First Source Bank,

South Bend, IN

HUD's Loss Mitigation Program for FHA-Insured Loans

Office of Audit, Region 5
Chicago, IL

Audit Report Number: 2015-CH-1006
September 11, 2015

To	Kathleen Zadareky, Deputy Assistant Secretary for Single Family Housing, HU
	//**signed**//
From:	Kelly Anderson, Regional Inspector General for Audit, Chicago Region, 5AGA
Subject:	First Source Bank, South Bend, IN, Did Not Always Properly Implement Its Loss Mitigation and Quality Control Programs in Accordance With HUD Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of First Source Bank's implementation of its Loss Mitigation program for Federal Housing Administration-insured loans.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 312-353-7832.

Audit Report Number: 2015-CH-1006
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First Source Bank, South Bend, IN, Did Not Always Properly Implement Its Loss Mitigation and Quality Control Programs in Accordance With HUD Requirements

Highlights

What We Audited and Why

We audited First Source Bank, a Federal Housing Administration (FHA) supervised lender located in South Bend, IN. We selected First Source based on our analysis of risk factors of single-family loan servicers in Region 5's jurisdiction.[1] Our audit objectives were to determine whether First Source (1) consistently and appropriately applied loss mitigation options for eligible borrowers, (2) accurately reported the default and 90-day delinquency status of FHA-insured loans, and (3) performed servicing quality control reviews that met the U.S. Department of Housing and Urban Development's (HUD) requirements.

What We Found

First Source did not always (1) implement its Loss Mitigation program in accordance with HUD's requirements and (2) accurately report borrowers' loan default information or loss mitigation activities in FHA Connection. These servicing deficiencies resulted in (1) HUD incurring losses of more than $105,000 and (2) an increased risk to the FHA Mutual Mortgage Insurance Fund of more than $258,000. In addition, HUD did not always have complete and accurate information to properly assess the performance of FHA-insured loans and effectively monitor First Source's loss mitigation efforts.

First Source did not always (1) review a sample of 10 percent of its nonperforming[2] FHA-insured loans monthly and (2) maintain complete quality control records. As a result, HUD and First Source lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, thus potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require First Source to (1) reimburse HUD $32,885 for the one loan that did not receive active and proper loss mitigation or were improperly denied loss mitigation, (2) support or reimburse HUD $139,487 for the loans that lacked evidence that appropriate loss mitigation was applied, (3) indemnify HUD $191,074 for the active loans that did not receive proper loss mitigation, and (4) implement adequate procedures and controls to address the issues cited in this audit report.

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[1] The region contains six States: Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.
[2] Delinquent or defaulted loans, claims, and foreclosures

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Background and Objectives

First Source Bank, a supervised lender,[3] received approval as a Federal Housing Administration (FHA) lender on December 11, 1934. On February 28, 1991, First Source became an unconditional FHA direct endorsement lender, which also originates and services U.S. Department of Veterans Affairs and conventional loans.

FHA provides mortgage insurance on loans made by FHA-approved lenders. This insurance provides lenders with protection against losses as the result of homeowners' defaulting on their mortgage loans. The lenders bear less risk because FHA will pay a claim to the lender in the event of a borrower's loan default. Loans must meet certain requirements established by FHA to qualify for insurance.

The U.S. Department of Housing and Urban Development (HUD) established the Loss Mitigation program in 1996 to ensure that distressed FHA-insured borrowers would have opportunities to keep their homes and reduce losses to FHA's insurance fund. Loan servicers must offer loss mitigation options to borrowers in distress based on the borrower's financial circumstances and the status of the loan. The program consists of reinstatement options to promote retention of borrowers' homes and disposition options, which assist borrowers in disposing of their homes.

The reinstatement options are special forbearance, partial claim, loan modification, and the Home Affordable Modification Program (HAMP). A special forbearance is a written repayment agreement between a loan servicer and borrower, containing a plan to reinstate a delinquent loan. A partial claim consists of an interest-free loan to the borrower in the amount needed to reinstate the mortgage, thereby becoming a subordinate mortgage payable to HUD. The FHA-HAMP loss mitigation option, which became effective August 15, 2009, combines the loan modification and partial claim loss mitigation options.

The disposition options are preforeclosure sale and deed in lieu of foreclosure. The preforeclosure sale option allows the defaulted borrower to sell his or her home and use the sales proceeds to satisfy the mortgage debt even if the proceeds are less than the amount owed. A deed in lieu of foreclosure allows a borrower to turn over his or her home to HUD in exchange for a release from all mortgage obligations.

Our objectives were to determine whether First Source (1) consistently and appropriately applied loss mitigation options for eligible borrowers, (2) accurately reported the default and 90-day delinquency status of FHA-insured loans, and (3) performed servicing quality control reviews that met HUD's requirements.

[3] A supervised lender is an FHA-approved financial institution that is a member of the Federal Reserve System or an institution with accounts insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

Results of Audit

Finding 1: First Source Did Not Always Actively and Properly Implement Its Loss Mitigation Program in Accordance With HUD's Requirements

First Source did not always (1) consistently and appropriately implement its loss mitigation program in accordance with HUD's requirements and (2) accurately report borrowers' loan default information or loss mitigation activities in FHA Connection.[4] These weaknesses occurred because First Source lacked adequate procedures and controls to ensure that it complied with HUD requirements. These servicing deficiencies resulted in (1) HUD incurring losses of more than $105,000 and (2) an increased risk to the FHA Mutual Mortgage Insurance Fund of more than $258,000. In addition, HUD did not always have complete and accurate information to properly assess the performance of FHA-insured loans and effectively monitor First Source's loss mitigation efforts.

First Source Did Not Consistently and Appropriately Implement Its Loss Mitigation Program

First Source did not consistently and appropriately implement its loss mitigation program in accordance with HUD requirements. For 12 of the 40 loans (30 percent) reviewed, First Source did not properly

- Evaluate or analyze the borrower's financial situation to arrive at the correct loss mitigation eligibility decision for 2 loans,
- Select or correctly implement the appropriate loss mitigation option for 7 loans,[5]
- Maintain documentation to support its loss mitigation decision for 2 loans, and
- File the incentive claim for 1 loan in a timely manner.

The tables in appendices D and E of this report shows the loans with significant loss mitigation deficiencies cited above and the actual or estimated loss amounts associated with the deficiencies. Appendix C contains the related criteria.

First Source Did Not Always Properly Enter Borrowers' Loan Default and Loss Mitigation Information Into FHA Connection

First Source did not always consistently and accurately enter borrowers' loan default information or loss mitigation activities into FHA Connection. Of the 40 loans reviewed, First Source did not enter (1) complete default information for 2 loans and (2) accurate loss mitigation activities for 13 loans. For example, First Source reported a borrower's loss mitigation status in FHA Connection as a type II special forbearance trial payment plan when according to its servicing

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[4] FHA Connection is an Internet-based system that allows FHA-approved lenders to have real-time access to several of FHA's systems over HUD's Internet system for the purpose of originating and servicing FHA loans.

[5] Three of the seven loans were only cited in the recommendations, see footnote 8.

records, the borrower was participating in the FHA-HAMP loan modification loss mitigation option (see appendix F).

Other Servicing Deficiencies

Contrary to HUD regulations, for 16 of the 40 loans (40 percent), First Source was unable to support that it (1) performed a limited denial of participation or General Services Administration search on the borrowers and (2) performed a title search. The table below shows the servicing deficiencies for the 16 loans (see appendix G).[6]

Servicing deficiencies	Count
Lack of limited denial of participation or General Services Administration search	16
Lack of title search	1
Total	**17**

First Source Lacked Adequate Procedures and Controls

The weaknesses described above occurred because First Source lacked adequate procedures and controls to ensure that it complied with HUD requirements. Specifically, First Source used a workout checklist to analyze borrowers' loans for loss mitigation; however, it did not consistently update its review checklist to account for changes in HUD's servicing regulations. For example, the checklist indicated that 31 percent of a borrower's gross monthly income was the starting point for loss mitigation in accordance with Mortgagee Letter 2009-23. However, this mortgagee letter was updated[7] to emphasize that rather than starting the review based on a borrower's gross monthly income, lenders should assess the borrower's overall income, employment status, and surplus income.

In addition, First Source experienced staff turnover in significant default servicing positions. According to its assistant vice president of mortgage loan servicing, First Source went through a transition period from August through December 2013 in which it transferred responsibilities and functions from its former loss mitigation specialist to a newly hired specialist. During that timeframe, the vice president of mortgage loan servicing had to devote more time to directly performing loss mitigation and training new loss mitigation staff rather than overseeing and reviewing borrowers' payment plans and monitoring the loss mitigation process.

According to First Source, regarding the inaccurate information reported in HUD's FHA Connection, in July 2012, when it changed from using an in-house servicing and reporting system to a commercial servicing system, the transition resulted in data errors. For example, when First Source's loss mitigation specialist would enter a loan's default information into the new system, the system would automatically change the loan's oldest unpaid installment date to July 2012. According to First Source, it had reached out to HUD to correct the reporting

[6] One of the sixteen loans contained more than one deficiency
[7] Mortgagee Letter 2012-22

deficiencies. However, as of June 2015, First Source had not provided documentation to show that it had reported data inaccuracies to HUD and that the errors had been corrected.

Conclusion

First Source lacked adequate procedures and controls to ensure that it (1) actively and properly implemented its loss mitigation program in accordance with HUD requirements and (2) accurately reported borrowers' loan default information or loss mitigation activities in FHA Connection. These servicing deficiencies resulted in (1) HUD incurring losses and paying partial and loss mitigation incentive claims of more than $105,000 on four loans and (2) an increased risk to the FHA Mutual Mortgage Insurance Fund of more than $258,000 on five loans.[8] In addition, HUD did not always have complete and accurate information to properly assess the performance of FHA-insured loans and effectively monitor First Source's loss mitigation efforts.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family require First Source to

1A. Reimburse HUD $32,885 for loss incurred on one loan that did not receive active and proper loss mitigation or were improperly denied loss mitigation.

1B. Support or reimburse HUD $71,827 for the loss incurred or incentive claim paid on two loans (FHA case numbers 151-8081634 and 151-9161593) that lacked support of appropriate loss mitigation decisions.

1C. Indemnify HUD $191,074 for two loans that were still active and did not receive proper loss mitigation (FHA case numbers 151-6263199 and 151-9226347) and one loan (FHA case number 156-0374114) in which the borrower's revised payment was incorrect (50 percent loss severity rate applied to the unpaid balance of $382,147)[9]

1D. Support or indemnify HUD $67,660 for the two active loans (FHA case numbers151-9161593 and 263-4317828) that lacked evidence that loss mitigation was properly implemented (50 percent loss severity rate applied to the unpaid principal balance of $135,318).

1E. Reimburse HUD $500 for the inappropriate loss mitigation incentive claim paid on a loan in which the claim was not filed in a timely manner.

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[8] Of the 12 loans with significant loss mitigation deficiencies, we did not question the amount of the partial claim for 4 loans. On February 14, 2014, HUD issued a letter clarifying that if the lender elected to use an FHA-HAMP loan modification and partial claim and the partial claim was used to reduce a borrower's mortgage payment below the target principal, interest, taxes, and insurance payment, FHA would not request a refund for the unnecessary partial claim amount if the borrower's trial payment plan was approved before May 1, 2014. For one loan, the loss mitigation incentive claim was questioned in recommendation 1B and the unpaid principal balance was questioned in recommendation 1D.

[9] See appendix E

1F. Strengthen its controls over its loss mitigation process. Such controls should include but not be limited to (1) improving its process for implementing loss mitigation and reviewing loss mitigation decisions to confirm that they are correct and comply with HUD's requirements, (2) providing additional training to all staff members who have contact with borrowers who are eligible to participate in loss mitigation, and (3) ensuring the accuracy of the information maintained in its loan servicing system.

Finding 2: First Source Did Not Always Comply With HUD's and Its Own Quality Control Requirements

First Source did not always adequately implement its quality control program in accordance with HUD requirements and its own quality control plan. Specifically, it did not always (1) review a sample of 10 percent of its nonperforming FHA-insured loans monthly and (2) maintain complete quality control records. This noncompliance occurred because First Source lacked adequate procedures and controls to ensure that it complied with HUD's quality control requirements and its own quality control plan. As a result, HUD and First Source lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, thus potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

First Source's Sample Size for Its Servicing Reviews Was Not Always Sufficient

First Source did not always review a sample of 10 percent of its nonperforming FHA-insured loans monthly. HUD requires that lenders servicing less than 3,500 loans in their total FHA loan portfolio review 10 percent of the FHA loans for each area of servicing.[10] The areas to be reviewed for servicing include delinquent loans, loss mitigation efforts, foreclosure processing, claims, and claims without conveyance of title.

Further, First Source's monthly delinquent loan population did not always include all relevant loans. According to First Source's policy, it would not include a loan in its delinquent servicing population if the loan had been reviewed within the previous 18 months. However, its policy did not take into account (1) loans that had multiple delinquency episodes or (2) relevant delinquent servicing benchmarks that could occur after the loan had been reviewed. For example, First Source reviewed one loan when the borrowers had been 2 months delinquent in their mortgage payments; however, relevant delinquent servicing benchmarks, such as loss mitigation actions and foreclosure activities, had not occurred at the time this loan was selected for review. In accordance with First Source's policy, this loan would not have been reviewed again for at least 18 months.

In addition, First Source did not always review separate samples of loans (1) for properties that were in foreclosure or (2) submitted for claim. Instead, it combined the loans for these servicing areas and selected a sample of 10 percent for review. We identified loans that had been reviewed as part of First Source's foreclosure review that had been excluded from its claim review. As a result of these loans having been excluded, they had not been reviewed for several significant events, such as the (1) timely submission of each property's deed to HUD, (2) vacancy inspections, and (3) conveyance of the properties to HUD within 30 days after the acquisition of their titles, since these events would have occurred after the associated properties had been foreclosed upon.

First Source Did Not Maintain Complete Quality Control Records

First Source did not always maintain quality control review records as required by its quality control plan. As part of its quality control program documentation, it was required to maintain records of its reviews for up to 3 years. However, First Source was unable to provide

[10] HUD Handbook 4060.1, REV-2, paragraphs 7-10(B) and (C)

documentation of its monthly review of foreclosures, claims, and delinquent loans for December 2012. However as a result of our audit, First Source located its audit documentation to support its review of delinquent loans for December of 2012. Further in July 2015, First Source performed a retroactive review of the loans that were in foreclosure or resulted in claims in December 2012.

First Source Lacked Adequate Procedures and Controls

First Source lacked adequate procedures and controls to ensure that it (1) reviewed a sample of 10 percent of its nonperforming FHA-insured loans monthly and (2) maintained documentation of its quality control servicing reviews in accordance with HUD requirements and its own quality control plan. According to First Source's compliance manager and assistant vice president for quality assurance, the quality control manager and staff were told to exclude loans that had been reviewed in the last 18 months to reduce the chance of loans being reviewed several times, thus keeping a loan that had not been reviewed from being selected. Further, First Source was not able to explain why the records had not been maintained for up to 3 years as required by its plan.

As a result of our audit, to ensure that it reviewed a sample of 10 percent of its nonperforming loans as required by HUD, First Source modified its quality control plan to include loans that had been previous reviewed in the last 18 months.

Conclusion

First Source lacked adequate procedures and controls to ensure that it adequately implemented its quality control program in accordance with HUD's requirements and its own quality control plan. As a result, HUD and First Source lacked assurance that potential servicing deficiencies were identified and mitigated in a timely manner, potentially resulting in an increased risk to FHA's Mutual Mortgage Insurance Fund.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require First Source to

2A. Implement adequate procedures and controls to ensure that it (1) complies with HUD requirements for reviewing nonperforming loans and (2) maintains complete records to support its loss mitigation activities.

Scope and Methodology

We performed our audit work from December 2014 through June 2015 at First Source's office in South Bend, IN, and our offices located in Chicago, IL, Columbus, OH, and Detroit, MI. The audit covered the period December 1, 2012, through November 1, 2014, and was adjusted as necessary.

To accomplish our objectives, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to HUD's Loss Mitigation program. Further, we reviewed First Source's servicing policies and procedures, quality control plan, and quality control documentation. We also reviewed First Source's electronic and hardcopy loan servicing files. We interviewed First Source's employees and HUD's National Servicing Center staff.

<u>Loss Mitigation Review</u>
Using data maintained in HUD's Single Family Data Warehouse system[11] as of January 26, 2015, we identified 2,323 loans that were serviced by First Source during the audit period, December 1, 2012, through November 1, 2014. From the universe of loans identified, we randomly selected 15 loans for review during the survey, 5 loans each from the following three categories: loans that went into claim, loans for which HUD paid loss mitigation incentive claims, and active loans that were in default 90 days or more during the audit period.

During the audit phase, we reviewed a sample of 25 loans,[12] which represented 100 percent of FHA-insured loans in First Source's portfolio that fell into one of the following categories: (1) loans that went into claim (claim status) during our audit period for which HUD paid loss mitigation claims (8 loans), (2) loans for which HUD paid a loss mitigation claim and the servicer denied loss mitigation or the loss mitigation efforts failed during the audit period (13 loans), and (3) loans that went into claim with no reported loss mitigation cost to HUD for which the servicer denied loss mitigation or the loss mitigation efforts had failed (4 loans).

For the 40 loans reviewed, we determined whether First Source documented its attempts to contact each borrower in default before the 90-day deadline of the borrower's financial review for home retention options (for example, special forbearance, loan modification, and partial claim) in accordance with HUD requirements. We reviewed the collection notes, copies of notification letters sent to borrowers, and other documentation in the servicing files to determine whether First Source repeatedly attempted to contact the borrowers, as applicable, regarding loss mitigation or to request missing documentation. Further, we determined whether First Source (1) properly evaluated borrowers' financial information to determine the appropriate loss mitigation option that could be offered to the borrowers and took the appropriate loss mitigation actions that

[11] HUD's Single Family Data Warehouse is a collection of database tables structured to provide HUD users easy and efficient access to single-family housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics.
[12] We excluded three loans reviewed during the survey phase; therefore, a total of 25 (28 - 3) loans were reviewed during the audit phase.

were reasonably expected to generate the smallest financial loss to the FHA insurance fund and (2) generally made appropriate attempts to intervene before it initiated the first legal action and, as appropriate, initiated the foreclosure process in a timely manner in accordance with applicable HUD requirements. We also reviewed the delinquent loan reporting to ensure that information in HUD systems was recorded accurately. The significant deficiencies identified are included in this report.

The conclusion in this audit report is limited to the 40 loans reviewed. We did not include First Source's compliance with HUD's loss mitigation requirements for its entire portfolio of serviced and sponsored FHA-insured loans.

Quality Control Review

For our review of First Source's quality control program, we obtained First Source's quality control review reports that were completed during our audit period, December 1, 2012, to November 1, 2014. We performed analyses to determine whether First Source complied with HUD regulations for the servicing quality control reviews of the following: (1) areas to be reviewed, (2) frequency, and (3) sample size.

We relied on information maintained in HUD's Neighborhood Watch and Single Family Data Warehouse systems[13] for informational and sampling purposes only. We also relied on data maintained in First Source's servicing system, such as electronic loan files. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequately reliable for our purposes. The testing consisted of comparing data in the electronic files to information from HUD's systems. The audit results were based on our review of electronic and supporting hardcopy documentation maintained by First Source.

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 objectives.

[13] Neighborhood Watch refers to a Web-based software application that displays loan performance data for single-family lenders and appraisers using FHA-insured single-family loan information. The system is designed to highlight exceptions so that potential problems are readily identifiable.

Internal Controls

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.

Relevant Internal Controls

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

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

- Compliance with applicable laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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 Deficiencies

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

- First Source lacked adequate procedures and controls to ensure that it consistently and appropriately implemented its loss mitigation program in accordance with HUD's requirements and accurately reported borrowers' loan default information or loss mitigation activities in FHA Connection (see finding 1).

- First Source lacked adequate procedures and controls to ensure that it adequately implemented its quality control plan for servicing delinquent FHA-insured loans in accordance with HUD requirements or its own quality control plan (see finding 2).

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Ineligible 1/	Unsupported 2/	Funds To Be Put To Better Use
1A	$32,885		
1B		$71,827	
1C			$191,074
1D		67,660	
1E	500		
Totals	**$ 33,385**	**$ 139,487**	**$191,074**

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.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ 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. In this instance, the funds to be put to better use represent savings by the FHA insurance fund realized by not having to pay future claims on loans that default.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

1st Source Bank

P.O. Box 149
South Bend, IN 46624

August 28, 2015

Ms. Kelly Anderson
Regional Inspector General for Audit, Region 5
United States Department of HUD-Office of Inspector General
Ralph H. Metcalfe Federal Building
77 West Jackson Boulevard, Room 2201
Chicago, Illinois 60604

RE: Discussion Draft Report

Dear Ms. Anderson:

The following information is being provided in response to the discussion draft you provided on August 12, 2015.

Finding 1: 1st Source Did Not Always Actively and Properly Implement Its Loss Mitigation Program in Accordance with HUD's Requirements

Comment 1

1st Source Did Not Consistently and Appropriately Implement Its Loss Mitigation Program

- The Draft states that for 17 of the 40 loans reviewed 1st Source did not properly implement HUD's Loss Mitigation Program. We disagree with this statement for the following reasons:
    1. Four of the seventeen cases were excluded according to Footnote 9, however they have been included in calculating the percent of error.
    2. The same four cases have erroneously been included in Appendix D under the classification of "Inappropriate Loss Mitigation Option". No case narratives have been included in the audit report to support the inclusion of these loans. Our records indicate the following on these cases:
        - Case Number 151-6319689: A June 22, 2015 email from the auditor listed this case number with the notation that it "generally complied".
        - Case Number 151-7832112: The same email from the auditor listed this case number with the notation that it was missing documentation. The documentation was forwarded on July 7th and no further communication was received.
        - Case Number 151-7757005: Similarly, this case was mentioned in a March 16, 2015 email noting that bank statements were missing. These were provided to the auditor and no further communication was received.
        - Case Number 151-7967923: The auditor initially noted that an inappropriate loss mitigation option was chosen for this case. Once we submitted a copy of

Auditee Comments

Ref to OIG Evaluation

HUD's February 14, 2014 clarification letter the auditor noted that this case was "resolved" in his June 12, 2015 email.

3. We disagree with the conclusion drawn on eight of the remaining cases and will address these cases individually under the heading of Appendix H, Case Narratives. Our disagreement with these conclusions obviously affects several subsequent sections of the report.

1st Source Did Not Always Properly Enter Borrowers' Loan Default and Loss Mitigation Information Into FHA Connection

Comment 2

- While we agree that there were errors in our FHA Connection reporting it should be noted that those errors were the result of a mortgage servicing system conversion. As we explained to the auditor, once we found the error we contacted HUD to not only inform them of the occurrence but also gain assistance in correcting the problem. Copies of several emails evidencing our communication with HUD were provided.

Other Servicing Deficiencies

- **Lack of limited denial of participation or General Services Administration search:** We agree that our files lacked proof of this search.
- **Lack of documentation that the how to avoid foreclosure pamphlet was provided to borrowers:** This documentation was sent to the auditor in July for the four cases listed. Copies of our on-line letter log noting the day the letter was sent is included as Exhibit 1a through Exhibit 1d. We disagree with this deficiency. (Comment 3)
- **Missing servicing notes and payment history:** We disagree with the finding. The notes and payment history for Case #156-0031956 were provided to the auditor on two occasions. (Comment 4)
- **Lack of documentation showing that a rejection letter was sent:** We disagree with this finding relating to Case #263-4551015. Exhibit 1d is attached which shows the loss mitigation denial letter sent October 26, 2012. (Comment 5)
- **Lack of Title Search:** We agree with this finding.

1st Source Lacked Adequate Procedures and Controls

- We disagree with this statement and the example listed. 1st Source began using the new waterfall checklist provided as Attachment A to Mortgagee Letter 2012-22 as soon as it was released. Evidence of its use was documented in the files for Case #151-9161593 as well as Case #263-4240417. (Comment 6)
- The last paragraph on page five erroneously states: "According to its vice president of mortgage loan servicing…". This conversation was held with the assistant vice president of mortgage loan servicing. (Comment 7)

Conclusion

- We disagree that borrowers were unable to remain in their homes due to incorrect eligibility decisions. Three cases were cited for incorrect eligibility. Two of those cases were non-owner occupied. The third case involved a recently divorced borrower who completed her loss mitigation package just seven days prior to the sheriff's sale. During conversations with our staff

Auditee Comments

Ref to OIG Evaluation

she debated whether or not she wanted to keep the home and finally concluded that she would not be able to afford the property.

- We disagree with the remaining conclusions based upon our review of the Case Narratives in Appendix H.

Finding 2: 1st Source Did Not Always Comply With HUD's and its Own Quality Control Requirements

1st Source's Sample Size for Its Servicing Reviews Was Not Always Sufficient

Comment 8

- While we agree with this finding, we want to be clear that 1st Source has always used a 10% sample size in its servicing reviews as prescribed by HUD. The practice of selecting 10% of our foreclosures and subsequently using that sample for both foreclosures as well as claims has now been changed.

1st Source Did Not Maintain Complete Quality Control Records

Comment 9

- We agree that a portion of one of our audit papers was missing. This was a simple filing error by our staff rather than intentional non-compliance. Evidence of this was the fact that other work papers were available to the auditor for the same time period. Our internal procedures require us to maintain our quality control records for a longer period of time than required by HUD as an assurance that HUD requirements are followed.

Appendix H, Case Narratives

Comment 10

- **Case Number 132-2247156, Loss mitigation options were not evaluated or presented to the borrower in a timely manner. An improper eligibility decision was made:** This borrower was granted a Partial Claim in 2011 which brought the loan current. They subsequently re-defaulted in March 2012. Since this borrower failed to reaffirm the debt when they filed for Chapter 7 bankruptcy relief, we were unable to make "aggressive efforts to reach the borrower" as suggested by the auditor. We did send a breach letter on April 2, 2012 which included the required Loss Mitigation materials, however the borrower failed to submit a package for review. Our attorney proceeded with foreclosure and the sheriff's Deed was signed on March 1, 2013. We were later informed that the foreclosure action was questioned by HUD since it was a continuation of a previous complaint rather than a new foreclosure action. After discussions with HUD, our attorney filed a new complaint with the court to clear this error. HUD subsequently sold this property on September 25, 2013. The borrower submitted a complete loss mitigation package to our office on October 30, 2013. We were unable to approve the package since the foreclosure was complete and the property had been sold. Copies of the Ford County Illinois sales records for this property are attached as Exhibit 2.a. A copy of the Sheriff's Deed is attached as Exhibit 2.b.

Comment 11

- **Case Number 151-6263199, An inappropriate loss mitigation option was selected:** As the auditor states, a borrower qualifies for a formal forbearance if 85 percent of their surplus income is enough to bring the loan current within six months. We maintain that the borrower qualified for this option since they had one payment in their possession to immediately apply to the arrearage. When taking the lower amount of past due payments into consideration, the borrower was able to cure the delinquency using 85 percent of their surplus income within the six month timeframe. It should also be noted that the borrower had offered two payments to

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apply to the arrearage however the loss mitigation specialist required just one payment to enter into the plan. The auditor also questioned timeliness of borrower's January 2014 plan payment. A copy of the borrower's check is attached as Exhibit 2.c providing proof that the borrower remitted those finds within the required plan timeframe.

Comment 12

- **Case Number 151-7627104, FHA-HAMP was improperly applied twice within 24 months:** We disagree with the auditor on this case. The first loss mitigation application was a Standard Partial Claim, not an FHA-HAMP. Additionally, the second loss mitigation application was a Standard Modification. At the auditor's request we have included a copy of our loss mitigation recommendation form as Exhibit 2.d, which clearly states the borrower was approved for a Standard Partial Claim rather than a Hamp Partial Claim. Furthermore, the date of the recommendation is October 23, 2012 which was prior to the new waterfall.
- **Case Number 151-8081634, Supporting documentation for its loss mitigation evaluation was not maintained:** We agree with this finding as we have been unable to locate this loss mitigation file.

Comment 13

- **Case Number 151-8648890, Supporting documentation for its loss mitigation evaluation was not maintained:** All financial documentation used to evaluate this case was provided to the auditor on July 7, 2015. We are able to reproduce this file if needed. The auditor has indicated that this will be removed.
- **Case Number 151-9021088, The loss mitigation claim was not filed in a timely manner**: We agree with this finding.

Comment 14

- **Case Number 151-9161593, An inappropriate loss mitigation option was selected:** We maintain that the FHA-HAMP Modification was the appropriate option. Although the auditor claims we should have used food stamps as a reduction in expense rather than an increase in income, we were instructed differently during a HUD Servicing Review in January 2013. The 2013 auditor clearly calculated total income as food stamps plus disability income in their written response and further calculated 31% of that total in determining Loss Mitigation eligibility. A second issue was raised with this case regarding part-time income. Our analysis used part-time income from GlassLink which was verified by a letter from that company. The auditor mistakenly thought we used the borrower's letter stating that she would work as a waitress with undetermined income. A copy of the GlassLink letter is attached at Exhibit 2.e.

Comment 15

- **Case Number 151-9226347, An improper eligibility decision was made:** While we agree that the loss mitigation specialist failed to consider the borrower's self- employment income when analyzing the case, the borrower was not occupying the property and as such, did not qualify for HAMP. The borrower's letter states that he had not occupied the property since 2010. A copy of that letter is attached as Exhibit 2.f.
- **Case Number 156-0374114, An Inappropriate loss mitigation option was selected:** We agree with this finding.

Comment 16

- **Case Number 156-0882200, An improper eligibility decision was made:** We disagree with this finding. This borrower was awarded two homes through her divorce settlement which was just seven days before the scheduled sheriff's sale. Given the short time-frame, our staff worked with her to analyze loss mitigation options for this home and verbally told her what the estimated payments would be versus the income she reported to us. During a phone call just one day prior to the sheriff sale, the borrower told our staff that she could not afford the home since she was not confident that her former husband would make child support payments. She further stated that she would keep the other home she was granted through the divorce. Consequently, we did not cancel the foreclosure sale and pursue any additional options for this borrower.

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- **Case Number 263-4240417**, **An Inappropriate loss mitigation option was selected:** The auditor claims 1st Source failed to appropriately review loss mitigation options for this borrower since we concluded that the borrower lacked surplus income and did not quality for FHA-HAMP. We agree with this assessment. Two months later, our staff attended a HUD Webinar on March 5, 2014 entitled HUD Loss Mitigation FHA HAMP Program FAQS Guidance that clarified this issue.

Comment 17

- This case was also noted as having a second inappropriate loss mitigation option since the auditor felt we should have offered a formal forbearance. We disagree with that statement since the borrower did not have surplus funds sufficient to bring the loan current within six months per the HUD guide. The auditor's work paper incorrectly lists the borrower as being past due four payments rather than five payments. We believe the error is due to the timing of the assessment. Since the loss mitigation option was reviewed on January 24, 2014, the new monthly repayment amount would not be effective until March 1, 2014. Thus the February payment would need to be included in the arrearage as well.

Comment 18

- **Case Number 263-4317828, Supporting documentation for its loss mitigation decision was not maintained:** We agree that our documentation could have been more complete however our collection notes clearly show that the borrower was uncooperative.

Comment 19

- **Case Number 263-4383675, Loss mitigation options were not evaluated in a timely manner.** We disagree with this finding. This borrower was granted a partial claim in September 2010 and defaulted shortly afterward. We received an incomplete loss mitigation package on August 5, 2011 and informed the borrower by letter of the missing information. The borrower failed to respond and was removed from the loss mitigation program on September 23, 2011. Once again, written notice was provided to the borrower. The July 27, 2012 incident noted by the auditor was a computer input error made by our staff. We explained this on two occasions. As the auditor indicated, foreclosure sale had already been held on March 22, 2012 so no loss mitigation options were available.

I appreciate your review of the foregoing information. Should you require any additional information or clarification please do not hesitate to contact me.

Sincerely,

Debra A. Bass

Debra A. Bass
Vice President
Mortgage Banking

Enclosures

OIG Evaluation of Auditee Comments

Comment 1 First Source contends that four loans were erroneously included in the exceptions identified in the report, and no case narratives were provided to support the inclusion of these loans. First Source further maintains that these statements were mitigated during the audit. Our communication during the audit as well as after the exit conference included narratives that explained each of the four mentioned loans were included in the report because First Source filed an unnecessary partial claim when an FHA-HAMP modification was the appropriate decision option. In response, First Source provided a clarification letter from HUD that stated "it has come to FHA's attention that the policy guidance included in Mortgagee Letter 2012-22 and Mortgagee Letter 2013-32 has been misinterpreted by some lenders…if the lender elected to use FHA-HAMP loan modification and partial claim, and the partial claim was used to reduce a mortgagor's mortgage payment below the targeted payment, FHA will not request a refund for the extraneous partial claim amount, provided that the mortgagor's trial payment plan was approved before May 1, 2014." As the partial claims represented unnecessary and unwarranted charges to the FHA insurance fund we included them in the report, but did not seek indemnification or reimbursement. These four loans will remain in the report.

Comment 2 First Source contends that it was aware of reporting errors and had contacted HUD for correction. The audit team reviewed the correspondence provided by First Source and was unable to locate any communication with HUD or the national servicing center regarding First Source's request for assistance or guidance to correct the problem. First Source provided documentation that was consistent with its explanation that mortgage servicing errors occurred during a system change-over; however, no documentation was provided to show that it was aware of reporting errors or communication with HUD that advised that these errors could not or should not be corrected.

Comment 3 First Source contends that the "How to Avoid Foreclosure Pamphlet" was provided to the borrowers. First Source provided documentation that the required letters had been sent; therefore, we modified the report as appropriate.

Comment 4 First Source contends that one of the files contained notes and a servicing history. We disagee. During the audit, First Source provided an initial payment history; however, it did not provide explanations for gaps in reporting of servicing. The audit team reviewed additional documentation and was able to determine that the gaps were from when the mortgage was current, which did not necessitate detailed servicing notes. Since this loan was current, we removed this exception from the report.

Comment 5 We reviewed the provided exhibits and removed this exception from the report.

Comment 6 First Source contends it was using the waterfall checklist instituted by Mortgagee Letter 2012-22. We agree that the two files contained documentation to show that First Source used Mortgagee Letter 2012-22. However, FHA case number 151-9161593 the issue cited in the report did not involve the use of the waterfall, instead it involved the lack of support for the borrower's income. For FHA case number 263-4240417 we removed the inclusion of this loan based on additional documentation (see comment #17). The report did not question whether First Source used the waterfall; instead the report stated that First Source did not consistently update its review sheet to reflect changes made to HUD's servicing requirements.

Comment 7 First Source contends that the report used an incorrect title for one of its staff. We agree, and changed the last paragraph to state that according to First Source's assistant vice-president of mortgage loan servicing.

Comment 8 Although First Source agreed with this finding, it contends that it had always used a 10 percent sample size. As detailed in the report, it did not always use a 10 percent sample size that included all relevant loans as required by HUD.

Comment 9 First Source acknowledged that a portion of one its auditing workpapers were missing. First Source should work with HUD in addressing the recommendation in the audit report.

Comment 10 First Source contends that the borrowers had entered into bankruptcy and under HUD regulations could not be contacted. We agree. The requirements that were in-place when the loan was serviced did not permit First Source to perform loss mitigation on borrowers in chapter 7 bankruptcy that had not reaffirmed their mortgages. One month after the borrower was denied loss mitigation, servicing criteria was changed to allow borrowers that had not reaffirmed their mortgage eligible for loss mitigation. Therefore, we removed this exception from the report.

Comment 11 First Source contends that because the borrower had one payment in his possession to immediately apply towards the arrearage which would have reduced the balance, it could be brought current in 6 months with 85 percent of the borrower's surplus income. Therefore, he qualified for a formal forbearance. We disagree. The documented payment plan in the borrower's file listed this amount as a regular mortgage payment and First Source's response defined the amount as a payment. As these amounts represent actual mortgage payments; instead of surplus income, they should not be applied to the total arrearages. Therefore, this exception will remain in the report.

Comment 12 We agree and removed the exception regarding loss mitigation from the report. However, this loan still contained reporting deficiencies; therefore, it was still included in the report.

Comment 13 We agree and removed the exception from the report.

Comment 14 First Source provided documentation to show that it was instructed by HUD during a servicing review in January 2013 that total income should include food stamps along with earned income to determine loss mitigation eligibility. They also provided a letter from the borrower's employer that supported her income as $10 per hour. These two factors qualified the borrower for the FHA-HAMP option that was selected. We agree that under the FHA-HAMP program, food stamps can be considered as income. The borrower's servicing file contained a financial statement that listed $647 as food stamps. However, the file did not contain documentation to show that the borrower received $647 per month in food stamps and that this source and amount of income was likely to reasonably continue for at least the next 12 months as required by mortgage letter 2013-32. Additionally, the letter identified that the borrower was employed part time earning $10 per hour, but it did not indicate the expected number of hours, as part time hours could vary. Therefore, without documentation of (1) the amount and continuity of the borrower's food stamp income and (2) the number of hours that the borrower worked per week, we were unable to determine if First Source made the appropriate loss mitigation eligibility decision. Therefore, the exception regarding the potentially inappropriate loss mitigation decision will remain in the report.

Comment 15 First Source agrees that the loss mitigation specialist failed to consider the borrower's self-employment income when analyzing the case; however, the borrower was not living in the property and was not eligible for FHA-HAMP. However the "Supplemental Documentation—Frequently Asked Questions Home Affordable Modification Program" guide states that if the borrower had been occupying the property as his or her principal residence immediately before his or her displacement, intends to occupy the property as his or her principal residence upon his or her return and the current occupant was not a tenant, the mortgage loan was eligible for consideration under HAMP. Furthermore First Source's notes indicate the borrower had wanted to save his home. He had the quit claim deed, and was advised to submit his packet for a possible workout. Based on the supplemental guidance and the borrower's income, the borrower qualified for a FHA-HAMP loan modification. The purpose of the residency requirement was to keep borrowers from receiving loss mitigation for a rental property or an abandoned property. Therefore, this exception will remain in the report.

Comment 16 First Source states that loss mitigation was not required because the borrower informed First Source that she could not afford the home, and wanted to keep the other home that was awarded through the divorce. First Source's servicing notes did not show that the borrower was moving to the other home and that she did not believe she could afford the current home. Furthermore, the borrower lived in the property nearly 6 months after the foreclosure sale. The notes indicate that First Source told the borrower that it would not stop the foreclosure sale. Therefore, this exception will remain in the report.

Comment 17 We agree and removed this exception from the report.

Comment 18 First Source acknowledged that its documentation could have been more complete; however, its collection notes showed that the borrower was uncooperative. We acknowledge that First Source collection notes showed that the borrower was initially uncooperative. However, as detailed in the report First Source inappropriately denied the borrower's participation in the deed in lieu loss mitigation option because an income tax lien was placed on the property, although there were sufficient incentive funds available to pay off the lien. Mortgagee Letter 2002-13 states that funds may be used to pay off junior liens to clear the title.

Comment 19 We agree and removed this exception from the report.

Appendix C

Criteria

Finding 1

HUD Handbook 4330.1, REV-5, section 7-12, states that lenders must ensure that servicing files fully document that all servicing requirements have been followed and steps have been taken to save a mortgage before to deciding to foreclose. All actions taken with respect to collection, forbearance, or other actions alternative to foreclosure must be fully documented.

Mortgagee Letter 2000-05 states that loss mitigation is not optional and servicers are required to document their evaluation of each delinquent loan no later than the 90th day of delinquency to determine which loss mitigation option was appropriate as this is the only way to ensure that a default was addressed in a timely manner and cured before the loan falls further into delinquency. Further, it requires servicers to use loss mitigation whenever feasible to avoid foreclosure and retain a complete audit trail confirming compliance with all loss mitigation requirements.

Mortgagee Letter 2008-43 states that if the lender's evaluation indicates that the borrower was not eligible for preforeclosure sale or another loss mitigation option, the lender must immediately advise the borrower of this decision in writing, explaining the reason for denial and giving the borrower at least 7 calendar days to respond. In the servicing or claim review file, the lender must maintain all evidence (such as supporting documentation, including all communication logs) of compliance with HUD's Loss Mitigation program requirements. Additionally, all properties sold under the preforeclosure sale program must have a clear, marketable title. Before executing form HUD-90045 (approval to participate), the lender must obtain a title search or preliminary report verifying that the title was not impaired with unresolvable title problems or with junior liens that cannot be discharged as permitted by HUD.

Mortgagee Letter 2009-23 states that under FHA-HAMP, the lender may receive an incentive fee of up to $1,250. This total includes $500 for the partial claim. It also states that for partial claim filing, lenders must file a claim for insurance benefits for the partial claim within the 60-day timeframe stated in Mortgagee Letter 2003-19 to receive incentive fees for the FHA-HAMP loss mitigation action.

The Mortgagee Letter 2009-23 attachment providing guidelines for FHA-HAMP states that no credit alert interactive voice response system review is required but HUD's limited denial of participation and General Services Administration exclusion lists are required checks for all borrowers.

Mortgagee Letter 2009-39 states that no later than the January 2010 reporting cycle, all lenders must report borrowers approved to begin the FHA-HAMP trial payment plan as Single Family Default Monitoring System status code 39.

Mortgagee Letter 2009-39, Appendix 1 – Delinquency or Default Status Codes, provides that an account in foreclosure requires further reporting. This reporting includes the first legal action to commence foreclosure (code 68), which indicates that the first public legal action required to initiate foreclosure has been completed.

Mortgagee Letter 2012-22 streamlined FHA's loss mitigation home retention option priority order by replacing its current four-tier incentive structure with a three-tier structure, consisting of special forbearances, loan modifications, and FHA-HAMP. It also updated the incentive order by adding initial assistance options, consisting of informal and formal forbearances, which are the only options available to delinquent borrowers without verifiable losses of income or increases in living expenses. Informal forbearance plans are oral agreements relating to a period of 3 months or less, and formal forbearance plans are written agreements relating to a period of greater than 3 months but less than 6 months. If the lender has concluded that 85 percent of the borrower's surplus income is sufficient to bring the mortgage current within 6 months, the only available loss mitigation option is a formal forbearance plan that provides for repayment within 6 months. If 85 percent of surplus income will not cure the arrearage, a stand-alone modification or FHA-HAMP needs to be considered. It also states that for the borrower to be eligible for FHA-HAMP, he or she should not have surplus income that is greater than $300. A surplus income is required only for a formal forbearance or stand-alone modification.

Mortgagee Letter 2013-32 states that to qualify for FHA-HAMP, a defaulted borrower must not have received a stand-alone modification or FHA-HAMP in the previous 24 months.

Finding 2

HUD Handbook 4060.1, REV- 2, paragraph 7-3(K), states that quality control review reports and followup must be maintained by the lender for up to 2 years and made available to HUD.

HUD Handbook 4060.1, REV-2, paragraph 7-10(B), states that due to the importance of these aspects of servicing, lenders must perform monthly reviews of delinquent loan servicing, claims, and foreclosures.

HUD Handbook 4060.1, REV-2, paragraph 7-10(C), states that lenders servicing fewer than 3,500 loans in their FHA portfolio must review 10 percent of the FHA loans for each area of servicing in paragraph 7-10(A) in accordance with the review period described in paragraph 7-10(B).

First Source's quality control plan requires audit (quality control) records to be maintained for 3 years.

Appendix D

Schedule of Loss Mitigation Deficiencies

	Loss mitigation deficiencies			
FHA case number	Incorrect eligibility decision	Inappropriate or incorrectly implemented loss mitigation option	Failure to maintain documentation to support loss mitigation action	Failure to file a loss mitigation claim in a timely manner
151-6263199		X		
151-6319689		X		
151-7757005		X		
151-7832112		X		
151-7967923		X		
151-8081634			X	
151-9021088				X
151-9161593		X		
151-9226347	X			
156-0374114		X		
156-0882200	X			
263-4317828			X	
Totals	**2**	**7**	**2**	**1**

Appendix E

Estimated Losses to HUD From Loss Mitigation Deficiencies

	FHA case number	Unpaid principal balance	Loss Incurred	Partial claim paid	Actual and estimated losses				
					Recommendation 1A	Recommendation 1B	Recommendation 1C[14]	Recommendation 1D[15]	Recommendation 1E
1	151-6263199	$63,132					$31,566		
2	151-6319689*	54,501		$12,225					
3	151-7757005*	47,780		5,827					
4	151-7832112*	97,764		7,956					
5	151-7967923*	46,958		3,410					
6	151-8081634		$71,077			$71,077			
7	151-9021088	92,289		500					$500
8	151-9161593	89,119		750		750		$44,560	
9	151-9226347	254,959					127,480		
10	156-0374114	64,056		8,154[16]			32,028		
11	156-0882200		32,885		32,885				
12	263-4317828	46,199						23,100	
	Totals	**$856,757**	**$103,962**	**$38,822**	**$32,885**	**$71,827**	**$191,074**	**$67,660**	**$500**

Note: FHA case numbers with an asterisk (*) were excluded based on our comments in footnote number 8.

[14] Unpaid principal balance *50 percent
[15] Unpaid principal balance *50 percent
[16] This loan was eligible for a partial claim; however, the borrower's payment after the loan modification was too high.

Appendix F

Schedule of Reporting Deficiencies

FHA case number	Reporting deficiencies: Lacked complete delinquent or default information	Reporting deficiencies: Inaccurate loss mitigation activity reported to HUD
132-2247156	X	
151-6319689		X
151-6950561		X
151-7469703		X
151-7627104		X
151-7741034		X
151-7832112		X
151-8171735		X
151-9021088		X
156-0512627		X
156-0528157		X
263-4240417		X
263-4551015	X	X
263-4814803		X
Totals	**2**	**13**

Appendix G

Schedule of Other Servicing Deficiencies

	Other servicing deficiencies	
FHA case number	No limited denial of participation or General Services Administration search	Lack of title search
132-2247156	X	
151-6319689	X	
151-6704382	X	
151-6950561	X	
151-7627104	X	
151-7741034	X	
151-7832112	X	
151-7967923	X	
151-9021088	X	
151-9161593	X	
151-9272081	X	
151-9349122	X	
156-0528157	X	
156-0592444	X	
263-4240417	X	
263-4551015	X	X
Totals	**16**	**1**

Appendix H

Case Narratives

FHA case number: 151-6263199
Loan amount: $82,264
Unpaid principal balance: $63,132
Months delinquent: 9
Status as of 7/2//2015: First legal action to commence foreclosure

Servicing deficiency: An inappropriate loss mitigation option was selected.

First Source approved the borrower for a loss mitigation option for which he did not qualify. Contrary to HUD's requirements,[17] it incorrectly determined that the borrower qualified for a formal forbearance. HUD requires that for a formal forbearance, 85 percent of the borrower's surplus income needs to be enough to cure arrears or bring the loan current within 6 months. However, 85 percent of the borrower's surplus income was enough to bring the loan current within 7 months, not 6 months. Because the plan did not meet the requirements for a formal forbearance, the servicer should have continued down the priority order list and considered other loss mitigation options, including loan modification or partial claim.

[17] Mortgagee Letter 2012-22

FHA case number: 151-8081634

Loan amount: $89,103
Unpaid principal balance: $0
Months delinquent: 24
Status as of 4/30/2015: Property conveyed to HUD

Servicing deficiency: Supporting documentation for its loss mitigation evaluation was not maintained.

First Source did not maintain documentation supporting that a formal financial analysis was completed for the borrower's eligibility for loss mitigation as part of its complete claim review file. According to HUD Handbook 4330.1, REV-5, paragraph 1-4(E), First Source was required to retain the servicing file for a minimum of the life of the mortgage plus 3 years. Although First Source indicated that a formal financial analysis had been completed, it was unable to locate the financial documents as part of its claim review file. Therefore, we were unable to determine the borrower's financial condition and whether the loss mitigation options were properly considered and made available to the borrower.

FHA case number: 151-9021088
Loan amount: $100,671
Unpaid principal balance: $92,289
Months delinquent: 0
Status as of 4/30/2015: Reinstated after loss mitigation intervention

Servicing deficiency: The loss mitigation claim was not filed in a timely manner.

First Source did not file in a timely manner to receive a loss mitigation partial claim incentive payment of $500. The borrower was eligible for FHA-HAMP, which included a loan modification and a partial claim. However, HUD requires that lenders file a claim for insurance benefits for the partial claim within the 60-day timeframe stated in Mortgagee Letter 2003-19 to receive incentive fees for the FHA-HAMP loss mitigation action. Further, HUD requirements refer to the 60-day timeframe as "within 60 days of the date the subordinate lien to HUD is executed." The loss mitigation claim information in HUD's Neighborhood Watch system indicated that the date received for the partial claim was December 6, 2013, which was more than 60 days from the date on which the subordinate lien was executed, August 28, 2013.

FHA case number: 151-9161593
Loan amount: $99,816
Unpaid principal balance: $89,119
Months delinquent: 8
Status as of 6/4/2015: First legal action to commence foreclosure

Servicing deficiency: An inappropriate loss mitigation option was selected.

First Source selected a loss mitigation option for which the borrower did not qualify. First Source used the borrower's food stamps as income to qualify her for a FHA-HAMP. However, it did not obtain documentation from the borrower or funding agency to verify the amount and expected continuance in order to use food stamps as income. Additionally, the borrower's part-time income was supported by a letter from her employer which identified her hourly wage but did not state the expected number of hours. When we used supported income, which excluded the food stamp income, due to lack of support of continuance, the borrower did not qualify for FHA-HAMP and should have been considered for a preforeclosure sale or deed in lieu loss mitigation option.

Mortgagee Letter 2000-05 states that to be considered for any of the loss mitigation options, the borrower must provide detailed financial information to the lender. Regardless of the option under consideration, the lender must analyze the borrower's current and future ability to meet the monthly mortgage obligation by estimating the borrower's assets and surplus income.

FHA case number: 151-9226347
Loan amount: $275,793
Unpaid principal balance: $254,959
Months delinquent: 17
Status as of 4/30/2015: Property conveyed to HUD

Servicing deficiency: An improper eligibility decision was made.

First Source did not properly review the borrower's financials and, thus, made an incorrect eligibility decision for loss mitigation. During the servicing period, the borrower separated from his wife, who was living in the subject property while he was living in an apartment. Initially, the borrower had attempted to complete a short sale, but several offers did not materialize. When the divorce decree was finalized and the borrower's wife moved out of the house, he decided that he wanted to save the property. First Source mistakenly concluded after analyzing the borrower's financials that he could not afford to stay in the house. However, based on our analysis, the borrower had adequate income and was eligible for FHA-HAMP with a loan modification and partial claim.

Although, the payment that was determined using the partial claim was above the target payment, it was still within 40 percent of the borrower's income. First Source calculated the borrower's income as $4,000 per month. However, when we calculated the borrower's income, using his pay stubs and self-employment income, we determined that his income was $5,700. As a result of our calculation, the borrower's front-end ratio would be lower than the front-end ratio that was calculated using First Source's income amount.

FHA case number: 156-0374114
Loan amount: $69,279
Unpaid principal balance: $64,056
Months delinquent: 0
Status as of 4/2/2015: Reinstated by borrower without loss mitigation claim

Servicing deficiency: An incorrectly implemented loss mitigation option.

First Source incorrectly calculated the borrower’s target monthly payment for an FHA-HAMP modification. Mortgagee Letter 2012-22, attachment A, shows a series of calculations and comparisons to determine the target monthly payment amount for an FHA-HAMP modification. Specifically, First Source used the borrower’s incorrect gross income and a higher market interest rate of 4.75 percent instead of 4.50 percent for its calculation of the target monthly payment. This error resulted in a target monthly payment of $591 instead of $511. As a result, the trial payment and the permanent payment was $80 (16 percent) higher than it should have been for the remaining life of the loan.

FHA case number: 156-0882200
Loan amount: $214,423
Unpaid principal balance: $0
Months delinquent: 21
Status as of 4/30/2015: Property conveyed to HUD

Servicing deficiency: An improper eligibility decision was made.

The servicing files did not support that First Source made the proper eligibility decision for loss mitigation. After analyzing the borrower's income and expenses, First Source incorrectly concluded that the borrower did not qualify for a loan modification because she had deficit income. HUD provides guidance stating that an owner-occupant borrower with surplus income of less than 15 percent or $300 may be approved for a standard or stand-alone (rate and term) modification under FHA-HAMP guidelines.[18] It would depend on successful completion of a trial payment plan and whether there were other burdens (for example, a non-FHA lien that the holder is unwilling to subordinate) that prohibited a modification. Using the priority order list, our analysis indicated that the borrower qualified for FHA-HAMP, consisting of a loan modification with a partial claim payment option. This option would have resulted in a partial claim of $56,624, which would have lowered the borrower's payments from $1,500 to $1,235 per month and allowed for a front-end ratio of 25 percent.

[18] Frequently Asked Questions for Mortgagee Letters 2012-22 and 2013-32

FHA case number: 263-4317828
Loan amount: $50,145
Unpaid principal balance: $46,199
Months delinquent: 22
Status as of 1/29/2015: Foreclosure sale held

Servicing deficiency: Supporting documentation for its loss mitigation decision was not maintained.

In November 2013, the servicer reported that the borrower had been approved to participate in its preforeclosure sale program, which was about 3 months after the borrower was supposedly approved for a special forbearance (August 10 through November 8, 2013). Additionally, according to the servicer's activity notes, on January 14, 2014, First Source started the procedures for the deed in lieu loss mitigation option; however, the borrower's servicing file did not contain documentation detailing the result of the preforeclosure sale loss mitigation option.

On February 6, 2014, First Source denied the borrower's participation in the deed in lieu loss mitigation option because an income tax lien was placed on the property, although there were sufficient incentive funds available to pay off the lien. Mortgagee Letter 2002-13 states that funds may be used to pay off junior liens to clear the title. First Source stated that the loan was denied because there were liens other than the income tax lien on the property. However, it was unable to provide documentation to support these liens.