Issue Date March 14, 2012
Audit Report Number 2012-FW-1006

TO: Charles S. Coulter
Deputy Assistant Secretary for Single Family Housing, HU

//signed//

FROM: Gerald R. Kirkland
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: J&M Mortgage Brokers, Ltd., Houston, TX, Did Not Comply With HUD-FHA Loan Requirements in Underwriting 6 of 20 Loans

HIGHLIGHTS

What We Audited and Why

We audited J&M Mortgage Brokers, Ltd., dba Mortgages USA, a Dallas, TX-based nonsupervised direct endorsement lender. We selected J&M because it had a high rate of defaults and claims within the first year. Our audit objectives were to determine whether J&M originated Federal Housing Administration (FHA)-insured single family mortgages in accordance with U. S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions and implemented a quality control plan that met HUD and FHA requirements.

What We Found

J&M did not originate 6 of 20 loans reviewed in accordance with HUD and FHA requirements. Of the six loans, five had significant underwriting deficiencies and did not qualify for FHA insurance, and one had minor deficiencies. As a result, J&M exposed HUD to unnecessary insurance risks totaling more than $327,000 and caused HUD to incur losses of more than $65,000.

J&M violated the HUD and FHA requirements because it did not have adequate controls in place to ensure that it understood and complied with those requirements. Further, it lacked a compliant quality control plan and process, which may have prevented it from detecting or correcting some of the errors.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require J&M to (1) buy down one loan by $1,750 due to overinsurance, (2) indemnify HUD for three loans with an estimated potential loss of $325,482,[1] (3) reimburse the FHA insurance fund $65,559 for actual losses on one loan, and (4) ensure that its quality control plan and loan origination practices comply with HUD requirements. We also recommend that HUD refer J&M to the Mortgagee Review Board for administrative actions for failure to implement a quality control program in compliance with HUD requirements.

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

Auditee's Response

We provided our discussion draft to J&M on February 10, 2012, and held the exit conference on February 17, 2012. We requested a written response by February 24, 2012. We extended the written response date at J&M's request, and J&M provided its written comments, along with supporting documents, on February 29, 2012. J&M agreed with some conclusions and disagreed with others. J&M provided explanations and documentation in its response to support its position. We reviewed the explanations and documentation and determined that they were not sufficient to justify changes to the report.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report. The supporting documents provided with J&M's response is available in its entirety upon request.

[1] The amount is based on the estimated percentage of loss of 64 percent that HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2011.

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BACKGROUND AND OBJECTIVES

J&M Mortgage Brokers, Ltd., dba Mortgages USA, is a nonsupervised direct endorsement lender, which was approved by the U. S. Department of Housing and Urban Development (HUD) to originate Federal Housing Administration (FHA) mortgage loans on March 23, 2007. J&M's corporate headquarters is located at 4455 LBJ Freeway, Suite 1200, Dallas, TX.

The direct endorsement program simplified the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. Lenders are responsible for complying with all applicable HUD regulations and are required to evaluate the borrower's ability and willingness to repay the mortgage debt. Lenders are protected against default by FHA's Mutual Mortgage Insurance Fund, which is sustained by borrower premiums. FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers and projects that might not be able to meet conventional underwriting requirements by protecting the lender against default.[2]

According to HUD's Neighborhood Watch system,[3] J&M originated 340 loans totaling $47.8 million in 2008. In 2009 and 2010, it originated 608 loans totaling $90.7 million and 294 loans totaling $42.6 million, respectively. J&M's overall default rate during our review period ranged from 3.73 to 6.34 percent, while the national average default rate ranged between 2.43 and 4.9 percent during the same period.

J&M had one branch office in Plano, TX, in December 2010; however, it closed the branch office after a few months. It did not have any other branch offices during the review period. J&M did not service the loans it originated, rather it sold its loans to other companies.

Our audit objectives were to determine whether J&M originated FHA insured single family mortgages in accordance with HUD and FHA regulations, procedures, and instructions and implemented a quality control plan that met HUD and FHA requirements.

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2 HUD defines a default as the inability to make timely mortgage payments or otherwise comply with mortgage terms. A loan is considered in default when no payment has been made 30 days after the due date. Once a loan is in default, the lender can exercise legal rights defined in the contract to begin foreclosure proceedings.

3 Neighborhood Watch is Web-based software that displays loan performance data for FHA-insured single-family loans. The system is designed to highlight exceptions so that potential problems are readily identifiable.

RESULTS OF AUDIT

Finding: J&M Did Not Originate 6 of 20 Loans Reviewed in Accordance With HUD and FHA Requirements

Six of 20 loans reviewed did not comply with HUD and FHA requirements. All six loans had underwriting deficiencies. Five[4] of the six loans had significant deficiencies and should not have been approved for FHA insurance, while the sixth loan[5] was qualified but was overinsured. These conditions occurred because J&M did not have adequate controls in place to ensure that it understood and complied with those requirements. Further, it lacked a compliant quality control plan and process, which may have prevented it from detecting or correcting some of the errors. As a result, J&M exposed HUD to unnecessary insurance risks totaling more than $327,000 and caused HUD to incur losses of more than $65,000.[6]

J&M Did Not Comply With HUD and FHA Requirements

Six of 20 home loans reviewed did not comply with HUD requirements because they contained one or more underwriting deficiencies.

Specifically, J&M

- Overinsured two loans,
- Miscalculated income for one loan and used questionable income documentation for another loan,
- Did not properly resolve credit discrepancies for two loans,
- Did not ensure that the borrowers had sufficient funds to close two loans, and
- Improperly handled documents for one loan.

4 FHA case numbers 492-8348210, 492-8509134, 492-8352641, 493-8913880, and 493-9530796
5 FHA case number 421-4564607
6 See Appendix C for details on questioned costs

The table below shows a summary of the loan deficiencies. Appendix D contains case narratives that provide additional details for each of the six deficient loans.

Summary of underwriting deficiencies

Case number	Overinsured	Incorrect or unverified income	Unresolved credit discrepancies	Unverified funds to close	Improperly handled documents
492-8348210	X		X		
492-8509134		X			X
421-4564607	X				
492-8352641		X	X	X	
493-8913880			X		
493-9530796				X	

J&M Overinsured Two Loans

J&M's underwriters overinsured two loans. They overinsured FHA loan 492-8348210 by $9,193 and FHA loan 421-4564607 by $1,750. Overinsurance alone did not make the loans ineligible for FHA insurance.

FHA loan 492-8348210 was for the purchase of a HUD real estate-owned property[7] that J&M's underwriter approved with a loan-to-value ratio of 108 percent. HUD limited such loans to 96.5 percent at that time.[8] The loan was overinsured because J&M's underwriter allowed the borrower to include closing costs and prepaid expenses in the mortgage in violation of HUD's rules.[9] The loan-to-value ratio was shown on the loan transmittal and underwriting summary form, which accompanied the loan and was signed by an underwriter. Therefore, the underwriter should have been aware that the loan was insured for more than 100 percent. However, the underwriter either was not aware of HUD's rule prohibiting the inclusion of closing costs and prepaid expenses in the mortgage or chose to ignore the rule and queried an investor company for confirmation about the proper procedures for underwriting this loan. However, according to a current underwriter, the investor's guidance was incorrect, and the investor purchased the overinsured loan.

J&M's underwriter also calculated the loan-to-value ratio using an incorrect home value. According to HUD's requirements,[10] the lower appraised as-is value of $70,100 should have been used, but the underwriter used the higher sales value of $71,100. Therefore, the actual loan-to-value ratio should have been 113 percent.

7 A HUD real estate-owned property is a one to four unit residential property HUD acquired by foreclosing on an FHA-insured mortgage. HUD is the property owner and offers it for sale to recover the loss on the foreclosure claim.
8 HUD Handbook 4155.1, paragraph 2.A.2.a.
9 HUD Handbook 4155.1, paragraph 2.A.2.c and Mortgagee Letter 00-27
10 Mortgagee Letter 00-27

The borrower later refinanced this loan through J&M into a new FHA mortgage, which was not overinsured.

FHA loan 421-4564607 was a refinanced loan for which the buyer obtained cash from his equity in the home. The loan was closed with a loan-to-value ratio of 87.19 percent. HUD allows a maximum loan-to-value ratio of 85 percent for cash-back refinance loans.[11] As a result of using the higher loan-to-value ratio, the refinanced loan was overinsured by $1,750.

In both overinsured FHA loans, the underwriters should have been aware of loan-to-value limitations. However, the underwriters were either not aware of or chose to ignore the requirement and in at least one case, relied on investor guidance.

Underwriters Miscalculated Income for One Loan and Used Questionable Income Documentation for Another Loan

J&M's underwriters used unsupported bonus or incentive pay to determine income for FHA loan 492-8509134 and questionable income documentation for FHA loan 492-8352641.

For FHA loan 492-8509134, the underwriter incorrectly included bonus or incentive pay that the borrower had previously received but that was not regular and recurring. HUD Handbook 4155.1, paragraph 4.D.2.b, requires that for overtime and bonus income to be used to qualify the borrower, the lender must establish that the borrower has received such income for the past 2 years and that the overtime and bonus income is likely to continue. The handbook allows periods less than 2 years if the lender can justify and document the reason for using the income to qualify the borrower.

The borrower had only worked for the employer for 1 year and supplied pay stubs covering only 2 months. J&M obtained a statement from the employer that the borrower could work as much overtime as he wanted; however, there was no explanation or similar statement for the bonus or incentive pay. Therefore, the bonus or incentive pay should not have been included in the income calculation. Using the correct monthly income increased the borrower's front-end ratio[12] from 30.9 to 41.9 percent and the back-end ratio[13] from 56 to 76.1 percent. Had the correct income been entered into the automated underwriting system, the system would probably have disapproved the loan due to the borrower's large back-end ratio.[14] All income entered into the automated underwriting system for risk assessment purposes must meet FHA requirements for qualifying income. The

[11] HUD Handbook 4155.1, REV-5, paragraph 1-11B

[12] The front-end or mortgage payment-to-income ratio measures the borrower's ability to pay the mortgage by comparing the borrower's income to his or her expected payment for the mortgage.

[13] The back-end or total monthly debt-to-income ratio measures the borrower's ability to pay the mortgage by comparing the borrower's income to his or her mortgage payments, credit card payments, child support, and other debt payments.

[14] For loans underwritten by the automated underwriting system, combined with FHA's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard, the system determines the acceptable credit variables.

lender is responsible for determining that the income meets FHA's requirements.[15]

For FHA loan 492-8352641, the underwriter did not correctly verify that the borrower had been employed at the time of the loan application and processing. HUD rules required J&M[16] to obtain the borrower's most recent pay stub; however, J&M obtained and used a pay stub which could not be identified as the borrower's pay stub because it contained no name, address, or Social Security number.

Because of the miscalculated income and questionable income documentation, the two loans were not qualified for FHA insurance. HUD foreclosed upon and resold FHA loan 492-8509134. This resulted in losses of $65,559 to HUD.

J&M Did Not Resolve Credit Discrepancies or Properly Process Loans

For three loans, J&M did not properly resolve credit discrepancies or take additional steps to properly process loans when borrowers had substantial credit discrepancies.

For FHA loan 493-8913880, J&M did not properly resolve credit discrepancies. It did not obtain the borrower's previous rental payment history as required and did not require the borrower to explain in writing the collections shown on the borrower's credit report.[17]

For FHA loan 492-8348210, the underwriter correctly determined and documented that the borrower had an insufficient credit history. However, the underwriter did not perform the additional required step of documenting that the borrower had 2 months' cash reserves.[18]

J&M did not properly process FHA loan 492-8352641 because the underwriter did not downgrade the loan and conduct a manual review. Although Technology Open To Approved Lenders (TOTAL) Scorecard guidelines require an underwriter to conduct a manual review when a borrower's credit report reveals that the borrower disputed credit accounts or public records,[19] the underwriter did not downgrade the loan, and there was no indication in the file that the underwriter reviewed the disputed collection accounts as required.

Because of the unresolved credit discrepancies and improper processing, the three loans were not qualified for FHA insurance.

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[15] FHA's Technology Open To Approved Lenders (TOTAL) Mortgage Scorecard User Guide, page 5

[16] Documentation guidelines given on the TOTAL Scorecard feedback certificate from the automated underwriting system

[17] HUD Handbook 4155.1, REV-5, paragraphs 2-3A and C

[18] HUD Handbook 4155.1, paragraph 4.C.3.d

[19] FHA's Technology Open To Approved Lenders (TOTAL) Mortgage Scorecard User Guide, page 24

Loans Lacked Sufficient Evidence of Funds To Close

For FHA loans 492-8352641 and 493-9530796, the underwriters did not ensure that the borrowers had sufficient funds to close.

The underwriter gave the borrower for FHA loan 492-8352641 credit for lease payments reportedly paid while living in the property as his downpayment for the loan. According to HUD requirements,[20] both a rent-with-option-to-purchase agreement and the appraiser's estimate of market rent are required to determine how much of the lease payments can be used as the borrower's cash investment. J&M did not obtain a rent-with-option-to-purchase agreement and did not require the appraiser to estimate the fair market rent as required. According to documentation in the FHA file, the underwriter gave the borrower credit for $11,000 in rent; however, the underwriter only included evidence supporting that the borrower paid $8,525. In addition, the underwriter did not deduct an amount for fair market rent from the $8,525 as required. Only amounts paid in excess of the fair market rent can be credited toward the downpayment.

For FHA loan 493-9530796, the underwriter did not verify the source of a large increase in the borrower's accounts before closing as required.[21] The borrower needed $2,998 for closing and had $1,945 in a bank account before receiving a $3,451 deposit from an unidentified source.

Because the funds for closing for the two loans were not properly supported, the loans were not eligible for FHA insurance.

J&M Accepted Improperly Handled Documents

For FHA loan 492-8509134, the underwriter accepted improperly handled documents to verify the borrower's employment and income. HUD Handbook 4155.1, paragraph 1.B.1.f, prohibits lenders from accepting or using documents relating to the credit, employment, or income of borrowers when those documents are handled by or transmitted from or through interested third parties (for example, real estate agents, builders, sellers) or by using their equipment. Because this loan was qualified using improperly handled documents, it should not have been underwritten for FHA insurance.

Both J&M's Quality Control Plan and Its Quality Control Process Were Inadequate

J&M Mortgage did not have a written quality control plan in place for most of the audit period. Its quality control plan was revised as of January 1, 2011; however, it was also generally noncompliant with FHA requirements because it did not contain elements required by chapter 7 of

[20] HUD Handbook 4155.1, REV-5, paragraph 2-10N
[21] HUD Handbook 4155.1, REV-5, paragraph 5.2.b

HUD Handbook 4060.1. For example, it was silent on the requirements to adequately train staff involved in the quality control process and document how sample sizes and selections for review were to be determined. It also did not require field reviews of appraisals on 10 percent of the loans selected for review.[22]

Further, J&M's quality control process did not comply with HUD's or its own requirements. J&M did not perform quality control reviews in some months in which a review was required and did not conduct its quality control reviews within 90 days from the end of the month in which the loan closed as required.[23] J&M's quality control review reports also did not state whether corrective actions were taken as required based on the quality control findings. In addition, although J&M's quality control plan correctly required that all early payment default loans be reviewed, it did not review any of the 12 early payment default loans that occurred during our audit period. Without reviewing its defaulted loans, J&M had no system in place to assess why the loans defaulted and correct problems in its underwriting process, which may have contributed to the defaults.

In addition, J&M did not report a significant finding contained in its quality control review to HUD as required. In one of its quality control reports, the reviewer found errors, which she labeled as serious. HUD Handbook 4060.1, REV-2, paragraph 7-3J, requires that findings of fraud or other serious violations be immediately referred, in writing (along with any available supporting documentation), to the director of HUD's Quality Assurance Division in the HUD Homeownership Center having jurisdiction (determined by the State where the property is located).[24] In lieu of submitting a paper report, lenders must use the "lender reporting" feature in the Neighborhood Watch Early Warning System. During the audit period, J&M did not report any serious quality control findings to HUD through its Neighborhood Watch system as required.

J&M Did Not Have Proper Written Policies and Procedures

J&M did not have written policies and procedures regarding the origination and processing of FHA-insured loans at the time we began the review. Staff responsible for processing and underwriting FHA-insured loans primarily relied on their own knowledge of HUD and FHA requirements, although one loan processor told us that she followed a checklist. Other staff told us that they received email updates regarding HUD and FHA changes from the current

[22] HUD Handbook 4060.1, REV-2, paragraphs 7-3C, 7-6C, and 7-6E(3)

[23] HUD Handbook 4060.1, REV-2, paragraph 7-6A

[24] HUD has four Homeownership Centers (HOCs) that handle many of its mortgage insurance operations, including monitoring the origination and servicing practices of HUD-approved single family mortgagees, for a designated geographic area.

underwriter, HUD, and investor mailing lists. J&M staff also relied upon underwriting guidance from the investors buying the loans. For example, a staff member expressed surprise that FHA loan 492-8348210 passed the investor's prepurchase audit and told us that if the loan had been improperly underwritten, the investor would not have purchased it.

J&M had experienced a large turnover in management and staff since the six questioned loans were underwritten, and the current underwriter was unable to explain why the loans were not underwritten in compliance with HUD and FHA regulations.

Conclusion

J&M's loan origination for 6 of 20 loans and its quality control practices did not comply with HUD's and FHA's requirements. As a result, J&M originated five loans that should not have been FHA insured and overinsured two loans including one of the five that should not have been FHA insured. Further, its quality control plan was not properly implemented and may have prevented it from detecting or correcting the errors. As a result, J&M's faulty loans caused HUD to suffer losses totaling $65,559 for one loan and subjected HUD's insurance fund to unnecessary insurance risks totaling $327,232.

Recommendations

We recommend that the Deputy Secretary for Single Family Housing require J&M to

1A. Buy down $1,750 for one overinsured loan.[25]

1B. Indemnify HUD for three insured loans[26] with unpaid principal balances of $508,566 net of overinsurance thereby putting an estimated $325,482 to better use based on the FHA insurance fund average loss rate of 64 percent of the unpaid principal balances.

1C. Reimburse the FHA insurance fund $65,559 for losses incurred on one loan.[27]

1D. Implement a quality control plan and process and loan origination practices that comply with HUD requirements and are adequate to consistently identify and correct underwriting deficiencies in a timely manner and report significant quality control findings.

[25] FHA case number 421-4564607
[26] FHA case numbers 492-8352641, 493-8913880, and 493-9530796
[27] FHA case number 492-8509134

1E. Ensure that its staff and loan correspondents are thoroughly trained regarding HUD regulations and procedures.

We also recommend that the Deputy Assistant Secretary for Single Family Housing

1F. Refer J&M to the Mortgagee Review Board for consideration of administrative actions for failure to implement a quality control program in compliance with HUD requirements.

SCOPE AND METHODOLOGY

We performed audit work from May 25 through December 14, 2011. The audit period covered April 1, 2009, through March 31, 2011. We performed our work at J&M's corporate offices in Dallas, TX, and our office in Houston, TX.

To accomplish our objectives, we

- Reviewed 20 FHA-insured loans that were originated by J&M during the audit period;
- Interviewed J&M officials,[28] loan officers, processors, and underwriters;
- Reviewed J&M financial records and independent audit reports;
- Reviewed public records and HUD's Neighborhood Watch system;
- Reviewed applicable HUD regulations[29], requirements, and mortgagee letters; and
- Obtained profit and loss data from HUD's Single Family Data Warehouse system.

We obtained a download of the FHA loans that J&M originated from April 1, 2009, through March 31, 2011, from HUD's Neighborhood Watch system. The download showed that J&M originated 778 FHA-insured loans valued at $114.9 million. We did not evaluate the reliability of HUD's Neighborhood Watch system because we used the data for background purposes only.

We extracted the 29 loans which had defaulted within the first year of origination from the database and sorted them by the number of payments made before the first 90-day delinquency was reported. We selected the 20 loans with the lowest number of payments before the first 90-day delinquency and reviewed them. The loans selected ranged from 1 to 10 payments and had original mortgage amounts totaling over $2.8 million. The results of our detailed testing apply to only those 20 loans and cannot be projected.

We performed detailed testing and reviewed the underwriting procedures for the 20 loans. We reviewed documentation from the HUD Homeownership Center loan endorsement files and loan files provided by J&M. Our testing and review included (1) analysis of borrowers' income, assets, and liabilities; (2) review of borrowers' savings ability and credit history; (3) verification of selected data on the underwriting worksheet and settlement statements; and (4) confirmation of employment and gifts.

We also obtained and reviewed J&M's quality control plan and the quality control review reports and supporting documentation to determine the sufficiency and timeliness of the quality control reviews on closed loans.

When loans had significant underwriting deficiencies that warranted indemnification, we calculated the indemnification amount as 64 percent of the net unpaid mortgage balance.

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[28] J&M appointed its acting chief financial officer to be our designated point of contact for policies and procedures and for obtaining quality control documents.

[29] Two versions of HUD Handbook 4155.1 were in effect during the audit. HUD Handbook 4155.1, REV-5 is a hardcopy version for loans originated prior to May 10, 2009, while HUD Handbook 4155.1 is a consolidated electronic version for loans originated on or after May 10, 2009.

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:

- Policies and procedures intended to ensure that FHA-insured loans are properly originated, underwritten, and closed.
- Policies and procedures intended to ensure that the quality control program is an effective tool in reducing underwriting errors and noncompliance.

We assessed the relevant controls identified above.

A deficiency in internal controls 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 Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- J&M did not have effective controls in place to ensure that FHA-insured loans were originated, underwritten, and closed in accordance with HUD and FHA requirements (finding).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		$ 1,750
1B		325,482
1C	$65,559	
Totals	**$65,559**	**$327,232**

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/ 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 recommendation 1A will reduce the risk to the insurance fund by the amount of overinsurance. Implementation of recommendation 1B to require J&M to indemnify HUD for three loans that were not originated in accordance with HUD-FHA requirements will reduce FHA's risk of loss to the insurance fund. The amount reflects that, upon the sale of the mortgaged property, FHA's average loss experience is about 64 percent of the unpaid principal balance. The 64 percent loss rate is based on HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition computation for the first quarter of fiscal year 2012 based on actual sales.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

mortgages usa ★ com

4455 LBJ Freeway
Dallas, Texas 75244
972-720-0500

February 27, 2012

U.S. Department of Housing and Urban Development
Office of Inspector General, Region VI
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102

SUBJECT: J&M Mortgage Brokers, Ltd., Houston, TX, Did Not Comply With HUD-FHA Loan Requirements in Underwriting 6 of 20 Loans

J&M Mortgage Brokers, Ltd. is in receipt of your letter dated February 10, 2012 in which you notified J&M of findings and recommended corrective action. Please find below are written responses to these findings and recommended corrective action.

Violation #1: J&M Overinsured Two Loans

Item #1: J&M's underwriters overinsured two loans. They overinsured FHA loan 492-8348210 by $9,193 and FHA loan 421-4564607 by $1750. Overinsurance alone did not make the loans ineligible for FHA insurance.

Item #2: FHA loan 492-8348210 For the purchase of a HUD Real estate-owned property that J&M's underwriter approved with a loan-to-value ratio of 108 percent. HUD limited such loans to 96.5 percent at that time. The loan was over insured because J&M's underwriter allowed the borrower to include closing costs and prepaid expenses in the mortgage in violation of HUD's rules. The loan to value ratio was shown on the loan transmittal and underwriting summary form, which accompanied the loan and was signed by an underwriter. Therefore the underwriter should have been aware that the loan was insured for more than 100 percent. However, the underwriter either was not aware of HUD's rule prohibiting the inclusion closing costs and prepaid expenses in the mortgage or chose to ignore the rule and queried an investor company for confirmation about the proper procedures for underwriting this loan. However, according to a current underwriter, the investor's guidance was incorrect, and the investor purchased the over insured loan.

Item #3: J&M'S underwriter also calculated the loan-to-value ratio using an incorrect home value. According to HUD's requirements, the lower appraised as-is-value of $70,100 should have been used, but the underwriter used the higher sales value of $71,100. Therefore, the actual loan-to-value ratio should have been 113 percent. The borrower later refinanced this loan through J&M into a new FHA mortgage, which was not overinsured.

Item #4: FHA loan 421-4564607 Was a refinanced loan for which the buyer obtained cash from his equity in the home. The loan was closed with a loan-to-value ratio of 87.19 percent. HUD allows a maximum loan-to-value ratio of 85 percent for cash-back refinance loans. As a result of using the higher loan-to-value ratio, the refinanced loan was insured by $1,750.

Response to Violation 1:

<u>FHA Loan Number 492-8348210</u>

Borrower: [redacted]. This loan was refinanced by J&M. There is nothing to Challenge.

Comment 1

<u>FHA Loan Number 421-4564607</u>

Borrower: [redacted]. J&M agrees with these findings and will reimburse HUD $1,750.

<u>Violation #2: Underwriters Miscalculated Income for One Loan and Used Questionable Income Documentation for Another Loan.</u>

Item #1: J&M's underwriters used unsupported bonus or incentive pay to determine income for FHA loan 492-8509134 and questionable income documentation for FHA loan 492-8352641.

Item #2: The underwriter incorrectly included bonus or incentive pay that the borrower had previously received but that was not regular and recurring. HUD Handbook 4155.1, paragraph 4.D.2.b, requires that for overtime and bonus income to be used to qualify the borrower, the lender must establish that the borrower has received such income for the past 2 years and that the overtime and bonus income is likely to continue. The handbook allows periods less than 3 years if the lender can justify and document the reason for using the income to qualify the borrower.

Item#3: The borrower had only worked for the employer for 1 year and supplied pay stubs covering only 2 months. J&M obtained a statement from the employer that the borrower could work as much overtime as he wanted; however, there was no explanation or similar statement for the bonus or incentive pay. Therefore, the bonus or incentive pay should not have been included in the income calculation. Using the correct monthly income increased the borrower's front-end ratio from 30.9 to 41.9 percent and the back-end ratio from 56 to 76.1 percent. Had the correct income been entered into the automated underwriting system, the system would probably have disapproved the loan due to the borrower's large back-end-ratio. All income entered into the automated underwriting system for risk assessment purposes must meet FHA requirements for qualifying income. The lender is responsible for determining that the income meets FHA's requirements.

Comment 2

Comment 3

Item #4: For FHA loan 492-8352641, The underwriter did not correctly verify that the borrower had been employed at the time of the loan application and processing. HUD rules required J&M to obtain the borrower's most recent pay stub; however J&M obtained and used a paystub which could not be identified as the borrower's pay stub because it contained no name, address, or Social Security Number.

Response to Violation 2:

FHA Number 492-8509134

Borrower: [redacted]. A letter from the borrower's employer indicated that the borrower had recently been allowed to work as much overtime as he wanted. The borrower had recently had a pay increase of $4.00 per hour and was expected to get another increase of $10.00 per hour at the first of 2010. The letter also indicated that the borrower was showing 100% in his work quality and is excelling within the corporation. The borrower's income of $4,386.27 was based on Year to Date income. With the expected raise of $10 per hour the borrower's base income would increase from $17.51 to $27.51 which would increase his monthly income to $4,768.79 not including bonus or incentive pay.

FHA Number 492-8352641

Borrower: [redacted]. The file contains a paystub dated 02/01/2009 for pay period 2/01/2009 – 02/15/2009 that appears to have been cut off during imaging. The file also contains a paystub dated 01/23/2009 and on dated 12/24/2008 for pay period 01/01/2009 – 01/15/2009 and 12/01/2008 – 12/15/2008 which reflects the borrowers name, address, and name of employer.

Violation #3 J&M Did Not Resolve Credit Discrepancies or Properly Process

Item#1: For three loans, J&M did not properly resolve credit discrepancies or take additional steps to properly process loans when borrowers had substantial credit discrepancies.

Item#2: For FHA loan 493-8913880 J&M did not properly resolve credit discrepancies. It did not obtain the borrower's previous rental payment history as required and did not require the borrower to explain in writing the collections shown on the borrower's credit report.

Item#3: For FHA loan 492-8348210, J&M, the underwriter correctly determined and documented that the borrower had an insufficient credit history. However, the underwriter did not perform the additional required step of documenting that the borrower had 2 month' cash reserves.

Comment 4

Comment 5

Item#4: J&M did not properly process FHA loan 492-8352641 because the underwriter did not downgrade the loan and conduct a manual review. Although Technology Open To Approved Lenders (TOTAL) Scorecard guidelines require an underwriter to conduct a manual review when the borrower's credit report reveals that the borrower disputed credit accounts or public records, the underwriter did not downgrade the loan, and there was no indication in the file that the underwriter reviewed the disputed collection accounts as required.

Response to Violation 3:

FHA Loan Number 493-8913880

Borrower: [redacted]. The information was run through FHA Total Scorecard with an Accept Recommendation. HUD 4155.1, 4.C.2.b states that If the loan receives an Accept/Approve recommendation from the Technology Open To Approved Lenders (TOTAL) Scorecard, the housing/rental history requirement stated above is waived. HUD 4155.1 4.C.2.d states Collection accounts trigger neither an explanation requirement nor a hypothetical monthly payment to be used in qualifying borrowers. The presence of collection accounts in the borrower's credit history already result in lowering the credit bureau scores used in TOTAL and, thus, no further information need be provided by the borrower.

FHA Loan Number 492-8348210
Borrower: [redacted]. This loan was refinanced by J&M. There is nothing to Challenge.

FHA Loan Number 492-8352641
Borrower: [redacted]. FHA TOTAL Scorecard User Guide states:
Disputed Accounts/Collections and Public Records
If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review unless any of the following circumstances apply:
The disputed account has a zero balance
The disputed account is marked as "paid in full" or "resolved"
The disputed account is *both*
-less than $500, *and*
-more than 24 months old

The FHA Loan Underwriting and Transmittal Summary were signed by the Underwriter indicating that the Underwriter acknowledged reviewing the documents.
9 total accounts were disputed accounts.

- **3 disputed accounts were less than 500 and more than 24 months old**
- **1 disputed account was for medical**
- **5 disputed accounts did not meet the criteria above.**

Violation #4 Loans Lacked Sufficient Funds To Close

Item #1 For FHA loans 492-8352641 and 493-9530796, the underwriters did not ensure that the borrowers had sufficient funds to close.

Item #2 The underwriter gave the borrower for FHA loan 492-8352641 credit for lease payment reportedly paid while living in the property as his down payment for the loan. According to HUD requirements, both a rent-with-option-to-purchase agreement and appraiser's estimate of market rent are required. According to documentation in the FHA file, the underwriter only included evidence supporting that the borrower paid $8,525. In addition, the underwriter did not deduct an amount for fair market rent from the $8,525 as required. Only amounts paid in excess of the fair market rent can be credited toward the down payment.

Item #3 For FHA loans 493-9530796, the underwriter did not verify the source of a large increase in the borrower's accounts before closing as required. The borrower needed $2,998 for closing and had $1,945 in a bank account before receiving a $3,451 deposit from an unidentified source.

Response to Violation 4:

Comment 6

FHA Loan Number 492-8352641

Borrower: [redacted]. Based on HUD.gov Fair Market Rate information the Final FY 2008 FMRs By Unit Bedrooms for a 3 bedroom house was $1,156 per month or $13,872 per year. The 1003 indicates that the borrower monthly rent is $1,500 per month or $18,000 per year. Based on these figures the allowable credit would be $4,128. In addition to the credit of $4,128 the seller is allowed to contribute up to 6% of the purchase price toward the borrower's closing costs. Based on a purchase price of $206,250 the seller can contribute up to $12,375. HUD 4155.1 2.A.3.b

Comment 7

FHA Loan Number 493-9530796

Borrower: [redacted]. Compensating Factors: a) the borrower worked for the same employer as a school teacher for 2 years and 6 months; b) the Borrower's Mid Credit Score was 663; c) the borrower debt-to-income ratio was 47.837. As of November 30, 2011 the borrower was current on the loan indicating the underwriter's decision was correct.

Violation #5 J&M Accepted Improperly Handled Documents

Item #1 For FHA loan 492-8509134, the underwriter accepted improperly handled documents to verify the borrower's employment and income. HUD Handbook 4155.1, paragraph 1.B.1.1, prohibits lenders from accepting or using documents relating to the credit, employment, or income of borrowers when those documents are handled by or transmitted from or through interested third parties (for example, real estate agents, builders, sellers) or by using their equipment.

Comment 8

Response to Violation 5:

FHA Loan Number 492-8509134

Borrower: [redacted]. Paystubs and W-2's were faxed using San Angelo Real Estate Company's fax machine as shown by the header at the top of the pages. However, two Paystubs found in the file indicated the borrower's hourly wages the same as the documents from the San Angelo office were faxed from The UPS store. We have implemented into Policy and Procedures to not allow borrower's documents to be handled by or transmitted from or through interested third parties per HUD Handbook 4155.1, paragraph 1.B.1.1.

Violation #6 Both J&M's Quality-Control Plan and Its Quality Control Process were Inadequate

Item #1 J&M Mortgage did not have a written quality control plan in place for most of the audit period. Its quality control plan was revised as of January 1, 2011; however, it was also generally non compliant with FHA requirements because it did not contain elements required by chapter 7 of HUD Handbook 4060.1. For example, it was silent on the requirements to adequately train staff involved in the quality control process and document how sample sizes and selections for review were to be determined. It also did not require field review appraisals on 10 percent of the loans selected for review.

Item #2 Further, J&M's quality control process did not comply with HUD's or its own requirements. J&M did not perform quality control reviews in some months in which a review was required and did not conduct its quality control reviews within 90 days from the end of the month in which the loan closed as required. J&M's quality control review reports also did not state whether corrective actions were taken as required based on the quality control findings. In additional, although J&M's quality control plan correctly required that all early payment defaulted loans be reviewed, it did not review any of the 12 early payment default loans that occurred during our audit period. Without reviewing its defaulted loans, J&M had no system in place to assess why the loans defaulted and correct problems in its underwriting process, which may have contributed to the defaults.

Item #3 In addition, J&M did not report a significant finding contained in its quality control review to HUD as required. In one of its quality control reports, the reviewer found errors, which she labeled as serious. HUD Handbook 4060.1, REV-2, paragraph 7-31, requires that findings of fraud or other serious violations be immediately referred, in writing (along with any available supporting documentation), to the director of HUD's Quality Assurance Division in the HUD Homeownership Center having jurisdiction (determined by the State where the property is located) In lieu of submitting a paper report, lenders must use the "lender reporting" feature in the Neighborhood Watch Early Warning System. During the audit period, J&M did not report any serious quality control findings to HUD through its Neighborhood Watch System as required.

Comment 9

Response to Violation 6:

As of June 2011 J&M has implemented a Quality Control Plan which contains all of the elements required by chapter 7 of HUD Handbook 4060.1. This Quality Control Plan includes sample size, selections for review were to be determined, and requires field review appraisals on 10 percent of the loans selected for review. J&M has contracted a Third Party Quality Control Company to review monthly selections. These quality control reviews are being performed within 90 days from the end of the month in which the loan closed as required. In addition 100% of Early Payment loans are being reviewed. All of J&M's quality control review reports are being responded to with a Management Response Letter to our Third Party Quality Control Company.

Based upon the information provided and the proactive measures taken by our institution over the preceding year, we believe that the recommended corrective actions would not be justified at this time.

Thank you for your consideration.

Sincerely,

Jeff Morgan

President/J&M Mortgage Brokers, Ltd.

Enclosure

OIG Evaluation of Auditee Comments

Comment 1: J&M acknowledged that one loan had been re-financed and agreed that a second loan was overinsured. J&M agreed to reimburse HUD for the overinsurance. We did not change the report.

Comment 2: J&M stated that the borrower's effective income was expected to increase because he had a letter from his employer projecting that he would receive a promotion and an expected raise of $10 per hour by the beginning of 2010. We disagree because HUD Handbook 4155.1, paragraph 4.E.5.c prohibits using projected or hypothetical income to qualify potential borrowers unless the income is from a performance raise and is scheduled to begin within 60 days of loan closing. In this case, the projected wage increase was due to a possible promotion instead of a performance raise, and would take effect by the beginning of 2010 which was 5 months after loan closing. We did not change the report.

Comment 3: J&M noted that the file contained prior period pay stubs which reflected the borrower's name, address, and employer. We agree that there were some prior period pay stubs which exhibited the appropriate identifying information. However, the most recent paystub should not have been used because it could not be reliably attributed to the borrower without identifying information. Since this paystub should not have been used, J&M could not document the most recent full month's earnings for the borrower as required. Further, J&M did not obtain a verbal verification of employment as required. We did not change this finding.

Comment 4: J&M stated that since the loan received an "accept" rating from the Technology Open to Approved Lenders (TOTAL) Scorecard, the credit resolution items cited in the finding were not required. We disagree. According to documentation in the file, this loan was downgraded to a "refer" rating and required to be manually underwritten. The loan was also shown as being manually underwritten in HUD's Neighborhood Watch system. Under the rules for manually underwritten loans, the credit resolution items are required. We did not change the finding.

Comment 5: J&M stated that the TOTAL Scorecard User Guide allowed an exception to the requirement that the mortgage application be referred to a manual underwriter when the borrower disputed collection accounts or public records. J&M further stated that its underwriter's signature on the Loan Transmittal form indicates that the underwriter reviewed the required documents. We disagree because the TOTAL Scorecard User Guide that was in effect at the time J&M closed this loan contained no exceptions. Therefore, the application should have been downgraded and referred to a DE underwriter to be manually underwritten. We did not change the report.

Comment 6: J&M's response did not address HUD's requirement that the underwriter verify a rent-to purchase option agreement exists and that an appraiser has given an estimate of fair market rent. We did not change the report.

Comment 7: J&M's response did not address the underwriting deficiency. We did not change the report.

Comment 8: J&M acknowledged that income documents were faxed using the real estate company's fax machine. However, J&M stated that two additional paystubs from a third party's fax machine confirmed the borrower's hourly wages. J&M used the paystubs and W-2s transmitted through the real estate company to qualify the borrower for the loan, and their income calculations were based on these improperly handled paystubs.

J&M stated that it had changed it policies and procedures to not allow borrowers' documents to be handled by or transmitted through interested third parties. We did not verify that J&M changed its policies and procedures to prohibit using such documents in the future and do not have an opinion on it. We did not change the report.

Comment 9: J&M stated that it has implemented a quality control plan which complies with HUD requirements, and has hired an independent company to perform its quality control reviews. We have not verified these changes and do not have an opinion on them. We did not change the report.

Appendix C

SUMMARY DATA FOR LOANS REVIEWED[30]

Loan number	Original mortgage	Unpaid balance	Overinsured portion of mortgage	Claims paid	Loss on property sale	Net unpaid principal balance	64 percent of unpaid balance	Loan status
492-8348210	$70,576	N/A	$9,193	N/A	N/A	N/A	N/A	Refinanced into new FHA loan
492-8509134	154,646	N/A	N/A	$161,810	$65,559	N/A	N/A	Foreclosed upon and resold
421-4564607	70,970	$61,516	1,750	N/A	N/A	N/A	N/A	Delinquent
492-8352641	202,514	193,925	N/A	N/A	N/A	$193,925	$124,112	Conveyed to insurer
493-8913880	193,837	187,009	N/A	N/A	N/A	187,009	119,686	Chapter 13 bankruptcy
493-9530796	131,081	127,632	N/A	N/A	N/A	127,632	81,684	Current
Totals	**$823,624**	**$570,082**	**$10,943**[31]	**$161,810**	**$65,559**	**$508,566**	**$325,482**	

30 Loan information is based on the loan status as of November, 30, 2011.
31 We did not claim the $9,193 in overinsurance for loan 492-8348210 because the loan was refinanced.

Appendix D

CASE NARRATIVES

Case Narrative—Loan Number 492-8348210

Mortgage amount: $78,576
Date of loan closing: May 26, 2009
Status as of November 30, 2011: Terminated, refinanced (was 12 months delinquent)
Payments before first default reported: One
Payments before first 90-day delinquency reported: One
Underwriting deficiencies:
The underwriter did not

- Verify that the borrower had 2 months' cash reserves after determining that the borrower had insufficient credit.
- Reject the closing costs and prepaid expenses from being included in the mortgage.
- Ensure that the mortgage did not exceed the maximum loan-to-value ratio of 96.5 percent.
- Correctly calculate the actual loan-to-value ratio.

The underwriter did not verify that the borrower had 2 months' cash reserves after determining that the borrower had insufficient credit. Further, J&M caused HUD to overinsure the loan when the underwriter (1) incorrectly included closing costs for a HUD real estate-owned property into the mortgage and (2) used an incorrect value for the property. HUD Mortgagee Letter 00-27 prohibits including closing costs in the mortgage, except for those borrowers participating in the Officer or Teacher Next Door programs. This borrower was not a participant in either program. Further, Mortgagee Letter 00-27 requires using the lower of the as-is value or the sales price for the property. The underwriter signed the form HUD-92900 showing a loan-to-value ratio of 108 percent, while the maximum allowable loan-to-value ratio was 96.5 percent. In addition, the underwriter used the sales price of the home instead of the lower as-is value to calculate the loan-to-value ratio. When the correct as-is value was used, the LTV ratio was 113 percent. As a result of including the closing costs and using the wrong property value, HUD overinsured the loan by $9,193. However, J&M later refinanced the loan with an appropriate loan-to-value ratio.

Case Narrative—Loan Number 492-8509134

Mortgage amount: $154,646
Date of loan closing: July 31, 2009
Status as of November 30, 2011: Title conveyed to insurer. Claims paid totaled $161,810. HUD sold the property on October 5, 2010, for $96,251. The total loss to HUD was $65,559.
Payments before first default reported: Zero
Payments before first 90-day delinquency reported: Two
Underwriting deficiencies:
The underwriter did not

- Disallow unsupported bonus or incentive pay from being included in borrower's income calculation.
- Reject employment and income verifications handled by interested third parties.

The underwriter incorrectly included bonus or incentive pay that had been received on past pay stubs but was not regular and recurring. HUD Handbook 4155.1, paragraph 4.D.2.b, requires that for overtime and bonus income to be used to qualify the borrower, the lender must establish that the borrower had received such income for the past 2 years and that it was likely to continue. The underwriter did not obtain an explanation or verification of the incentive pay. As a result of including the unsupported incentive pay, the borrower's income was overstated, and the automated underwriting system did not have accurate information on which to base its risk rating. The borrower's mortgage payment-to-income and fixed payment-to-income ratios should have been 41.9 and 76.1 percent, respectively, instead of the 30.9 and 56 percent that J&M entered into the automated underwriting system. The reason reported in HUD's Neighborhood Watch system for the payment delinquencies was excessive obligations.

The underwriter also improperly accepted employment and income verifications, which were transmitted from or through the fax machine of one of the real estate companies that was a party to the sales transaction. This is a violation of HUD Handbook 4155.1, paragraph 1.B.1.f, which prohibits lenders from accepting or using documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (for example, real estate agents, builders, sellers) or by using their equipment.

Case Narrative—Loan Number 421-4564607

Mortgage amount: $70,970
Date of loan closing: March 30, 2009
Status as of November 30, 2011: 1 month past due
Payments before first default reported: One
Payments before first 90-day delinquency reported: Three
Underwriting deficiencies:
The underwriter did not

- Ensure that the mortgage did not exceed the correct loan-to-value ratio of 85 percent.

The underwriter incorrectly allowed the cash-out refinanced loan to exceed an 85 percent loan-to-value ratio in violation of HUD Handbook 4155.1, REV-5, paragraph 1-11B. The underwriter signed a form HUD-92900 LT showing a loan-to-value ratio of 87.19 percent. As a result, the loan was overinsured by $1,750.

Case Narrative—Loan Number 492-8352641

Mortgage amount: $202,514
Date of loan closing: March 14, 2009
Status as of November 30, 2011: Property conveyed to insurer. No claim information was available
Payments before first default reported: One
Payments before first 90-day delinquency reported: Three
Underwriting deficiencies:
The underwriter did not

- Correctly verify the borrower's current employment.
- Downgrade the loan which received an "accept" rating from the automated underwriting system to a "refer" rating due to the many disputed collection accounts on the borrower's credit report.
- Enter the correct appraised value into the automated underwriting system.
- Obtain a rent-with-option-to-purchase agreement between the seller and borrower as required.
- Verify the downpayment funds.
- Obtain a market value appraisal as required for lease-to-own transactions.

The underwriter incorrectly used questionable documentation to verify the borrower's current employment. One pay stub obtained was a partial stub and did not contain the borrower's name, address, Social Security number, or any other identifying information. In addition, although the loan received an accept rating from the automated underwriting system, the TOTAL Scorecard guidelines required that if the borrower had disputed any credit accounts or public records on the credit report, the application should be referred to an underwriter for a manual review. There was no indication that the underwriter reviewed these accounts as required. Further, J&M entered an incorrect appraised property value of $207,000 instead of the correct value of $210,000 into the automated underwriting system and on the form HUD-92900 LT, although this was an immaterial error that did not make a difference in whether the loan would have been approved.

The underwriter also failed to require that a rent-with-option-to-purchase agreement be provided. HUD Handbook 4155.1, REV-5, paragraph 2-10N, requires that when rent credit is given, both the rent-with-option-to-purchase agreement and the appraiser's estimate of market rent must be included in the endorsement package. Only the amount of the rental payments that exceed the appraiser's estimate of fair market rent should be considered as the borrower's cash investment or downpayment. The file contained a statement from the seller, which was attached to the sales contract, stating that the borrower was being given credit for $11,000 in rent paid during 6 months while the borrower lived in the property. However, the file contained support for only $8,525 of the rental payments, and there was no determination of the estimated fair market rent. Yet the underwriter incorrectly gave the borrower credit for the full $11,000 in reported rental payments. Further, an analysis of the support for the $8,525 in reported rental payments revealed that the payments did not follow a regular pattern that would be associated with a rental agreement. The borrower made a large payment in February 2008 to cover a little more than 2 months' rent and did not make any further rental payments until September 2008.

Case Narrative—Loan Number 493-8913880

Mortgage amount: $193,837
Date of loan closing: April 2, 2009
Status as of November 30, 2011: 18 months delinquent (Chapter 13 bankruptcy)
Payments before first default reported: Four
Payments before first 90-day delinquency reported: Six
Underwriting deficiencies:
The underwriter did not

- Obtain previous rental payment history when required.
- Document the compensating factors used to support the loan approval with qualifying ratios 19 points in excess of the approved HUD ratios.
- Did not obtain an explanation from the borrower for two collections on the credit report.

The underwriter did not require the borrower to explain two collections shown on his credit report as required. HUD Handbook 4155.1 REV-5, section 2-3, requires that the lender obtain a sufficient written explanation from the borrower regarding collections. Further, paragraph 2-3A requires that the lender determine the borrower's payment history of housing obligations for the most recent 12-month period.

The underwriter also did not record on the "remarks" section of the form HUD-92900-WS and HUD-92900-PUR the compensating factor(s) used to support the loan approval since the borrower's debt ratio exceeded the approved maximum ratio of 31 and 43 percent. The borrower's ratios were 41 and 62 percent.

Case Narrative—Loan Number 493-9530796

Mortgage amount: $131,081
Date of loan closing: March 4, 2010
Status as of November 30, 2011: Current
Payments before first default reported: Two
Payments before first 90-day delinquency reported: Six
Underwriting deficiencies:
The underwriter did not

- Verify the source of funds for a large deposit to the borrower's account before closing.

There was a large unexplained increase in the borrower's bank accounts that exceeded 2 percent of the sales price. The borrower's statement of accounts as of January 27, 2010, showed a total ending balance of $1,944.53. However, the borrower's bank statement for the period ending February 26, 2010, just before the loan closing on March 4, 2010, showed an ending balance of $5,485. The loan file contained only the final summary page with ending balances for the period ending February 26, 2010, and did not contain a full statement showing detailed transactions for the month. HUD Handbook 4155.1, paragraph 5.2.b, requires the lender to obtain a credible explanation and documentation of the source of funds when there is a large increase in the borrower's accounts. The underwriter did not obtain an explanation of the increase or documentation of the source of the increase.