attorney letter."

Americare did not require the borrower's mother to prepare or sign a loan application as a coborrower or cosigner as required by HUD/FHA. The income, assets, liabilities, and credit history for all borrowers, coborrowers, and cosigners must be considered in determining their creditworthiness for the mortgage.

Americare did not evaluate or comment on the mother's credit history. Four months earlier, the mother had filed a Chapter 7 bankruptcy. Americare could not accept the mother as a coborrower or cosigner due to her recent bankruptcy because of a number of unmet conditions. The mother's SSI benefits should have not been included in the borrower's effective income.

The payment-to-income and debt-to-income ratios reported on the mortgage credit analysis worksheet were 22 and 43 percent, respectively. Americare significantly understated the ratios when it accepted about half of the borrower's effective income from an ineligible source. Using only the borrower's income, the ratios would increase to 45 and 83 percent, respectively. When the qualifying ratios exceed HUD's guidelines of 31 and 43 percent, HUD requires lenders to document compensating factors to justify approving the loan. Americare did not identify compensating factors.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraphs 2-1 and 2-2, state that the creditworthiness of a borrower, coborrower, and cosigner is determined by considering their income, assets, liabilities, and credit history. They must sign the loan application and are liable for repaying the mortgage obligation.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that a Chapter 7 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage if at least 2 years have elapsed since discharge of the bankruptcy. An elapsed period of less than 2 years but not less than 12 months may be acceptable if the borrower can show certain conditions and the lender provides required documentation.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

Loan number: 492-7667490

Mortgage amount: $93,972

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 28, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: Nine

Loss to HUD: $47,710

Summary:

We found material underwriting deficiencies relating to the borrower's income.

Income:

Americare did not document the reason(s) for accepting unstable and unverifiable income and less than 2 years of overtime to approve the loan.

The borrower had three employers over the most recent 12 months and one employer for the 6 years prior. The borrower was employed at the current employer for 7 months. Americare did not document that the borrower was in the same line of work or that the borrower continued to advance in income or benefits. Employment documents did not describe the borrower's position at two of the last four employers. Although the verification of employment for the current employer stated that the probability of continued employment was "likely," the history showed that the borrower's employment was not stable. Americare did not properly verify income for all of the required past 2 years when it did not document the Internal Revenue Service (IRS) form W-2 for the period September through November 2005.

Americare used 6 months of overtime to calculate the qualifying payment-to-income and debt-to-income ratios of 28 and 44 percent, respectively. It did not document the reasons for averaging 6 months of overtime and not developing a trend over a 2-year period as required. Americare calculated the borrower's income as $3,380 per month based on regular pay of $2,600 and overtime of $780 per month. Using the regular pay would increase the qualifying ratios to 37 and 57 percent. These ratios exceed HUD's guidelines of 31 and 43 percent, respectively.

HUD/FHA Requirements:

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

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.

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

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

HUD Handbook 4155.1, REV-5, paragraph 2-7, states that both overtime and bonus income may be used to qualify if the borrower has received such income for the past 2 years and it 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, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

Loan number: 492-7697201

Mortgage amount: $91,563

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 25, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: Seven

Loss to HUD: $50,255

Summary:

We found material underwriting deficiencies relating to the borrowers' income and credit history.

Income:

Americare used excessive income to approve the loan. The coborrower worked a total of 6 months at three different employers over the 2-year period before the current employer of only 2 days. The coborrower's explanation letter addressed two gaps in employment of 2 months and 15 months. Americare used the coborrower's rate of pay at the current employer of 2 days to compute effective income. Although the coborrower appeared to continue to advance in income, Americare did not document that the coborrower's current employment was likely to continue. Americare did not document the reason for determining that the coborrower had the capacity to repay the mortgage or could be reasonably expected to continue employment through at least the first 3 years of the mortgage.

Americare calculated the borrowers' total income as $3,380 per month, which included the borrower's income of $1,733 and the coborrower's income of $1,647. The coborrower's income amount was based on the $9.50 per hour rate at the current employer of only 2 days. Excluding the coborrower's income and using only the borrower's income would increase the payment-to-debt and the total debt-to-income ratios to 51 and 76 percent. These ratios exceed HUD guidelines of 31 and 43 percent.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that we do not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years.

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval. Americare did not identify strong compensating factors to justify accepting the qualifying ratios exceeding HUD's guidelines (see Credit section).

Credit:

Americare did not adequately evaluate the borrowers' credit histories. It did not document the reason(s) for not considering collection and charge-off accounts. Americare did not obtain borrower explanations for all collections accounts or credit inquiries made within 90 days of the credit report. In addition, it did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history.

A review of the borrowers' credit report disclosed 14 collection accounts and 1 charge-off account totaling $17,361. Americare did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. Americare documented borrowers' explanations for only five collection accounts and did not document the reason for four recent inquiries.

Americare identified average overtime pay of $337 per month received in 2005 and 2006 year-to-date as a compensating factor. This is a HUD-allowable compensating factor; however, this factor alone is not strong enough to justify accepting the borrowers' derogatory credit history when approving this loan. The borrowers had not shown that they had the ability to pay housing expenses equal to or greater than the proposed amount, and the borrowers' housing expenses would be increasing significantly (from $0 to $884). In addition, the borrowers reported only $309 in reserves on the loan application.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they had not paid the collections at the time of the loan application but were willing to accept a significant ($884) increase in monthly housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines include other compensation not used for qualifying, borrower has demonstrated an ability to pay housing expense equal to or greater than the proposed mortgage payment, and substantial cash reserves of at least 3 months' worth after closing. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 492-7703727

Mortgage amount: $86,138

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: September 27, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: 17

Loss to HUD: $54,157

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Americare did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection accounts. Americare did not obtain borrower explanations for all collection accounts. In addition, it did not identify strong compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed 12 collection accounts and 1 repossession account from 1999 through 2006 totaling $29,409. Americare did not document an analysis of the credit history to determine whether the collections and charge-off were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. Americare documented the borrower's explanations for only two of the derogatory accounts. It did not document compensating factors to justify accepting the borrower's derogatory credit history when approving this loan.

The borrower's proposed housing expense significantly increased by $328 (73 percent) from $450 to $778.

It appeared that the borrower had a disregard for financial obligations and/or an inability to manage debt since he had not paid the collections at the time of the loan application but was willing to accept a significant (73 percent) increase in the monthly housing expense.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7738863

Mortgage amount: $104,607

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 12, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Eight

Loss to HUD: $74,078

Summary:

We found material underwriting deficiencies relating to the borrowers' income, excessive debt ratios, and credit history.

Income:

Americare inappropriately used the Social Security benefits of the borrowers' adult children along with the borrowers' income to determine effective income.

Americare's loan documents showed that the borrowers' grown children (ages 21 and 24) received $1,558 in Social Security benefits. Americare's underwriter did not verify the children's credit reports to determine whether they had significant debt, bankruptcies, foreclosure, or derogatory credit histories because they were not coborrowers or cosigners on the loan. Since they were not parties to the transaction, their creditworthiness was not considered, and their income should have not been included with the borrowers' income.

Americare's underwriter calculated the borrowers' income as $3,115 a month, which included the children's income of $1,558 and the borrowers' income of $1,558. Using only the borrowers' income, the qualifying ratios would increase (see Ratios & Compensating Factors section).

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraphs 2-1 and 2-2, state that the creditworthiness of the borrower, coborrower, and cosigner is determined by considering their income, assets, liabilities, and credit history. They must sign the loan application and are liable for repaying the mortgage obligation.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

<u>Excessive Debt Ratio</u>:

The borrowers' debt-to-income ratio of 45 percent exceeded HUD's guideline of 43 percent. In addition, Americare included ineligible income when calculating the qualifying ratios (see Income section). Using only the borrowers' income would increase the payment-to-income and debt-to-income ratios to 58 and 90 percent. Both recalculated ratios significantly exceed HUD's guidelines of 31 and 43 percent. Americare did not document compensating factors to justify accepting the high qualifying ratios.

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

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, identifies the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines and for accepting derogatory credit history. Underwriters must record in the "remarks" section of the form HUD-92900 (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.

<u>Credit</u>:

Americare did not adequately evaluate the borrowers' credit history. It did not document the reason(s) for not considering collection accounts. In addition, Americare did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history.

A review of the borrowers' combined credit reports disclosed nine collections, one charge-off, and one late payment account. The balances due for these accounts totaled $3,069, with five recent collections totaling $1,500. The loan file did not address payment of the outstanding collections, which was identified as a condition to close by the underwriter. Americare did not document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. It did not identify compensating factors to justify accepting the borrowers' derogatory credit history when approving this loan.

The borrowers' proposed housing expense significantly increased by $394 (76 percent) from $518 to $912.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they did not pay the collections at the time of the loan application but were willing to accept a significant (76 percent) increase in the monthly housing expense.

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

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7739636

Mortgage amount: $86,809

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: December 22, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: Six

Loss to HUD: $0

Summary:

We found material underwriting deficiencies relating to the borrowers' income, gift, and credit history.

Income:

Americare inappropriately used Social Security benefits of the coborrower's adult stepson along with the borrower's income to determine effective income.

Americare loan documents showed that the coborrower's adult stepson (age 54) received $507 in Social Security benefits. Americare did not verify the stepson's credit reports to determine whether he had significant debt, bankruptcies, foreclosure, or derogatory credit histories. Since the stepson was not a party to the transaction, his creditworthiness was not considered, and his income should have not been included with the borrowers' effective income.

Americare calculated the borrowers' total income as $4,303 per month. The income included the borrower's income of $972, the coborrower's income of $2,269, and the coborrower's other earnings of $1,062 (this included the stepson's income of $507). Excluding the stepson's income would not cause the qualifying ratios to exceed HUD's guidelines.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraphs 2-1 and 2-2, state that the creditworthiness of the borrower, coborrower, and cosigner is determined by considering their income, assets, liabilities, and credit history. They must sign the loan application and are liable for repaying the mortgage obligation.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

Gift Funds:

Americare did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the actual transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Americare did not adequately evaluate the borrowers' credit histories. It did not document the reason(s) for not considering collection and charge-off accounts. It did not document explanations for the nonoccupying coborrower's collection accounts. In addition, it did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history.

A review of the borrowers' credit reports disclosed 50 collection accounts from 1995 through 2006 totaling $23,570. There were 25 accounts with a balance due of $6,118 that went into collection within 2 years of loan closing. The loan file did not address payment of the outstanding collections. Americare did not document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. It did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history when approving this loan.

The borrowers' proposed housing expense significantly increased by $545 (218 percent) from $250 to $795.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they did not pay the collections at the time of the loan application but were willing to accept a significant (218 percent) increase in monthly housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7790183

Mortgage amount: $122,084

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: April 30, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Four

Loss to HUD: $94,143

Summary:

We found material underwriting deficiencies relating to the borrowers' income, gift, and credit history.

Income:

Americare did not properly verify the borrowers' income. It did not document that a written or verbal verification of employment was obtained for the borrowers. Americare also did not certify that original income employment documents were examined or document the name, title, and telephone number of the person with whom employment was verified. Consequently, it used unsupported income of $1,751 for the borrowers to approve the loan.

Americare calculated the borrowers' total income at $5,494 per month. This amount was based on the borrower's income of $1,751, the coborrower's income of $2,690, and the son's SSI/Survivor Worker Compensation benefits of $1,054. The borrowers' unsupported income comprised 32 percent of the total income and should have been excluded.

Americare understated the ratios when it accepted the borrowers' unsupported income of $1,751. Excluding this income changes the calculated payment-to-income and debt-to-income ratios to 41 and 61 percent, respectively. These ratios exceed HUD's guidelines of 31 and 43 percent. Americare did not document compensating factors.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that we do not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years.

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, identifies compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Gift Funds:

Americare did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the actual transfer by check, wire transfer, or any other method was not documented to ensure that the funds used to close came from an acceptable source. In addition, Americare did not verify that the organization was a nonprofit.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Americare's underwriter did not adequately evaluate the borrowers' credit histories. It did not document the reason(s) for not considering collection accounts. In addition, Americare did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history.

A review of the borrowers' credit reports disclosed 23 collection accounts from 1999 through 2007 totaling $10,906 and 3 recent collections totaling $475. The loan file did not address payment of the outstanding collections as identified as a condition to close by the underwriter. Three of the collections were for utilities.

The borrowers' proposed housing expense significantly increased by $647 (144 percent) from $450 to $1,097.

It appeared that the borrowers had a disregard for financial obligations and/or an inability to manage debt since they did not pay the collections at the time of the loan application but were willing to accept a significant (144 percent) increase in the monthly housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 493-8109055

Mortgage amount: $101,279

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 23, 2005

Status as of April 30, 2010: Claim

Payments before first default reported: Six

Loss to HUD: $73,459

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Americare's underwriter did not adequately evaluate the borrower's credit history. Americare did not document the reason(s) for not considering collection accounts and did not document borrower explanations for all collection accounts. In addition, it did not identify strong compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed seven collection accounts and three charge-off accounts from 1997 through 2005 totaling $44,242 and three recent collections totaling $440. The loan file did not address payment of the outstanding collections as identified as a condition to close by the underwriter. Americare did not identify strong compensating factors to justify accepting the borrower's collection accounts when approving this loan.

The borrower's proposed housing expense significantly increased by $490 (121 percent) from $405 to $895.

It appeared that the borrower had a disregard for financial obligations and/or an inability to manage debt since he did not pay the collections at the time of the loan application but was willing to accept a significant (121 percent) increase in the monthly housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 493-8201387

Mortgage amount: $36,083

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 29, 2006

Status as of April 30, 2010: Claim

Payments before first default reported: 11

Loss to HUD: $13,578

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Americare's underwriter did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection accounts and did not document borrower explanations on all collection accounts. In addition, Americare did not identify strong compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed five collection accounts from 2003 through 2006 totaling $1,379. The loan file did not address payment of the outstanding collections as identified as a condition to close by the underwriter. Americare did not document sufficient borrower explanations concerning the lack of credit and revolving credit accounts, nor did it adequately document the verification or analysis of nontraditional credit. Americare did not document compensating factors to justify accepting the borrower's collection accounts when approving this loan. One of the collection accounts was for unpaid rent at a prior address.

With five derogatory accounts on the credit report, some with balances, and the borrower's income at $1,298 per month, it appeared that the borrower had a disregard for financial obligations and/or an inability to manage debt since he had not paid the collections at the time of the loan application.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 493-8357125

Mortgage amount: $174,443

Section of Housing Act: 203(b)

Loan purpose: Refinance

Date of loan closing: June 28, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: $99,303

Summary:

We found material underwriting deficiencies relating to the borrower's income, excessive debt ratios, and credit history.

Income:

Americare used excessive income to approve the loan. It included unsupported net rental income of $237 that was added to the borrower's effective income. Documents in the loan file showed that the lease agreement for the borrower's rental property appeared to be between a family member and the nonpurchasing spouse on a month-to-month basis. Americare did not sufficiently verify the rental income by obtaining copies of the rent check(s) and relied on a copy of the lease agreement. The tax transcripts for 2005 and 2006 did not include rental income since the lease agreement was entered into in 2007.

Americare calculated the borrower's income as $4,585 per month. The income amount was based on the borrower's employment and child support income totaling $4,348 and net rental income of $237. The net rental income was based on gross rental income of $850, less related mortgage and tax expenses of $401 and other expenses.

Americare's underwriter should have included the $401 in the borrower's total liabilities because it pertained to her rental property's actual mortgage and tax expenses, and the underwriter could not offset this liability against unsupported rental income.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that we do not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years.

HUD Handbook 4155.1, REV-5, paragraph 2-2, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

HUD Handbook 4155.1 REV-5, paragraph 2-7M, states that rent received for properties owned by the borrower is acceptable if the lender can document that the rental income is stable. Examples of stability may include a current lease, an agreement to lease, or a rental history over the previous 24 months that is free of unexplained gaps greater than 3 months. The rental income may be considered effective income if shown on the borrower's tax returns. Otherwise, the income only may be considered a compensating factor and must be documented adequately by the lender. The following is required to verify all rental income: (1) Schedule E of IRS form 1040 and (2) current leases.

HUD Handbook 4155.1, REV-5, paragraph 2-11, states that the borrower's liabilities include all installment loans, revolving charge accounts, and other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other recurring charges extending 10 months or more.

Excessive Debt Ratios:

The borrower's payment-to-income and debt-to-income ratios exceeded HUD's allowable ratios of 31 and 43 percent, respectively. The respective ratios reported on the mortgage credit analysis worksheet were 33 and 45 percent. Americare's underwriter understated these ratios by accepting unsupported gross rental income of $850, which increased the monthly income by $237 net and decreased the monthly liabilities by $401.

Recalculating the ratios to exclude the net rental income and increase the liabilities resulted in payment-to-income and debt-to-income ratios of 35 and 57 percent, respectively, which significantly exceeded the 31 and 43 percent guidelines. These excessive debt ratios may have been justified if significant compensating factors had been present, but in this case, the compensating factors were not sufficient.

HUD/FHA Requirements

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios to 31 and 43 percent, respectively. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval.

HUD Handbook 4155.1, REV-5, paragraph 2-13, identifies the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines. Underwriters must record in the "remarks" section of the HUD 92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

<u>Credit</u>:

Americare's underwriter did not adequately evaluate the borrower's credit history. Americare did not document the reason(s) for not considering collection accounts and did not document borrower explanations on all collection accounts. In addition, it did not identify strong compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed 18 past-due and collection accounts from 2001 through 2007 totaling $28,538 and 6 recent collections totaling $20,902. The loan file did not address payment of the outstanding collections as identified as a condition to close by the underwriter. Americare did not document compensating factors to justify accepting the borrower's collection accounts when approving this loan.

Americare accepted insufficient explanations from the borrower for the derogatory accounts in his credit report. The explanation letter addressed 6 of the 18 derogatory accounts. The lender or borrower did not indicate in the file whether any of the derogatory accounts belonged only to the nonpurchasing spouse.

The borrower's proposed housing expense significantly increased by $782 (104 percent) from $751 to $1,533.

It appeared that the borrower had a disregard for financial obligations and/or an inability to manage debt since he had not paid the collections at the time of the loan application but was willing to accept a significant (104 percent) increase in the monthly housing expense.

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

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. 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 lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.