



Issue Date	September 21, 2011
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Audit Report Number	2011-LA-1017
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TO: Deborah Holston, Acting Deputy Assistant Secretary for Single Family Housing, HU

*Tanya E. Schulze*

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

SUBJECT: Universal American Mortgage Company, Las Vegas, NV, Branch Did Not Comply With HUD Regulations in the Origination and Quality Control of FHA-Insured Loans

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the Federal Housing Administration (FHA)-insured loan process at Universal American Mortgage Company (lender) to determine whether the lender complied with U.S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions in the origination and quality control review of FHA-insured loans. The review was part of our efforts to improve the integrity of the single-family insurance programs. We selected the lender's Las Vegas branch because its default rate, when compared to the national average, was the highest of all of its branches.

### **What We Found**

The lender did not follow HUD requirements in the origination or quality control review of FHA-insured loans. Specifically, all 15 loans reviewed

contained underwriting deficiencies and inappropriate restrictive covenants that affected the insurability of the loan. In addition, we reviewed 10 quality control reviews, and all 10 were in violation of HUD regulations or the lender's quality control policies.

### **What We Recommend**

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing require the lender to (1) indemnify HUD against losses for the 9 of 10 FHA-insured loans with significant underwriting deficiencies and unallowable restrictive covenants of more than \$1.1 million; (2) reimburse the FHA insurance fund \$118,861 in losses resulting from the claims and associated expenses paid on 1 loan with significant underwriting deficiencies or unallowable restrictive covenants; (3) develop, implement, and enforce written controls to ensure that FHA-insured loans are originated in compliance with HUD regulations; and (4) fully implement its quality control plan and follow up to ensure that its quality control reviews are conducted in accordance with HUD regulations.

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

### **Auditee's Response**

We provided the lender a discussion draft report on August 10, 2011, and held an exit conference with lender officials on August 18, 2011. The lender provided written comments on August 25, 2011. It generally disagreed with the report.

The complete text of the lender's response, along with our evaluation of that response, can be found in appendix B of this report. The auditee also provided additional documentation related to the underwriting of the loans we questioned. We did not include this in the report because it was too voluminous; however, it is available upon request.

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## BACKGROUND AND OBJECTIVE

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The Federal Housing Administration (FHA) created by Congress in 1934 is the largest mortgage insurer in the world. The homeowners pay into the FHA insurance fund through mortgage insurance. The U.S. Department of Housing and Urban Development (HUD) uses these funds to operate the FHA insurance program. The insurance provides lenders with protection against losses as the result of homeowners defaulting on home mortgages. In fiscal year 2010, FHA insured more than 1.75 million single-family mortgages totaling more than \$319 billion. Among all mortgage originations, FHA insured 38 percent of all home-purchase loans and 9 percent of all refinance loans<sup>1</sup>. The enabling legislation of Title II of the National Housing Act authorizes FHA single-family programs.

Various sanctions exist that allow the HUD Homeownership Centers<sup>2</sup> and FHA the flexibility to respond appropriately to any noncompliance action by a direct endorsement lender or other program participant. The Homeownership Centers and the Mortgage Review Board may impose the following sanctions: lender probation, withdrawal of direct endorsement status, withdrawal of FHA approval, indemnification agreements, civil money penalties, and sanctions against individual program participants.

Universal American Mortgage Company, LLC (lender), is a nonsupervised lender approved January 1, 1960, to originate FHA loans. The lender originates loans under the lender insurance program, which enables high-performing lenders to insure FHA mortgage loans without a pre-endorsement review by HUD. Universal American Mortgage Company, LLC, Universal American Mortgage Company of California, and North American Title Company are all affiliates of Lennar Financial Services, LLC. Lennar Financial Service is a wholly owned subsidiary of Lennar Corporation, a national residential homebuilder. The lender's headquarters is at 700 N.W. 107th Avenue, Miami, FL, and the company has branches in 13 States. The lender provides mortgage financing services principally to purchasers of Lennar Corporation homes.



The lender has 16 FHA-approved active branch offices. Between October 1, 2008, and September 30, 2010, it originated 8,554 FHA-insured loans totaling more than \$1.61 billion. We selected the Las Vegas, NV, branch for review because it had the highest compare ratio of

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<sup>1</sup> FHA insurance data obtained from HUD's annual report to Congress regarding the financial status of the FHA Mutual Mortgage Insurance Fund, Fiscal Year 2010.

<sup>2</sup> The Homeownership Center's objectives include (1) reducing the risk of defaults and claims to FHA, (2) improve lender performance, and/or (3) remove non-complying lenders from the program.

all of the lender's branches. The Las Vegas branch originated 581 FHA-insured loans totaling more than \$130 million during our audit period with more than \$700,000 in claims paid by HUD on four loans<sup>3</sup>.

The objective of the audit was to determine whether the lender's Las Vegas branch complied with HUD regulations in the origination and quality control review of FHA-insured loans.

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<sup>3</sup> We used Neighborhood Watch, HUD's online information system for FHA-insured loans, to obtain loan origination data for the lender.

## RESULTS OF AUDIT

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### Finding 1: Universal American Mortgage Company Did Not Comply With HUD Regulations in the Origination of FHA-Insured Loans

Universal American Mortgage Company had significant underwriting deficiencies in 10 of the 15 loan files reviewed and unallowable restrictive covenants in all 15 loan files reviewed. This condition was caused by the underwriters' not exercising sound judgment and due diligence when underwriting FHA loans and the lender's not having policies and procedures to identify unallowable restrictive covenants. As a result, the FHA insurance portfolio incurred losses of \$118,861 and remained at risk for losses of more than \$1.1 million on loans that did not meet HUD requirements.

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#### **Ten Loan Files Contained Significant Underwriting Deficiencies**

Our loan file review of 15 FHA-insured loans identified 10 with significant underwriting deficiencies that included improper calculation and inadequate documentation of income, inadequate documentation of credit or debt, and inadequate documentation of assets (see appendixes C and E). The lender did not underwrite the 10 loans as required by HUD Handbook 4155.1, chapter 3, which states that the "lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and documented."

For example, the underwriter approved loan 332-4680917 without verifying that the borrower's employment would continue when relocating to the Las Vegas area. This borrower defaulted after two payments, and HUD paid a claim in the amount of \$118,861.

In another example, the underwriter approved loan 332-4646174 using significant overtime income. A week before closing, the borrower quit a second job to work overtime at her primary job. The underwriter obtained a verification of income from the employer stating that the borrower would work 25 hours of overtime per week. However, the underwriter did not establish a history of overtime income and did not verify with the employer that the overtime was likely to continue as required by HUD Handbook 4155.1, REV. 5, Paragraph 2-7A (See appendix D). Because of the significant violation noted, the FHA insurance fund is at risk of a potential loss of \$176,954.

The table below lists the 15 loan files reviewed and the deficient areas associated with each loan.

FHA loan number	Case file review revealed underwriting deficiency				Significant underwriting deficiencies*
	Income	Credit	Assets	Misc.	
332-4710214		✓	✓	✓	
332-4711039	✓	✓		✓	
332-4680917	✓		✓		✓
332-4905750	✓	✓			✓
332-4646174	✓	✓	✓		✓
331-1386377		✓			✓
332-4772348	✓		✓		✓
332-4746911	✓				✓
332-4705686				✓	
331-1343149				✓	
332-5009143		✓	✓		✓
332-5029755	✓		✓		✓
332-4657522			✓		✓
332-4837072	✓		✓	✓	✓
332-4729886			✓	✓	
<b>Total</b>	8	6	9	6	10

\*Appendix E contains details of each loan file review.

The five loans not considered to have significant underwriting deficiencies, identified in the table above, also contained violations that did not comply with HUD regulations. In these cases, either the underwriting deficiencies were not significant enough to impact the insurability of the loan, or the loan would have been eligible based on other factors even if the underwriter had properly adjusted for the deficient item. However, as discussed in the next section, these loans contained unallowable restrictive covenants.

**All Loans Contained  
Unallowable Restrictive  
Covenants**

The lender filed unallowable restrictive covenants. A review of the applicable county recorder's records revealed legal restrictions on conveyance in all 15 loans reviewed. As illustrated in the excerpt below, the deed restriction, called the occupancy and antispeculation agreement, set the occupancy period at 1 year and restricted the borrower from selling or renting the home during the occupancy period. The addendum stated that any breach would entitle the seller, at its sole election, to receive from buyer, as liquidated damages for such breach, the sum of \$50,000. The buyer's obligation to pay the liquidated damages constituted a lien on the property. This deed restriction on conveyance violated HUD regulations. Specifically, 24 CFR (Code of Federal Regulations) 203.41(b) states that "a mortgage shall not be eligible for

insurance if the mortgaged property is subject to legal restrictions on conveyance.”

Also, a review of the final title policy revealed a recorded charitable agreement imposing endowment fee obligation in 2 of the 15 loans reviewed. This agreement established a lien, which required payment of a fee upon conveyance of title. This was a violation of HUD Handbook 4155.2, paragraph 6.A.1.h (see criteria in appendix D). The endowment fee, similar to the occupancy and antispeculation agreement, was in violation of 24 CFR 203.41(b).

The table below contains the loan files that include the Lennar charitable agreement imposing endowment fee obligation and associate fees paid by borrower.

<b>FHA loan number</b>	<b>Fees on HUD-1 settlement statement</b>	<b>Recorded with final title policy</b>
331-1386377	\$101	x
331-1343149	\$122	x
<b>Total</b>	<b>\$223</b>	<b>2</b>

The lender’s underwriting policies and procedures did not address unallowable restrictive covenants. As a result, the lender did not identify this deficiency before the loans’ closing. Lender officials stated that the lender designed the occupancy and antispeculation agreement in the purchase contract to deter investors from coming into the market and flipping the properties when the builder advertised its homes in family communities. The lender had taken steps to remedy this issue in future loans and current loans in which the 1-year agreement was still in force. It had advised its underwriters to remove the agreement in any future purchase contracts and created a letter to send out to all current borrowers that had entered the agreement within a year to void that part of the purchase agreement.

**Lack of Due Diligence  
Increased Risk of Loss to the  
FHA Insurance Fund**

HUD Handbook 4155.1, REV-5, Foreword states, “This [underwriting] decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation.” The lender did not exercise both sound judgment and due diligence when it submitted the 15 loans reviewed for FHA insurance. The lender had established underwriting policies



and procedures. However, two of the three responsible underwriters admitted to making errors when underwriting FHA loans.

In addition, the lender's compensation plan for its underwriters included compensation based on the number of underwriting decisions made. This is a form of commission contrary to HUD Handbook 4060.1, REV-2, paragraph 2-9A, which states, "employees who perform underwriting and loan servicing activities may not receive commissions." Commissions provide an incentive for underwriters to focus on quick underwriting decisions rather than compliance with HUD regulations.

## Conclusion

The lender's failure to follow HUD's FHA regulations and requirements placed the FHA insurance fund at additional risk for losses. As discussed, 10 of the 15 loans reviewed had significant underwriting deficiencies, and all 15 loans had unallowable restrictive covenants. This condition was caused by the underwriters' not exercising sound judgment and due diligence when underwriting FHA loans and the lender's not having policies and procedures to identify unallowable restrictive covenants. From the 10 loans with significant underwriting deficiencies, the total unpaid mortgage balance of nine of the loans was more than \$2 million with an estimated loss to HUD of more than \$1.1 million. The remaining loan had an actual loss to HUD of \$118,861.

## Recommendations

We recommend that the HUD Acting Deputy Assistant Secretary for Single Family Housing

- 1A. Refer the lender to the Mortgagee Review Board to take appropriate administrative action, such as imposing civil money penalties for the 15 loans due to the lender's failure to underwrite loans in compliance with HUD regulations and the unallowable restrictive covenants.

We also recommend that HUD's Acting Deputy Assistant Secretary for Single Family Housing require the lender to

- 1B. Indemnify HUD against any future losses on 9 of 10 loans with significant underwriting deficiencies. The projected loss is \$1,188,588 based on HUD's loss severity rate of 59 percent of the unpaid balance of \$2,014,555 (see appendixes C and E).

- 1C. Reimburse HUD for \$118,861 in losses resulting from the amount in claims and associated expenses paid on one loan with significant underwriting deficiencies and unallowable restrictive covenants (see appendixes C and E).
- 1D. Discontinue the use of the restrictive covenants with FHA-insured loans and refrain from executing this document or filing it with the county recorder's office.
- 1E. Analyze all FHA loans originated by the Las Vegas branch beginning October 1, 2008 and nullify the charitable endowment and anti-speculative agreements or indemnify the loans if the agreements are not nullified.
- 1F. Develop, implement, and enforce written controls to ensure that underwriting policies are followed, restrictive covenants are not included in the sales deed and final title policies, and quality control reviews of FHA-insured loans comply with HUD regulations.
- 1G. Revise its underwriter's compensation plan to adhere to HUD requirements and to discontinue the use of commissions.

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## Finding 2: Universal American Mortgage Company's Quality Control Reviews Were Inadequate

Universal American Mortgage Company did not adequately perform quality control reviews for FHA-insured loans in accordance with HUD requirements and its own quality control plan. Deficiencies included the failure to complete (1) thorough quality control reviews, (2) the required reverifications, and (3) the quality control reviews in a timely manner. The lender disregarded HUD's quality control review requirements as well as its own quality control plan. The deficient quality control loan reviews may have prevented the lender from correcting systemic deficiencies that could reduce unnecessary risk to HUD.

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### **The Lender Did Not Complete Thorough Quality Control Reviews**

We examined 10 quality control reviews and determined that all 10 of the lender's reviews were inadequate and did not meet HUD requirements. HUD Handbook 4060.1, REV-2, paragraph 7-6F, requires the lender to perform quality control reviews for compliance with HUD underwriting regulations, sufficiency of documentation, and the soundness of underwriting judgments. The lender performed random monthly and early payment default quality control reviews; however, the reviews performed were not always thorough.

For example, the lender performed an early payment default quality control review of loan 332-4905750. The reviewer noted incorrect income calculations and insufficient documentation for the source of funds. The lender had previously performed a random monthly quality control review of the same loan without noting the significant income and source of fund issues. In addition, the lender did not report the significant deficiencies to HUD as required by HUD Handbook 4060.1, REV-2, paragraph 7-3J.

Further, the desk review of the appraisals did not address areas required by HUD Handbook 4060.1, REV-2, paragraph 7-6E(3). Specifically, it did not address the validity of comparables, the value conclusion, and the overall quality of the appraisal. The checklist was not completely filled out for three of the loan files reviewed, indicating that the lender did not perform a thorough desk review.

### **The Lender Did Not Complete the Required Reverifications**

HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), requires the lender to reverify the employment and assets of the borrower. Also, the lender's own quality control plan requires reverification of loan application information. The lender performed reverifications during its quality control reviews. However, it did not always obtain written employment reverifications or reverifications of assets or applications.

For example, the lender performed an early payment default quality control review of loan 332-4657522. The borrower received gift funds to assist with closing costs, but the lender did not attempt to reverify the gift funds as required.

### **The Lender Did Not Perform FHA-Insured Quality Control Reviews in a Timely Manner**

HUD Handbook 4060.1, REV-2, paragraph 7-6A, requires lenders to review loans routinely selected for quality control review within 90 days from the end of the month in which the loan closed. The purpose of the requirement is to ensure that the lender identifies the problems left undetected before closing as early as possible. The lender did not always perform quality control reviews within the timeframes required by HUD. It did not review 8 of the 10 FHA loans in a timely manner. The lender stated that during the beginning of our audit period, it did not have sufficient quality control staff to perform the required reviews in a timely manner. A contractor now performs all random monthly quality control reviews.

Three of the eight reviews were early payment default reviews. HUD regulations do not indicate a timeframe for the completion of early payment default reviews. However, HUD Handbook 4060.1, REV-2, paragraph 7-2, states that one of the basic overriding goals of quality control is to ensure swift and appropriate corrective action. Therefore, prudence would dictate that these loans be reviewed shortly after being identified as early payment defaults. Mortgagee Letter 2011-02 states mortgagees must perform reviews of early payment defaults within 45 days from the end of the month that the loan is reported as 60 days past due. We understand this mortgagee letter was not enforceable during our audit period. However, we were conservative when determining timeliness by using the 90 day requirement used for random monthly reviews. During our audit period, the lender only performed early

payment default reviews periodically. It has adopted new policies to ensure that monthly early payment default reviews are performed.

The following table outlines the deficiencies noted during our review.

FHA loan number	Quality control reviews revealed deficiencies for				
	Timeliness	Reverification of application	Reverification of funds (sources/gifts)	Reverification of employment	Desk appraisals
332-4905750	✓ 373 days		✓		✓
332-5037217	✓ 164 days	✓	✓		✓
332-5010896	✓ 110 days		✓		✓
332-5183127	✓ 102 days		✓		✓
332-5010952	✓ 198 days		✓		✓
332-5271606			✓		✓
332-5178859		✓	✓		✓
331-1361737	✓ 446 days				
332-4657522	✓ 212 days	✓	✓	✓	✓
332-4772348	✓ 128 days	✓	✓		✓
<b>Total</b>	<b>8</b>	<b>4</b>	<b>9</b>	<b>1</b>	<b>9</b>

\*The days listed represents the number of days it took from the beginning of the month following the date of closing to complete the review.

### The Lender Disregarded Its Own Policies and Procedures

The lender disregarded HUD’s quality control review requirements as well as its own quality control plan. Its quality control plan stated that it would reverify, in writing, all original documentation used to verify employment, income, and credit references. When the lender did not receive the written verifications, it would make a documented attempt to conduct telephone verifications. However, its quality control staff did not always follow these procedures. Also, the quality control contractor stated that it did not always attempt to reverify bank information and or obtain written verification of employment.

In addition, the checklist the lender used to perform its desk reviews of the appraisals did not cover all of the elements required by HUD. Specifically, the checklist did not address the validity of comparables, the value conclusion, and the overall quality of the appraisal.

### Conclusion

The lender did not adequately perform quality control reviews for FHA-insured loans or report significant quality control findings to HUD. This condition

occurred because the lender disregarded HUD's quality control review requirements as well as its own quality control plan. The deficient quality control loan reviews may have prevented correction of systemic deficiencies that could reduce unnecessary risk to HUD.

## **Recommendations**

We recommend that the HUD Acting Deputy Assistant Secretary for Single Family Housing require the lender to

- 2A. Fully implement its quality control plan and follow up with the lender to ensure that its quality control reviews are conducted in accordance with HUD regulations.
- 2B. Update its quality control loan file checklist to ensure that it complies with HUD regulations.

## SCOPE AND METHODOLOGY

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Our audit period covered loans with beginning amortization dates from October 1, 2008, to September 30, 2010. We selected the Las Vegas branch (2149000219) because its national compare ratio (insert footnote C here) was 337 percent, which was the highest of all of its branches. We conducted our fieldwork at the Las Vegas branch office between January and June 2011.

We reviewed the underwriting documentation for 15 FHA-insured loans selected nonstatistically based on the existence of loan defaults and claims. We used Neighborhood Watch, HUD's online information system for FHA-insured loans, to identify all loans from the branch. During our audit period, the Las Vegas Universal American Mortgage Company branch office originated 581 loans and had 63 seriously delinquent loans totaling more than \$15 million. HUD has paid claims totaling \$716,456 on four of the loans. Using data mining software, we selected a sample of 15 loans with the following criteria:

- All loans in claim status;
- All loans with six or fewer payments before falling into default status; and
- All loans with a default reason of "curtailment of borrower income," "excessive obligations," or "other."

We revised our initial sample by removing a streamline refinance and replacing it with a purchase mortgage based on its high front and back ratios.

To perform our quality control file reviews, we obtained a listing from the lender of all early payment default loans and random quality control reviews performed on loans originated by the Las Vegas branch during our audit period. There were a total of 38 quality control reviews, 28 random quality control reviews, and 10 early payment default reviews. Using auditor judgment, we reviewed 10 (26 percent) of the quality control reviews. We used statistical software's random number generator to select the 10 loans reviewed. We also reviewed the onsite branch office quality control reviews covering our audit period.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials on single-family requirements;
- Reviewed the lender's processing, underwriting, and closing policies and procedures;
- Reviewed the lender's FHA-insured loan files;
- Interviewed appropriate staff;
- Reviewed the quality control plan;
- Reviewed 10 of the quality control reviews; and
- Performed site visits to employers when available to reverify employment documentation.

We used the source documents downloaded onto the lender's online system called BlitzDocs to determine borrower income, employment history, and debt. For loans underwritten by an automated underwriting system, we reviewed the FHA loan file to determine whether it contained the documentation needed to support the integrity and accuracy of the data used by the automated underwriting system to recommend approval of the loan. For manually underwritten loans, we reviewed the loan documents to determine whether they supported the underwriting decision and complied with HUD Handbook 4155.1, REV-5, Mortgage Credit Analysis.

We used Neighborhood Watch to obtain the unpaid mortgage balances and the actual losses to HUD for each of the 15 loans reviewed. HUD paid claims on four of the loans that we determined had significant underwriting deficiencies; however, one property was still in HUD's inventory or the sale information was not available. We requested that HUD indemnify against losses for these loans because it had not realized any losses.

We also used the data maintained by HUD in its Neighborhood Watch system to obtain background information and to identify the universe of loans. We did not rely on the data to reach our conclusions; therefore, we did not assess the reliability of the data.

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



# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

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

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## Relevant Internal Controls

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

- Policies and procedures intended to ensure that the lender properly originates, underwrites (approves), and closes FHA-insured loans (finding 1).
- Policies and procedures intended to ensure that the quality control program is an effective tool for reducing underwriting errors (finding 2).

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Weaknesses

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

- The lender did not have adequate internal controls to reasonably ensure that loan originations complied with HUD requirements and prudent lending practices (finding 1).
- The lender did not have adequate internal controls to ensure that its quality control personnel complied with its own quality control plan or HUD's quality control regulations (finding 2).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1B		\$1,188,588
1C	\$118,861	
Totals	\$118,861	\$1,188,588

- 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. In this case, ineligible costs are HUD's actual losses on FHA-insured homes sold in preforeclosure sales or by HUD (see appendix C).
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If HUD implements our recommendations to indemnify loans not originated in accordance with FHA requirements, it will reduce FHA's risk of loss to the insurance fund. The amount noted reflects HUD's calculation that FHA loses on average 59 percent of the claim amount when it sells a foreclosed-upon property (see appendix C). The 59 percent loss rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2010 based on actual sales.




## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

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### Ref to OIG Evaluation

### Auditee Comments

 UNIVERSAL AMERICAN MORTGAGE COMPANY
August 24, 2011
Tanya E. Schulze Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of Inspector General, Region IX 611 West Sixth Street, Suite 1160 Los Angeles, California 90017-3101
Dear Ms Schulze:
Universal American Mortgage Company, LLC (UAMC) acknowledges receipt of your findings report for the audit of our office in Las Vegas, Nevada. UAMC continually strives to originate quality mortgage products and audit reports such as your assist us in furthering our initiatives for quality. We also appreciate the opportunity to respond to the findings noted in your report.
We have completed our review of the audit report findings and are providing responses and supporting documentation to address each of the exceptions. Where corrective action was warranted, we have initiated the appropriate action and the action is noted in the detailed response. We trust that the information and documentation herein provided adequately addressed your findings and that any findings found to be resolved will be removed.
We thank you for your time and consideration. If you have any questions or need further clarification on the information or documentation submitted, please contact Becky Moore, Vice President of Quality Assurance, at 305-229-6561 or via email at beckymoore@uamc.com.
Sincerely,
 Denise K. Peller Quality Control Manager
Enclosure:
700 N.W. 107 Ave, 3 <sup>rd</sup> Floor, Miami, FL 33172 (305)229-6500 

**Finding 1: Universal American Mortgage Company Did Not Comply With HUD Regulations in the Origination of FHA-Insured Loans.**

Significant Underwriting Deficiencies:

Universal American Mortgage Company had significant underwriting deficiencies in 10 of the 15 loan files reviewed and unallowable restrictive covenants in all 15 loan files reviewed. This condition was caused by the underwriters' not exercising sound judgment and due diligence when underwriting FHA loan and the lender's not having policies and procedures to identify unallowable restrictive covenants. As a result, the FHA insurance portfolio incurred losses of \$118.628 and remained at risk for losses of more than \$1.1 million on loans that did not meet HUD requirements.

UAMC Response:

UAMC underwriting management has reviewed each of the cited loans with the staff members responsible for the approvals. We have provided a detailed response to the ten loans cited for significant underwriting deficiencies, and believe that our response provides additional information that will clear four of the loans completely, specifically FHA loan numbers 331-1386377, 332-5009143, 332-5029755 and 332-4657522. We also believe that we were able to clear several deficiencies noted in the remaining six files. We were not previously provided detail regarding the additional five loans cited for technical deficiencies, which were not significant enough to impact the insurability of the loan, or the loan would have been eligible based on other factors even if the underwriter had properly adjusted for the deficient item.

All Loans Contained Unallowable Restrictive Covenants:

Occupancy and Anti-Speculation Agreements:

The lender filed unallowable restrictive covenants. A review of the applicable county recorder's records revealed legal restrictions on conveyance in all 15 loans reviewed. As illustrated in the excerpt below, the deed restriction, called the Occupancy and Anti-Speculation Agreement, set the occupancy period at one year and restricted the borrower from selling or renting the home during the occupancy period. The addendum stated that any breach would entitle the seller, at its sole election, to receive from buyer, as liquidated damages for such breach, the sum of \$50,000. The buyer's obligation to pay the liquidated damages constituted a lien on the property. This deed restriction violated HUD regulations...

UAMC Response:

UAMC acknowledges that compliance with HUD requirements was unintentionally breached. As a result, we have heightened awareness of this issue with all of our staff, including underwriting, processing and closing, during several conference calls and meetings. A detailed memorandum was sent to every associate in May 2011 and is posted in our Policy and Procedure Manual, which is available on-line to every staff member. A second reminder is due to be published very shortly. We have also included a review for the presence of this covenant in both the Pre-Funding and the Post-Closing Random Monthly Quality Control Audits. Further, the builder has advised us that they have removed the option to select that addendum from all of their purchase agreements.

**Comment 1**

**Comment 2**

To accomplish remediation, we have identified each FHA loan closed within the state of Nevada from October 1, 2008 to date where the borrower's purchase agreement and/or recorded deed contained the Occupancy and Anti-Speculation Agreement addendums. Those lists of loans have been provided to our title partner, North American Title, who is in the process of preparing releases for recording for each loan identified.

**All Loans Contained Unallowable Restrictive Covenants:  
Charitable Housing Agreement**

Also, a review of the final title policy revealed a recorded charitable agreement imposing an endowment fee obligation in 3 of the 15 loans reviewed. This agreement established a lien, which required payment of a fee upon conveyance of title. This was a violation of HUD Handbook 4155.2, paragraph 6.A.1.h. The endowment fee, similar to the Occupancy and Anti-Speculation Agreement, was in violation of 24 CFT 203.41 (b).

The table below contains the loan files that include the Lennar charitable agreement imposing an endowment fee obligation and associate fees paid by the borrower:

FHA Loan Number	Fees on HUD-1 Settlement Statement	Recorded with Final Title Policy
331-1386377	\$101	x
331-1343149	\$122	x
332-4746911	\$0	x
Total	\$223	3

**UAMC Response:**

UAMC acknowledges that compliance with HUD requirements was unintentionally breached. As a result, we have heightened awareness of this issue with all of our staff, including underwriting, processing and closing, during several conference calls and meetings. A detailed memorandum was sent to every associate in May 2011 and is posted in our Policy and Procedure Manual, which is available on-line to every staff member. A second reminder is due to be published very shortly. We have also included a review for the presence of this requirement in both the Pre-Funding and the Post-Closing Random Monthly Quality Control Audits.

**Comment 3**

To address the specific loans mentioned above, please note that the first two loans were originated from our branch in Reno, which is part of UAMC CA. The loans originated by this branch from January 1, 2009 until May 23, 2011, had already been reviewed as part of a previous audit. We are obtaining recorded releases of the charitable agreements for each loan where applicable. In addition, we are refunding any charitable agreement fees collected from borrowers in the form of principal reductions to their loans.

**Comment 4**

The third cited loan was originated from our Las Vegas branch. The title exception mentioned above did not apply to this loan, as the lot and block of the subject loan did not fall within the lots and blocks referenced in the title exception. The title exception applied to lots 239 -248 of block 1, lots 278-282 and lot 299-300 of block 2. This loan was made on lot 252 of block 1. We did examine all loans closed in the subdivision since October 1, 2008 and found one loan, on lot 300

of block 2 that will require a release of the charitable agreement, of which, we have requested from the Charitable Housing Foundation. No fee was collected from the borrower for that loan.

**Lack of Due Diligence Increased Risk of Loss to FHA Insurance Fund:**

HUD Handbook 4155.1, REV-5, Foreword states, "This (underwriting) decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation." The lender did not exercise both sound judgment and due diligence when it submitted the 15 loans reviewed for FHA insurance. The lender had established underwriting policies and procedures. However, two of the three responsible underwriters admitted to making errors when underwriting FHA loans.

In addition, the lender's compensation plan for its underwriters included compensation based on the number of underwriting decisions made. This is a form of commission contrary to HUD Handbook 4060.1, REV-2, paragraph 2-9A, which states, "employees who perform underwriting and loan servicing activities may not receive commissions." Commissions provide an incentive for underwriters to focus on quick underwriting decisions rather than compliance with HUD regulations.

**UAMC Response:**

As noted by the examiners, UAMC has established underwriting policies and procedures which are available to all associates and are communicated in weekly meetings, email correspondence and periodic distributions of policies and procedures updates. With respect to the two underwriters who admitted to making errors in underwriting the cited loans, we wish to point out that these are very experienced underwriters who have underwritten thousands of loan files over their career. These underwriters have been counseled to be more diligent in their review of each loan file. UAMC has also taken the step to reduce the use of LP Validators to clear underwriting conditions.

We, at UAMC, are continually striving to improve our processes and the quality of our loans. In that regard, we would like to highlight some of the actions taken during the past year. In March 2011, a new position was filled for a Vice President of Risk Management who provides an additional level of oversight for the quality of loans originated by UAMC. Additionally, UAMC has increased its underwriting staff by 60% and is providing additional training opportunities for underwriters and other loan production associates

Another step taken to improve loan quality was the insertion of a second level of review within the loan process by the addition of a new position, entitled Loan Review Specialist (LRS). The LRS reviews loans after the first submission to underwriting and after the final submission to underwriting to validate that the documentation in the file supports the AUS findings, utilizing the LP matrix to further validate proper documentation.

With regard to underwriter compensation, UAMC respectfully submits that the OIG Auditors are incorrect in their conclusion that UAMC's compensation plan for its underwriters constitutes the payment of "commissions" to its underwriters. Importantly, UAMC understands fully that HUD requirements do not permit underwriters to be compensated on a commission basis. UAMC does

**Comment 5**

**Comment 6**

not in fact compensate its underwriters on a commission basis. UAMC's compensation of its underwriters is in full compliance with the requirements of HUD Handbook 4060.1 Rev-2.

As a matter of sound business practice, UAMC rewards its more productive employees based on their increased contributions to the organization, in the interest of fairness, and with the overall objective of trying to retain the best employees that it can. Experienced and qualified underwriters are in high demand. In order to remain competitive in the marketplace, UAMC has established an incentive system for extra work performed by its underwriters. Specifically, UAMC has established minimum work performance standards for its employees.

UAMC's underwriters are required to meet the minimum standards set for their positions. If the underwriter performs beyond the established standard, they are paid an incentive in the form of a bonus. UAMC considers this as being no different than merit pay. Importantly, this incentive pay is not dependent on whether a loan is approved, denied, or closed. UAMC respectfully requests that this "finding" be removed.



### Loan File Deficiencies

FHA case #: 332-4680917 [REDACTED]	Mortgaged amount: \$222,901
Date of loan closing: October 10, 2008	Unpaid principal balance: \$219,322.78
Loan purpose: Purchase an existing home, not previously owned	Default status: Pre-foreclosure Sale Completed

#### Income Deficiency:

According to HUD regulations 4155.1 Rev-5 paragraph 1.2, a principal residence is a property that will be occupied by the borrower for the majority of the calendar year. At least one borrower must occupy the property and sign the security instrument and the mortgage note for the property to be considered owner-occupied. HUD's security instruments require a borrower to establish bona fide occupancy in the home as the borrower's principal residence within 60 days after signing the security instrument with continued occupancy for at least one year. We will not insure a mortgage if we conclude that the transaction was designed to use FHA mortgage insurance as a vehicle for obtaining investment properties, even if the property to be encumbered will be the only one owned using FHA mortgage insurance.

The lender closed on a home in North Las Vegas while the borrower lived and worked in California. According to the loan notes, the lender was aware of the borrower's work situation and the borrower claimed she would be able to telecommute from the home in North Las Vegas. The lender closed the loan without verifying this information. The borrower only made two payments before the loan went into default. Due to the lender not ensuring the borrower would have employment near the new home, we are requesting indemnification of the loan.

#### UAMC Response:

In an attempt to resolve the deficiency, UAMC contacted the borrower's employer to determine whether the borrower did indeed work remotely. The employer would not provide information to us at this date, but we spoke with the borrower at her job. She still works for the same employer. She stated that she had worked remotely, however her employer discontinued allowing this due to the economic crisis and she had to move back to California. We checked address records with Lexis Nexis, which indicates that

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**Comment 7**

Names have been redacted for privacy reasons.

the borrower did occupy the subject property from 2008 until 2009. We have counseled our staff to be more vigilant. UAMC continues to train and provide weekly underwriting meetings.

**Asset Deficiency:**

The lender did not adequately verify a large deposit in account. According to HUD regulations 4155.1 Rev-5 Paragraph 2.10.A, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The lender noted a large deposit of \$5,400 in the loan notes, which the borrower verbally stated was a mistake by the bank. The lender did not include that bank statement in the file and did not verify this explanation was accurate.

**UAMC Response:**

Our underwriter indicated that the funds from the deposit mentioned in the loan notes were not documented because they were not needed for cash to close or considered for qualification. We have counseled our staff that the source of funds must be documented, and not just addressed, for all large deposits. UAMC continues to train and provide weekly underwriting meetings.

**Asset Deficiency:**

The lender did not document the actual transfer of funds from Nehemiah to the title company as required. HUD regulation 4155.1 Rev-5 paragraph 2.10.C states 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. We verified the actual transfer with the title company; however, it is the lenders responsibility for obtaining the transfer documentation.

**UAMC Response:**

It is our policy and practice to comply fully with HUD's documentation requirements. Based on our review of this file, we are unable to determine with certainty the reason that the documentation showing the transfer of funds from Nehemiah was not found in the loan file. However, the HUD-1 Certified Settlement Statement on the line entry 204 "Nehemiah Gift Funds" shows a credit to the buyer of the gift funds and that the closing agent received these funds.

**Comment 8**

**Comment 9**

**Misc. Deficiency**

The borrower signed one blank page of the uniform residential loan application. This page contains information to determine whether the borrower had FHA loans in the past and whether he owns any other real estate. HUD does not allow the lender to accept signed blank documents.

**UAMC Response:**

The borrower did complete the page that is referenced above on the initial loan application, which was signed by the borrower on 8/13/2008 (Please see Attachment No.2). All questions were marked "No", except for the statement "I have received information on lead paint poisoning", which was marked "Yes". There were other copies of the uniform residential loan application in the loan file, and the page in question was left blank on those copies. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Loan File Deficiencies**

FHA case #: 332-4905750 [REDACTED]	Mortgaged amount: \$176,739
Date of loan closing: May 21, 2009	Unpaid principal balance: \$171,962
Loan purpose: Purchase an existing home, not previously owned	Default status: Bankruptcy Plan Confirmed

**Income Deficiency:**

The lender included overtime in the income calculation when the trend showed a significant decrease over the past two years. HUD handbook 4155.1 Rev-5 paragraph 2.7.A states that earning trends must be established and documented for overtime and bonus income. If either type shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying. There is no indication in the loan file or the notes that the lender considered the declining trend in the borrower's overtime income, and did not provide a sound rationalization in writing for including the income for borrower qualifying. Furthermore, the lender did not obtain support that overtime income is likely to continue in the future. As a result, the lender overstated the borrower's monthly income by \$374. This resulted in the borrower's qualifying ratios increasing from 35.605% and 54.968% to 40% and 62% respectively. Due to the unstable overtime income, we are requesting indemnification of the loan.

**UAMC Response:**

Since many employers will not guarantee that overtime will continue as a matter of policy, we will look to a history of receipt to determine whether overtime is likely to continue. In this file, the borrower had consistently received overtime during the previous 28 months reported by The Work Number verification of employment. The underwriter used a conservative approach to calculate overtime income by using the lower year to date earnings. We also noted that the borrower had other income and bonus income for the previous two years, neither of which was used in qualifying income. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Comment 10**

**Asset Deficiency**

The lender did not establish a history of accumulating savings for the borrower, and did not obtain evidence of the source of funds for \$3,500 (\$1,000 earnest money deposit + \$2,500 of funds paid at closing) of the borrower's investment in the property. HUD regulations at 4155.1 rev-5 paragraph 2.10 state that all funds for the borrower's investment in the property must be verified and documented. If the amount paid for the earnest money deposit appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit.

On May 1, 2009, the lender stated in the loan notes that the assets will be coming from the borrower's checking account and a withdrawal from her 401K. Then on May 11, 2009, the lender states that they still needed the borrower's bank statements. The final residential loan application signed on May 20, 2009 only has the 401k listed as assets, and does not list a bank account as indicated in the loan notes. There are no bank statements in the loan file.

The down payment required is \$6,300 (180,000 x 3.5%). The borrower paid \$1,000 for the earnest money deposit and provided a cashier's check in the amount of \$5,500 to the title company at closing, for a total down payment of \$6,500. The lender did not obtain documentation on where the May 1, 2009 earnest money deposit check came from. For the funds paid at closing, the borrower obtained a check in the amount of \$3,000 on May 7, 2009 from her 401k to go towards the \$5,500. There is no support in the file for the remaining \$2,500 paid at closing.

In addition, the lender did not determine whether the borrower incurred recent debt to obtain part of the required cash investment. Mortgagee Letter 2004-47 requires the lender to determine whether any recent debt was incurred to obtain any part of the required cash investment on the property being purchased. The lender did not obtain an explanation for a loan inquiry by Dollar Loan Center made on April 27, 2009, just four days prior to the borrower providing the earnest money deposit. The lender should have obtained an explanation to determine whether the borrower incurred recent debt to obtain part of the cash investment on the property.

**UAMC Response:**

Our review indicated that the source of funds for the initial \$1,000 earnest money deposit was less than 2% of the purchase price and was not excessive based on the

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**Comment 11**

**Comment 12**

borrower's history of accumulating savings. The borrower documented a balance of over \$9,000 in her 401k account. In addition, the borrower's 2008 tax return, filed April 15, 2009, reflected an income tax refund paid in the amount of \$3,220. Therefore, source of funds documentation was not required according to HUD Handbook 4155.1 5.B.2 (a).

In regard to the remaining funds for closing, FHA requires us to document assets according to the requirements listed in the Total Scorecard findings. In this case, the Total Scorecard required only a copy of the most recent retirement account statement to document sufficient funds to close and documentation of the conditions under which the funds may be withdrawn or borrowed. This is the documentation that was obtained by UAMC. Because the findings did not require evidence of actual withdrawal of the money, we respectfully submit that the assets for closing were correctly documented. We are attaching a copy of the LP findings and documentation of the conditions under which funds may be withdrawn from the retirement account, which were located in the Credit Docs section of our loan file (See Attachments No. 3 and 4). Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Credit Deficiency**

The lender did not determine whether the borrower incurred recent debt to obtain part of the required cash investment. The lender did not obtain an explanation for a loan inquiry by Dollar Loan Center made 4 days before the borrower provided the earnest money deposit.

**UAMC Response:**

This appears to have been an oversight on the part of the loan underwriter. However, this does not appear to be related to the source of funds for the earnest money deposit, as the borrower did receive an income tax refund in the amount of \$3,220 at that time.

### Loan File Deficiencies

FHA case #: 332-4646174 [REDACTED]	Mortgaged amount: \$312,061
Date of loan closing: October 30, 2008	Unpaid principal balance: \$301,881.07
Loan purpose: Purchase an existing home, not previously owned	Default status: Chapter 13 bankruptcy

#### Income Deficiency:

The lender did not use due care when including new overtime income in the borrower's qualifying ratios. HUD handbook 4155.1 Rev. 5, paragraph 2-7(A) states both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past two years, and the employment verification must not state that such income is unlikely to continue. Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

From January 1, 2008 to October 2008, the borrower worked at two jobs. However, the borrower decided in October 2008, the same month the loan closed, to quit one of the jobs and work at the other job where she would be able to increase her hours. The lender obtained an explanation from the current job, which stated that the borrower would work 40 hours a week at \$33 per hour, and an additional 25 hours a week at a rate of \$49.50 per hour. The lender also obtained a copy of a paycheck that showed the first week that the borrower worked these hours.

However, Overtime income is not allowable in this situation because the lender was not able to show that the borrower received overtime income during the last two years. The lender does state that it used the letter and the pay stub showing one week of overtime, however, there appears to be no follow up by the lender with the employer to determine the likelihood or duration of the overtime.

This borrower defaulted on her mortgage after only four payments. The underwriter was in violation of HUD regulations, and did not use due diligence when underwriting this loan. We also spoke to the executive director of the current job and he was very hesitant to say that the overtime was a permanent or long-term arrangement.

**Comment 13**

We determined the borrower's income for qualifying purposes should have been \$5,720 per month ((40 hrs/week x \$33/hr x 52 weeks per year) /12 months). Using this income the borrower's front and back ratios increased from 25.078% and 49.995% to 41% and 81% respectively. Due to this underwriting issue, we are requesting indemnification of the loan.

**UAMC Response:**

At the time the loan was underwritten, the borrower [REDACTED] presented a history of consistently working more than 40 hours per week, either with two or three different employers at one time, or with additional hours at one employer. It is not uncommon for a registered nurse to work for more than one employer at a time or to work additional hours for the same employer. The borrower's income level remained relatively consistent throughout the 32 months documented in the file. Based on the history and confirmation of continuance from the borrower's current employer, it appears to UAMC that the stability and continuance of the income used for qualification was well supported.

**Comment 14**

The loan did become delinquent in the first year, however the attached servicer's collection notes indicate that the reason for default was the loss of the co-borrower's employment [REDACTED] - See Attachment No. 5). This borrower did not disclose employment or income to UAMC in their loan application, and no income from [REDACTED] was considered in our underwriting analysis. We would also point out that, although [REDACTED] represented to the servicer that their default was due to a reduction in income, the servicer appears to have obtained updated documentation of income from the borrowers at least four times between May 2009 and February 2010. Each time, the servicer determined that the borrowers did not qualify for any modification or assistance. It appears that the reason for delinquency may have been unrelated to income issues. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Credit Deficiency:**

The lender did not take significant overdraft and nonsufficient fund charges shown on the bank statements into consideration. The lender's policy states the following: "Watch out for nonsufficient funds and overdrafts on the bank statement since this could affect our underwriter's credit decision. These issues must be addressed with Underwriting." The borrower's July to August 2008 bank statement shows that the year to date overdraft charges is \$1,302 and the nonsufficient funds charges were \$249 for a total of



\$1,551 (\$1,302 + \$249). This equates to approximately \$193 in overdraft and nonsufficient fund charges per month (\$1,551/8 months).

In addition, HUD Handbook 4155.1, REV-5, paragraph 2.3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. 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. When delinquent accounts are revealed, the lender must document their 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. There is no evidence that this was discussed with the underwriter. This is an indication that the borrower was not financially responsible.

**UAMC Response:**

The underwriter has been counseled and further instructed that any significant overdraft and/or non sufficient fund instances must be taken into consideration when analyzing the borrower's credit history. Also, reminders and additional training have provided to the entire underwriting staff in this regard.

**Credit Deficiency:**

The lender did not maintain documentation for all copies of the credit report ran and did not document where the borrower obtained the funds to pay off previous debt. HUD Handbook 4155.1 Rev-5 paragraph 2.4.A.2 states that lenders must retain all copies of all credit reports and document in writing an analysis of the reasons for any discrepancies between the credit reports. The loan notes indicate that the borrower's credit scores were 580 and 599. The notes indicate that the borrower paid off a Dollar Loan Center account to assist in bringing their credit scores up. The only credit report in the file shows new credit scores of 617 and 622.

In addition, HUD Handbook 4155.1 Rev-5 paragraph 2.10.C states when someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to purchase and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage. The credit report shows the borrower closed the Dollar Loan Center account for \$1700 on June 2008, which was the same month the borrower applied for the loan. The file does not indicate how the borrower paid the debt or describe the discrepancies in writing.

**Comment 15**

**UAMC Response:**

We are attaching a copy of the original credit report for this borrower, which we obtained from our LOS system (See Attachment No. 6). All credit reports pulled for a borrower are reviewed by the underwriter and imaged in our LOS system for our records. Although there was no specific documentation regarding the source of funds for the borrower to pay the debt to Dollar Loan Center in the amount of \$1,700, we noted that the borrower's monthly residual income was approximately \$5,000 so that the amount to pay this debt would not have been excessive in relation to their monthly income. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Asset Deficiency:**

The lender did not verify large deposits made to the borrower's account. HUD Handbook 4155.1 paragraph 2.10.B states if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. At the time, the borrower was working two jobs, so the deposits for her paychecks were not included, and the deposit for the tax return was not included. There was no evidence in the file that the lender obtained explanations for the large deposits listed below. This is a violation of HUD regulations, and HUD has no assurance that these deposits did not come from interested parties to the sale of the home. However, Nehemiah provided gift funds to cover closing costs, not the borrowers. As a result, this issue is not as significant as if the borrower had paid the closing costs from her own funds.

The bank statements in the lenders file shows the following deposits:

- April 17, 2008 - \$5,000 Customer Deposit
- July 21, 2008 - \$2,000 Customer Deposit
- August 4, 2008 - \$1,600 Customer Deposit
- August 13, 2008 - \$1,400 Customer Deposit
- September 2, 2008 - \$1,400 Customer Deposit

**UAMC Response:**

Our review found that the deposits in question were not used for qualification or needed for cash to close. They did not appear to be excessive in relation to the

**Comment 16**

borrower's income and type of employment as the borrower is a Registered Nurse who had a history of working for more than one employer at a time. Secondary employment could have accounted for the deposits in question. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

### Loan File Deficiencies

FHA case #: 331-1386377 [REDACTED]	Mortgaged amount: \$198,259
Date of loan closing: May 29, 2009	Unpaid principal balance: \$192,315
Loan purpose: Purchase an existing home, not previously owned	Default status: Repayment

**Credit Deficiency:**

The lender did not obtain documentation that federal taxes were paid, and they did not verify that the IRS and borrower made a satisfactory repayment plan in writing. According to HUD Handbook 4155.1 Rev-5 paragraph 2.5, if the borrower, as revealed by public records, credit information, or HUD's Credit Alert Interactive Voice Response System (CAIVRS), is presently delinquent on any Federal debt (e.g., VA-guaranteed mortgage, Title I loan, Federal student loan, Small Business Administration loan, delinquent Federal taxes) or has a lien, including taxes, placed against his or her property for a debt owed to the U.S., the borrower is not eligible until the delinquent account is brought current, paid, otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the Federal agency owed and is verified in writing.

As of March 18, 2009, Mr. Jackson was making monthly payments to the IRS for taxes owed from 2004 and 2005. Due to an injury and loss of employment, the borrower did not submit tax returns for FY 2006 and 2007. In 2008, Social Security awarded the borrower for his injuries as well as a pension. The award of these funds caused a large tax liability in the amount of \$13,104. The notes in the file state that the borrower filed for an extension, and on May 16, 2009 filed his taxes using Liberty Tax Service.

The \$13,104 in taxes are considered delinquent because they were not paid by the tax April 15, tax deadline. IRS form 4868 can be used to file for an automatic six-month extension. In order to get the six-month extension the form must be filed no later than the date the tax return is due (April 15). However, there is no indication when the extension was, if ever, filed with the IRS. Also, payments are considered late if they are not paid when the tax return is filed. If the borrower cannot pay the debt, they must apply to enter into a payment plan with the IRS. There is no evidence in the file that the

**Comment 17**

borrower had applied for, or was in the process of entering, into a payment plan. The borrower did not have enough funds in reserves to cover both the closing costs of the house, and the tax debt that he owed. As a result, at the time of closing this loan was not eligible for FHA insurance.

**UAMC Response:**

Our research indicates that the IRS will approve an installment plan if the amount owed is \$25,000 or less and the balance will be paid off in 60 months or less. In this case, the underwriter was more conservative and calculated a payment based on a 36 month term which was included in the debt-to-income ratio. We are attaching documentation located on the IRS website regarding payment plans and additional information obtained from Ask.com regarding typical IRS payment plans (See Attachment No. 7). Because the borrower was qualified with a conservatively calculated monthly payment for this debt, we believe that this deficiency should be considered technical in nature and not sufficiently significant to impact the insurability of the loan.

### Loan File Deficiencies

FHA case #: 332-4772348 [REDACTED]	Mortgaged amount: \$191,239
Date of loan closing: December 15, 2008	Unpaid principal balance: \$191,239
Loan purpose: Purchase an existing home, not previously owned	Default status: Eviction Completed

#### Income Deficiency:

The lender understated negative rent included in the qualifying ratios for one of the borrower's rental properties. HUD Handbook 4155.1 Rev-5 paragraph 2.7.M states rental income can be included 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 three months. The lender obtained a Schedule E from the 2007 tax returns. However, the lender notes state the property was not rented out until October 2007. The lender did not provide a lease and the tax returns do not provide a stable rental history over the previous 24 months.

According to the Final URLA, the amount of rent received used to calculate negative rent is \$650 per month. We reviewed the bank transaction detail report over the past three months and could not determine if any of the deposits were rental income. The total amount included on the Schedule E for rents received is \$1,113, which does not correlate with the rent amount from October 2007 to December 2007. The documentation provided is insufficient support of rental income and rental stability as required by HUD.

Due to the situation described, we adjusted the qualifying ratios by removing the negative rent amount for the property of \$46.75 per month as calculated by the lender and added the home equity line of credit debt associated with the property of \$656 per month. This increased the back ratio from 53% to 65%. Due to this issue, we are requesting indemnification of the loan.

**Comment 18**

**UAMC Response:**

The UAMC underwriter has been reminded of the need to adequately document rental income with a current lease. UAMC continues to train all staff and provide guidance in weekly underwriting meetings.

**Asset Deficiency:**

The lender did not obtain documentation to verify a large deposit. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.B, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The borrower received a large \$3,000 deposit on December 12, 2008, with a quick explanation that it is from the borrower's home equity line of credit. The lender did not obtain the proper documentation to verify the large deposit was actually from the home equity line of credit. Without this large deposit, the borrower would not have enough funds to pay the \$3,541.13 in closing costs.

**UAMC Response:**

UAMC reviewed the file and found that the deposit of \$3,000 was made on December 1, 2008. This was the same date that the EMD of \$2,500 cleared the borrower's account. We did not locate additional documentation regarding the source of funds; however this amount was less than 2% of the purchase price. According to HUD Handbook 4155. 1 2.10(b), earnest money deposits under 2% do not require documentation for the source of funds. Additionally, the borrower's total cash needed for closing was \$3,341, after the \$2,500 EMD. The borrower's most recent bank printout balance was \$6,118.57. The source of funds for \$5,000 of that balance was documented in the file. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

### Loan File Deficiencies

FHA case #: 332-4746911 [REDACTED]	Mortgaged amount: \$203,194
Date of loan closing: January 29, 2009	Unpaid principal balance: \$197,446.52
Loan purpose: Purchase an existing home, not previously owned	Default status: Reinstated after loss mitigation intervention

#### Income Deficiencies:

##### *Change in employment status*

The lender did not question the borrower's stability of income after a change in employment status the day of closing. According to HUD Handbook 4155.1 Rev-5 section 2, 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.

The lender received two verifications of employment for both borrowers that work for the same primary employer. The lender sent the first verification on November 12, 2008, which indicated the employees were full time. The employment status for both borrowers changed to "on-call" on the second verification received the day of closing on January 29, 2009. The wife's verification of employment under the section "Remarks: if employee was off work for any length of time. Please indicate time period and reason," stated, "For your information, the employee is on an on-call status, last day worked on 01/13/09." On January 28, 2009, the employer signed the verification of employment showing that the wife did not work for a period of 15 days.

We met with a Human Resource representative of the employer on March 25, 2010 to determine the difference from one verification to the other. The Human Resource representative stated that the employees were full time, but were essentially laid off between the first and second verification, and that the hotel would call them if they had any work to be done on an on-call basis. As mentioned in the statement above, the wife



did not work for 15 days before closing showing the possible instability of the on-call income.

*Part-time income instability*

The lender should have excluded the part time income of \$213.75 a month due to the instability shown in the decline in income from 2007 to 2008, the lack of a current verification that the borrower is likely to continue to work part time with the employer, and the lender's own hesitance in using the part time income. HUD Handbook 4155.1 Rev-5 paragraph 2.7.B states that part-time/second job income, including employment in seasonal work, may be used in qualifying if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years and will continue to do so.

The lender took the conservative route when calculating part time income by using the average monthly income for 2008 only. While the lender did document that the borrower has worked the job for the past two years, it did not document the likeliness the borrower will continue to do so. The Work Number verification states it is current as of June 4, 2008, but the lender ran the report on January 27, 2009. We determined this is not a proper verification of employment. Because the employer did not update the system since June 2008 and the loan closed January 2009 the lender should have obtained a verbal verification from the Clark County School District and asked about the likeliness of continued employment.

The lender was originally hesitant on using the part time income as noted in Destiny notes, but decided to use it to maintain the borrower's accept status. The lenders comments are pasted below: "Please note that I didn't clear income as their YTD is lower than the 40 hours weekly qualified with and had to add her 2nd substitute teaching job to keep in line ratio wise and maintain their accept status. Ratios are very tight, but my YTD approach on the income was the most conservative way to go."

Due to the insufficient underwriting on the income documentation, we are requesting indemnification of the loan.

**UAMC Response:**

In reference to the borrower's part time income, we respectfully disagree with the finding that stability of part-time earnings was not supported. We would have been unable to obtain a verification of employment directly from the employer, as evidenced by the fact that they use The Work Number verification service. Although the earnings record had not been updated since June of 2008, the verification of employment did

**Comment 19**

show that the borrower was an active substitute teacher as of the date it was issued in January 2009. We know that substitute teachers are paid by assignment and may have long periods where they do not accept assignments. This borrower had been a substitute teacher since February of 2006, with earnings reported for the previous two years.

In reference to the likelihood of continuance, we would like to point out that The Work Number verification does not ever provide a statement regarding likelihood of continuance of employer. As a matter of policy, most employers will not guarantee continuance of employment for any borrower. As noted by the examiners, the borrower did have history of more than two years with this employer and the underwriter used the most conservative method possible to calculate the amount of income used to qualify. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Legal Restrictions on Conveyance:**

The lender, through the Lennar Charitable Housing Foundation, established a lien, which required payment of a fee upon conveyance of title in violation of HUD regulations. Schedule B, part I, of the final title policy reflected a recorded charitable agreement imposing endowments fee obligation. The document requires new owners to pay a fee upon property conveyance.

**UAMC Response:**

The title policy exception noted reads as follows: "Terms, Covenants, Conditions and Provisions in an instrument entitled "Charitable Housing Agreement Imposing Endowment Fee on Transfer and Lien executed by and between Lennar Charitable Housing Foundation, a California Nonprofit Public Benefit and Greystone Nevada, LLC, a Delaware Limited Liability Company recorded 11/19/07 in Book 20071119 as Document No. 1113 of official records. AFFECTS: Lots 239 thru 248 in Block 1, Lots 278 thru 282 and 299 thru 300 in Block 2". This exception only applies to certain legal descriptions, and our subject property is not among that group. The subject property is lot number 252 in block 1 (Please see Attachment No. 8). Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Comment 20**

**Loan File Deficiencies**

FHA case #: 332-5009143 ██████████	Mortgaged amount: \$235,653
Date of loan closing: October 26, 2009	Unpaid principal balance: \$230,765.74
Loan purpose: Purchase an existing home, not previously owned	Default status: Delinquent

**Asset Deficiency:**

The lender did not determine the source of two large deposits, which affected the borrower's ability to pay closing costs. HUD Handbook 4155.1 Rev-5 paragraph 2.10.B states if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. According to the lender notes, the borrower opened a new account to deposit gift funds from the 401k of the non-purchasing spouse. In addition, the notes state the lender did not include two unverified deposits of \$1800 and \$2000 of possible gift funds in the new account making the new balance \$2052.56 to be used as the borrowers depository assets. It does not appear the lender attempted to get an explanation of the two deposits. In addition, we determined the lender did not actually remove the \$2000 unverified deposit as stated in the notes. Without at least one of the unverified deposits, the borrower would not have had enough funds to close. Because the lender closed the loan without verifying large deposits used as funds to close, we are requesting indemnification of loan. HUD has no assurance that the funds came from an acceptable source.

**UAMC Response:**

UAMC's review of the file noted that the borrower brought \$7,800 to closing and the balance in their account at Weststar CU was \$9,439.23. The gift deposit of \$3,688.27 from the non-purchasing spouse was documented with a gift letter, 401k statement reflecting withdrawal of the funds and a printout from the borrower's account with Weststar CU documenting deposit of the gift funds. There were three additional deposits; a cash deposit on 10/9/2009 of \$2,000, a cash deposit on 10/16/2009 of \$1,800 and a cash deposit on 10/21/2009 of \$2,000. With regard to the first deposit, this amount and date coincides with the borrower's bi-weekly net payroll on 10/9/2009. Additionally, the Weststar CU printout has a notation with that deposit which states

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“Deposit Pre Notification from McLane Foodservice”. The second deposit of \$1,800 on 10/16/2009 did not represent an increase in the borrower’s overall assets, as the borrower’s second account with Wells Fargo showed an average balance of \$2,037.87 followed by a current balance of \$107.64 on the Verification of Deposit form. Furthermore, the borrower would have had sufficient documented funds for closing, without considering the deposit of \$1,800. The third deposit of \$2,000 on 10/21/2009 was a documented gift from the borrower’s father-in-law. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Credit Deficiency:**

The lender did not ensure that all tax liabilities were included in the qualifying ratios. According to HUD Handbook 4155.1 Rev-5 paragraph 2.11.A, in computing the debt-to-income ratios, the lender must include the monthly housing expense and all other additional recurring charges extending ten months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc. Debts lasting less than ten 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. In addition, HUD Handbook 4155.1 Rev-5 paragraph 2.5.B states the federal tax liens may remain unpaid provided the lien holder subordinates the tax lien to the FHA-insured mortgage. If any regular payments are to be made, they must be included in the qualifying ratios.

The borrower’s pay stub listed a garnishment from a tax levy in prior pay stubs with a year-to-date amount of \$1683.76. The pay stub did not show whether it was a federal or local tax levy. The levy did not appear to be active, but the lender should have requested a letter of explanation from the borrower explaining this matter to ensure the borrower is not paying the tax agency through a reoccurring obligation. This may not be a significant issue, but the lender should practice due diligence when there are signs of possible reoccurring debt.

**UAMC Response:**

As noted by the examiners, the borrower’s paystubs did not show any current withdrawals for this item, which would indicate that this item had been satisfied prior to the paystub date of August 14, 2009. Additionally, the borrower’s credit report does not reflect any open tax lien in public records or credit history. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Comment 22**

### Loan File Deficiencies

FHA case #: 332-5029755 [REDACTED]	Mortgaged amount: \$254,782
Date of loan closing: October 23, 2009	Unpaid principal balance: \$248,642.58
Loan purpose: Purchase an existing home, not previously owned	Default status: Delinquent

#### Income Deficiency:

The lender inappropriately used part-time income without a two-year history. According to HUD Handbook 4155.1 Rev-5 paragraph 2.7.B, part-time/second job income, including employment in seasonal work, may be used in qualifying if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years and will continue to do so. The borrower was employed from July 15, 2008 to October 14, 2009. The borrower only worked uninterrupted for 15 months, which is short of the two-year requirement.

In addition, HUD handbook 4155.1 Rev-5 paragraph 2.7.B states income from a part-time position that has been received for less than two years may be included as effective income, provided the lender justifies and documents that the income's continuance is likely. Income from part-time positions not meeting these requirements may be considered as a compensating factor only. The lender obtained a verification of employment, but it did not state whether the borrower was likely to continue employment and the lender did not document any justification for using part-time income for less than two years. The lender should not have included the \$907 as effective income. This increases the front and back ratio from 39.248% and 45.616% to 49.9285 and 58.029%, respectively. Due to the difference in income, we are requesting indemnification of the loan.

#### UAMC Response:

UAMC reviewed the file and found that we had obtained documentation of a previous second job for the borrower. The IRS W-2 transcripts in the file show that the borrower

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worked for [REDACTED] CPA in 2007, receiving \$3,223 in income for that year. This was in addition to the borrower's full time employment. This previous second job was inadvertently left off of the 1003. All of the borrower's current and previous employments are in the same line of work. We believe the stability and continuance of the borrower's secondary employment was supported in this instance.

In summary, the borrower's two year employment history is as follows:

**Primary employment:**

Present: [REDACTED]: Dec 2008 to present

Previous: [REDACTED]: September 2007 to November 2008

Previous: [REDACTED]: 2007 (information derived from 2007 W-2)

**Secondary Employment:**

Present: [REDACTED]: July 2008 to present (borrower also worked there from 2000 to 2002)

Previous: [REDACTED]: 2007 (information derived from 2007 W-2)

**Asset Deficiency:**

The lender did not obtain an explanation of unknown large deposits. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.B, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The bank statement included three unknown large deposits of \$540, \$700, and \$200 at the end of August 2009 and early September 2009 for a total of \$1,440. The paystubs supported all other large deposits. The file did not contain any explanation of the deposits. The unknown deposits equal 32.9% (\$1140/\$4373.27) of the total amount of deposits for the statement. The borrower received gift funds to pay for the closing costs so it is not a significant issue, however, the lender should verify all large deposits per HUD regulations.

**UAMC Response:**

The underwriter did not question the deposits as they were not needed for cash to close, and the account in question is held jointly with another individual who would likely be making deposits also.

**Comment 24**

### Loan File Deficiencies

FHA case #: 332-4657522 [REDACTED]	Mortgaged amount: \$274,659
Date of loan closing: September 26, 2008	Unpaid principal balance: \$266,594.46
Loan purpose: Purchase an existing home, not previously owned	Default status: First Legal Action to Commence Foreclosure

**Asset Deficiency:**

The lender included an extra \$2,020.71 in assets. The AUS report states the lender needs to document the conditions under which funds may be withdrawn or borrowed and that only 60 percent of the vested amount of the account may be used as funds to close or cash reserves. The lender used 70 percent of the current value of a retirement account instead of 60 percent of the vested amount.

**UAMC Response:**

According to our research, the HUD Handbook 4155.1 Rev-5 guidelines during this time period stated that retirement assets should be counted at 60% of value, *unless* the borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and any withdrawal penalties. The IRS tax tables for 2008 (Please see Attachment No. 9) show the borrower's tax rate to be approximately 15% based on the total annualized income of approximately \$79,850. Therefore, the use of 70% of the 401K as an asset was conservative for this borrower. Considering the borrower's 15% tax bracket and the IRS's 10% withdrawal penalty, the borrower's tax exposure would only be 25% instead of the 30% utilized. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Asset Deficiency:**

The lender did not determine the source of funds for the earnest money deposit, which appeared excessive based on the borrower's bank statement. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.A, if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's

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history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check. A certification from the deposit-holder acknowledging receipt of funds and separate evidence of the source of funds is also acceptable. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit. The HUD-1 shows the seller received \$1,500 for the earnest money deposit. However, the file only contains evidence of one \$500 money order for the earnest money deposit made on May 30, 2008. In addition, the bank statement on file ends April 30, 2008 with an ending balance of \$356.82. The lender did not have any other documentation on file to support the \$1,500 earnest money deposit. Because we cannot determine if the funds were from an acceptable source we are requesting indemnification of the loan.

**UAMC Response:**

Because the borrower received most of the funds for closing from a Nehemiah gift and the earnest money was less than 2%, UAMC respectfully disagrees that further documentation of the source of funds for the earnest money deposit would have strengthened the loan file. Further, the HUD-1 shows that the borrower was refunded \$1,224 at closing as the bulk of the funds needed for closing came from the father's gift of \$3,000 plus \$8,730 from Nehemiah. Therefore, only \$276 of the initial EMD was utilized in the transaction. The borrower's bank statement clearly supported they had sufficient funds in their accounts to cover the \$276 that were needed. We also noted that the borrower had residual income of approximately \$3,000 per month, which would support a deposit of \$1,500. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

**Asset Deficiency:**

The lender did not properly document the source of gift funds. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.C.2.b states regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.



The borrower received gift funds from two parties, one from the father of the borrower for \$3,000 and the rest from Nehemiah Corporation for \$8,370. For the gift from the father, the lender obtained a gift letter, a copy of the official check, a statement showing money in the donor's account, and a signed receipt of funds from the title company. However, the donor's statement shows a \$3,000 deposit in the account on the same day the official check was made. The donor would not have had enough money to pay the gift without the \$3,000 deposit and the lender did not document where that deposit came from. The gift funds were used to pay off debt at closing and because it cannot be determined the funds were from an acceptable source, we are requesting indemnification of the loan.

In addition, the lender obtained a gift letter for Nehemiah; however, it did not document the actual transfer of funds from Nehemiah to the title company. Mortgage lenders are responsible for assuring that the gift to the homebuyer from the charitable organization meets the appropriate FHA requirements and the transfer of funds is properly documented. During our visit to the title company, we found the supporting documentation for the wire transfer. The Lender needs to ensure that it maintains the supporting documentation of the wire transfer in the loan file.

**UAMC Response:**

UAMC respectfully disagrees with the auditor's findings with regard to documentation of the source of funds for the \$3,000 gift by the borrower's father as we could not find a requirement for a lender to document the source of funds for any deposits to a donor's account in our research. Based on the above, we respectfully request that this finding be removed from the cited deficiencies.

With regard to the Nehemiah gift funds, it is our policy and practice to comply fully with HUD's documentation requirements. Based on our review of this file, we are unable to determine with certainty the reason that the documentation showing the transfer of funds from Nehemiah was not found in the loan file. However, the HUD-1 Certified Settlement Statement on the line entry 204 "Nehemiah Gift Funds" shows a credit to the buyer of the gift funds and that the closing agent received these funds.

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**Comment 8**

### Loan File Deficiencies

FHA case #: 332-4837072 [REDACTED]	Mortgaged amount: \$241,534
Date of loan closing: March 18, 2009	Unpaid principal balance: \$233,213.69
Loan purpose: Purchase an existing home, not previously owned	Default status: Delinquent

**Asset Deficiency:**

The lender did not obtain a credible explanation of a large unknown deposit. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.B, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The borrower's account included a \$2,800 unexplained large deposit on March 10, 2009. Because the borrower received gift funds to pay for closing costs this is not a significant issue, however, the lender should follow HUD regulations and verify large deposits.

**UAMC Response:**

UAMC has counseled this associate and continues to offer training and provide guidance in weekly underwriting meetings.

**Asset Deficiency:**

The lender did not obtain documentation to show the actual withdrawal of funds from the donor's account. According to HUD Handbook 4155.1 Rev-5 paragraph 2.10.C.1, if the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The borrower received a total of \$11,510 in gift funds. The lender's file included the top of the donor's bank statement with a total in all accounts of \$13,055.03, a copy of each of the cashier's checks, and a copy of the borrower's statement showing the funds were received. However, none of the documents shows the actual withdrawal came from the donor's account. The lender should have obtained documentation showing the money coming out of the donor's account to ensure the funds were not from an unacceptable source. Because we cannot determine the gift is from an acceptable source we requesting indemnification of the loan.

**UAMC Response:**

UAMC has counseled this associate and continues to offer training and provide guidance via weekly underwriting meetings.

**Miscellaneous Deficiency:**

The lender cannot rely on its verification of employment due to discrepancies with the W-2. The income reported on the 2008 W-2 is \$36,068.58 while the verification of employment states that 2008 income was \$59,310.68. The lender did not question this difference. We attempted to re-verify this income, but the employer is no longer in business. The lender did not use the inflated income for qualification purposes. We are only questioning the verification of employment. Because the lender did not use due care when reviewing loan documentation, we are requesting indemnification of the loan.

**UAMC Response:**

UAMC has counseled this associate and continues to offer training and provide guidance in weekly underwriting meetings.

**Income Deficiency:**

The lender obtained insufficient documentation to determine overtime per HUD regulations. According to HUD Handbook 4155.1 Rev-5 paragraph 2.7.A, both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past two years, and the employment verification must not state that such income is unlikely to continue. Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes. The lender used \$396.45 per month of overtime income when qualifying the borrower. According to the lender notes, the lender used a 14.5-month average to determine overtime income; however, the file documentation was insufficient to support this amount. The only reliable evidence of any overtime income in the file is on one paycheck with an amount of \$1501.50. One pay stub does not support a two-year history of overtime and should not be included as effective income. The decrease in income increases the front ratio and back ration from 34% and 38% to 37% and 53%, respectively. Because the lender did not provide supporting documentation for income calculations, we are asking indemnification of the loan.

**UAMC Response:**

UAMC has counseled this associate and continues to offer training and provide guidance in weekly underwriting meetings.

## **Finding 2: Universal American Mortgage Company's Quality Control Reviews Were Inadequate**

UAMC did not adequately perform quality control reviews for FHA-insured loans in accordance with HUD requirements and its own quality control plan. Deficiencies included:

### **The Lender Did Not Complete Thorough Quality Control Reviews:**

We examined 10 quality control reviews and determined that all 10 of the lender's reviews were inadequate and did not meet HUD requirements... The lender performed random monthly and early payment default quality control reviews; however, the reviews performed were not always thorough.

For example, the lender performed an early payment default quality control review of loan 332-4905750. The reviewer noted incorrect income calculations and insufficient documentation for the source of funds. The lender had previously performed a random monthly quality control review of the same loan without noting the significant income and source of funds issues. In addition, the lender did not report the significant deficiencies to HUD as required by HUD Handbook 4060.1, REV-2, paragraph 7-3J.

Further, the desk review of the appraisals did not address areas required by HUD Handbook 4060.1, REV-2, paragraph 7-6E(3). Specifically, it did not address the validity of the comparables, the value conclusion, and the overall quality of the appraisal. The checklist was not completely filled out for three of the loan files reviewed, indicating that the lender did not perform a thorough desk review.

### **UAMC Response:**

**Loan # 332-4905750.** UAMC management determined that the UAMC QC analyst failed to make the correct income determination and the insufficient documentation of asset source. As such, the loan was not reported as having significant deficiencies to HUD. Please refer to our response to the cited underwriting deficiencies in Finding 1 for this same loan. We have discussed this with the UAMC QC analyst for future reviews.

With respect to the finding that the desk review of the appraisals did not address areas required by HUD Handbook 4060.1, REV-2, paragraph 7-6E (3), UAMC respectfully disagrees with the HUD OIG auditor's findings. The auditor appears to have based this deficiency on the fact that the UAMC QC Audit Questionnaire does not ask detailed questions regarding the review of each aspect of the appraisal. We wish to point out that the QC Questionnaire is not intended to be used as a checklist, rather as a trigger for the reviewer to perform analysis. The questions on the Audit Questionnaire are purposefully broad, so as not to limit the auditor's ability to adequately analyze any possible exception. All our QC auditors are fully trained and have extensive experience to perform a complete and comprehensive desk review of appraisal reports. The QC Questionnaire contains two questions that the auditor use to note any and all discrepancies or deficiencies noted in their review of the appraisal report. Those questions are: "Has the appraiser completed the appraisal per USPAP specifications and guidelines?" and "Does the appraisal meet investor's

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(FHA, VA, etc as applicable) guidelines?" We are not certain of the checklist the HUD OIG auditor referred to that was not completely filled out for three of the loan files reviewed.

**The Lender Did Not Complete the Required Reverifications:**

HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), requires the lender to reverify the employment and assets of the borrower. Also, the lender's own quality control plan requires reverification of loan application information. The lender performed reverifications during its quality control reviews. However, it did not always obtain written employment reverifications or reverifications of assets or applications.

For example, the lender performed an early payment default quality control review of loan 332-4657522. The borrower received gift funds to assist with closing costs, but the lender did not attempt to reverify the gift funds as required.

**UAMC Response:**

With respect to seven of the nine loans cited for assets, this was a result of a misunderstanding by the Quality Control vendor contracted by UAMC. The vendor was of the understanding that only assets that were brought to closing were needed to be re-verified and as a result, did not re-verify all assets. This issue has been clarified with the contractor and UAMC has increased its oversight of re-verifications. As to the remaining two loans, UAMC mailed the requests for re-verifications but we did not receive responses and the bank will not verify a customer's bank account information over the telephone. In an effort to be more effective with our requests, we have added the following language to our cover letter for re-verification requests of assets: "If a fee is required for this service, we will be happy to pay it."

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UAMC respectfully disagrees with the auditor's finding regarding the re-verifications of applications. The auditors cited four loans with this finding. For two of those loans, requests were mailed to the borrower to re-verify the application, but the borrower did not respond. The remaining two loans were early payment default loans. It has not been our practice to request a re-verification of the application from the borrowers in early payment default reviews. This re-verification step is, as the auditor stated, a policy that is over and above HUD requirements for re-verification. We require the borrowers to sign and date the final loan application reflecting all the data used to qualify the loan prior to closing the loan. We also send a request for re-verification of the application for closed loans selected for QC review.

**The Lender Did Not Perform FHA-Insured Quality Control Reviews in a Timely Manner:**

HUD Handbook 4060.1, REV-2, paragraph 7-6A, requires lenders to review loans routinely selected for quality control review within 90 days from the end of the month in which the loan closed. The purpose of this requirement is to ensure that the lender identifies the problems left undetected before closing as early as possible. The lender did not always perform quality control reviews within the timeframes required by HUD. It did not review 8 of the 10 FHA loans in a timely manner. The lender stated that during the beginning of our audit period, it did not have sufficient quality control staff to perform the required reviews in a timely manner. A contractor now performs all random monthly quality control reviews.

Three of the eight reviews were early payment default reviews. HUD regulations do not indicate a timeframe for completion of early payment default reviews. However, HUD Handbook 4060.1, REV-2, paragraph 7-2, states that one of the basic overriding goals of quality control is to ensure swift and appropriate corrective action. Therefore, prudence would dictate that these loans be reviewed shortly after being identified as early payment defaults. During our audit period, the lender only performed early payment default reviews periodically. It has adopted new policies to ensure that monthly early payment default reviews are performed.

The following table outlines the deficiencies noted during our review:

FHA Loan Number	Quality Control reviews revealed deficiencies for				
	Timeliness	Reverification of Application	Reverification of funds (Sources/gifts)	Reverification of Employment	Desk appraisals
332-4905750	373 days		x	x	x
332-5037217	164 days	x	x	x	x
332-5010896	110 days		x		x
332-5183127	102 days		x	x	x
332-5010952	198 days		x	x	x
332-5271606			x	x	x
332-5178859		x	x		x
331-1361737	446 days				
332-4657522	212 days	x	x	x	x
332-4772348	128 days	x	x	x	x
Total	8	4	9	7	9

UAMC Response:

The OIG auditors stated that they calculated the timeliness based on the last date any reverification document was received and reviewed by the QC analyst, as documented by the date the document was uploaded into the blitzdocs loan file. However, it is UAMC's understanding that timeliness of review of the loan file and timeliness of document reverification are two separate issues. HUD Handbook 4060.1, 7-6 (A) states that loans must be reviewed within 90 days from the end of the month in which the loan closed. UAMC's process is that QC Processors will send out all requests for reverification after the loan selections are made. Selections are made within the first two weeks following the end of the month under review. At the same time, QC Analysts will begin their reviews of the loan files. This review will include review of any reverification request responses that have already been received. Of course, attempts are made to obtain the reverification responses prior to the QC loan review, but that is not always possible. A QC associate reviews each reverification response received before it is uploaded to the blitzdocs loan file. Any discrepancies are followed up on and added to the audit findings where indicated. We do not hold up reviews of the loan files until all reverification request responses have been received because if we did, it would not be possible to finish the review of the files within 90 days of the end of the month following loan closing. The chart below represents the timeframes for review of the cited loans based on the actual review dates and demonstrates that 4 of the 5 cited loans in random monthly reviews were reviewed within 90 days. With regard to remaining 3 loans, it is our understanding that HUD guidelines (HUD 4060.1, 7-6 (D)) do not provide a timeframe for review of early payment default loans. We are attaching a status history report (Attachment No. 1) to show the review dates for each of the loans cited for random monthly

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quality control reviews. We wish to point out that the first date that the loan is put into "Reviewed" status represents the date the review was completed by the QC analyst.

**Comment 34**

FHA Loan Number	UAMC Loan Number	HUD Calculated Review Timeliness	Audit Type	Date Closed	Date EPD Reported	Date of Review	Elapsed Time from end of month (Random Reviews)
332-4905750	9913757	373 days	May 2009 Random	5/21/2009	N/A	10/21/2009	143 days
332-5037217	5184346	164 days	October 2009 Random	10/22/2009	N/A	1/28/2010	89 days
332-5010896	5314745	110 days	October 2009 Random	10/28/2009	N/A	1/28/2010	89 days
332-5183127	6031942	102 days	June 2010 Random	6/14/2010	N/A	8/26/2010	57 days
332-5010952	4807749	198 days	October 2009 Random	10/15/2009	N/A	1/27/2010	88 days
331-1361737	9467358	446 days	2009 Neighborhood Watch EPD	2/26/2009	10/20/2009	1/6/2010	79 days
332-4657522	8321150	212 days	2009 Neighborhood Watch EPD	9/26/2008	5/20/2009	12/29/2009	212 days
332-4772348	9264151	128 days	2009 Neighborhood Watch EPD	12/17/2008	7/20/2009	1/6/2010	128 days

The Lender Disregarded Its Own Policies and Procedures:

The lender disregarded HUD's quality control review requirements as well as its own quality control plan. Its quality control plan stated that it would reverify, in writing, all original documentation used to verify employment, income and credit references. When the lender did not receive the written verifications, it would make a documented attempt to conduct telephone verifications. However, its quality control staff did not always follow these procedures. Also, the quality control contractor stated that it did not always attempt to reverify bank information or obtain written verification of employment.

In addition, the checklist the lender used to perform its desk reviews of the appraisals did not cover all of the elements required by HUD. Specifically, the checklist did not address the validity of the comparables, the value conclusion, and the overall quality of the appraisal.

UAMC Response:

**Comment 35**

**Comment 36**

UAMC respectfully disagrees with the auditor's assertion that UAMC disregarded HUD's quality control review requirements as well as its own quality control plan. We have responded above, to the cited deficiencies for inadequate desk reviews of appraisals, reverifications of assets and applications. The remaining deficiencies were for reverifications of employment where five of the seven loans cited were loans where the employer verifies employment via "The Work Number" and the QC re-verification was also made via an updated report from "The Work Number". Employers who participate in "The Work Number" do not provide verifications of employment

via any other method. They provide employment information directly to The Work Number. Also, verifications of employment from "The Work Number" are an industry accepted "written verification of employment." We want to point out that in past audits, HUD auditors did not object to lender re-verification via updated report from "The Work Number."

**Comment 37**

The re-verifications of employment were requested and received for the remaining two loans. For case number 332-5183127, direct re-verification of employment was received from the borrower's current employer on Sept 16, 2010, and from the co-borrower's current employer on Aug 26, 2010. Direct re-verification of the borrower's previous employment was received on August 19, 2010 (Please see Attachments 10, 11 and 12).

**Comment 38**

For case number 332-4657522, direct re-verification of the borrower's current employment was received on March 3, 2010, and direct re-verification of the borrower's previous employment was received on Dec 11, 2009. A verbal re-verification of the co-borrower's employment was made on January 26, 2010, after we received no response to our written request, which was issued on December 2, 2009. We did continue to attempt a written re-verification, sending a second request on April 14, 2010 (Please see Attachments 13, 14, 15 and 16).

Based on the above, we respectfully request that this finding be removed from the cited deficiencies.



## OIG Evaluation of Auditee Comments

- Comment 1** We reviewed the lender's response and supporting documentation. We removed some deficiencies from the report; however, there is not sufficient documentation to clear any of the loans completely. Details of the five loans with technical deficiencies were included in the draft report for the lender's response. However, the lender chose not to respond to the deficiencies.
- Comment 2** We acknowledge that the lender is taking steps to remedy these violations. Any corrective actions need to be submitted to HUD for review during the audit resolution process.
- Comment 3** These loans were selected for review because HUD's Neighborhood Watch System identified these loans as being originated by the lender's Las Vegas branch.
- Comment 4** We reviewed the title documentation and agree that the title exception did not apply to this property. We updated the report accordingly.
- Comment 5** We agree the lender has underwriting policies in place. However, these experienced underwriters allowed significant underwriting deficiencies to occur. We are encouraged the lender is continually striving to improve the quality of its processes and quality of its loans.
- Comment 6** We disagree. HUD Handbook 4060.1 paragraph 2.9A states compensation of employees may be on a salary, salary plus commission, or commission only basis and includes bonuses. Employees who perform underwriting and loan servicing activities may not receive commissions. HUD Santa Ana Homeownership Center staff reviewed the lender's underwriter compensation plan. HUD stated that even though compensation is not based on the approval of the loan, it still provides an incentive for quick underwriting rather than focusing on compliance with HUD regulations. As a result, this finding was not removed from the report.
- Comment 7** The lender should have obtained verification from the employer before the loan closed that the borrower could telecommute on a permanent basis. HUD Handbook 4155.1 Rev-5 Chapter 2 states 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. Without verifying the borrower could telecommute on a permanent basis before closing, the lender could not ensure income was likely to continue. As a result, this deficiency was not removed from the report.

**Comment 8** HUD Handbook 4155.1 Rev-5 2.10.C states when the transfer of gift funds 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. The HUD-1 Certified Settlement Statement does not show the actual transfer of gift funds from the donor to the title company. It is the lender's responsibility to obtain the transfer documentation, such as the evidence of wire transfer. As a result, this deficiency was not removed from the report.

**Comment 9** We reviewed the documentation provided and we removed the deficiency from the report.

**Comment 10** We disagree. HUD Handbook 4155.1 Rev-5 paragraph 2.7.A states that an earnings trend must be established and documented for overtime income. If the trend shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying. Also, the lender's underwriters stated that they would question significant declines in overtime income and be more likely to use it as a compensating factor. There is no evidence in this case that the underwriter questioned the significant decline in the overtime income and there was no written justification in the file as required. This deficiency was not removed from the report.

**Comment 11** We reviewed all supporting documentation, and the attachments provided, and we have removed the asset deficiency from the report.

**Comment 12** We disagree. The lender did not obtain any bank information showing that the tax refund received by the borrower was in her account and available for the earnest money deposit. HUD Handbook 4155.1 Rev-5 paragraph 2.4.B states the lender must ascertain the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment on the property being purchased. The borrower must explain in writing all inquiries shown on the credit report in the last 90 days. HUD's Total Scorecard Guide, under the assets section, also states that for loans that have received an accept status, the lender must also determine that any recent debts were not incurred to obtain part or all of the required cash investment on the property being purchased. The lender did not question a Dollar Loan Center inquiry on the credit report that occurred four days before the borrower made the earnest money deposit. As a result, this deficiency was not removed from the report.

**Comment 13** We disagree. HUD Handbook 4155.1 Rev-5, paragraph 2.7.A states both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying

purposes. An earnings trend also must be established and documented for overtime and bonus income.

We agree that the borrower worked more than 40 hours per week at multiple places and the borrower's income remained relatively consistent throughout the 32 months documented in the file. However, for the most part, income earned was from working non-overtime hours. Overtime is inconsistent and can be reduced at anytime. As a result, HUD requires a two-year history, showing overtime income is consistently earned. In this case, the borrower did not have a two-year history of working significant overtime. Also, the lender did not document in writing its rationale for using the income at the time of closing. The lender should not have used the overtime income to qualify the borrower and should have only used it as a compensating factor. As a result, this violation was not removed from the report.

**Comment 14** Neighborhood Watch lists the reason for default as "Unable to Contact Borrower." We are unsure of the actual reason for default. It may or may not be related to income issues. The documentation provided does not prove that a loss of income was or was not the cause of the default.

**Comment 15** We reviewed the documentation and removed the violation from the report. The lender needs to ensure that all credit reports are maintained in its loan file as required by HUD regulations.

**Comment 16** We disagree. The borrower was working two jobs during this time period and we took this into account when reviewing the bank statements. We did not question any deposits that were associated with employment. Also, the deposits in question were significant deposits all of which were \$1,400 or higher. To ensure large deposits are not provided by interested third parties, HUD Handbook 4155.1 Rev-5 paragraph 2.10.B states, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of those funds. The lender did not obtain a credible explanation for the deposits in question. As a result the deficiency was not removed from the report.

**Comment 17** We reviewed the documentation provided and we disagree with the lender attempting to calculate a payment plan without verifying the IRS established a payment plan in writing. According to HUD Handbook 4155.1 Rev-5 paragraph 2.5 the borrower is not eligible until the delinquent account is brought current, paid, otherwise satisfied, or a satisfied repayment plan is made between the borrower and the federal agency owed and is verified in writing. In addition, in our interview with the lender's underwriters, the underwriters stated they would have wanted to see a payment plan in writing prior to approving the loan. In the absence of a written repayment plan between the borrower and the IRS, this loan was not eligible for insurance. This violation remains as a significant violation which impacts the insurability of the loan.

**Comment 18** We disagree. HUD Handbook 4155.1 Rev-5 paragraph 2.10 states, all funds for the borrower's investment in the property must be verified and documented. Acceptable sources of these funds include the following: savings and checking accounts. A verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

On December 1, 2008, a \$3,000 deposit was made and the earnest money deposit of \$2,500 was taken out of the account. The lender did not obtain the proper documentation to verify that the deposit was from the home equity line of credit. On December 8, 2008 the balance ending, after the \$3,000 deposit, was \$6,118.57. The borrower needed \$3,541.13 in closing funds. Without the \$3,000 deposit, whether it was used for the earnest money deposit or the closing costs, the borrower would not have had enough to pay closing costs because the ending balance would be \$3,118.57, which is \$422.56 short of closing costs. As a result, this deficiency remained in the report.

**Comment 19** We disagree. The borrower's income from a part time job decreased from \$651.25 per month to \$213.75 per month. Also, the Work Number indicated that from June 2008 through January 2009, an eight month span, there was no part time income earned. The significant decline in part-time income and the amount of time between teaching jobs indicate that the part-time income is not stable. As a result this income should not be included for qualifying purposes. HUD Handbook 4155.1 Rev 5 Section 2 states that income may not be used if it comes from any source that is not stable. In this case the part-time income does not appear to be stable. As a result, this deficiency remained in the report.

**Comment 20** We reviewed the attached documentation and removed this deficiency from the report.

**Comment 21** The lender should have obtained the transfer of funds documentation for the \$1,800 deposit to verify it was transferred from another account. The lender stated the \$2,000 deposit coincided with the borrower's payroll. However, the paystub should have been obtained to support this amount. Without at least one of the two deposits the borrower would not have had enough funds to pay closing. As a result, this deficiency remained in the report.

**Comment 22** The lender's own policy states that the underwriter should review deductions on the borrower's paystubs to ensure the borrower does not have any deductions for undocumented loans, or is currently having pay garnishment for child support, etc. Also, HUD Handbook 4155.1 Rev-5 states that lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA. The lender should not have assumed the item has been satisfied and should have obtained documentation showing this. As a result, this deficiency remained in the report.

**Comment 23** We disagree. Handbook 4155.1 Rev-1 paragraph 2.7.B states part-time/second job income, including employment in seasonal work, may be used in qualifying if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years and will continue to do so. Income from a part-time position that has been received for less than two years may be included as effective income, provided the lender justifies and documents that the income's continuance is likely. Income from part-time positions not meeting these requirements may be considered as a compensating factor only.

The lender stated it believed the borrower had shown a history of part time income in other jobs. However, the lender cannot determine from the W-2's that the employers in question were part time since the W-2 does not show dates. There is a time gap between January 2007 to August 2007 in which the borrower could have worked these jobs separately. In addition, it is required the lender determine if continuance is likely to use part time income for less than two years and this was not established.

**Comment 24** We disagree. While the issue is technical in nature, the lender is responsible for following HUD regulations. Regardless of whether the funds are being used for closing or not, large deposits require a credible explanation for the source of those funds to ensure the funds were not provided by an interested third party to the transaction.

**Comment 25** Although the lender included the tax table for 2008 showing the tax rate of 15%, it does not take into consideration the need for conclusive evidence that a higher percentage of retirement assets could be withdrawn. As a result, this deficiency remained in the report.

**Comment 26** We disagree. HUD Handbook 4155.1 Rev-5 2.10.A states if the amount of the earnest money deposit appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. The borrower paid the earnest money on May of 2008 and closing costs and gift funds were not provided until September of 2008. The ending balance in the borrower's bank statement at the end of April only reflected \$356.82 with a beginning balance of only \$25. Documentation in the file does not support the borrower had a history of accumulated savings sufficient to pay the \$1,500 earnest money deposit at the time it was due despite the amount actually used for the loan. Also, there is no evidence in the file that the borrower actually paid the full \$1,500 earnest money deposit. The lender should have documented the earnest money deposit. As a result, the deficiency remained in the report.

**Comment 27** We disagree. HUD Handbook 4155.1 Rev-5 paragraph 2.10.C.2 specifically states if the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the donor must provide written evidence that those funds were borrowed from an acceptable source, i.e., not

from a party to the transaction, including the lender. In this instance the donor only had one deposit listed of \$3,000, which is the exact amount provided as a gift. The lender should question if these funds were borrowed or provided by an interested third party, especially when the funds were used to pay off debt at closing. As a result, this deficiency remained in the report.

**Comment 28** We agree with the lender's quality control analyst that the income was not calculated correctly. In addition, the lender did not provide evidence that it disagreed with its quality control analyst on either the source of funds or income calculation issue at the time the review was completed. These issues should have been reported to HUD when the deficiency was cited by the lender's quality control analyst. As a result, this deficiency remained in the report.

**Comment 29** The lender did not provide any other documentation showing what work was completed on the review, except for the checklist. Without any other documentation, we cannot determine that a thorough review was completed that addressed the areas required by HUD. As a result, this deficiency remained in the report.

**Comment 30** The desk review checklist for case numbers 332-5183127, 332-5271606, and 332-5178859 were not completed. Not all items in the checklists were filled out completely indicating a full desk review was not performed. As a result, this deficiency remained in the report.

**Comment 31** HUD Handbook 4060.1 paragraph 7.1 states all FHA approved mortgagees, including loan correspondents, must implement and continuously have in place a Quality Control Plan for the origination and/or servicing of insured mortgages as a condition of receiving and maintaining FHA approval. The lender should implement the policies created, which state the lender will send out verifications of application for both early payment default reviews as well as random monthly audits and document any follow-up requests or attempts to re-perform verifications. As a result, this deficiency remained in the report.

**Comment 32** The lender stated that timeliness on the review of the loan file and timeliness of the document reverification are two separate issues. We disagree with the lender.

HUD Handbook 4160.1 Rev-2 paragraph 7.6, which includes the basic requirements for quality control of single-family production, states that in order for a Quality Control Program to be useful and acceptable to FHA, there are several requirements that must be met. Mortgagees must adhere to each of the requirements below when conducting reviews. These requirements include reverification of credit documentation, underwriting decisions, and condition, clearance, and closing. The reverifications are part of the loan file review and

HUD regulations state that these reviews must be performed within 90 days from the end of the month in which the loan is closed.

The lender's reverification procedures in its quality control policy state that if a response has not been obtained after a reasonable time, a second request for this information will be sent. If the written reverification is not returned, a documented attempt to conduct a telephone reverification will be made. The quality control files did not contain evidence that the lender sent out second requests or attempted to obtain a telephone reverification to ensure this process was completed in a timely manner. Without the reverification data, the loan file review cannot be completed.

**Comment 33** HUD Handbook 4060.1 Rev-2 paragraph 7.2 states that one of the overriding goals of a quality control plan is to assure swift and appropriate corrective action. Mortgagee Letter 2011-02 states mortgagees must perform reviews of early payment defaults within 45 days from the end of the month that the loan is reported as 60 days past due. We understand that this mortgagee letter is not enforceable at the time of our audit period. However, to be conservative we determined timeliness based on the 90 days used for random monthly reviews to ensure that HUD's goal of swift and appropriate corrective action was met.

**Comment 34** We disagree. The lender is unable to complete the file reviews without obtaining the reverification documentation. Also, the lender did not document that it made an effort to obtain the re-verifications in a timely manner. As a result, the calculation of timeliness will remain the same in the audit report.

**Comment 35** We disagree that the lender followed HUD's quality control requirements and its own quality control plan as noted in comments 28 through 35.

**Comment 36** Verification of employment regarding "The Work Number" has been removed from the report.

**Comment 37** We reviewed the documentation provided and removed this issue for loan file 332-5183127.

**Comment 38** For loan file 332-4657522, attachment 16 is not sufficient documentation to support the lender's attempt to send out a written re-verification. As a result, this deficiency remained in the report.

## Appendix C

### LOAN DETAILS FOR UNDERWRITING DEFICIENCIES

The table below contains the actual and projected losses to HUD corresponding to the loans recommended for indemnification under finding one.

FHA loan number	Significant underwriting deficiencies	Unallowable restrictive covenants	Unpaid mortgage balance	Actual losses to HUD	Indemnification amount (unpaid balance x 59% loss rate)
332-4905750	x	x	\$170,120		\$100,371
332-4680917	x	x		\$118,861	
332-4646174	x	x	\$299,922		\$176,954
331-1386377	x	x	\$190,834		\$112,592
332-4772348	x	x	\$183,973		\$108,544
332-4746911	x	x	\$196,214		\$115,766
332-5009143	x	x	\$229,174		\$135,213
332-5029755	x	x	\$247,144		\$145,815
332-4837072	x	x	\$231,757		\$136,737
332-4657522	x	x	\$265,417		\$156,596
<b>Totals</b>	<b>10</b>	<b>15</b>	<b>\$2,014,555</b>	<b>\$118,861</b>	<b>\$1,188,588</b>



## Appendix D

### CRITERIA

#### *Income Deficiencies:*

##### **HUD Handbook 4155.1, REV-5, Paragraph 1-2**

A principal residence is a property that will be occupied by the borrower for the majority of the calendar year. At least one borrower must occupy the property and sign the security instrument and the mortgage note for the property to be considered owner-occupied. HUD's security instruments require a borrower to establish bona fide occupancy in the home as the borrower's principal residence within 60 days after signing the security instrument with continued occupancy for at least one year. We will not insure a mortgage if we conclude that the transaction was designed to use FHA mortgage insurance as a vehicle for obtaining investment properties, even if the property to be encumbered will be the only one owned using FHA mortgage insurance.

##### **HUD Handbook 4155.1, REV-5, Chapter 2**

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.

##### **HUD Handbook 4155.1, REV-5, Paragraph 2-7A**

Both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past two years, and the employment verification must not state that such income is unlikely to continue. Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

An earnings trend must be established and documented for overtime and bonus income. If either type shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying.

##### **HUD Handbook 4155.1, REV-5, Paragraph 2-7B**

Part-time/second job income, including employment in seasonal work, may be used in qualifying if the lender documents that the borrower has worked the part-time job uninterrupted for the past two years and will continue to do so. Income from a part-time position that has been received for less than two years may be included as effective income, provided the lender justifies and documents that the income's continuance is likely. Income from part-time positions not meeting these requirements may be considered as a compensating factor only.

For qualification purposes, part-time income refers to jobs taken to supplement the borrower's income from regular employment (i.e., a second job – not meaning primary jobs of less than 40 hours per week.) If a borrower's regular employment involves less than a typical 40-hour workweek, the stability of that income should be evaluated as any other regular, on-going primary employment. For example, a registered nurse may have worked 24 hours per week for the last year. Although this job requires less than 40 hours of work per week, it is the borrower's primary employment and is to be considered effective income.

We recognize that many low- and moderate-income families rely on part-time and seasonal income for day-to-day needs. Lenders must not restrict the consideration of such income sources in qualifying these borrowers.

**HUD Handbook 4155.1, REV-5, Paragraph 2-7M**

Rental income can be included 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 three months.

The following is required to verify all rental income:

1. *Schedule E of IRS [Internal Revenue Service] Form 1040.* Depreciation may be added back to the net income or loss shown on Schedule E. Positive rental income is considered gross income for qualifying purposes; negative rental income must be treated as a recurring liability. The lender must be certain that the borrower still owns each property listed, by comparing the Schedule E with the real estate owned section of the residential loan application. (If the borrower in the same general area owns six or more units, a map disclosing the locations must be submitted evidencing compliance with FHA's seven-unit limitation. See paragraph 4-8 for additional information.)

2. *Current Leases.* If a property was acquired since the last income tax filing and is not shown on Schedule E, a current signed lease or other rental agreement must be provided. The gross rental amount must be reduced for vacancies and maintenance by 25 percent (or the percentage developed by the jurisdictional HOC [Homeownership Center]), before subtracting PITI [principal, interest, taxes, and insurance] and any homeowners' association dues, etc., and applying the remainder to income (or recurring debts, if negative).

**HUD Handbook 4155.1, REV 5, Paragraph 2-9B**

B. Documentation Requirements. The following documents are required from self-employed borrowers:

1. Signed and dated individual tax returns, plus all applicable schedules, for the most recent two years.
2. Signed copies of federal business income tax returns for the last two years, with all applicable schedules, if the business is a corporation, an "S" corporation, or a partnership.
3. A year-to-date profit-and-loss (P&L) statement and balance sheet.

4. A business credit report on corporations and “S” corporations.

*Asset Deficiencies:*

**HUD Handbook 4155.1, REV-5, Paragraph 2-10**

All funds for the borrower’s investment in the property must be verified and documented.

**HUD Handbook 4155.1, REV-5, Paragraph 2-10A**

If the amount paid for the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower’s history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit.

**HUD Handbook 4155.1, REV-5, Paragraph 2-10B**

If there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

**HUD Handbook 4155.1, REV-5, Paragraph 2-10C(2)**

If the gift funds are to be provided at closing:

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

Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor’s own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

**HUD Handbook 4155.1, REV-5, Paragraph 2-10C(1)**

If the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or

other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit is also required.

**The Total Scorecard Report: Retirement Accounts**

Obtain most recent employer, depository or brokerage statements for each account to verify sufficient funds required to close. Document conditions under which funds may be withdrawn or borrowed. Only 60 percent of the vested amount of the account may be used as funds to close or cash reserves.

*Credit Deficiencies:*

**Mortgagee Letter 2004-47: FHA Total Mortgage Scorecard User Guide – Earnest Money and Other Large Deposits**

Determine that any recent debts were not incurred to obtain part or all of the required cash investment on the property being purchased.

**Mortgagee Letter 2004-47: FHA Total Mortgage Scorecard User Guide – System Overrides and Manual Downgrades**

A system override occurs when a loan application variable triggers a requirement (a “review rule”) that an underwriter review the loan file. A manual downgrade becomes necessary if additional information, not considered in the AUS [automated underwriting system] decision, affects the overall insurability or eligibility of a mortgage otherwise rated as an accept or approve. Both system overrides and manual downgrades may be triggered by inaccuracies in credit reporting, by eligibility issues, and for other reasons including the unlikely failure of the scorecard or AUS to recognize a derogatory credit variable. Unless specifically permitted to continue to use the Accept/Approve documentation class, such as following a favorable resolution of a credit issue due to an error in reporting, you must document as a Refer risk class and are accountable for the credit and ratio warranties on these loans. If the automated underwriting system you are using does not provide for a system override for any of the conditions shown below, then you are required to manually downgrade the loan to a refer under any of the following conditions:

Credit Issues: Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to an underwriter for review.

**HUD Handbook 4155.1, REV-5, Paragraph 2-3**

Past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. A borrower who has made payments on previous and current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

When analyzing a borrower's credit history, examine the overall pattern of credit behavior, rather than isolated occurrences of unsatisfactory or slow payments. A period of financial difficulty in the past does not necessarily make the risk unacceptable if the borrower has maintained a good payment record for a considerable time period since the difficulty. When delinquent accounts are revealed, the lender must document their 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 delayed mail delivery or disputes with creditors.

**HUD Handbook 4155.1, REV-5, Paragraph 2-4A(2)**

Lenders must retain all copies of all credit reports and document in writing an analysis of the reasons for any discrepancies between the credit reports. If a lender receives any information inconsistent with the information on the credit report, the lender must reconcile the inconsistency.

**HUD Handbook 4155.1, REV-5, Paragraph 2-5**

A borrower must be rejected if any of the following conditions apply:

B. Delinquent Federal Debts. If the borrower, as revealed by public records, credit information, or HUD's Credit Alert Interactive Voice Response System (CAIVRS), is presently delinquent on any Federal debt (e.g., VA [U.S. Department of Veterans Affairs]-guaranteed mortgage, Title I loan, Federal student loan, Small Business Administration loan, delinquent Federal taxes) or has a lien, including taxes, placed against his or her property for a debt owed to the U.S., the borrower is not eligible until the delinquent account is brought current, paid, otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the Federal agency owed and is verified in writing.

**HUD Handbook 4155.1, REV-5, Paragraph 2-10C**

When someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to purchase and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage.

**HUD Handbook 4155.1, REV-5, Paragraph 2-11A**

The borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other additional recurring charges extending ten months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc. Debts lasting less than ten 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.

*Miscellaneous Deficiencies:*

**Mortgagee Letter 2004-47**

On November 20, 2003, the Federal Housing Administration (FHA) issued Notice H-2003-25, FHA's Technology Open To Approved Lenders (TOTAL) Mortgage Scorecard User Guide. This Mortgagee Letter contains the User Guide in its entirety with updates to clarify policy, provide additional guidance, and incorporate the credit policy guidance announced in Mortgagee Letter 2004-44.

**Mortgagee Letter 2004-47: FHA Total Mortgage Scorecard User Guide – Documentation Requirements**

All standard FHA documentation requirements must be met, with the exception of those described below which may allow for reduced documentation sets based upon the risk classification of the loan. Though fewer in numbers than on manually underwritten loans, credit history, income and employment, and assets must still be verified. You must also document any situation not addressed in this user guide.

“Faxed” Documents—If income/employment, asset, or other documents are “faxed” to the lender, the documents must clearly identify the employer, depository/investment firm’s name and source of information. The lender is accountable for ascertaining the authenticity of the document by examining, among other things, the information included at the top or banner portion of the fax received by the lender. The document itself must also include a name and telephone number of the individual with the employer or financial institution that can verify the accuracy of the data.

**Mortgagee Letter 2004-47: FHA Total Mortgage Scorecard User Guide –Employment/Income**

For loan applications rated as Accept/Approve, use the following to verify employment for employed borrowers: Current Employment---Specific underwriting requirements for what constitutes acceptable types and sources of income, as well as stability of income requirements are described in Chapter 2 of HUD Handbook 4155.1. The lender is responsible for verifying the accuracy of the amount of income being reported, and for determining if it can be considered as effective income in determining the payment-to-income and debt-to-income ratios.

**HUD Handbook 4155.1, REV-5, Chapter 3**

The lender is responsible for asking sufficient questions to elicit a complete picture of the borrower’s financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and documented.

**HUD Handbook 4155.1, REV-5, Paragraph 3-1G, Federal Income Tax Returns**

Federal income tax returns (both individual returns and business returns) for the past two years, including all applicable schedules, for self-employed borrowers, are required. Commissioned individuals must provide individual federal income tax returns for the past two years. The lender must obtain signed Forms IRS 4506, IRS 8821, or whatever form or

electronic retrieval service is appropriate for obtaining tax returns directly from the IRS for any loan for which the borrower's tax returns are required.

**HUD Handbook 4155.1, REV-5, Paragraph 3-2C**

Lenders may not have borrowers sign documents in blank, or on blank sheets of paper.

*Legal Restrictions on Conveyance:*

**24 CFR 203.41(b)**

(b) Policy of free assumability with no restrictions. A mortgage shall not be eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance, except as permitted by this part.

**HUD Handbook 4155.2, Paragraph 6.A.1.h**

With respect to title objections, the lender is responsible for ensuring that FHA will accept any conditions of title to the property.

*Quality Control:*

**HUD Handbook 4060.1, REV-2, Paragraph 2-9A**

A. Employees.

Compensation of employees may be on a salary, salary plus commission, or commission only basis and includes bonuses. All compensation must be reported on Form W-2. Employees who perform underwriting and loan servicing activities may not receive commissions.

**HUD Handbook 4060.1, REV-2, Paragraph 7-2**

The following are the overriding goals of Quality Control. Mortgagees must design programs that meet these basic goals:

- Assure compliance with FHA's and the mortgagee's own origination or servicing requirements throughout its operations;
- Protect the mortgagee and FHA from unacceptable risk;
- Guard against errors, omissions and fraud; and
- Assure swift and appropriate corrective action.

Failure to comply with specific Quality Control requirements may result in sanctions and the imposition of Civil Money Penalties by the Mortgagee Review Board (MRB).

**HUD Handbook 4060.1, REV-2, Paragraph 7-3J**

J. Notification to HUD. Findings of fraud or other serious violations must be immediately referred, in writing (along with any available supporting documentation) to the Director of the Quality Assurance Division in the HUD Homeownership Center (HOC) having jurisdiction (determined by the State where the property is located)

**HUD Handbook 4060.1, REV-2, Paragraph 7-6A**

A. Timeliness. Loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected prior to closing are identified as early after closing as possible.

**HUD Handbook 4060.1, REV-2, Paragraph 7-6E(2)**

Documents contained in the loan file should be checked for sufficiency and subjected to written re-verification. Examples of items that must be reverified include, but are not limited to, the mortgagor's employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds. Sources of funds must be acceptable as well as verified.

**HUD Handbook 4060.1, REV-2, Paragraph 7-6E(3)**

3. Appraisals. A desk review of the property appraisal must be performed on all loans chosen for a Quality Control review except streamline refinances and HUD Real Estate Owned (REO) sales. The desk review must include a review of the appraisal data, the validity of the comparables, the value conclusion (“as repaired” to meet safety and soundness requirements in HUD Handbook 4905.1 (as revised)), any changes made by the underwriter and the overall quality of the appraisal.

**HUD Handbook 4060.1, REV-2, Paragraph 7-6F**

F. Underwriting Decisions. Each Direct Endorsement loan selected for a quality control review must be reviewed for compliance with HUD underwriting requirements, sufficiency of documentation and the soundness of underwriting judgments.



## Appendix E

### LOAN SUMMARIES FOR UNDERWRITING DEFICIENCIES FOR THE 15 LOANS

The following table provides a listing of deficiencies noted in each FHA-insured loan file reviewed. However, the occupancy and antispeculation agreement violation noted in finding 1 is not included in the underwriting deficiencies below.

FHA case number	Violation	Finding(s)										
332-4710214	<p>Credit deficiency:</p> <p>Mortgage Letter 2004-47: FHA Total Mortgage Scorecard User Guide – System Overrides and Manual Downgrades</p>	<p>The borrower’s credit report noted one collection account under dispute. The lender did not refer the loan to be manually underwritten or document the override of the disputed account.</p>										
	<p>Asset deficiency:</p> <p>HUD Handbook 4155.1, REV-5, paragraph 2-10C</p>	<p>The lender did not document the actual transfer of funds from the donor to the title company as required. We verified the actual transfer with the title company; however, it is the lender’s responsibility to obtain the transfer documentation.</p>										
	<p>Asset deficiency:</p> <p>HUD Handbook 4155.1, REV-5, paragraph 2-10A</p>	<p>The lender did not verify the earnest money deposit of \$1,000 that appeared excessive based on borrower’s history of savings.</p>										
		<table border="1"> <thead> <tr> <th data-bbox="865 1032 1056 1057">Statement dates</th> <th data-bbox="1409 1032 1854 1057">Total of savings and checking accounts</th> </tr> </thead> <tbody> <tr> <td data-bbox="865 1062 1241 1086">Opening balance as of 07/01/2008</td> <td data-bbox="1409 1062 1486 1086">\$58.65</td> </tr> <tr> <td data-bbox="865 1091 1224 1115">Ending balance as of 07/31/2008</td> <td data-bbox="1409 1091 1520 1115">\$1,341.53</td> </tr> <tr> <td data-bbox="865 1120 1224 1144">Ending balance as of 08/31/2008</td> <td data-bbox="1409 1120 1499 1144">\$500.74</td> </tr> <tr> <td data-bbox="865 1149 1192 1174">Average balance for 3 months</td> <td data-bbox="1409 1149 1499 1174">\$633.64</td> </tr> </tbody> </table>	Statement dates	Total of savings and checking accounts	Opening balance as of 07/01/2008	\$58.65	Ending balance as of 07/31/2008	\$1,341.53	Ending balance as of 08/31/2008	\$500.74	Average balance for 3 months	\$633.64
Statement dates	Total of savings and checking accounts											
Opening balance as of 07/01/2008	\$58.65											
Ending balance as of 07/31/2008	\$1,341.53											
Ending balance as of 08/31/2008	\$500.74											
Average balance for 3 months	\$633.64											
		<p>The borrowers obtained the cashier’s check for the earnest money deposit 2 days after their bank accounts showed a balance of \$500.74.</p>										
	<p>Miscellaneous deficiency:</p> <p>HUD Handbook 4155.1, REV-5, paragraph 3-2C</p>	<p>The borrower signed one blank page of the uniform residential loan application. This page contains information to determine whether the borrower had FHA loans in the past and whether the borrower owns any other real estate. HUD does not allow the lender to accept blank signed documents.</p>										

We determined that these deficiencies were technical in nature.

<b>FHA case number</b>	<b>Violation</b>	<b>Finding(s)</b>
<b>332-4711039</b>	Credit deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-11A	The borrower's pay stub listed garnishments that were not included in the mortgage credit analysis worksheet. There were two payments on the pay stub titled "Court Order Exp" and "Court Charge NV." The monthly average of these two payments was \$224.24. There were no explanations in the file of how long this obligation was to continue or what it was. All recurring obligations expected to last more than 10 months are required to be included in the liabilities section of the mortgage credit analysis worksheet.
	Income deficiency:  HUD Handbook 4155.1, REV 5, paragraph 2-9B(3)	One of the borrowers was a self-employed individual. The file contained a profit and loss statement for the year but not a balance sheet as required.
	Miscellaneous deficiency:  Mortgagee Letter 2004-47: Total Score Card User Guide – Documentation Requirements	The fax number on the rental verification did not appear on the header. Without this information, the lender could not be sure that the document came directly from the landlord.

We determined these deficiencies were technical in nature.

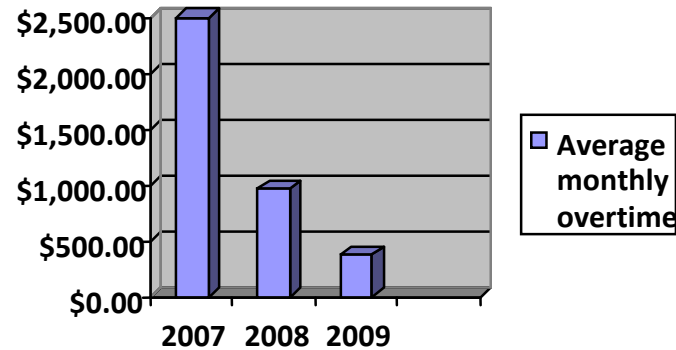
<b>FHA case number</b>	<b>Violation</b>	<b>Findings</b>
<b>332-4680917</b>	Income deficiency:  HUD Handbook 4155.1, REV-5, paragraph 1-2	The lender closed on a home in North Las Vegas while the borrower lived and worked in California. The borrower claimed that she would be able to telecommute from the home in North Las Vegas. According to the loan notes, the lender was aware of the borrower's work situation; however, the lender closed the loan without verifying this information.  The borrower made two payments before the loan went into default. Due to the lender's not ensuring that the borrower would have employment near the new home, we are requesting indemnification of the loan.
	Asset deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-10B	The lender did not adequately verify a large deposit in the borrower's bank account. The lender noted a deposit of \$5,400 in the loan notes, which the borrower verbally stated was a mistake by the bank. The lender did not include that bank statement in the file and did not verify that the explanation was accurate.

Asset deficiency: The lender did not document the actual transfer of funds from the donor to the title company as required. We verified the actual transfer with the title company; however, it is the lender’s responsibility to obtain the transfer documentation.

HUD Handbook 4155.1, REV-5, paragraph 2-10C(2)

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Findings
332-4905750	Income deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-7A	The lender included overtime in the income calculation when the trend showed a significant decrease over the past 3 years.



There was no indication in the loan file or the notes that the lender considered the declining trend in the borrower’s overtime income, and the lender did not provide a sound rationalization in writing for including the income for borrower qualification.

Further, the lender did not obtain support showing that overtime income was likely to continue in the future. As a result, the lender overstated the borrower’s monthly income. This error resulted in the borrower’s qualifying ratios increasing from 36 and 55 percent to 40 and 62 percent, respectively. Due to the unstable income, we are requesting indemnification of the loan.

Credit deficiency: The lender did not determine whether the borrower incurred recent debt to obtain part of the required

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cash investment. The lender did not obtain an explanation for a loan inquiry by Dollar Loan Center made 4 days before the borrower provided the earnest money deposit.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Findings
332-4646174	<p data-bbox="464 440 674 474">Income deficiency:</p> <p data-bbox="464 505 821 565">HUD Handbook 4155.1, REV-5, paragraph 2-7A</p>	<p data-bbox="840 440 1988 500">The lender did not use due care when including new overtime income in the borrower’s qualifying ratios.</p> <p data-bbox="840 532 1988 716">From January 1 to October 2008, the borrower worked at two jobs. However, the borrower decided in October 2008, the same month the loan closed, to quit one of the jobs and work at the primary job where she would be able to increase her hours. The lender obtained an explanation from the primary job, which stated that the borrower would work an additional 25 hours per week at a rate of \$49.50 per hour. The lender also obtained a copy of a paycheck showing the first week that the borrower worked these hours.</p> <p data-bbox="840 748 1988 932">However, overtime income is not allowable in this situation because the lender was not able to show that the borrower had worked overtime the past 2 years. The lender stated that it used the letter and the pay stub showing 1 week of overtime; however, there appeared to have been no follow-up by the lender with the employer to determine the likelihood or duration of the overtime. We spoke to the executive director of the primary employment, and he was hesitant to say that the overtime was a permanent or long-term arrangement.</p> <p data-bbox="840 964 1556 998">The borrower defaulted on her mortgage after only four payments.</p> <p data-bbox="840 1031 1988 1084">We determined that the borrower’s front and back ratios increased from 25 and 50 percent to 41 and 81 percent, respectively. Due to this underwriting issue, we are requesting indemnification of the loan.</p>
	<p data-bbox="464 1143 659 1177">Credit deficiency:</p> <p data-bbox="464 1208 821 1268">HUD Handbook 4155.1, REV-5, paragraph 2-3</p>	<p data-bbox="840 1143 1988 1385">The lender did not take significant overdraft and nonsufficient fund charges shown on the bank statements into consideration. The lender’s policy stated the following: “Watch out for nonsufficient funds and overdrafts on the bank statement since this could affect our underwriter’s credit decision. These issues must be addressed with Underwriting.” The borrower’s July to August 2008 bank statement showed that the year-to-date overdraft charges were \$1,302 and the nonsufficient funds were \$249 for a total of \$1,551 (\$1,302 + \$249). This amount equates to approximately \$194 in overdraft and nonsufficient fund charges per month (\$1,551/8 months). This is an indication that the borrower was not financially responsible.</p>

There was no evidence that the underwriter considered this issue when qualifying the borrower.

Asset deficiency: There was no evidence in the file that the lender obtained explanations for the large nonpayroll deposits listed below.

HUD Handbook 4155.1, paragraph 2-10B

- April 17, 2008 - \$5,000
- July 21, 2008 - \$2,000
- August 4, 2008 - \$1,600
- August 13, 2008 - \$1,400
- September 2, 2008 - \$1,400

This is a violation of HUD regulations, and HUD had no assurance that these deposits did not come from interested parties to the sale of the home.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Finding(s)
331-1386377	Credit deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-5	In 2008, the borrower had a large tax liability in the amount of \$13,104. The lender did not obtain documentation showing that the taxes were paid and did not verify that the IRS and borrower made a satisfactory repayment plan in writing.  There was no evidence in the file that the borrower applied for or was in the process of entering into a payment plan with the IRS. The borrower did not have enough funds in reserve to cover both the closing costs of the house and the tax debt that he owed.  As a result, at the time of closing, this loan was not eligible for FHA insurance.
	Legal restrictions on conveyance: HUD Handbook 4155.2, paragraph 6.A.1.h 24 CFR 203.41(B)	The lender, through the Lennar Charitable Housing Foundation, established a lien, which required payment of a fee upon conveyance of title in violation of HUD regulations. Schedule B, part I, of the final title policy reflected a recorded charitable agreement imposing endowments fee obligation. The document requires new owners to pay a fee upon property conveyance. The borrower paid a fee at closing of \$101 reflected on the HUD-1 settlement statement.

We determined that this deficiency was significant in nature. Because of the significant underwriting deficiency, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violations	Finding(s)
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332-4772348

Income deficiency:

HUD Handbook 4155.1, REV-5,  
paragraph 2-7M

The lender understated negative rent included in the qualifying ratios for one of the borrower's rental properties. The lender obtained a Schedule E from the 2007 tax returns. However, the borrower did not rent out the house until October 2007, according to the lender notes. The lender did not provide a lease, and the tax returns did not provide a stable rental history over the previous 24 months.

According to the final uniform residential loan application, the amount of rent received to calculate negative rent was \$650 per month. We reviewed the bank transaction detail report over the past 3 months and could not determine whether any of the deposits were rental income. The documentation provided was insufficient support of rental income and rental stability as required by HUD.

Due to the situation described, we adjusted the qualifying ratios by removing the negative rent amount for the property and added the home equity line of credit debt associated with the property of \$656 per month. This change increased the back ratio from 53 to 65 percent. Due to this issue, we are requesting indemnification of the loan.

Asset deficiency:

HUD Handbook 4155.1, paragraph  
2-10B

The lender did not obtain documentation to verify a large deposit. The borrower received a \$3,000 deposit on December 1, 2008, with a quick explanation that it was from the borrower's home equity line of credit. The lender did not obtain the proper documentation to verify that the deposit was from the home equity line of credit. Without this large deposit, the borrower would not have had enough funds to pay the closing costs.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Finding(s)
332-4746911	Income deficiency:  HUD Handbook 4155.1, REV-5, chapter 2	<p>The lender did not question the borrower's stability of income after a change in employment status the day of closing.</p> <p>The lender received two verifications of employment for both borrowers, who worked for the same primary employer. The lender sent the first verification on November 12, 2008, which indicated that the employees were full time. The employment status for both borrowers changed to "on-call" on the second verification received the day of closing on January 29, 2009. The wife's verification of employment under the section, "Remarks: if employee was off work for any length of time. Please indicate time period and reason," stated, "For your information, the employee is on an on-call status, last day worked on 01/13/09." On January 28, 2009, the employer signed the verification of employment showing that the wife did not work for a period of 15 days.</p> <p>We met with a human resource representative of the employer on March 25, 2011, to determine the difference between the verifications. The human resource representative stated that the employees were</p>

full time but were essentially laid off between the first and second verification and that the hotel would call them if it had any work to be done on an on-call basis. As mentioned in the statement above, the wife did not work for 15 days before closing, showing the possible instability of the on-call income.

Income deficiency:

HUD Handbook 4155.1, REV-5, paragraph 2-7B

The lender should have excluded the part-time income of \$213.75 per month due to the instability shown in the decline in income from 2007 to 2008, the lack of a current verification that the borrower was likely to continue to work part time with the employer, and the lender’s own hesitancy in using the part-time income.

The lender took the conservative route when calculating part-time income by using the average monthly income for 2008 only. While the lender documented that the borrower had worked the job for the past 2 years, it did not document the likelihood that the borrower would continue to do so. The work number verification stated it was current as of June 4, 2008, but the lender ran the report on January 27, 2009. This was not a proper verification of employment. Because the employer had not updated the system since June 2008 and the loan closed in January 2009, the lender should have obtained a verbal verification from the employer and asked about the likelihood of continued employment.

The lender was originally hesitant on using the part-time income, as noted in the loan file notes, but decided to use it to maintain the borrower’s accept status. The lender’s comments are pasted below: “Please note that I didn’t clear income as their YTD [year to date] is lower than the 40 hours weekly qualified with and had to add her 2nd substitute teaching job to keep in line ratio wise and maintain their accept status. Ratios are very tight, but my YTD approach on the income was the most conservative way to go.”

Due to the instability of income, we are requesting indemnification of the loan.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Finding(s)
332-4705686	Miscellaneous deficiency: Mortgage Letter 2004-47: FHA Total Mortgage Scorecard User Guide – Employment / Income	The lender did not meet the Total Score Card feedback requirements. The Total Score Card required the lender to obtain pay stubs for a 30-day period and 2 years worth of IRS Forms W-2 to support the income for both the borrower and coborrower. However, the lender only obtained one pay stub documenting 2 weeks of income for the borrower and only obtained the Form W-2 for 1 year for the coborrower.

We determined that these deficiencies were technical in nature.

FHA case number	Violation	Finding(s)
331-1343149	<p>Miscellaneous deficiency:</p> <p>Mortgage Letter 2004-47: FHA Total Mortgage Scorecard User Guide –Documentation Requirements</p>	<p>The lender accepted two faxed verification of employment documents when the header did not clearly identify the source of the documents. To ensure that documents relating to credit, employment, or income of borrowers are not handled by interested third parties, the lender should have ensured that the header or footer clearly identified the source of the document.</p>
	<p>Legal restrictions on conveyance: HUD Handbook 4155.2, paragraph 6.A.1.h 24 CFR 203.41(B)</p>	<p>The lender, through the Lennar Charitable Housing Foundation, established a lien, which required payment of a fee upon conveyance of title in violation of HUD regulations. Schedule B, part I, of the final title policy reflected a recorded charitable agreement imposing endowments fee obligation. The document requires new owners to pay a fee upon property conveyance. The borrower paid a fee at closing of \$122 reflected on the HUD-1 settlement statement.</p>

We determined that these deficiencies were technical in nature.

FHA case number	Violation	Finding(s)
332-5009143	<p>Asset deficiency:</p> <p>HUD Handbook 4155.1, REV-5, paragraph 2-10B</p>	<p>The lender did not determine the source of two large deposits, which affected the borrower’s ability to pay closing costs.</p> <p>According to the lender notes, the borrower opened a new account to deposit gift funds from the 401k of the nonpurchasing spouse. In addition, the notes stated that the lender did not include two unverified deposits of \$1,800 and \$2,000 in the new account, making the new balance \$2,052.56, to be used as the borrower’s depository assets. It did not appear that the lender attempted to get an explanation of the two deposits.</p> <p>In addition, we determined that the lender did not remove the \$2,000 unverified deposit as stated in the notes. Without at least one of the unverified deposits, the borrower would not have had enough funds to close. HUD had no assurance that the funds came from an acceptable source.</p>
	<p>Credit deficiency:</p> <p>HUD Handbook 4155.1 REV-5, paragraph 2-11A</p> <p>HUD Handbook 4155.1, REV-5, paragraph 2-5B</p>	<p>The lender did not ensure that all liabilities were included in the qualifying ratios.</p> <p>The borrower’s pay stub listed a garnishment from a tax levy in prior pay stubs with a year-to-date amount of \$1,683.76. The pay stub did not show whether it was a Federal or local tax levy. The levy did not appear to be active, but the lender should have requested a letter from the borrower explaining this matter to ensure that the borrower was not paying the tax agency through a recurring obligation.</p>



We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

<b>FHA case number</b>	<b>Violation</b>	<b>Finding(s)</b>
<b>332-5029755</b>	Income deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-7B	The lender inappropriately used part-time income without a 2-year history. The borrower's employment was from July 15, 2008, to October 14, 2009. The borrower only worked uninterrupted for 15 months, which is short of the 2-year requirement.  The lender obtained a verification of employment, but it did not state whether the borrower was likely to continue employment, and the lender did not document justification for using part-time income for less than 2 years. The lender should not have included the part-time income as effective income. This error increased the front and back ratios from 39 and 46 percent to 50 and 58 percent, respectively.
	Asset deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-10B	The lender did not obtain an explanation of unknown large deposits. The bank statement included three unknown deposits of \$540, \$700, and \$200 at the end of August and early September 2009 for a total of \$1,440. The file did not contain an explanation of the deposits. The unknown deposits equaled 33 percent of the total amount of deposits for the statement. The borrower received gift funds to pay for the closing costs so it was not a significant issue; however, the lender should have verified all large deposits according to HUD regulations.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

<b>FHA case number</b>	<b>Violation</b>	<b>Finding(s)</b>
<b>332-4657522</b>	Asset deficiency:  The Total Scorecard Report: Retirement Accounts	The lender included an extra \$2,020.71 in assets. The lender used 70 percent of the current value of a retirement account instead of 60 percent of the vested amount.
	Asset deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-10A	The lender did not determine the source of funds for the earnest money deposit, which appeared excessive based on the borrower's bank statement. The HUD-1 settlement statement showed that the seller received \$1,500 for the earnest money deposit. However, the file only contained evidence of one \$500 money order for the earnest money deposit made on May 30, 2008. In addition, the bank statement on file ended April 30, 2008, with an ending balance of \$356.82. The lender did not have any other documentation on file to support the \$1,500 earnest money deposit.
	Asset deficiency:	The lender did not properly document the source of gift funds. The borrower received gift funds from two parties, one from the father of the borrower for \$3,000 and the rest from a nonprofit for \$8,370. The

HUD Handbook 4155.1, REV-5, paragraph 2-10C(2)(b)

borrower's father obtained the official check the same day as a \$3,000 deposit. The donor would not have had enough money to pay the gift without the \$3,000 deposit, and the lender did not document where it came from.

In addition, the lender obtained a gift letter from the nonprofit; however, it did not document the actual transfer of funds to the title company. During our visit to the title company, we found the supporting documentation for the wire transfer. However, the lender should have ensured that it maintained the supporting documentation of the wire transfer in the loan file.

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Finding(s)
332-4837072	Asset deficiency:	The lender did not obtain a credible explanation of a \$2,800 unknown deposit. Because the borrower received gift funds to pay for closing costs, this is not a significant issue; however, the lender should have followed HUD regulations and verified large deposits.
	HUD Handbook 4155.1, REV-5, paragraph 2-10B Asset deficiency:	The borrower received a total of \$11,510 in gift funds. The lender's file included the top of the donor's bank statement with a total in all accounts of \$12,855.01, a copy of each of the cashier's checks, and a copy of the borrower's statement showing that the funds were received. However, none of the documents showed that the actual withdrawal came from the donor's account. To ensure that the borrower did not receive funds from an unacceptable source, the lender should have obtained documentation showing the money coming from the donor's account.
	HUD Handbook 4155.1, REV-5, paragraph 2-10C(1)  Miscellaneous deficiency:	The lender could not rely on its verification of employment due to discrepancies with the IRS Forms W-2. The income reported on the 2008 W-2 was \$36,068.58, while the verification of employment stated that 2008 income was \$59,310.68. The lender did not question this difference. We attempted to reverify this income, but the employer was no longer in business. The lender did not use the inflated income for qualification purposes.
	HUD Handbook 4155.1, chapter 3  Income deficiency:	The lender obtained insufficient documentation to determine overtime according to HUD regulations. The lender used \$396.45 per month in overtime income when qualifying the borrower. According to the lender notes, the lender used a 14.5-month average to determine overtime income; however, the file documentation was insufficient to support this amount. The only reliable evidence of any overtime income in the file was on one paycheck with an amount of \$1,501.50. The decrease in income increased the front and back ratios from 34 and 38 percent to 37 and 53 percent, respectively.
	HUD Handbook 4155.1, REV-5, paragraph 2-7A	

We determined that these deficiencies were significant in nature. Because of the significant underwriting deficiencies, along with the unallowable restrictive covenants, we are seeking indemnification for this loan.

FHA case number	Violation	Finding(s)
332-4729886	Miscellaneous deficiency:  HUD Handbook 4155.1, chapter 3  Asset deficiency:  HUD Handbook 4155.1, REV-5, paragraph 2-10C(1)	In 2007 and 2006, the IRS Form W-2 on file was higher than the verification of employment by more than \$16,000 and \$1,600, respectively. The lender used a reasonable method to calculate income; however, it should have questioned the significant difference in the income documentation.  The borrower received gift funds to cover the earnest money deposit and closing costs. The lender obtained a deposit slip but did not document the donor's deposit with the borrower's bank statement as required.

We determined that these deficiencies were technical in nature.