Issue Date October 25, 2010	
Audit Report Number 2011-AT-1001	

TO: Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU

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FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Nationwide Home Loans, Miami, FL, Did Not Follow HUD Requirements in Approving FHA Loans and Implementing Its Quality Control Program

HIGHLIGHTS

What We Audited and Why

We audited Nationwide Home Loans, Inc. (Nationwide), a Federal Housing Administration (FHA)-approved direct endorsement lender, located in Miami, FL. The audit objectives were to determine whether the lender followed U.S. Department of Housing and Urban Development (HUD) requirements when (1) originating and underwriting loans and (2) implementing its quality control program. We selected this lender because its high default rate of 23 percent was significantly higher than the Miami HUD area average default rate of 10 percent.

What We Found

Nationwide did not follow HUD requirements when it used various independent loan officers to originate its loans. Specifically, it used at least 16 independent loan officers to originate 41 loans underwritten in the Miami HUD area in 2009. These 16 loan officers were also employed by or owned businesses involved with mortgage lending or other related fields such as real estate sales and mortgage processing. This condition occurred because the lender disregarded HUD requirements when originating its loans. As a result, Nationwide approved loans that were not eligible for FHA insurance and increased the risk to the FHA insurance fund by more than $4 million.

In addition, Nationwide did not follow HUD requirements when originating and underwriting loans for FHA insurance. It used inaccurate and unsupported information to qualify borrowers for five of six FHA loans reviewed. This condition occurred because the lender disregarded HUD requirements, did not exercise due care in originating and underwriting these loans for FHA insurance, and lacked controls to ensure compliance with HUD requirements. As a result, Nationwide approved loans that did not qualify for FHA insurance and unnecessarily placed the FHA insurance fund at risk for almost $1 million.

Further, Nationwide did not implement a quality control program that complied with HUD requirements. It did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain the required provisions. These conditions occurred because Nationwide disregarded HUD requirements. As a result, Nationwide increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Nationwide to indemnify HUD for the 46 ineligible FHA loans with an estimated potential loss of $5 million. We also recommend that Nationwide be referred to the Mortgagee Review Board for consideration of imposing civil money penalties for the ineligible loans and taking appropriate administrative actions against the individuals and entities responsible. Finally, we recommend that Nationwide develop, implement, and enforce (1) written controls to ensure that loans are originated and underwritten in accordance with HUD requirements and (2) a quality control program that complies with HUD requirements.

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

Auditee’s Response

We discussed our review results with Nationwide and HUD officials during the audit. We provided a copy of the draft report to Nationwide on September 22, 2010, for its comments and discussed the report with officials at the exit conference on October 7, 2010. Nationwide provided its comments on October 7, 2010. It generally agreed with our findings.

The complete text of Nationwide’s response, along with our evaluation of the response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Nationwide Home Loans, Inc. (Nationwide) is a Federal Housing Administration (FHA)-approved non-supervised direct endorsement lender based in Miami, FL. Under the direct endorsement program, the U.S. Department of Housing and Urban Development (HUD) authorizes approved lenders to underwrite FHA loans without HUD's prior review and approval. A non-supervised lender is an institution which has as its principal activity the lending or investing of funds in real estate mortgages. It may submit applications for mortgage insurance and may originate, underwrite, purchase, hold, and service insured loans or sell mortgages. Nationwide became an FHA-approved lender in August 2007 and currently does not have any active branch offices. The lender does not sponsor any loan correspondents but acts as the principal for three authorized agents. The principal-authorized agent relationship provides the lender the flexibility to collaborate with another FHA lender to originate FHA loans.

HUD's Neighborhood Watch system showed that from March 1, 2008, to February 28, 2010, Nationwide originated 218 loans in HUD's Miami office jurisdiction. As of February 28, 2010, 50 of the 218 loans (23 percent) with mortgage amounts totaling more than $10.8 million were in default. Nationwide's default rate significantly exceeded the Miami office jurisdiction's default rate of 10 percent. However, the lender has not originated any FHA loans since July 2009. In November 2009, Nationwide came under new ownership. Currently, most of Nationwide's employees involved in originating and underwriting the loans from our audit period are no longer employed at Nationwide.

On June 18, 2010, HUD notified Nationwide of its intent to terminate the lender's origination approval agreement because of its high default and claim rate. On July 30, 2010, an informal hearing was held between Nationwide and HUD officials. On September 9, 2010, HUD terminated Nationwide's origination approval agreement for a period of six months.

Our audit objectives were to determine whether the lender followed HUD requirements when (1) originating and underwriting loans and (2) implementing its quality control program.

RESULTS OF AUDIT

Finding 1: Nationwide Did Not Follow HUD Requirements When It Used Independent Loan Officers To Originate Loans

Nationwide did not follow HUD requirements when it used independent loan officers to originate its loans. Specifically, it used at least 16 independent loan officers to originate 41 loans underwritten in the Miami HUD area in 2009, contrary to HUD requirements. These 16 loan officers were also employed by or owners of businesses involved with mortgage lending or other related fields. This condition occurred because the lender disregarded HUD requirements when originating its loans. As a result, Nationwide approved loans that were not eligible for FHA insurance and increased the risk to the FHA insurance fund by more than $4 million.

Nationwide did not follow HUD requirements when it used independent loan officers to originate 41 loans with mortgages totaling more than $7 million. It underwrote 126 loans in the Miami HUD area in 2009. We reviewed 123 of the lender's loan files. Lenders must follow HUD Handbook 4060.1, REV-2, "FHA Title II Mortgagee Approval Handbook," to operate as an FHA-approved lender. This handbook provides the general requirements to be approved for participation in FHA mortgage insurance programs and provides specific requirements related to the loan origination functions. Paragraph 2-13 of HUD Handbook 4060.1, REV-2, states that lenders are not permitted to outsource functions that materially affect underwriting decisions or increase the risk to FHA. Specifically, lenders are not allowed to outsource the management, underwriting, and loan origination functions. In addition, HUD Handbook 4060.1, REV-2, paragraph 2-9A defines an employee as those individuals under the direct supervision and control of an FHA approved lender. Below is a table that summarizes that the types of independent loan officers that originated the loans, number of loans and mortgage amounts involved, and associated violations.

Loan Officers	Relationship	Prohibited by HUD (HUD Handbook 4060.1, REV-2)	Loans Involved	Original Mortgage	Unpaid Principal Balance	Indemnification Amount
12	Not FHA Approved Lenders	Paragraph 2-9G (Employees Are Not Allowed to Have Outside Employment in Mortgage Lending, Real Estate, or Related Fields)	21	$3,775,035	$3,726,281	$2,235,768

4	FHA Loan Correspondent	Paragraph 2-18 (Require Authorized Loan Correspondent and Sponsor, or Principal and Authorized Agent Relationship)	20	$3,357,086	$3,332,587	$1,999,552
16 (Total)	Employed By or Owned Businesses Involved in Mortgage Lending or Related Fields	Paragraph 2-13 (Outsourcing of Loan Origination Function) Paragraph 2-22 (Compensation for Services Not Permitted by HUD)	**41**	**$7,132,121**	**$7,058,867**	**$4,235,320**

The table includes an estimated loss of more than $4.2 million from the 41 loans based on 60 percent of the unpaid principal balance of $7 million. Sixty percent of the unpaid principal balance was the average loss incurred by HUD for fiscal year 2009 when the FHA property was resold for less than the unpaid principal balance as determined by HUD statistics.

Independent Loan Officers Were Affiliated With Other Mortgage Lending Entities or Related Fields

Nationwide knowingly used at least 16 loan officers that were also employed by or owners of other mortgage lending, real estate, or other related fields to originate 41 loans for Nationwide in 2009. According to HUD Handbook 4060.1, REV-2, paragraph 2-9G, loan officers are allowed to have outside employment, but the outside employment may not be in mortgage lending, real estate, or a related field.

Nationwide was aware that these independent loan officers were employed by or owners of other mortgage lending companies or related services. Various documents were found throughout the lender's loan files which indicated that these individuals worked for other companies during the time they originated loans for Nationwide. The front cover of the lender's loan file identified the names of the other lending companies and/or independent loan officers that originated the loans. Broker fee sheets were found in some of the lender loan files that itemized the independent loan officers' compensation with the names of the broker company or loan officers for originating the loan. In addition, the loan applications listed the names of the independent loan officers that originated the loans as employees of Nationwide.

The Florida Division of Corporations' Web site disclosed that these independent loan officers were owners, presidents, vice presidents, directors, and managing members of the same businesses found on or within Nationwide's loan files. Although documentation in the files identified that the independent loan officers performed loan origination functions, these loans were submitted to HUD as being originated by Nationwide. Therefore, Nationwide submitted false information to HUD for FHA insurance.

For example, the lender's loan file for FHA loan 095-1109120 contained several documents indicating that the loan officer worked for another mortgage company. The file contained a loan application with the independent loan officer's signature as an employee of Nationwide, an employment verification processed by the independent loan officer's own mortgage company, and the front cover of the file showed the name of the independent loan officer and her mortgage company. In addition, the settlement agent for this loan was the vice president of the independent loan officer's company. From our search of the Florida Division of Corporations Web site, we found that the independent loan officer was the president of the mortgage company shown on the front cover of the lender's loan file. As of August 31, 2010, this loan was in the foreclosure process.

In addition, 12 of the 16 independent loan officers were not from FHA-approved lenders, so they may not have been familiar with FHA requirements and were not authorized to originate FHA loans. The 12 independent loan officers originated 21 of the 41 loans. Four of the twenty one (19 percent) loans were delinquent as of August 31, 2010.

FHA-Approved Lenders Used Did Not Have the Required Established Relationship With Nationwide

Nationwide used FHA-approved lenders that did not have the required established relationship with Nationwide to originate loans. HUD Handbook 4060.1, REV-2, paragraph 2-18, states that lenders may not perform only a part of the loan origination process, such as taking the loan application, and routinely transfer the underwriting package to another lender except between a loan correspondent and its sponsor and a principal and its authorized agent.

Four of the sixteen independent loan officers that originated 20 of the 41 loans for Nationwide were identified as owners of FHA-approved loan correspondent lender entities. Of the 20 loans originated by the other FHA lenders, only 4 were disclosed in the HUD Neighborhood Watch system as being originated by the other lenders. As FHA-approved lenders, the lenders should have been familiar with HUD requirements for participating in the FHA program. The FHA lenders used by Nationwide did not have approved loan correspondent and sponsor or principal and authorized agent relationships with Nationwide. Six of the twenty (30 percent) loans originated by the FHA approved loan correspondents were delinquent as of August 31, 2010 and only one was disclosed as being originated by the FHA loan correspondent.

Nationwide Made Various Payments to the Independent Loan Officers

Nationwide used various methods to pay the independent loan officers. In some instances, it paid the commission directly to the other mortgage lending company instead of to the independent loan officer. Many of these payments were not disclosed on the HUD-1 settlement statements. Nationwide also issued Internal Revenue Service (IRS) form W-2 to some of these independent loan officers. These payments were not allowed because the loan originations by the independent loan officers were not permitted by HUD, and all of the payments to them are considered prohibited payments. HUD Handbook 4060.1, paragraph 2-22, states that a lender may not pay any fee, kickback, compensation, or thing of value (including a fee representing all or part of the lender's origination fee) to any person or entity in connection with a FHA-insured mortgage transaction except for services actually performed and permitted by HUD.

The Lender Disregarded HUD Requirements

Nationwide's current owner stated that he was unaware of this practice when he acquired the business in November 2009. All of the loans were underwritten between January and July of 2009 when the business was under the management of the former owner. The former owner stated that independent loan officers were used to originate loans but they were all from FHA-approved lenders. Although 4 of the independent loan officers were from FHA-approved lender entities, the remaining 12 were not. In addition, 16 of the 20 loans originated by the FHA-approved lenders were not disclosed to HUD as having been originated by these other FHA lenders and were reported as having been originated by Nationwide.

As a result of Nationwide's use of independent loan officers, Nationwide increased the risk to the FHA insurance fund. It did not have direct control and supervision of its independent loan officers to ensure that they followed HUD requirements when originating the loans. In addition, the use of the independent loan officers skewed and circumvented the monitoring and enforcement efforts of the lender's own quality control reviews and by HUD. Allowing these independent loan officers to originate loans for more than one FHA lender at a time permits poorly performing and ineligible loans to be spread across multiple lenders, which makes it more difficult for HUD and the lender to identify the individuals or entities responsible for these loans. We estimate that HUD would suffer a loss of more than $4.2 million from the 41 loans based on 60 percent of the unpaid principal balance of $7 million. Sixty percent of the unpaid principal balance was the average loss incurred by HUD for fiscal year 2009 when the FHA property was resold for less than the unpaid principal balance as determined by HUD statistics.

As of August 31, 2010, 10 of the 41 loans (24 percent) were delinquent or in the foreclosure process, while the remaining 31 were current or reinstated.

Appendix C lists the 41 loans originated by the independent loan officers.

Conclusion

Nationwide used 16 independent loan officers to originate 41 ineligible loans with mortgages totaling $7 million. Nationwide was not allowed to contract out the origination functions, and the independent loan officers were not allowed to have outside employment in mortgage lending, real estate, or related fields. However, various documents throughout the lender's loan files indicated that the loan officers worked for these businesses, including other FHA lenders, when they originated loans for Nationwide. As a result, Nationwide increased the risk to the FHA insurance fund by $4 million by (1) not having direct control and supervision of the independent loan officers to ensure that FHA requirements were followed when originating the loans; (2) misrepresenting the individuals and entities that originated and processed the loans to HUD on which HUD relied for its monitoring and enforcement efforts; and (3) misrepresenting the origins of the loans, which would circumvent the lender's own quality control review when identifying root causes for deficiencies or fraud.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner

1A. Require Nationwide to indemnify the 41 ineligible FHA-insured loans with an estimated loss of $4,235,320. The estimated loss was based on the loss severity rate of 60 percent as determined by HUD statistics for fiscal year 2009 and the total unpaid principal balance of $7,058,867 of the 41 loans as of August 2010.

1B. Refer Nationwide to the Mortgagee Review Board to take appropriate administrative action against the lender including debarring the responsible individuals and imposing civil money penalties for the 41 ineligible loans and associated false statements.

1C. Require Nationwide to develop, implement, and enforce written controls to ensure that the loans are originated by allowable loan officers or FHA-approved lenders that have established authorized relationships with the lender in accordance with HUD requirements.

Finding 2: Nationwide Did Not Follow HUD Requirements When Originating and Underwriting Loans

Nationwide did not follow HUD requirements when originating and underwriting loans for FHA insurance. It used inaccurate and unsupported information to qualify borrowers for five of six FHA loans reviewed. This condition occurred because the lender disregarded HUD requirements, did not exercise due care in originating and underwriting these loans for FHA insurance, and lacked controls to ensure compliance with HUD requirements. As a result, Nationwide approved loans that did not qualify for FHA insurance and placed the FHA insurance fund at risk for almost $1 million.

Loans Had Significant Underwriting Deficiencies

Nationwide did not follow HUD requirements when originating and underwriting five of the six loans reviewed. The five loans had original mortgage amounts totaling more than $1.6 million. Lenders must follow HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance on One-to Four-Unit Mortgage Loans," when underwriting FHA loans. This handbook describes the procedures for evaluating the borrower's credit history, capacity to make payments, and available cash assets to close the mortgage. The lender is responsible for eliciting a complete picture of the borrower's financial situation, source of funds for the transaction, and intended use of the property. The lender's decision to approve the loan must be documented, supported, and verifiable.

The table below shows the summary of deficiencies identified for the five loans.

FHA case number	Inaccurate or unsupported employment & other income	Inadequate credit analysis	Unsupported source of funds	Maximum allowable mortgage exceeded	Minimum required cash investment not met	Property not owner occupied
095-1164560	X					X
095-0927805	X					
095-0679947	X	X	X		X	
095-1026242	X	X				
095-1076080	X	X		X		
Total	5	3	1	1	1	1

Examples of the underwriting deficiencies include the following:

Inaccurate Employment Information

Nationwide did not accurately verify or support borrowers' employment information for five loans. HUD Handbook 4155.1, Chapter 2, Section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

HUD Mortgagee Letter 2005-16 updated the qualifying front and back ratios to 31 and 43 percent, respectively.

For FHA loan 095-0927805, the lender used $9,087 as the borrower's monthly employment income to qualify the borrower for the $276,353 FHA-insured mortgage. This amount included income from two different jobs. However, we confirmed with the borrower and the first employer that the borrower's monthly employment income was $2,759. The borrower stated that she never held the second job and did not provide employment information to the lender regarding the second job. Our recalculation of the borrower's qualifying front and back ratios equaled 98 and 133 percent instead of 29.7 and 40.4 percent, respectively. As a result, the borrower would not have qualified for the loan because the lender submitted inaccurate employment information to HUD. In addition, the borrower's recalculated qualifying ratios overwhelmingly exceeded the FHA-established qualifying ratios.

Inadequate Credit Analysis

Nationwide omitted borrowers' liabilities from consideration in approving their loans without written explanation for three loans. HUD Handbook 4155.1, paragraph 2-11, states that in computing the qualifying ratios, the lender must include the monthly housing expense and all other recurring charges extending 10 months or more. If a debt payment, such as a student loan, is scheduled to begin within 12 months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis unless the borrower provides written evidence that the debt will be deferred to a period outside this timeframe.

For FHA loan 095-1076080, the lender omitted $27,372 of the borrower's debts in computing the qualifying ratios. The lender only considered $16,496 of the borrower's debts while the documentation in the loan file showed debts totaling $43,868. The $27,372 of debts omitted were student loans. There was no written evidence that the student loans would have been deferred for more than 12 months. Our recalculation of the borrower's qualifying front and back ratios equaled 41 and 96 percent, respectively. As a result, the borrower would not have qualified for the loan because the borrower's recalculated qualifying ratios significantly exceeded the FHA-established qualifying ratios.

Loan Amount Greater Than Maximum Allowable Mortgage

Nationwide did not properly calculate the maximum allowable mortgage and approved a loan that exceeded the maximum allowable mortgage amount. HUD Handbook 4155.1, paragraph 1-7, specifies that mortgages may only be insured for up to a certain amount provided the borrower makes the required minimum cash investment. HUD Mortgagee Letter 05-43 updated the maximum allowable mortgage amount for refinanced loans. The letter stated that refinance loans in which the borrower received cash back in excess of $500 would be allowed a maximum allowable mortgage amount of 95 percent of the appraisal value.

For FHA loan 095-1076080, the lender approved a mortgage of $330,000 for this cash-out refinance loan. The borrower received $3,190 to pay the 2008 property tax shown in the HUD-1 settlement statement. The appraisal report for the loan showed that the property was appraised at $345,000. Therefore, the maximum loan amount should have been $327,750 or 95 percent of the appraised value. As a result, the mortgage amount exceeded the maximum allowable mortgage by $2,250.

Appendix D details the deficiencies for each of the five loans and Appendix E provides a schedule of indemnification amounts for those loans.

The Lender Lacked Controls and Disregarded HUD Requirements

Nationwide disregarded HUD requirements, did not exercise due care in originating and underwriting these loans for FHA insurance, and lacked controls to ensure compliance with HUD requirements. As a direct endorsement lender, Nationwide was allowed to endorse mortgage loans for FHA insurance without a detailed technical underwriting review by HUD. In approving loans for FHA insurance, the underwriter certified that he (1) had personally reviewed the application documents, (2) ensured that prudent underwriting procedures were followed, and (3) was familiar with HUD requirements such as the procedures referenced in HUD Handbook 4155.1.

We reviewed the loan files with the underwriter associated with the loans to determine why these loans were approved with deficiencies. The underwriter was aware of some of the FHA requirements, such as requiring documentation to justify omitting a borrower's liabilities, but decided to disregard this requirement. For example, the underwriter omitted a portion of a borrower's student loans without justification. The underwriter stated he knew deferred liabilities such as student loans required documentation showing a deferral of more than 12 months to be excluded from the qualifying ratios. The underwriter acknowledged that the file was not adequately documented to show the student loans were deferred for more than 12 months.

In another instance, the underwriter did not exercise due care by not questioning the 2 years of amended tax returns, which substantially increased the borrower's income from $25,000 to about $91,000, filed a few months before the loan application. Finally, Nationwide lacked controls to ensure compliance such as including the required documentation to support employment income or source of funds. In addition, Nationwide did not have written controls to ensure the underwriter's decision complied with HUD underwriting requirements and that documentation sufficiently supported the underwriter's decision before closing. It also had an insufficient post-quality control program (see finding 3).

We estimate that HUD would suffer a loss of $951,674 from the five loans based on 60 percent of the unpaid principal balance of nearly $1.6 million. Sixty percent of the unpaid principal balance was the average loss incurred by HUD for fiscal year 2009 when the FHA property was resold for less than the unpaid principal balance as determined by HUD statistics.

Conclusion

Nationwide did not follow HUD requirements when originating and underwriting five of six FHA loans reviewed. The deficiencies occurred because the lender disregarded HUD requirements, did not exercise due care, and lacked adequate controls to ensure that the loans were originated and underwritten in accordance with HUD requirements. As a result, Nationwide approved and insured five loans that were not eligible for FHA insurance. The loans placed the FHA insurance fund at risk for almost $1 million in potential losses.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

2A. Require Nationwide to indemnify the five ineligible FHA loans with an estimated loss of $951,674. The estimated loss was based on the loss severity rate of 60 percent as determined by HUD statistics for fiscal year 2009 and the total unpaid principal balance of $1,586,123 of the five loans as of August 2010.

2B. Determine the amount of over-insured mortgage for FHA case 095-1076080 and require Nationwide to pay down the loan balance and provide evidence of the principal reduction.

2C. Refer Nationwide to the Mortgagee Review Board to take appropriate administrative action against the lender, including debarring the responsible individuals and imposing civil money penalties.

2D. Require Nationwide to develop, implement, and enforce written controls to ensure that loans are originated and underwritten in accordance with HUD requirements.

Finding 3: Nationwide Did Not Follow HUD Requirements When Implementing Its Quality Control Program

Nationwide did not implement a quality control program that complied with HUD requirements. Specifically, it did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain the required provisions. These conditions occurred because Nationwide disregarded HUD requirements. As a result, Nationwide increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

As a condition of receiving and maintaining FHA approval, Nationwide must implement and continuously have in place a quality control program for the origination and/or servicing of insured mortgages. HUD Handbook 4060.1, REV-2, paragraph 7-2, states that lenders must design their quality control program to meet the basic goals of ensuring compliance with FHA's and the lender's origination and servicing requirements; protecting FHA and the lender from unacceptable risk; guarding against errors, omissions, and fraud; and ensuring swift and appropriate corrective action. The lender's quality control program contained deficiencies in its quality control reviews and its written quality control plan.

Quality Control Reviews Did Not Comply With HUD Requirements

Nationwide did not have any quality control reviews performed before May 2009, although the former owner was aware that quality control reviews were required as part of being an FHA lender. As part of the current owner's due diligence to determine the viability of purchasing Nationwide, an external contractor was hired in May 2009 to perform quality control reviews. The contractor performed quality control reviews on 14 FHA loans that Nationwide closed between March and July 2009. Nationwide did not underwrite any FHA loans after July 2009. We analyzed the quality control reviews performed and determined that Nationwide did not perform its quality control reviews according to HUD requirements. We found the following deficiencies:

Loans Not Reviewed Within Time Limit
HUD Handbook 4060.1, REV-2, paragraph 7-6A, states that loans must be reviewed within 90 days from the end of the month in which the loan closed. None of the 14 quality control reviews were performed within the 90 day limit. The elapsed days ranged from 96 to 264.

Frequency of Reviews Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6B, states that for lenders closing more than 15 loans monthly, quality control reviews must be conducted at least monthly and must address one month's activity. Lenders closing 15 or fewer loans monthly may perform quality control reviews on a quarterly basis. Based

on the lender’s loan activity from April 2008 to July 2009, it should have performed quarterly reviews for the months of April 2008 to September 2008. However, no reviews were performed. From October 2008 to July 2009, the lender should have performed at least ten monthly reviews. However, only five reviews were conducted monthly for the months of March 2009 to July 2009. No reviews were performed on loans that closed before March 2009. Therefore, the lender did not perform quality control reviews in accordance with the frequency basis required by HUD.

Ten Percent of the Originated Loans Not Reviewed
HUD Handbook 4060.1, REV-2, paragraph 7-6C, states that a lender that originates and/or underwrites 3,500 or fewer FHA loans per year must review 10 percent of its FHA loans. The lender originated 298 FHA loans from April 2008 to March 2010, requiring quality control reviews of at least 30 loans. However, only 14 quality control reviews were performed on the loans that closed between March and July 2009. Therefore, the lender did not have quality control reviews performed on 10 percent of the originated loans as required by HUD.

Early Payment Default Loans Not Reviewed
HUD Handbook 4060.1, REV-2, paragraph 7-6D, states that all early payment default loans must be reviewed. Early payment default loans are loans that have defaulted within the first six payments and become 60 days past due. During the 2-year period of April 2008 through March 2010, Nationwide had 33 early payment default loans. None of the 33 early payment default loans were reviewed.

Credit Reports Not Obtained
HUD Handbook 4060.1, REV-2, paragraph 7-6E(1), states that a new credit report must be obtained for each borrower whose loan is included in a quality control review unless the loan was a streamline refinance or was processed and approved by an automated underwriting system. Two of the fourteen loans reviewed were not approved by an automated underwriting system. Thus, for the two loans, credit reports should have been obtained for the borrowers. However, the credit reports for the borrowers were not obtained.

Document Reverifications Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), states that documents contained in the loan file, such as documents relating to borrower’s income, gifts, or sources of funds, should be checked for sufficiency and subjected to written reverification. We reviewed 5 of the 14 quality control reviews to determine whether reverifications were performed on the documents in the loan files. For all five loans, the borrower’s employment income, sources of funds, and/or gift funds were not properly reverified.

For the reverification of employment on one loan, the external contractor only reverified one of the borrower's two jobs and did not reverify the borrower's other employment, reasoning that it was not used to qualify for the loan. We reviewed the income documents for both employers and noted that both were used to calculate the gross monthly income to qualify for the loan. The external contractor did not send out the reverification of the borrower's source of funds on four loans, reasoning that the lender did not pay upfront or reimburse the cost to have the financial institution verify the borrower's sources of funds. Lastly, the external contractor did not reverify the gift funds for two loans.

Field Appraisal Not Performed

HUD Handbook 4060.1, REV-2, paragraph 7-6E(3), states that lenders are expected to perform field reviews on 10 percent of the loans selected per year during the sampling process. Thus, since the lender performed quality control reviews on 14 FHA loans during the year, at least 1 field appraisal should have been performed. The external contractor confirmed that it did not have any field appraisals conducted for its reviews.

Occupancy Verification Not Performed

HUD Handbook 4060.1, REV-2, paragraph 7-6E(4), states that in cases in which the occupancy of the subject property is suspect, the lender must attempt to determine whether the borrower is occupying the property. The external contractor stated that the occupancy of a property may be suspect when the loan application indicates that (1) the borrower will not be occupying the property as a primary residence, (2) the borrower owns a property other than the FHA property, or (3) the FHA property is relatively far from the borrower's place of employment. These indicators were present on 3 of the 14 loans. For two loans, the loan application showed that the borrower owned another property and was living in it before purchasing the FHA property. For another loan, the loan application showed that the FHA property was located in a different county more than 122 miles from the borrower's place of employment. These indicators should have resulted in attempts to determine whether the borrower was occupying the property. However, our review showed that occupancy verifications were not performed.

Conditions Needed for Loan Clearance and Closing Not Verified

HUD Handbook 4060.1, REV-2, paragraph 7-6G, states that each loan selected for a quality control review must be reviewed to determine whether conditions required for closing were met, the seller was the owner of record or was exempt, the loan closed and funds were disbursed according to instructions, and the closing and legal documents were accurate and complete. In our interview with the external contractor, the contractor indicated that she did not know that she was required to determine that the seller was the owner of record and to review the funds to determine that they were disbursed in accordance with the underwriting and closing instructions.

Corrective Actions Not Adequate To Address Deficiency

HUD Handbook 4060.1, REV-2, paragraph 7-3I, states that review findings must be reported to the lender's senior management within one month of completion of the initial report. Management must take prompt action to deal appropriately with any material findings such as discontinuance of borrower's employment income before the loan closing and sufficient documentation to support employment income. Of the 14 quality control reviews, at least 3 findings were material and required a response by the lender's management. Although the lender's management responded to two of the three reviews, its response was not prompt and did not appropriately respond to the cited deficiencies. The reports were provided to the lender in the first week of October 2009, but the lender did not provide a response until the end of December 2009. The lender's management did not respond to the other review. Thus, we assessed that the lender did not implement action to promptly and appropriately deal with material findings resulting from the quality control reviews.

The Written Plan Did Not Contain Required Provisions

Nationwide's written quality control plan did not contain HUD-required provisions. HUD Handbook 4060.1, REV-2, paragraph 7-3G, requires that each loan selected for a quality control review be reviewed to determine whether (1) conditions required for closing were met, (2) the seller was the owner of record or was exempt, (3) the loan closed and funds were disbursed according to instructions, and (4) the closing and legal documents were accurate and complete. Nationwide's written quality control plan did not contain the last three provisions. Nationwide's management acknowledged that these provisions should have been included in its written plan and explained that it was an oversight.

The Lender Disregarded HUD Requirements

Nationwide disregarded HUD requirements to implement and continuously have in place a compliant quality control program. It increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

The current management officials acknowledged that they were responsible for the deficiencies with the quality control reviews and provided explanations for the deficiencies. Nationwide's management stated that the priorities at the time were to determine the general quality of the loans, what procedures were in place and what procedures needed to be implemented, and, ultimately, whether to purchase the company. The current management recognized that the quality control reviews would not be performed in a timely manner, and the early payment default loans were not reviewed because following HUD's requirements was not the objective of the reviews.

In addition, Nationwide did not evaluate the work of the external contractor to ensure that the contractor

- Reverified the borrower's credit when needed;
- Reverified the borrower's employment, sources of funds, and gift funds;
- Reverified the borrower was occupying the property if occupancy of the subject property was suspect.
- Conducted a field appraisal of 10 percent of the loans selected for review;
- Determined whether the seller was the owner of record;
- Determined whether the loan closed and funds were disbursed according to instructions; and

Management stated that it was not aware that the external contractor did not perform these required services.

Further, the lender did not evaluate the work of staff to ensure that corrective actions were sufficient to address the deficiencies cited in the quality control report. Management agreed that the responses for the two quality control reports did not sufficiently address the cited deficiencies. Management explained that the responses for the other quality control report was not prepared because by the time the lender received the reports, the underwriter no longer worked at Nationwide.

Conclusion

Nationwide did not follow HUD requirements when implementing its quality control program. The lender disregarded HUD requirements to implement and have a continuous quality control program that complied with HUD requirements. As a result, Nationwide increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations. In addition, the effectiveness of Nationwide's quality control program to guard against errors, omission, and fraud was diminished.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

3A. Require Nationwide to develop, implement, and enforce a quality control program that complies with HUD requirements. Specifically, the lender needs to establish a written plan with controls, ensure that quality control reviews meet HUD requirements, and enforce and maintain its quality control program on a continual basis.

3B. Perform a review of Nationwide's quality control program within 9 months to determine whether adequate controls have been established and quality control reviews are conducted in compliance with HUD requirements.

SCOPE AND METHODOLOGY

Nationwide underwrote 218 loans within the jurisdiction of the Miami HUD office between the amortization dates of March 1, 2008, and February 28, 2010. As of February 28, 2010, 50 loans with mortgage amounts totaling $10.8 million were in default. We did not perform a 100 percent selection or a representative selection using statistical or nonstatistical sampling. We selected 6 loans for review based on various risk factors including loans (1) with mortgage amounts of $300,000 or greater, (2) that defaulted within 6 months of closing, and (3) that recently defaulted. The original mortgages of the six loans totaled approximately $1.98 million, and the unpaid principal balance totaled approximately $1.97 million. The results of our review apply only to the loans reviewed and cannot be projected to the universe of loans. We accessed HUD's Neighborhood Watch system to obtain information about the lender and its loans.

To accomplish the audit objectives, we

- Reviewed applicable HUD handbooks and mortgagee letters;
- Reviewed Nationwide's written policies and procedures for originating and underwriting loans;
- Reviewed FHA loan files and Nationwide's loan files;
- Reviewed Nationwide's written quality control plan;
- Analyzed the quality control review reports;
- Interviewed Nationwide's former and current employees, external quality control contractors, and the lender's current management; and
- Verified the accuracy of the information from the loan files with the borrowers and borrowers' employers.

Based on our interviews with the former owner and employees and our review of the loan files, we identified that the lender used independent loan officers to originate and/or process many of its FHA loans. For the 126 FHA loans that closed in 2009 totaling more than $22.4 million, we reviewed 123 of the lender's loan files to determine whether the loan was originated by an independent contract loan officer contrary to HUD requirements. Three of the loan files were not reviewed because the lender could not locate these files. We also reviewed the lender's general ledgers, 2009 IRS forms W-2 and 1099 issued by the lender, personnel files, and applicable HUD handbooks and mortgagee letters, as well as conducted searches on the HUD Neighborhood Watch system and Florida's Division of Corporations' Web site.

We assessed the reliability of computer-processed data maintained on two systems – HUD's Neighborhood Watch system and the external contractor's quality control system.

HUD's system is designed to highlight exceptions so that potential problems are readily identifiable. In particular, the system gives the ability to identify and analyze patterns, by geographic area or originating lender, in loans which became 90 days delinquent during the first 2 years. We assessed the reliability of the computer-processed data by comparing the data with the information we obtained from public records, our review of the loan file, and our verification with borrowers and employers. Specifically, we compared the following five data fields from the HUD Neighborhood Watch system:

- Borrower's name or the ownership of the property,
- Date of loan closing,
- Mortgage amount,
- Qualifying ratios, and
- Period the servicer reported the first legal action to commence foreclosure.

Our analyses showed that the qualifying ratios in the HUD system were not accurate and not supported by the loan files and our review. Additionally, public records showed that two of the foreclosure action dates posted on the HUD system were incorrect. The foreclosure action dates recorded in the HUD system showed the action occurring two to three months after the action dates found in the public records. Considering the overall results, we determined that the computer-processed data in HUD's Neighborhood Watch system related to qualifying ratios and foreclosure actions were unreliable (see finding 2).

For the quality control system, we selected 5 of the 14 quality control reviews performed and selected 4 computer-processed data fields to assess the data's reliability – (1) date of loan closing, (2) loan officer, (3) appraiser, and (4) date reverifications were sent. We compared the data to the documents contained in the lender's loan files such as the HUD-1 settlement statement, loan application, and appraisal report. We also compared the data to the dates on the employment, source of funds, and/or gift reverification packages contained in the quality control folders and to the information obtained from our interview with the external contractor. The information obtained from the external contractor and our review of the reverification packages did not support that the reverifications were sent as indicated in the quality control system. Therefore, we determined that the computer-processed data in the external contractor's quality control system related to reverification dates were not accurate and were unreliable (see finding 3).

During the course of the audit, we clarified HUD regulations and discussed potential issues with the Atlanta Homeownership Center, Quality Assurance Division. We also discussed the findings with Nationwide's current management.

We classified more than $5 million as funds to be put to better use. This is 60 percent of the $8.6 million in unpaid principal balances for the 46 FHA-insured loans that did not meet HUD's requirements. We used 60 percent because it has been determined that upon sale of the mortgaged properties, FHA's average loss was about 60 percent of the unpaid principal balance for fiscal year 2009.

Our review generally covered the period March 1, 2008, through February 28, 2010, and was extended as necessary. We conducted our fieldwork from April to July 2010 at Nationwide's office in Miami, FL, and at various other locations in the Miami-Dade and Broward County areas to conduct our interviews with the borrowers, employers, former owner and employees, and external quality control contractor.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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:

- Program operation – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Reliability of data – 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 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:

- Nationwide did not follow HUD requirements when it used independent loan officers to originate loans (see finding 1).

- Nationwide did not follow HUD requirements when originating and underwriting FHA loans (see finding 2).

- Nationwide did not follow HUD requirements when implementing its quality control program (see finding 3).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$4,235,320
2A	$951,674
Total	$5,186,994

1/ 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.

Implementation of our recommendations to require Nationwide to indemnify HUD for the 46 materially deficient and ineligible loans will reduce the risk of loss to the FHA insurance fund. The amount above reflects HUD's estimated loss of 60 percent of the unpaid principal balance of $8,644,990 from the loans as of August 31, 2010.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

U.S. Department of Housing and Urban Development
District Office of Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta , GA 30303-3388

Attention: James D. McKay
Regional Inspector General for Audit

Re: Nationwide Home Loans, Miami, Florida ("Nationwide")
Draft Report Response

Dear Mr. McKay:

Thank you for the opportunity to review the draft report and to be able to provide you with our comments.

Comment 1

As noted in the draft report the current owner acquired Nationwide in November 2009, and had no knowledge of the prior practices which are alleged to have occurred in connection with loans underwritten between January and July 2009. The current owner had no affiliation with the prior owners and management of Nationwide. The OIG audit commenced in April of 2010, at which time Nationwide was not actively operating and no FHA loans had been originated under the current ownership and management.

During the audit conducted by your office, we fully cooperated in providing access to all of Nationwide's files. However, due to the fact that Nationwide was no longer operating, had no employees, and that none of Nationwide's former employees were available for the audit, we were not able to provide any input and respond to the matters under investigation. Please be assured that if required by HUD, we will diligently assist it in conducting an internal investigation of Nationwide's underwriting and origination practices and procedures with respect to the subject loan files. As part of that investigation, we are also ready, willing and able to engage the services of qualified personnel to conduct an internal investigation of Nationwide's underwriting and origination practices and procedures. We will fully assist HUD, as we have previously assisted the OIG, in identifying and contacting former individual Nationwide employees who may be responsible for Nationwide's failure to have complied with all applicable HUD requirements.

Moving forward under completely new ownership and management, Nationwide's business plan includes the hiring of new personnel that is experienced, qualified and fully knowledgeable in the areas of FHA underwriting and loan origination practices. Additionally, we will bring an experienced Chief Compliance Officer on staff to develop, implement and enforce a written Quality Control Plan that complies with HUD requirements. We are dedicated to ensuring that those practices alleged in the draft report are not repeated by Nationwide in the future.

Please be assured that we will continue to fully cooperate with your office and HUD in connection with this matter.

Sincerely,
Nationwide Home Loans, Inc.

BY:__________________
Gilbert Kahn, President

OIG Evaluation of Auditee Comments

Comment 1 Nationwide did not disagree with our findings or recommendations. The current owner stated that he acquired Nationwide in November 2009, and had no knowledge of the prior practices which are alleged to have occurred in connection with loans underwritten between January and July 2009. The current owner stated he had no affiliation with the prior owners and management of Nationwide. In addition, Nationwide stated it is dedicated to ensuring that the practices alleged in the draft report are not repeated by Nationwide in the future, and will continue to fully cooperate with our office and HUD regarding this matter.

Nationwide's agreement with the findings and recommendations indicates its willingness to make necessary improvements to ensure it follows HUD requirements when originating and underwriting loans, and implementing its quality control program.

Appendix C

SCHEDULE OF INDEMNIFICATION AMOUNTS FOR THE 41 LOANS

No.	Independent loan officer (LO)	FHA case no.	Original mortgage amount	Unpaid mortgage balance	Indemnification amount[a]
1	LO 1 - **(1) FHA lender**	095-1047157*	$193,325	$191,214	$114,728
2		095-1058709*	$228,021	$226,927	$136,156
3		095-1078312*	$255,290	$251,364	$150,818
4		095-1085785	$ 62,790	$ 61,684	$ 37,010
5		095-1109120*	$209,859	$208,900	$125,340
6		095-1134778	$165,938	$163,826	$ 98,296
7		095-1139588	$ 95,635	$ 94,160	$ 56,496
8		095-1191588*	$171,830	$170,219	$102,131
9		095-1204810	$131,965	$145,027	$ 87,016
10		095-1232098	$106,160	$104,480	$ 62,688
11		095-1255995	$132,554	$130,766	$ 78,460
12		095-1280403	$142,373	$140,416	$ 84,250
13		095-1329603	$ 72,659	$ 71,644	$ 42,986
14	LO 2	095-1008912*	$167,785	$165,594	$ 99,356
15		095-1097305	$211,105	$209,613	$125,768
16	LO 3	095-1156592*	$108,007	$107,019	$ 64,211
17		095-1165848	$117,727	$115,780	$ 69,468
18	LO 4 - **(2) FHA lender**	095-0725361	$142,172	$140,317	$ 84,190
19		095-1107323	$205,214	$204,463	$122,678
20	LO 5 - **(3) FHA lender**	095-1164416	$113,898	$111,970	$ 67,182
21		095-1226982	$142,373	$139,959	$ 83,975
22		095-1231448*	$166,920	$164,815	$ 98,889
23	LO 6	095-1187400	$147,184	$144,572	$ 86,744
24		095-1201032	$ 76,493	$ 75,041	$ 45,025
25		095-1246515	$181,649	$178,972	$107,383
26		095-1261853	$111,935	$110,221	$ 66,133
27		095-1309457	$143,355	$141,443	$ 84,866
28	LO 7	095-1119525*	$219,833	$216,970	$130,182
29		095-1198353	$130,494	$128,238	$ 76,943
30		095-1207838	$270,019	$266,069	$159,642

No.	Independent loan officer (LO)	FHA case no.	Original mortgage amount	Unpaid mortgage balance	Indemnification amount[a]
31	LO 8	095-1323719	$166,920	$166,464	$ 99,879
32	LO 9 **- (4) FHA lender**	095-1085018	$267,073	$264,696	$158,818
33		095-1085053	$351,037	$345,740	$207,444
34	LO 10	095-1076891	$ 98,188	$ 96,458	$ 57,875
35		095-1213602	$245,471	$241,586	$144,951
36	LO 11	095-1264049	$ 98,384	$ 97,032	$ 58,219
37	LO 12	095-1139536	$185,576	$183,924	$110,354
38	LO 13	095-1177780	$ 99,415	$ 97,882	$ 58,729
39	LO 14	095-1212484*	$368,207	$364,072	$218,443
40	LO 15	095-1147886	$202,991	$201,732	$121,039
41	LO 16	095-1276292	$424,297	$417,598	$250,559
		Totals	**$7,132,121**	**$7,058,867**	**$4,235,320**

[a] We classified the $4,235,320 as funds to be put to better use. This is 60 percent of the $7,058,867 in unpaid principal balances for the 41 loans as of August 31, 2010. The 60 percent is the estimated percentage of loss to HUD for fiscal year 2009 when the FHA property was resold for less than the unpaid principal balance.

The FHA case numbers with an asterisk (*) indicate the loans that were delinquent or in the foreclosure process as of August 31, 2010.

Appendix D

LOAN DETAILS

Appendix D-1

<u>FHA case #</u>: 095-1164560	<u>Mortgaged amount</u>: $402,930
<u>Date of loan closing</u>: 04/07/2009	<u>Unpaid principal balance</u>: $402,125
<u>Loan purpose</u>: Purchase - existing	<u>Default status</u>: First legal action to commence foreclosure

<u>Employment Income Not Supported</u>

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, REV-5, chapter 2, section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Documents contained in the loan file such as the loan application, verification of employment, and pay stubs indicated that the borrower held two jobs. In addition, the loan file contained the borrower's amended 2007 and 2008 tax returns, which increased the borrower's taxable income from $9,110 to $73,157 and from $25,560 to $91,061, respectively. The 2007 and 2008 amended tax returns were dated January 14, 2009, and March 6, 2009, respectively. The borrower started the loan process in March 2009. The loan file contained no explanation regarding the increase to the borrower's income. The lender used the documents to support a monthly income of $7,953. Using the same documents, we calculated a monthly income of $7,477.

Our verifications with the two employers did not support the lender's income amount. We were only able to verify $1,614 from one of the borrower's employers. For the borrower's other employment, the employer stated that he did not know the borrower's income and did not have documentation to confirm the borrower's income. Yet, the individual was the vice president of the company at the time and had confirmed his signature on the verification of employment and the paychecks to the borrower. Due to the employer's inability to verify the borrower's income and an appearance of a financial relationship between the employer and the borrower (discussed below), we question the accuracy of the income information for this employer as reported in the loan file submitted to HUD. Therefore, we also could not recalculate the qualifying (housing payment-to-income and debt-to-income) ratios.

<u>FHA Property Not Owner Occupied</u>

HUD Handbook 4155.1, REV-5, paragraphs 1-1 and 1-2, state that FHA's single-family programs are limited to owner-occupied principal residences. A principal residence is a property that will be occupied by the borrower for the majority of the calendar year. HUD will not insure a mortgage if 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. We conducted an onsite visit to the FHA property and found the property to be rented. The renters stated and provided support to show that they began renting the property in August 2009 and paid rent to someone who claimed to be the property manager. Coincidentally, the name of the property manager was the same as the individual who employed the borrower but contended that he could not provide documentation to support the borrower's income.

FHA case #: 095-0927805 — Mortgaged amount: $276,353

Date of loan closing: 11/25/2008 — Unpaid principal balance: $267,625

Loan purpose: Purchase - existing — Default status: Delinquent

Employment Income Not Accurate

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, REV-5, Chapter 2, Section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. The loan application indicated that the borrower had two places of employment and that the second employment ended in January 2008. Yet, the loan file also contained October and November 2008 pay stubs and a verification of employment dated November 2008 from the second employer. The lender considered the total $9,087 monthly income from both employers but did not explain the inconsistency among the documents. Using the income from the two employers, the lender calculated housing payment-to-income and debt-to-income ratios of 29.7 and 40.4 percent, respectively.

Our verification with the borrower did not support the $9,087 monthly income. For the second employer, the borrower stated that she did not work for the employer and had not heard of it. Specifically, the borrower stated that she did not know the person who signed the verification of employment and did not provide and had not seen the pay stubs and IRS forms W-2 from the second employer that were in the loan file. We verified the borrower's employment information with her first employer. Based on the records provided by the first employer, we calculated the borrower's monthly income at the time to be $2,759. Using the verified and supported income amount, we calculated qualifying ratios of 97.7 and 133.0 percent.[2] Given the excessively high ratios, the borrower would not have qualified for an FHA mortgage loan.

[2] Mortgagee Letter 2005-16 listed the benchmark housing payment-to-income and debt-to-income ratios to be 31 and 43 percent, respectively.

FHA case #: 095-0679947	Mortgaged amount: $280,596
Date of loan closing: 06/17/2008	Unpaid principal balance: $279,830
Loan purpose: Purchase - existing	Default status: First legal action to commence foreclosure

Employment Income Not Accurate

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, REV-5, Chapter 2, Section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Documents contained in the loan file such as the borrower's and coborrower's pay stubs, tax returns, and Social Security letters did not support the income amount reported by the lender. The lender reported monthly income of $9,339, whereas our review of the documentation supported a monthly income of $8,118.

Our verification with the borrower and the tax returns ordered from the IRS during our interview supported a significantly lower amount. Our review of the tax returns and interview with the borrower showed that the borrower's monthly employment and Social Security income was $4,361. The borrower stated that the information in the tax returns contained in the loan file was not accurate and not provided by her.

Source of Funds Not Supported

The lender did not verify the borrower's funds to close. HUD Handbook 4155.1, REV-5, paragraphs 2-10 and 3-1F, state that all funds for the borrower's investment in the property must be verified and documented. A verification of deposit, along with the most recent bank statement, is to be provided to verify savings and checking accounts. Although a verification of deposit was in the loan file, it was not for the account provided in the loan application, and the loan file did not contain bank statements of the borrower's bank account to verify the $13,204 reported on the loan application. The borrower stated that the $13,204 listed in the loan account as her bank balance was incorrect.

Inadequate Credit Analysis

The lender did not include all of the borrower's liabilities or explain why it omitted the liabilities from the qualifying ratio calculation. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. The borrower's credit report listed total monthly recurring liabilities of $1,275. However, the lender only considered $1,029 of the borrower's liabilities in its calculation without providing a reason why the other liabilities were not included. Since the amount of liabilities was used in the calculation of the debt-to-income ratio and to support the lender's decision to approve the loan, documentation showing how the lender calculated the ratio should be included in the loan file.

Using the verified and supported income amount (see issue above) and considering all of the borrower's liabilities listed on the credit report, we calculated qualifying ratios of 56.7 and 85.9 percent. Given the excessively high ratios, the borrower would not have qualified for the FHA mortgage loan.

In addition, the lender did not obtain a written explanation from the borrowers to adequately explain the reason(s) for 23 collection accounts. 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. When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. When major indications of derogatory credit including judgments or collections exist, the lender must require sufficient written explanation from the borrower, and the explanation must make sense and be consistent with the other credit information in the file. The loan file contained a letter which explained that the borrowers were disputing many accounts or had no knowledge of the accounts. However, the lender did not ensure that the explanation addressed all 23 accounts. In addition, collections on 8 of the 23 accounts were started in 2008, the time the borrower began the loan process.

Minimum Required Cash Investment Not Met

The lender did not ensure that the borrower made the minimum cash investment to qualify for the loan amount. HUD Handbook 4155.1, REV-5, paragraph 1-7, states that HUD will insure the maximum loan amount provided that the borrower has made a cash investment of at least 3 percent of the contract sales price. Three percent of the contract sales price on the property is $8,550. The HUD-1 settlement statement showed that the borrower invested only $6,818, for a shortage of $1,732.

FHA case #: 095-1026242 Mortgaged amount: $305,962

Date of loan closing: 01/13/2009 Unpaid principal balance: $305,962

Loan purpose: Purchase - existing Default status: First legal action to commence foreclosure

Employment Income Not Accurate

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, REV-5, chapter 2, section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. The loan application contained in the loan file listed the borrower's monthly income at $7,706. The amount was supported by the borrower's 2006 and 2007 tax returns, which had reported annual incomes of $88,839 and $96,010, respectively. However, our review of the lender's loan file contained tax transcripts from the IRS that had been pulled January 12, 2009, which indicated that the borrower had total income of $9,300 in 2006 and did not file a tax return in 2007. Another review of the 2006 and 2007 tax returns contained in the loan file showed that written on the 2006 tax return was the phrase "does not match" and written on the 2007 tax return was the phrase "did not file." The loan file contained no explanation for the discrepancy or follow-up on the issue.

The borrower was self-employed. We were not able to locate the borrower to verify the information. We contacted a former officer of the company, but the individual certified that he did not have documentation regarding the borrower's employment. HUD Handbook 4155.1, REV-5, paragraph 2-9C, states that the lender must establish the borrower's earnings trend over the previous 2 years. Since the borrower's earnings could not be established for the past 2 years, the lender should not have approved this loan. As a result, we could not determine the borrower's effective income and could not recalculate the borrower's qualifying ratios.

Inadequate Credit Analysis

The lender did not include all of the borrower's liabilities or explain why it omitted the liabilities from the qualifying ratio calculation. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. According to the credit report, the borrower had a $29,576 car loan that the lender did not include in its calculation of the borrower's liabilities. The loan file contained no documentation to explain why the lender omitted the liability from the debt-to-income ratio calculation. Since the amount of liabilities is used to calculate the ratio and support the lender's decision to approve the loan, documentation showing how the lender calculated the ratio should be included in the loan file.

<u>FHA case #</u>: 095-1076080 <u>Mortgaged amount</u>: $335,775

<u>Date of loan closing</u>: 01/22/2009 <u>Unpaid principal balance</u>: $330,581

<u>Loan purpose</u>: Refinance – cash out <u>Default status</u>: Reinstated

<u>Employment Income Not Supported</u>

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower. Documents contained in the loan file such as the borrower's pay stubs did not support the income amount of $6,928 reported by the lender. In addition, our verification of the borrower's employment income supported a monthly income of $6,582.

<u>Inadequate Credit Analysis</u>

The lender did not include all of the borrower's liabilities or explain why it omitted the liabilities from the qualifying ratio calculation. The lender omitted $27,372 of the borrower's debts in computing the qualifying ratios. The lender only considered $16,496 of the borrower's debts while the documentation in the loan file showed debts totaling $43,868. The $27,372 of debts omitted were student loans. HUD Handbook 4155.1, REV-5, paragraph 2-11C, states that if a debt payment such as a student loan is scheduled to begin within 12 months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis unless the borrower provides written evidence that the debt will be deferred to a period outside the timeframe. The loan file contained no written evidence that the student loans would be deferred outside the timeframe and no written explanation from the lender regarding why the other liabilities were not included to calculate the debt-to-income ratio. Further, HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. Thus, documentation showing how the lender calculated the ratio should be included in the loan file.

Without the written explanations, we considered the total liabilities listed on the borrower's credit report to calculate a monthly recurring debt (not considering housing payments) of $3,656. Using the correct income amount (see issue above) and considering all of the borrower's liabilities, we calculated qualifying ratios of 40.6 and 96.1 percent. Given the excessive ratios, the borrower would not have qualified for a FHA mortgage loan.

In addition, the lender did not obtain a written explanation from the borrower to adequately explain the reason(s) for the four delinquent accounts, five collection accounts, and one judgment. 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. When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. When major indications of derogatory credit including judgments or collections exist, the lender must require sufficient written explanation from the borrower, and the explanation must make sense and be consistent with the other credit information in the file. The loan file contained no written explanation. By not obtaining a reasonable explanation, the lender failed to properly examine the borrower's pattern of credit behavior.

Loan Amount Greater Than Maximum Allowable Mortgage

The lender did not properly calculate the mortgage amount. This was a "cash out" refinance. The HUD-1 settlement statement showed that the borrower used the loan to pay off her 2008 property tax of $3,190. The HUD-1 also showed that the loan paid off the borrower's prior mortgage amount of $307,000. Mortgagee Letter 2005-43 states that FHA will insure a cash-out refinance of up to 95 percent of the appraiser's estimate of value. Applying the percentage to the appraised value of $345,000, we calculated a maximum loan amount of $327,750. However, the lender allowed the mortgage amount of the refinance to be set at $330,000. Therefore, the mortgage amount exceeded the maximum loan amount by $2,250. The mortgage loan was overinsured by $2,250.

Appendix E

SCHEDULE OF INDEMNIFICATION AMOUNTS FOR THE FIVE LOANS

FHA case number	Unpaid principal balance	Indemnification amount*	Status of loan as of August 31, 2010
095-1164560	$ 402,125	$241,275	Foreclosure process
095-0927805	$ 267,625	$160,575	Delinquent
095-0679947	$ 279,830	$167,898	Foreclosure process
095-1026242	$ 305,962	$183,577	Foreclosure process
095-1076080	$ 330,581	$198,349	Reinstated
Totals	**$1,586,123**	**$951,674**	

*We classified the $951,674 as funds to be put to better use. This is 60 percent of the $1,586,123 in unpaid principal balances for the five loans. The 60 percent is the estimated percentage of loss to HUD for fiscal year 2009 when the FHA property was resold for less than the unpaid principal balance.