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

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, New York-New Jersey Region, 2AGA

SUBJECT: MLD Mortgage, Inc., Florham Park, NJ, Did Not Always Comply With HUD-FHA Loan Origination and Quality Control Requirements

HIGHLIGHTS

What We Audited and Why

We audited Mortgage Lending Direct, Inc. (MLD), a nonsupervised lender[1] located in Florham Park, NJ, in support of the U.S. Department of Housing and Urban Development (HUD), Office of the Inspector General's (OIG) goal of improving the integrity of the single-family insurance program. We selected MLD for audit because its 8.88 percent default rate for Federal Housing Administration (FHA)-insured single-family loans with beginning amortization dates between February 1, 2009, and January 31, 2011, was nearly double the New Jersey State average of 4.45 percent for the same period. The audit objective was to determine whether MLD officials originated FHA-insured loans and implemented a quality control plan in accordance with HUD-FHA requirements.

What We Found

MLD officials did not always originate FHA-insured loans in accordance with HUD-FHA requirements. Specifically, 14 of the 25 loans reviewed exhibited

[1] A nonsupervised lender is an FHA-approved lending institution, the principal activity of which involves lending or investing funds in real estate mortgages.

material[2] underwriting deficiencies. As a result, the FHA insurance fund incurred an actual loss of $176,988 on one loan and is at risk for potential losses of more than $2.7 million on the remaining 13 loans. In addition, MLD officials charged borrowers unsupported fees of $15,611 and lacked adequate documentation for $8,996 in mortgage payoffs.

While MLD officials established a quality control plan that complied with HUD-FHA requirements, they did not ensure that the plan was implemented as established. Specifically, loans that defaulted within the first 6 months[3] were not reviewed, and deficiencies identified in rejected loans were not reported to management. As a result, MLD officials may have missed the opportunity to address systemic deficiencies in MLD's origination processes and, thus, reduce unnecessary risk to the FHA insurance fund.

What We Recommend

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require MLD officials to (1) indemnify HUD against potential losses of $2.7 million related to the 13 loans with material underwriting deficiencies; (2) reimburse the FHA insurance fund for the $176,988 claim paid; (3) obtain adequate documentation for unsupported fees of $15,611 and mortgage payoffs of $8,996 and if such documentation cannot be provided, refund or collect the applicable amounts due to or from the borrowers; and (4) strengthen controls to ensure that future FHA-insured loans are approved and the quality control plan is implemented in accordance with HUD-FHA 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 discussed the results of the audit with MLD officials during the audit and provided them a discussion draft audit report on December 16, 2011. We discussed the draft report with MLD officials at an exit conference held on January 11, 2012. We requested that MLD officials provide written comments to the discussion draft on January 18, 2012, which we received that date. MLD officials generally disagreed with the draft report findings, and provided specific comments for 4 of the 15 loans we had classified as having material underwriting deficiencies. The complete text of MLD's response, along with our evaluation of that response, can be found in appendix B of this report.

[2] A deficiency is considered material if it could affect the loan approval decision.
[3] Loans that default within the first six payments are considered early payment defaults.

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BACKGROUND AND OBJECTIVE

Mortgage Lending Direct, Inc. (MLD), doing busines as The Money Store, is a U.S. Department of Housing and Urban Development (HUD)-Federal Housing Administration (FHA)-approved Title II nonsupervised lender located in Florham Park, NJ. A nonsupervised lender is an FHA-approved lending institution that has as its principal activity the lending or investment of funds in real estate mortgages and may be approved to originate, sell, purchase, hold, and service FHA-insured mortgages.

MLD was incorporated on August 18, 2000, under the laws of the State of New Jersey for the primary purpose of engaging in mortgage banking for the origination and sale of mortgages. On May 30, 2003, MLD was designated a direct endorsement lender, which allowed it to underwrite FHA-insured single-family loans without prior review by HUD-FHA. MLD is licensed throughout the United States and the District of Columbia and during the review, operated one branch office in Florham Park, NJ, which administered the lender's Internet-based originations on a national scale, and another branch in Boca Raton, FL.

HUD's Neighborhood Watch system[4] reported that MLD officials originated 923 FHA-insured loans with beginning amortization dates between February 1, 2009, and January 31, 2011. As of January 2011, Neighborhood Watch reported that 78 of these loans were seriously delinquent and 4 loans were in claim status. As a result, MLD experienced a default rate for this 2-year period of 8.88 percent, which was double the New Jersey State average of 4.45 percent for the same period.

The audit objective was to determine whether MLD officials originated FHA-insured loans and established and implemented a quality control plan in accordance with HUD-FHA requirements.

[4] Neighborhood Watch is a Web-based comprehensive data processing, automated query, reporting, and analysis system that is intended to aid HUD in monitoring lenders and its programs and is designed to highlight exceptions to lending practices regarding high-risk mortgages so that potential problems are readily identifiable.

RESULTS OF AUDIT

Finding 1: MLD Officials Did Not Always Originate FHA-Insured Loans in Accordance With Regulations

MLD officials did not always originate FHA-insured loans in accordance with HUD-FHA requirements. Specifically, 14 of the 25 loans reviewed exhibited material underwriting deficiencies involving inadequate verification or documentation of borrowers' income, assets, liabilities, or employment history, and approval of a loan that was ineligible as a cash-out refinance. As a result, the FHA insurance fund incurred an actual loss of $176,988 for a claim paid on one loan and is at risk for potential losses of more than $2.7 million on the remaining 13 loans. In addition, MLD officials charged borrowers unsupported fees of $15,611 and lacked adequate documentation for mortgage payoffs of $8,996. These deficiencies occurred due to MLD officials' lack of due diligence in underwriting FHA-insured loans and unfamiliarity with HUD-FHA regulations.

Material Underwriting Deficiencies Noted

Review of 25 MLD loan files disclosed material underwriting deficiencies in 14 of the loans. These deficiencies occurred because MLD officials did not exercise due diligence in verifying and documenting borrowers' income, assets, liabilities, and employment history. While MLD officials used HUD's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard[5] in the underwriting process for 12 of these 14 loans, Mortgagee Letter 2004-01 provides that the undewriter is responsible for the integrity of the data used by TOTAL Scorecard and for resubmitting the loan when material changes are discovered or otherwise occur during loan processing. Further, Mortgagee Letter 2004-47 provides that, although documentation requirements for loans assessed through TOTAL Scorecard are less than those for manually underwritten loans, credit history, income, employment, and assets must be verified.

[5] TOTAL Scorecard is not an automated underwriting system, but a mathematical equation that evaluates a borrower's credit history along with several additional application variables to approve a loan for underwriting through an automated underwriting system or to refer the loan for traditional manual underwriting.

The table below summarizes the material deficiencies identified in the 14 loan files[6].

Deficiency	Number of loans
Incorrect or inadequate calculation of income of liabilities	6
Inadequate verification of earnest money deposit	4
Inadequate documentation of gifts	2
Inadequate verification of assets or funds to close	4
Judgment paid with loan proceeds	1
Inadequate verification of employment	3
Approval of cash-out refinance loan with late payments	2

Appendix C of this report provides a summary of the material underwriting deficiencies identified in each of the 14 loan files, and appendix E provides a detailed description of the underwriting deficiencies and applicable HUD-FHA requirements.

Incorrect Income and Liability Calculation

MLD officials did not adequately verify the borrower's income or liabilities for six loans. For example, for loan number 374-5539758, MLD officials calculated overtime income of the borrower based upon an 11.75 monthly overtime average and "other" income (reported on the verification of employment as "locality, overtime meals, adjustments, and Saturday pay") to develop the borrower's monthly income. While this process resulted in a $2,172 monthly overtime amount and $389 monthly "other" income, we calculated a 2-year average income based upon income data reported in the verification of employment as required by HUD Handbook 4155.1, paragraph 4D(2)(b). This calculation resulted in monthly overtime income of $1,695 and "other" income of $368, which was $497 less than that used to qualify the borrower. Additionally, MLD officials understated the borrower's monthly rental income by $212 because they applied the 85 percent vacancy rate as required by HUD Handbook 4155.1, paragraph 4.E.4b to the $3,200 monthly rent reported by the borrower as opposed to the $3,450 monthly rent documented in the property appraisal. The net result of the incorrect calculation of estimated borrower monthly income was a monthly overstatement of $285.

MLD officials also did not include a $246 monthly payment for a deferred education loan as a liability of the borrower. A credit report in the loan file reported that the borrower had an education loan that was deferred until May 6, 2010, with the first payment due December 6, 2010. Since the loan closing was scheduled for January 12, 2010, the first payment on the educational loan would

[6] The deficiencies noted are not independent of one another as one loan may have contained more than one deficiency.

be within 1 year of the loan's closing date and should have been considered when calculating the borrower's liabilities. The incorrect calculation of income and liabilities would cause the borrower's front and back ratios[7] to increase from 39.52 and 54.71 percent to 40.92 and 59.71 percent, respectively.

Unsupported Earnest Money Deposit

MLD officials did not adequately verify the earnest money deposit assets for four loans in which the deposit exceeded 2 percent of the sales price. HUD Handbook 4155.1, paragraph 5B(2)(a), requires that the source of any earnest money deposit be documented and verified if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings. Satisfactory documentation includes a copy of the borrower's cancelled check, certification from the deposit holder acknowledging receipt of funds, or separate evidence of the source of funds. Separate evidence includes a verification of deposit or a bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit at the time of the deposit. This evidence was not provided or contained in the loan files.

Inadequate Gift Documentation

MLD officials did not adequately verify or document the source of gift funds used for two loans. For example, while the loan file for FHA case number 352-6632782 contained a gift letter and cashier's check for $8,750, dated November 12, 2009, the donor's bank statement showed a $121 balance as of November 12, 2009, and that $8,750 was both deposited in and withdrawn from the account on November 13, 2009. Consequently, MLD officials did not reconcile discrepant information or document that the gift funds were the donor's own funds. HUD Handbook 4155.1, paragraph 5B(4)(d), requires that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source and were the donor's own funds. When the transfer occurs at closing, the lender is responsible for verifying that the closing agent received the funds in the amount of the gift from the donor and that the funds were from an acceptable source.

Inadequate Asset Documentation

MLD officials did not obtain adequate asset documentation for four loans. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's

[7] The front ratio is the mortgage-to-income ratio, and the back ratio is the fixed payment-to-income ratio. A front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors as discussed in HUD Handbook 4155.1 paragraph 4.F.3 are documented.

investment in the property be verified and documented. While the file for loan number 3526129743 contained a HUD-1 settlement statement indicating that the borrower was required to pay $2,545 at closing, there was no bank statement, check, or other documentation to support that the borrower had adequate funds to close or made a payment at closing. As of August 31, 2011, the property has had a preforeclosure sale completed and HUD paid a claim of $176,888.

Judgment Paid With Loan Proceeds

MLD officials approved one loan without documenting that a court-ordered judgment had been paid before closing. While the file for loan number 352-6131878 indicated that the borrower had a $907 judgment that had to be paid before closing and available assets of $433, the borrower received $37,499 as part of a cash-out refinance, and the judgment was included on the HUD-1 as being paid off with proceeds from the refinanced FHA mortgage. HUD Handbook 4155.1, REV-5, paragraph 2-3C, requires that court-ordered judgments be paid off before the mortgage loan is eligible for FHA insurance endorsement. In addition, FHA TOTAL Mortgage Scorecard User Guide, chapter 2, provides that evidence of payoff for any outstanding judgments shown on the credit report must be obtained before endorsement, and the desktop underwriting system used at MLD stated that as a condition of approval, evidence of payoff of the $907 debt should be in the file. However, other than the HUD-1 Settlement Statement reporting that the judgment would be paid off from the loan proceeds, there was no documentation in the loan file that the judgment had been satisfied.

Inadequate Verification of Employment

MLD officials did not adequately verify the employment history for three borrowers. HUD Handbook 4155.1, section 2-6, requires the lender to verify a borrower's employment for the most recent 2 full years with a recent pay stub and written or oral verification of employment, and for the borrower to explain any gaps in employment of a month or more. The file for loan number 352-6060237 did not contain adequate verification of employment for the borrower's two employers because there was no verification of employment. A pay stub from one employer for the period ending November 15, 2008 had a handwritten note on it stating "November 2007" and a 2007 W-2. For the second employer, there was a pay stub for the period ending November 15, 2008 with a handwritten note stating "February 2008".

Approval of Ineligible Loans

MLD officials approved two loans contrary to HUD regulations that prohibit a cash-out refinance if there were late payments or a skipped payment. Mortgagee Letter 05-43, dated October 31, 2005, requires a borrower to have made all mortgage payments within the month due for the previous 12 months to qualify for a cash-out refinance (that is, no loan payment may have been more than 30 days late and the loan must be current for the month due). However, MLD officials approved FHA loan number 352-6050094 as a cash-out refinance in which the borrower received $1,938 despite the fact that the loan file noted that the borrower's first mortgage payoff statement contained late charges of $156 and the borrower's second mortgage contained $43 in charges, the nature of which was not identified.

HUD Handbook 4155.1, REV-5, prohibits lenders from allowing borrowers to skip payments. The borrower must either make the payment when it is due or bring the monthly mortgage payment due to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payment skipped by the homeowner in the new mortgage amount. However, MLD officials allowed one borrower to include skipped conventional mortgage payments in the new FHA-insured loan. For loan number 352-6050094, the borrower skipped more than one mortgage payment for the first and second mortgages. The first mortgage closed on February 16, 2009 while the payoff statement listed the principal balance as of December 1, 2008. For the second mortgage, the borrower's payoff statement listed interest due of $870 while the credit report listed a monthly second mortgage payment of $233.

Other Deficiencies

Other underwriting deficiencies related to unsupported fees, that were not considered material, are listed in the following chart.

Loan number	Unsupported lock-in fees	Unsupported origination fee
352-6551926	$699	
374-5629094		$8,685
352-6050094	$699	
352-6197448	$699	
352-6255426	$699	
352-6068180	$699	
352-6060237	$699	
352-6269737	$635	
352-6278237	$699	
352-5829040	$699	
352-6086467	$699	
Total	$6,926	$8,685

MLD officials charged 10 borrowers unsupported lock-in fees. In nine cases, the fee was charged without written justification as required by HUD Handbook 4155.1, paragraph 1A(3)(b), which provides that lenders may charge a commitment fee to guarantee, in writing, the interest rate and any discount points for a specific period or to limit the extent to which the interest rate or discount points may change. MLD officials also charged one borrower a lock-in fee when the lock-in date was the date of the closing. HUD Handbook 4155.1, paragraph 1A(3)(b), further states that the minimum time for lock-ins or rate locks is 15 days and the loan may close in less than 15 days at the convenience of the borrower. For loan number 352-6551926, the borrower was charged a $699 commitment fee and executed a lock-in agreement that was dated on the closing date of November 19, 2009, without documentation to support that the lock-in fee was charged for the borrower's convenience.

MLD officials charged a borrower a 2.8 percent origination fee at closing amounting to $13,609 and were unable to document that the amount over 1 percent was customary. Of the 13 loans sampled which had an origination fee charged, only loan number 374-5629094 had an origination fee greater than 1 percent. Therefore, we view the excess portion over 1 percent, which equates to $8,685, to be unsupported.

Seller concessions were not listed on the HUD 1 as a reduction of the seller's proceeds for two loans (numbers 374-5629094 and 374-5240680). For loan number 374-5629094, a $30,000 seller concession was listed on the HUD-1, summary of borrower's transactions. However, the summary of seller's transactions did not list the seller's concession. The HUD 1 reported the cash to seller as $493,000; however, if a seller's concession of $30,000 was included, the cash to seller would be $463,000. HUD Handbook 4155.1, REV-5, chapter 3, provides that all information must be verified and documented.

Incomplete Information in the Loan File

Mortgage payoff statements in the loan file for 15 of the loans reported different payoff amounts than those reported on the HUD-1. Specifically, the mortgage payoff statements reported a cumulative total of $7,587 more than the HUD-1 for 14 loans and an understatement of $1,409 for one loan as compared to the HUD-1. Mortgagee Letter 92-5 prohibits a lender from processing loans without reconciling discrepancies in file documentation.

It is also important to note that how the mortgage payoff occurred could affect the eligibility of the loan for FHA insurance for 3 of the 15 loans, which initial loan value totaled $939,660. While the loans were initially classified as non-cash-out refinance loans, they may have actually closed as a cash-out refinance loan, for which they would not have qualified. As noted in the table below, there was a potential overstated payoff of $4,565 on the 3 loans, which in effect would have made them cash-out loans.

Loan number	Loan Value	Amount Due per Payoff Statement	Amount Due per HUD-1	Potential Overstated Payoff
352-6230998	430,402	411,954	415,873	3,919
352-6060237	155,168	143,461	143,851	390
352-6574991	$354,090	334,020	334,276	$ 256
Total	$939,660	889,435	894,000	$4,565

For loan number 352-6230998, while the borrower's mortgage payoff statement reported a total amount due on the loan of $411,954, the HUD-1 listed a payoff amount of $415,873, or an overpayment difference of $3,919. When the cash required at closing of $977 as listed on the HUD-1 is netted against the $3,919 potential overpayment, the borrower would be owed $2,942. However, since the mortgage payoff statement also listed late charges of $274 (which were not reported on the borrower's credit report and should have been questioned), the borrower would not have qualified for a cash-out refinance in accordance with Mortgagee Letter 05-43. In addition, procedures in MLD's quality control plan required that loans be tested to determine whether the loans were closed and funds disbursed in accordance with the underwriting and subsequent closing instructions, that closing and legal documents were accurate and complete, and that the HUD-l was accurately prepared and properly certified.

As a result, there was no assurance that documentation in the loan files accurately and completely reported the manner in which the loans closed, funds may be due to or from the borrowers, and loans may have been improperly classified as a non-cash-out refinance loans. If misclassified, the loans would have been ineligible, as such $405,598[8] is considered unsupported.

Conclusion

HUD Handbook 4155.1, REV-5, provides that approval of FHA-insured loans requires adequate documentation based upon sound underwriting principles that a borrower has the ability and willingness to repay the mortgage debt. MLD officials did not always originate loans reviewed in compliance with HUD-FHA underwriting requirements. We attribute this condition to weaknesses in MLD's

[8] This amount is derived by adding $249,870 representing HUD's potential loss related to loan 352-6230998 (applying HUD's loss severity rate of 59 percent to the unpaid principal balance of $423,508) plus the $155,728 claim amount paid on loan 352-6574991. Loan 352-6060237 is not included since indemnification is being requested based upon material underwriting deficiencies.

origination processes, which allowed underwriters to not exercise due diligence in underwriting loans. As a result, the FHA insurance fund incurred an actual loss of $176,988 for a claim paid on one loan and is at risk for potential losses of more than $2.7 million on 13 loans. In addition, MLD officials charged borrowers unsupported fees of $15,611 and inadequately supported mortgage payoffs of $8,996 ($7,587 in overfunded and $1,409 in underfunded mortgage payoffs). We attribute these deficiencies to MLD official's unfamiliarity with HUD-FHA underwriting regulations.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require MLD officials to

1A. Indemnify HUD for potential losses on the 13 loans with material underwriting deficiencies. The estimated loss to HUD, based on its most recent default loss rate of 59 percent[9] of the unpaid principal balance, is $2,756,325 (See Appendix D).

1B. Reimburse the FHA insurance fund $176,988 for a claim paid on loan number 352-6129743.

1C. Obtain documentation to support the $15,611 in unsupported fees and if adequate documentation cannot be provided, reimburse the borrowers.

1D. Obtain documentation to support $8,996 ($7,587 overfunded and $1,409 underfunded) in inadequately supported mortgage payoffs. If supporting documentation is not obtained, the FHA insurance fund should be reimbursed $7,587, and $1,409 should be collected from the borrower.

1E. Determine whether the unsupported $405,598 related to the three loans with potential overpayments were ineligible as cashout refinances, and if so determined, indemnify the FHA insurance fund $249,870 and repay the claim paid of $155,728.

1F. Implement additional controls to ensure that all future FHA-insured loans are approved in accordance with HUD-FHA requirements.

[9] The loss severity rate of 59 percent represents HUD's average loss experience for fiscal year 2010 on properties sold through its real estate-owned inventory as supported by the Single Family Acquired Asset Management System's case management profit and loss by acquisition data as of September 2010.

Finding 2: MLD Officials Did Not Implement Their Quality Control Plan in Accordance With HUD-FHA Requirements

While MLD officials established a quality control plan that complied with HUD-FHA requirements, the officials did not ensure that the plan was implemented in accordance with HUD-FHA's or its own requirements. Specifically, MLD officials did not ensure that (1) the reviews included loans that defaulted within the first 6 months, (2) deficiencies identified with rejected loans were reported to management for follow-up and corrective action, and (3) documentation to support the frequency and results of required annual reviews of branch offices was maintained. These deficiencies occurred because MLD officials had not established adequate controls to ensure that the quality control plan was properly implemented. Consequently, the effectiveness of MLD's quality control plan to identify systemic problems, initiate appropriate corrective action, and reduce unnecessary risk to the FHA insurance fund was weakened.

Quality Control Plan in Compliance With HUD-FHA Requirements

MLD's most recent written quality control plan complied with HUD-FHA requirements. HUD Handbook 4060.1, REV-2, chapter 7, requires all FHA-approved lenders to implement and continuously have in place a quality control plan for the origination and servicing of insured mortgages as a condition of receiving and maintaining FHA approval. This chapter also provides that quality control must be a prescribed and routine function of each lender's operations, whether performed by a lender's staff or an outside source.

During the review period, MLD's routine quality control reviews were conducted externally by a quality control contractor, and MLD used three different quality control contractors during the period. One firm conducted the reviews until June 2009 when MLD officials contracted with another firm, which conducted the reviews through April 2010. Beginning in May 2010, a different firm began conducting the reviews. HUD's Quality Assurance Division[10] conducted a review of MLD in June 2010, after which MLD agreed to update its quality control plan to address deficiencies cited.

[10] HUD's Quality Assurance Division is responsible for monitoring the performance of FHA approved lenders.

Quality Control Plan Not Implemented in Accordance With HUD-FHA Requirements

MLD officials did not ensure that their quality control plan was implemented in accordance with HUD-FHA's and its own requirements. Specifically, MLD officials did not ensure that (1) the reviews included loans that defaulted within the first 6 months, (2) deficiencies identified with rejected loans were reported to management for follow-up and corrective action, and (3) documentation to support the frequency and results of required annual reviews of branch offices was maintained.

Loans Defaulting Within the First 6 Months Not Reviewed

While MLD's quality control plan provided that all loans with payment defaults occurring within the first 6 months of origination would be selected for review as required by HUD Handbook 4060.1, REV-2, paragraph 7-6D, not all loans that defaulted within the first 6 months were reviewed by MLD's quality control consultant. Three loans that defaulted within 6 months that were contained in the sampled loans were not reviewed. An MLD official confirmed that MLD provided its quality control consultant closed and rejected loans monthly but not loans that went into default within 6 months. As a result, MLD management did not have the opportunity to determine the root cause of these early payment defaults and implement proper corrective action, thus preventing the deficiencies from recurring.

Rejected Loan Deficiencies Not Reported

Deficiencies identified in rejected loans reviewed as part of the quality control process were not disclosed to MLD management for corrective action as required by HUD Handbook 4060.1, REV-2, paragraph 7-8A(1), which provides that a 10 percent sampling of rejected loans be made to determine compliance with fair lending laws. In addition, HUD Handbook 4060.1, REV-2, paragraph 7-3I, states that review findings must be reported to the lender's senior management within 1 month of completion of the initial report. Management must take prompt action to deal appropriately with any material findings. The final report or an addendum must identify actions being taken, the timetable for their completion, and any planned follow-up activities. While one of the three monthly quality control reports selected for testing reported deficiencies with three of five rejected loans, the corresponding monthly quality improvement memorandum to management did not discuss these deficiencies. An MLD official said that MLD's policy was that rejected loans did not receive corrective action follow-up because they are regarded as low-risk since they were not submitted for FHA insurance. However, providing corrective action follow-up would ensure that rejected loans were properly underwritten.

Procedures for Branch Office Site Visits Not in Compliance With Regulations

MLD officials did not conduct or document annual site visits of branch offices as prescribed by MLD's quality control plan. HUD Handbook 4060.1, REV-2, paragraph 7-3G, provides that a lender's offices, including traditional and nontraditional branch and direct lending offices engaged in origination or servicing of FHA-insured loans, must be reviewed annually to ensure their compliance with HUD-FHA requirements. In addition, the criteria used by the lender to determine the frequency of onsite reviews should be in writing and available for review by HUD at the corporate office. MLD's quality control plan provided that annual onsite reviews would be performed by its quality control contractor and a report of such would be given to the MLD director of compliance and the Quality Assurance and Compliance Committee. However, during the review period, the branches received onsite reviews by MLD's board chairman, and no report documenting the results was generated. By properly documenting annual site visits conducted and their corresponding selection criteria, MLD officials could better justify the visit's purpose and determine whether all branch offices comply with HUD regulations.

Conclusion

MLD officials had not established adequate controls to ensure that their quality control plan was implemented in accordance with HUD-FHA requirements. As a result, MLD officials did not have the opportunity to consider follow-up and corrective action for potential deficiencies in loans that defaulted within the first 6 months and for rejected loans. Also, the results of branch office reviews were not documented. These deficiencies occurred because MLD officials had not established adequate controls to ensure that the quality control plan was properly implemented. Consequently, MLD officials may have missed the opportunity to prevent systemic deficiencies and reduce unnecessary risk to the FHA insurance fund.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing require MLD officials to

2A. Implement procedures to ensure that loans that default within the first 6 months of origination are tested during monthly quality control reviews as required by HUD regulations and MLD's quality control plan**.**

2B. Implement procedures to ensure that deficiencies found in rejected loans during monthly quality control reviews are reported to MLD officials for corrective action as required by HUD regulations and MLD's quality control plan.

2C. Strengthen procedures to ensure that annual reviews of branch offices are conducted and documented as prescribed by MLD's quality control plan.

SCOPE AND METHODOLOGY

We reviewed MLD because its default rate was twice that of the statewide average for loans with beginning amortization dates between February 1, 2009, and January 31, 2011. To accomplish the audit objectives, we reviewed HUD Handbook 4060.1, REV-2, applicable mortgagee letters, and reports of MLD reviews conducted by HUD's Quality Assurance Division. We reviewed MLD's policies and procedures for processing and underwriting loans and interviewed its staff to obtain an understanding of its quality control process and other internal control procedures.

To assess MLD's underwriting compliance with HUD-FHA regulations, we identified loans reported in HUD's Neighborhood Watch System as originated or sponsored by MLD during the period February 1, 2009, through January 31, 2011, and selected a nonstatistically based sample of 25 loans valued at more than $8.9 million. We used the loan data in HUD's Neighborhood Watch System for informational purposes. To ensure the integrity of the data relevant to our audit objectives, we performed a minimal level of testing and found the data to be sufficiently reliable for our purpose. This testing consisted of reconciling the loan amount, closing date, front and back ratios, the presence of gifts, among other items, to source documents.

The loans were selected considering the following factors, which are mutually exclusive: default after the borrower had made 13 or fewer payments, presence of gift funds, and a back ratio greater than 49 percent. Twenty-three loans were electronically underwritten by the Federal National Mortgage Association's Desktop Underwriter[11], and two loans were manually underwritten. We reviewed MLD's files for these 25 loans to assess the extent to which the loans were originated in accordance with HUD-FHA regulations, requested independent verification of borrower employment and gift receipts, and discussed potential deficiencies with MLD officials.

To assess MLD's quality control process, we randomly selected 3 of 12 quality control review reports conducted by MLD's consultant during the period June 2010 through May 2011 to analyze the timeliness and adequacy of the monthly reviews and the effectiveness of management follow-up on deficiencies reported. We did not select quality control reviews conducted before this time because other consultants performed those reviews and MLD had already taken action to address deficiencies reported in its prior process.

We performed the audit fieldwork from June through October 2011 at MLD's main office located at 30B Vreeland Road, Florham Park, NJ. 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 objective.

[11] The Federal National Mortgage Association Desktop Underwriter is an automated system that evaluates a borrower's credit worthiness and indicates a recommended level of underwriting and documentation needed to determine a loan's eligibility for FHA insurance.

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 objective:

- Loan origination process - Policies and procedures established by management to ensure that FHA-insured loans are originated in accordance with HUD-FHA requirements.

- Quality control process - Policies and procedures established by management to ensure that a quality control plan has been implemented and related reviews are performed in accordance with HUD-FHA requirements.

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 the 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:

- MLD officials did not ensure that FHA-insured loans were approved in accordance with HUD-FHA requirements (see finding 1).

- MLD officials did not adequately implement a quality control plan that ensured compliance with HUD-FHA requirements (see finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A			$2,756,325
1B	$176,988		
1C		$ 15,611	
1D		8,996	
1E		405,598	
Total	$176,988	$430,205	$2,756,325

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

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

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if HUD implements our recommendations to indemnify the 13 loans exhibiting material underwriting deficiencies, it will reduce FHA’s risk of loss to the insurance fund. The amount above is derived by applying HUD’s default loss rate of 59 percent to the loans’ unpaid principal balance of $4,671,738 as of August 31, 2011 (see appendix D).

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

MLD MORTGAGE INC.

January 18, 2012

VIA OVERNIGHT MAIL
Mr. Edgar Moore
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Re: MLD Mortgage, Inc.
OIG Draft Audit Report 2012-NY-10XX

Dear Mr. Moore,

MLD Mortgage, Inc. (the "Company") is in receipt of the Draft Audit Report 2012-NY-10XX (the "Report") from the Office of Inspector General (OIG). The Report is based on a review of the Company conducted between June and October 2011. The audit covers 25 loans originated by the Company during the period February 1, 2009 through January 31, 2011.

The Report states the reason for the audit was due to the fact the Company's default rate was 8.88 percent for Federal Housing Administration (FHA) insured single family loans with beginning amortization dates between February 1, 2009 and January 31, 2011. The audit objective was to determine whether MLD officials originated FHA insured loans and implemented a quality control plan in accordance with HUD-FHA requirements.

Comment 1

The Report further alleges that the loan files reviewed contained material deficiencies which resulted in actual losses to the FHA Insurance fund. The Company conducted an analysis of the delinquent loans being shown in Neighborhood Watch for the two year period. Based on this analysis, it became evident that the Compare Ratio was disproportionately impacted by the downturn in the economy and the tough economic times everyone has encountered. The analysis shows that 56% of the loans that went delinquent were due to a curtailment of income or unemployment; another 8% were affected by death or illness and 4% were having marital difficulties. Accordingly, 68% of the loans being reported delinquent were due to influences outside of the Company's control and not due to the quality of the loans originated. A further analysis showed that 97% of the loans reported reflected no underwriting deficiencies, and only 3% of the loans being reported delinquent were rated by HUD as "deficient". It is important to note that, of the 3% reported as "deficient," 2% of the loans were underwritten and received an "approve" by FHA's own automated underwriting system "Total Scorecard."

MLD Mortgage Inc., 30B Vreeland Road, Florham Park, NJ 07932
Phone: 973-805-2000

Comment 1

Further analysis revealed that the vast majority of the problem loans were wholesale loans. Based on this analysis, in May 2010 the Company ceased originations as a wholesale lender, and became exclusively a retail lender. Analysis also revealed that a disproportionate number of "streamline refinance" loans were defaulting. This was undoubtedly due to the absence of standard underwriting on such loans, as the default rate on streamlines nationwide is significantly higher than other FHA loans. The Company, based on this analysis, curtailed its Streamline FHA refinances. Finally, due to concerns regarding the Compare Ratio, the Company has significantly reduced its FHA originations and now originates less than five FHA loans per month.

Although these corrective actions were taken just over one year ago, the positive impact statistically on the two year Compare Ratio has not yet occurred and may not be evident until the middle of 2012. This is due to the fact that the wholesale and streamline refinance loans originated in 2009 and the first half of 2010 remain as part of the two-year Compare Ratio. Further, since FHA production has been dramatically reduced, there are many fewer current loans to dilute the impact of the prior defaults. The Company has taken corrective action and we expect that the Compare Ratio will eventually improve. The corrective actions taken by the Company are reflected in the "One Year" Compare Ratio which is at "0".

Comment 2

The Report further alleges that the Company did not maintain adherence to its own Policy & Procedures (P&P's) by failing to conduct annual reviews of the branch offices by its third party quality control contractor. The Report further acknowledges the fact that Company has only one branch office located in Boca Raton, Florida and that the branch received onsite reviews by the Company's board chairman, Mr. Morton Dear. Mr. Dear is a resident of Florida and New Jersey and as such spends a significant amount of time working out of the Boca Raton office. Due to Mr. Dear's frequent visits to the Boca Raton office on-site visits were being performed in accordance with the Company's P&P's. The only item missing to document this fact was the completion of a "branch checklist".

Comment 3

In August 2010 the Company established the Quality Assurance and Compliance Committee. The Committee is comprised of both Executive and Senior Management. The main purpose of this Committee is to supervise the Company's Quality Assurance and Compliance activities and manage its Quality Assurance and Compliance Risk. As stated during the exit interview that occurred on January 11, 2012; a change to the P&P's will be presented to the Committee at their next meeting which would allow for the Company to use a third party or a member of Executive and/or Senior Management to perform on-site branch reviews.

Comment 3

The Report further alleges that the deficiencies identified with rejected loans were not reported to management for follow-up and corrective action. This statement is erroneous as the Quality Control and Compliance Committee reviews the quality control reports in their entirety at their meetings. While these loans were not being incorporated into the management response due to being deemed low risk both Executive and Senior Management were aware of all deficiencies. It is also important to note the deficiencies cited on the rejected loans were confined to the loan officer not dating the initial application or the omission of race/sex information from the government monitoring section. Both of these items were subsequently addressed prior to the beginning of the audit. The Company mandated further training for its loan officers and as of July 2011 had already incorporated the rejected loan deficiencies into the management response.

Comment 4

The Report further alleges the Company did not have adequate internal controls to ensure that FHA loans were approved in accordance with HUD-FHA requirements. In December 2009 the Company hired an individual with over 10 years experience in underwriting and quality control solely for the purpose of a second level review of all FHA underwritten loans. This individual was responsible for ensuring that the underwriters were adhering to all FHA guidelines. In the event any loan was not underwritten in accordance with guidelines the loan was returned to the underwriter for correction of any/all deficiencies. These occurrences were also reported to Senior Management for review. Repeat violations and poor performance of an underwriter subjected the individual to disciplinary actions up to and including termination.

Comment 5

The Report is citing the Company for deficiencies on 10 loans related to charging "unsupported" lock-in fees without written justification. A review of the loans in question shows that these were all "third party originated", i.e. wholesale loans. On wholesale loans the Company required any/all conditions to be satisfied, including receipt and review of title and evidence all required insurance had been obtained prior to establishing a closing date. Once the Company received confirmation of a tentative closing date from the third party originator the funds were allocated and the interest rate guaranteed. HUD Handbook 4000.2 REV-3, paragraph 1-9 specifically states the minimum time for rate locks is 15 days but the loan may close in less than 15 days at the convenience of the borrower, and lock-in fees may still be earned. All of the loans closed within a very short time period of the "lock-in" date. In all of these instances the settlement dates were requested by the borrower(s) for the borrower's convenience.

The Report alleges noncompliance with HUD requirements in sixteen loans and recommends action by HUD regarding these assertions. Upon receipt of the draft Report the Company performed its own stringent analysis of the loans. Based on our review the Company strongly disagrees with a number of assertions in the Report and objects to the recommendations made regarding these loans. The following is the Company's response regarding the loans in question.

FHA Case No. 352-6131878

Comment 6

The Company is being cited due to the fact a judgment against the borrower was paid with the loan proceeds. The loan was originated as a cash out refinance with the borrower receiving $37,499 at settlement. The judgment in the amount of $907 was reflected as being paid with part of the loan proceeds and duly noted on the HUD-1 Settlement Statement. HUD guidelines do not restrict the purpose in which the proceeds will be used by the borrower(s) and also allows for debt consolidation with the proceeds. The borrower elected to pay off this debt with part of the proceeds. HUD Handbook 4155.1, REV-5, paragraph 2-3C, requires that court ordered judgments be paid off ***before*** the mortgage loan is eligible for insurance endorsement. The loan settled on February 25, 2009 and the paper binder requesting endorsement was received by HUD on March 27, 2009. The loan was endorsed for insurance on April 27, 2009. Therefore, the judgment was paid more than one month prior to requesting endorsement and more than two months prior to receiving endorsement.

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Comment 7

FHA Case No. 352-6269737

The Company is being cited for not reconciling discrepancies in the loan file documentation due to the pay off statement reflecting uncollected late charges of $49.69. Upon review of the pay off statement you will note that it reads "Late charge if payment received after 2/17/2009", not that unpaid late charges existed. The Company performed sufficient due diligence in verifying the borrower's mortgage payment history. The Company obtained a tri-merged credit report reflecting Bank of America was reporting the loan to have no late payments over the past 13 month period.

Comment 8

FHA Case No. 374-5437149

The Company is being cited for underwriting deficiencies relating to incorrect calculation of liabilities, more specifically not including the negative rental income reflected on the borrower's Schedule E of their tax returns. The subject property is a two unit dwelling. The rental income reflected on Schedule E is the rent received by the borrower's for the non-owner/tenant occupied unit in the subject property. Schedule E allows a tax filer to "write off" certain expenses associated with real estate such as, mortgage interest, taxes, insurance, etc. The borrower's accountant was "writing off" the portion of these items attributable to the tenant occupied unit. In qualifying the borrowers for the new financing the underwriter correctly used the full amount of the proposed housing payment in the debt ratios. The proposed housing payment includes principal, mortgage interest, taxes and insurance ("PITI"). In utilizing the method the auditor used in their analysis they are counting the liability twice.

4155.1 4.E.4.b states "The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes. Projected rent for the tenant-occupied units may:

- *only* be considered gross income, after deducting the Homeownership Center's (HOC) vacancy and maintenance factor, and
- *not* be used as a direct offset to the mortgage payment.

It is also important to note that no rental income was used in qualifying the borrowers. With that being said, no deficiency exists as the underwriter correctly calculated the debt to income ratio by using the new proposed PITI payment.

Comment 9

FHA Case No. 352-6255426

The Company is being cited for underwriting deficiencies relating to incorrect calculation of income. There exists a discrepancy in the method used by the auditor to calculate the borrower's income. The auditor annualized the income based on the "average" number of hours worked per week indicated on the Verification of Employment (VOE). The VOE is dated 3/24/2009 and indicates the borrower just started with this employer on 3/1/2009. Two pay stubs exist in the file dated 3/7/2009 and 3/21/2009. The 3/7/2009 pay stub shows 40 hours worked with regular earnings for that pay period of $1,360.00. The 3/21/2009 pay stub shows 80 hours worked with regular earnings of $2,720.00.

Since the borrower started on 3/1/2009 the 3/7/2009 pay stub reflected one week (40 hours) of regular earning. The 3/21/2009 pay stub was issued exactly two weeks after the 3/7/2009 pay stub was issued. This pay stub reflected two weeks (80 hours) of regular earnings. Based on the above it appears that the information reflected on the VOE as to average number of hours worked was erroneous. The underwriter, in the performance of their due diligence, noted the borrower worked a "conventional" work week and used the income reflected on the pay stubs to reconcile the discrepancy appearing on the VOE. No miscalculation of income exists.

MLD Mortgage, Inc. takes the matters raised in the draft Report seriously. The Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring adherence to HUD's rules and regulations. As stated above the Company's review of the loan files indicated that the Report's findings are at variance with the facts. The Company complied with FHA underwriting requirements in the loans identified. Accordingly, we respectfully request that the OIG revise the Report based on the information provided and remove these findings from their report.

Comment 10

Finally, The Company has already taken a proactive approach and implemented certain procedures to ensure compliance with all FHA/HUD guidelines/regulations. This fact is reflected in the one year Compare Ratio currently at "0" and the fact the September 2011, October 2011 and November 2011 delinquency reports obtained from Neighborhood Watch are all reporting the same loans.

If you have any additional questions, or if you need additional information, please do not hesitate to contact me directly at (973) 805 – 6022 or via email at Robert.oleynick@mldmortgage.com.

Sincerely,

Robert Oleynick
Director of Compliance

MLD Mortgage Inc., 30B Vreeland Road, Florham Park, NJ 07932
Phone: 973-805-2000

OIG Evaluation of Auditee Comments

COMMENT 1 MLD officials reasoning as to why loans became delinquent is based upon its loan servicers' reporting of default reasons, which we did not verify. In addition, while delinquencies may have been impacted by the economic downturn, there is no documented reason to suspect that loans underwritten by MLD Mortgage, Inc. would have been more severely impacted than those underwritten by other entities within the state of New Jersey. Accordingly, MLD Mortgage, Inc.'s default rate of 8.88, which was nearly double the state-wide average, represented a valid indicator of potential risk and cause to review MLD Mortgage, Inc.'s underwriting compliance with HUD/FHA requirements.

COMMENT 2 While MLD Mortgage, Inc.'s board chairman conducted quality control reviews of its branch office, this did not comply with its quality control plan that provided that the quality control contractor would perform the reviews and provide a written report of the results. Further, as acknowledged by MLD officials, the reviews performed by the board chairman were not formally documented.

COMMENT 3 As mentioned in the finding, MLD's on-site quality control review results were not documented in reports and provided to management so that systemic deficiencies could be addressed. However, MLD officials stated that changes to the branch office onsite monitoring will be considered. In addition, while MLD officials considered the deficiencies applicable to the rejected loans to be immaterial they have now included rejected loan deficiencies in the management response and mandated further training. These actions are responsive to our recommendation.

COMMENT 4 MLD officials stated that they hired an individual to conduct a second level review of all underwritten loans in December 2009; which should significantly strengthen its controls over underwriting if implemented as stated. However, this second level review was not in place for 12 out of the 14 loans cited with material deficiencies. Nevertheless, because of the weaknesses in underwriting identified in our findings, we stand by our conclusion that the company did not have adequate internal controls to ensure that all FHA loans were approved in accordance with HUD-FHA requirements.

COMMENT 5 MLD officials contend that all settlement dates were requested by the borrowers for their convenience; however, there is no documentation in the files to support this statement.

COMMENT 6 MLD officials stated that the judgment was reflected as being paid with part of the loan proceeds and duly noted on the HUD-1 Settlement Statement. MLD officials also stated that HUD Handbook 4155.1, REV-

5, paragraph 2-3C, requires that court ordered judgments be paid off before the loan is eligible for insurance. The officials note that the loan settled on February 25, 2009, and was endorsed for insurance on April 27, 2009, thus having been paid more than two months prior to receiving endorsement. We agree with the officials reading of HUD Handbook 4155.1, REV-5, paragraph 2-3C, but contend that the HUD-1 Settlement Statement is not adequate documentation that the judgment was paid off. In addition, the officials did not address the issue that the loan file did not contain documentation that the judgment was paid off as a condition of the loan's approval as required by their desktop underwriting system. Further, the loan file did not contain sufficient written explanation from the borrower about the judgment as required by Handbook 4155.1, REV-5, paragraph 2-3. Accordingly, the underwriting deficiency will remain in the report.

COMMENT 7 MLD officials have not provided adequate documentation that the borrower had not incurred late charges prior to the loan's closing on May 8, 2009. The officials refer to information contained in a monthly mortgage payment coupon dated as of January 29, 2009; however, the deficiency is based upon information contained in the actual mortgage payoff statement dated April 16, 2009 found in the loan file, which listed uncollected late charges.

COMMENT 8 Further review of the loan file disclosed that the underwriter had correctly calculated the debt to income ratio using the total proposed housing payment. Therefore, we agree with MLD officials' comment and removed this case from the final report.

COMMENT 9 MLD officials stated that the underwriter calculated the borrower's income based upon a 40 hour work week as noted on the borrower's two most recent paystubs. However, we calculated the income based upon a 37.5 work week as reported in the written verification of employment contained in the loan file. However, the loan file also contained a verbal verification of employment dated subsequent to the paystubs that stated the borrower was a part time employee. Accordingly, the underwriter should have obtained clarification for this conflicting information.

COMMENT 10 Our findings were based upon interviews, detailed analyses of loan files and MLD procedures, and comparison with HUD regulations. The questioned loans did not meet the threshold for insurability. As noted, we have considered the comments MLD officials provided for 4 of the 15 loans originally cited for material underwriting deficiencies and removed one loan previously reported as having a material underwriting deficiency. However, since MLD officials did not address the remaining 11 loans, no other adjustments to the report were made.

Appendix C

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA case number	Incorrect or inadequate calculation of income or liabilties	Inadequate verification of earnest money deposit	Inadequate documentation of gifts	Inadequate verification of assets or funds to close	Judgment paid with loan proceeds	Inadequate verification of employment	Approval of cash-out refinance loan with late payments
374-5539758	X		X				
352-6328972	X	X		X		X	
374-5629094		X					
352-6050094	X						X
352-6268357	X			X			
352-6129743				X			
352-6632782		X	X				
352-6255426	X						
352-6131878					X		
352-6060237						X	
352-6269737							X
352-5829040				X		X	
352-6127981		X					
352-6086467	X						
Totals	6	4	2	4	1	3	2

Appendix D

SCHEDULE OF ACTUAL AND POTENTIAL LOSSES TO THE FHA INSURANCE FUND

FHA case number	Settlement date	Number of payments before first default	Original loan amount	Unpaid principal balance	Claim paid	Potential loss to HUD (59 percent of unpaid principal balance)
374-5539758	1/12/2010	4	$589,132	$585,487		$345,437
352-6328972	8/19/2009	4	$323,259	$321,833		$189,881
374-5629094	3/26/2010	2	$490,943	$487,681		$287,732
352-6129743	3/11/2009	7	$333,485	$0	$176,988	$0
352-6050094	2/20/2009	7	$363,247	$358,792		211687
352-6632782	1/27/2010	8	$245,471	$243,234		$143,508
352-6255426	4/21/2009	9	$502,645	$497,117		$293,299
352-6131878	2/20/2009	10	$274,725	$269,421		$158,958
352-6060237	2/11/2009	11	$155,168	$153,159		$90,364
352-6269737	5/8/2009	12	$194,342	$190,735		$112,534
352-5829040	1/17/2009	13	$607,413	$597,684		$352,634
352-6127981	2/11/2009	14	$325,752	$315,048		$185,878
352-6086467	5/29/2009	14	$358,160	$351,968		$207,661
352-6268357	6/10/2009	14	$304,385	$299,579		$176,752
Total			**$5,068,127**	**$4,671,738**	**$176,988**	**$2,756,325**

Appendix E

CASE SUMMARY NARRATIVES

FHA case number: 374-5539758

Loan amount: $589,132

Loan purpose: Purchase

Settlement date: January 12, 2010

Status as March 15, 2011: Special forbearance

Payments before first default reported: Four

Summary: The loan evidenced underwriting deficiencies relating to incorrect calculation of income and liabilities and inadequate documentation of gifts.

Incorrect Calculation of Income and Liabilities

MLD officials used an 11.75 monthly average of overtime and "other" income (reported on the verification of employment as "locality, overtime meals, adjustments, and Saturday pay") to develop the borrower's monthly income. While this process resulted in a $2,172 monthly overtime and $389 monthly "other" income, we calculated the income based upon a 2-year average based upon income data reported in the verification of employment. This calculation resulted in a monthly overtime income of $1,695 and "other" income of $368, which was $497 less than that used to qualify the borrower. Additionally, MLD officials understated the borrower's monthly rental income by $212 because they applied the 85 percent vacancy rate as required by HUD Handbook 4155.1, paragraph 4.E.4b to the $3,200 monthly rent reported by the borrower as opposed to the $3,450 monthly rent documented in the property appraisal. MLD officials stated that the underwriter applied the 85 percent vacancy or collection loss to a monthly rent of $1,600 for two units, while we applied the same percentage to the $2,932 monthly rent according to the property appraisal. The net result of the overstatement and understatement of estimated borrower monthly income was an overstatement of $285.

MLD officials also did not include a $246 monthly payment for a deferred education loan as a liability of the borrower. A credit report in the loan file reported that the borrower had an education loan that was deferred until May 6, 2010, with the first payment due December 6, 2010. Since the loan closing was scheduled for January 12, 2010, the first payment on the educational loan would be within 1 year of the loan's closing date and should have been considered when calculating the borrower's liabilities. The incorrect calculation of income and liabilities would cause the borrower's front and back ratios to increase from 39.52 and 54.71 percent to 40.92 and 59.71 percent, respectively.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 4D(2)(b), provides that overtime income can be used to qualify a borrower if the income was received for the past 2 years and is likely to continue. If the employment verification states that the overtime and bonus income is unlikely to continue, it may not be used in qualifying. The lender must develop an average of bonus or overtime income for the past 2 years. Periods of overtime and bonus income of less than 2 years may be acceptable, provided the lender can justify and document in writing the reason for using the income for qualifying purposes. HUD Handbook 4155.1, paragraph 4.E.4b provides that 85 perecnt of rental income reported in the property appraisal be used to calculate income in order to account for vacancy and collection loss.

HUD Handbook 4155.1, paragraph 4C(6)(a), requires that debt payments, such as a student loan or balloon note, scheduled to begin or come due within 12 months of the mortgage loan closing be included by the lender as anticipated monthly obligations during the underwriting analysis. In addition, HUD Handbook 4155.1, paragraph 4C(4)(b), provides that when computing the back ratio, recurring obligations such as monthly housing expenses and additional recurring charges extending 10 months or more must be considered.

HUD Handbook 4155.1 paragraph 4.F.3 provides that a front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors are documented.

Inadequate Documentation of Gifts

Gift documentation in the loan file did not adequately support that the funds provided on December 16, 2009, were those of the donor. The donor's bank statement obtained by MLD reported that the donor deposited $8,500 on December 04, 2009, and that the donor's account balance was $373 before the $8,500 deposit and $552.67 after the gift withdrawal. In addition, the gift letter did not include the property's address.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5B(4)(d), provides that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source and were the donor's own funds.

FHA case number: 352-6328972

Loan amount: $323,259

Loan purpose: Purchase

Settlement date: August 19, 2009

Status as March 15, 2011: First action to commence foreclosure

Payments before first default reported: Four

Summary: The loan evidenced underwriting deficiencies relating to inadequate verification of earnest money, assets, employment, and liabilities.

Inadequate Verification of Earnest Money

The loan file lacked documentation showing that the source of an earnest money deposit of $11,741, representing 3.5 percent of the sales price, provided at closing was adequately analyzed and verified.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5B(2)(a), provides that if the amount of an earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify and document the source of the funds. Satisfactory documentation includes a copy of the borrower's cancelled check, certification from the deposit holder acknowledging receipt of funds, or separate evidence of the source of funds. Separate evidence includes a verification of deposit or bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit at the time of the deposit.

Inadequate Verification of Assets

The file contained two bank statements, dated March 31 and April 30, 2009, which reported a beginning and ending balance of $19,893. Since the loan's closing date was August 19, 2009, the March 31, 2009, bank statement and 21 of 30 days of the April 30, 2009, bank statement were more than 120 days old.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 1B(1)(h), provides that at loan closing, all documents in the mortgage loan application may not be more than 120 days old, or 180 days old for new construction.

Inadequate Verification of Employment
Incorrect or Inadequate Calculation of Liabilities

The loan file contained a 2008 tax return transcript, dated April 27, 2009, that reported a $25,650 tax liability for the self-employed borrower. However, the file also contained additional Internal Revenue Service correspondence disclosing that the borrower filed an amended 2008 return in June 2009; however, there was no documentation showing that MLD officials obtained a copy of the amended return or determined whether the borrower had an outstanding tax liability, which could have negatively affected the borrower's assets to close and ability to make timely mortgage payments.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 4D(4)(d), requires that self-employed borrowers provide signed and dated individual tax returns with all applicable tax schedules for the most recent 2 years, a year-to-date profit and loss statement, and a balance sheet. HUD Handbook 4155.1, paragraph 1B(1)(g), requires that the mortgage loan application package contain all documentation that supports the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower.

FHA case number: 374-5629094

Loan amount: $490,943

Loan purpose: Purchase

Settlement date: March 26, 2010

Status as March 15, 2011: Delinquent

Payments before first default reported: Two

Summary: The loan evidenced an underwriting deficiency relating to inadequate verification of an earnest money deposit.

Inadequate Verification of an Earnest Money Deposit

While the HUD-1, dated March 26, 2010, listed a $15,000 earnest money deposit, representing 3 percent of the sales price, there was no documentation to support that it was deposited or its source. While the file contained a coborrower's bank statement listing a $15,000 withdrawal on January 26, 2010, it did not contain a corresponding check to support to whom the check was written, the date received, or the source of the deposit at the time of closing.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5B(2), provides that if the amount of any earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify and document the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check, certification from the deposit holder acknowledging receipt of funds, or separate evidence of the source of funds. Separate evidence includes a verification of deposit or a bank statement showing that the average balance was sufficient to cover the amount of the earnest money deposit at the time of the deposit.

FHA case number: 352-6050094

Loan amount: $363,247

Loan purpose: Cash-out refinance

Settlement date: February 20, 2009

Status as March 15, 2011: Bankruptcy – court clearance obtained

Payments before first default reported: Seven

Summary: The loan evidenced underwriting deficiencies relating to incorrect calculation of liabilities and approval of an ineligible loan.

Incorrect Calculation of Liabilities

MLD officials understated borrower monthly liabilities by $169. As shown below, various errors caused MLD officials to calculate monthly liabilities of $581 as opposed to $750.

Liabilities as calculated in the file:	$581
Less liabilities removed because they were reported as paid on the HUD-1:	<$ 92>
Add liabilities added because they were reported as outstanding on the credit report:	261
Recalculated liabilities:	$750

This understatement caused the back ratio to increase from 56.96 to 59.91 percent.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 4C(4)(b), provides that when computing the debt-to-income ratio, the lender must include recurring obligations such as monthly housing expense and additional recurring charges extending 10 months or more, such as payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony.

HUD Handbook 4155.1 paragraph 4.F.3 provides that a front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors are documented.

Approval of Ineligible Loan

Contrary to HUD-FHA underwriting requirements, the borrower was approved for a cash-out refinance despite evidence in the file that the borrower had late payments on the refinanced mortgage(s) and was permitted to skip payments. The refinance of the borrower’s first mortgage was a $1,938 cash-out, while the payoff statement reported late charges of $156. The payoff statement for the refinance of the borrower's second mortgage reported charges of $42.64; however, the nature of these charges was not indicated.

The payoff statements for both of the borrower's mortgages disclosed that the borrower skipped more than one mortgage payment before the closing. The first mortgage closed on February 16, 2009 while the payoff statement listed the principal balance as of December 1, 2008. For the second mortgage, the borrower's payoff statement listed interest due of $870 while the credit report listed a monthly second mortgage payment of $233. As a result, the loan should not have been approved as a cash-out refinance.

HUD-FHA Requirements

Mortgagee Letter 05-43, dated October 31, 2005, provides that a borrower must have made all of his or her mortgage payments within the month due for the previous 12 months (that is, no payment may have been more than 30 days late and the loan is current for the month due) to be eligible for a cash-out refinance loan. Further, HUD Handbook 4155.1, REV-5, paragraph 1-10, prohibits lenders from allowing borrowers to skip payments, and the borrower must either make the payment when it is due or bring the monthly mortgage payment check to settlement because FHA does not permit the inclusion of mortgage payments skipped in the new mortgage amount.

Mortgagee Letter 92-5 prohibits a lender from processing loans without reconciling discrepancies in the file documentation. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the mortgage loan application package must contain all documentation that supports the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower.

FHA case number: 352-6268357

Loan amount: $304,385

Loan purpose: Purchase

Settlement date: June 10, 2009

Status as March 15, 2011: Ineligible for loss mitigation

Payments before first default reported: 14

Summary: The loan evidenced underwriting deficiencies relating to inadequate verification of assets and an inadequate calculation of liabilities.

Inadequate Verfication of Assets

MLD officials did not obtain a 3-month banking history or sufficient documentation to show that the borrower had the $12,717 needed to close on June 10, 2009. The file contained bank statements, dated February 19 and March 20, 2009, and reported a balance of $1,619 as of March 20, 2009.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5(B)(1)(A), provides that a borrower must have sufficient funds to cover borrower-paid closing costs and fees at the time of settlement. Funds used to cover the required minimum downpayment, as well as closing costs and fees, must come from acceptable sources and must be verified and properly documented. HUD Handbook 4155.1, paragraph 5B(2)(C)The lender must obtain a written verification of deposit and the borrower's most recent statements for all asset accounts to be used in qualifying. As an alternative to obtaining a written verification of deposit, the lender may obtain from the borrower original asset statements covering the most recent 3-month period. Provided that the asset statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements. If the loan was TOTAL Scorecard-approved and a written verification of deposit is not obtained, the lender may obtain a statement showing the previous month's ending balance for the most recent month. If the previous month's balance is not shown, the lender must obtain statements for the most recent 2 months to verify that there are sufficient funds to close.

Inadequate Calculation of Liabilities

The loan file contained discrepant information, which was not addressed or resolved. The borrower's bank statement in the file, dated February 19 to March 20, 2009, reported a $1,060 monthly mortgage payment; however, this potential liability was not reported on the borrower's credit reports, dated April 15 and April 24, 2009, or considered in the calculation of borrower liabilities. If this liability were included, the borrower's back ratio would rise from 49.75 to 72.25 percent.

HUD-FHA Requirements

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation. HUD Handbook 4155.1, paragraph 1B(1)(g), states that the mortgage loan application package must contain all documentation that supports the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower.

HUD Handbook 4155.1 paragraph 4.F.3 provides that a front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors are documented.

FHA case number: 352-6129743

Loan amount: $333,485

Loan purpose: Refinance - no cash-out

Settlement date: March 11, 2009

Status as of August 31, 2011: Preforeclosure sale completed

Payment before first default reported: Seven

Summary: The loan evidenced underwriting deficiencies relating to inadequate verification of funds to close.

Inadequate Verification of Funds To Close

The lender did not verify or document that the borrower had adequate funds to close. The HUD-1 reported that the borrower was required to pay $2,545 at closing; however, there was no bank statement or other documentation in the file to support that the borrower had adequate funds to close or that the funds were received. Consequently, HUD lacked assurance that the borrower provided the required funds to close.

HUD-FHA Requirements

HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented.

HUD Handbook 4155.1, REV-5, paragraph 5B(1)(a), states the borrower must have sufficient funds to cover borrower-paid closing costs and fees at the time of settlement.

FHA case number: 352-6632782

Loan amount: $245,471

Loan purpose: Purchase

Settlement date: January 27, 2010

Status as of August 31, 2011: Delinquent

Payment before first default reported: Eight

Summary: The loan evidenced underwriting deficiencies relating to inadequate documentation of a gift and an earnest money deposit.

Inadequate Documentation of Gifts

The loan file contained a gift letter and cashier's check for $8,750 from the donor, dated November 12, 2009. The file also contained a copy of the donor's bank statement that reported a balance of $121 as of November 12, 2009, and an $8,750 deposit on November 13, 2009, which was withdrawn the same day. This discrepant information was not explained.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5B(4)(d), provides that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were provided by an acceptable source and were the donor's own funds..

Inadequate Verification of Earnest Money Deposit

The HUD-1 showed an earnest money deposit of $8,750, which exceeded 2 percent of the $250,000 sales price. The file did not contain adequate supporting documentation for the earnest money deposit.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 5B(.2)(a), provides that a lender must verify and document the deposit amount and source of funds if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings. HUD Handbook 4155.1, paragraph 1B(1)(g), further provides that when standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower.

FHA case number: 352-6255426

Loan amount: $502,645

Loan purpose: Refinance no cash-out

Settlement date: April 21, 2009

Status as of August 31, 2011: First legal action to commence foreclosure

Payment before first default reported: Nine

Summary: The loan evidenced an underwriting deficiency relating to incorrect calculation of income.

Incorrect Calculation of Income

The borrower's monthly employment income listed on the FHA Loan underwriting and transmittal summary was $5,893; however, calculation of the monthly employment income based on the written verification of employment was $5,525. Therefore, monthly income was overstated by $368. As a result of the incorrect income calculation, the borrower's front ratio increased from 42.77 to 44.76 percent, and the back ratio increased from 44.52 to 46.60 percent.

HUD-FHA Requirements

FHA TOTAL Mortgage Scorecard User Guide, chapter 1, provides that the lender is responsible for the integrity of the data used to obtain the risk assessment and for resubmitting the loan when material changes are discovered or otherwise occur during loan processing.

FHA TOTAL Mortgage Scorecard User Guide, chapter 2, states that the lender is responsible for documenting and verifying the accuracy of the amount of the income being reported.

HUD Handbook 4155.1 paragraph 4.F.3 provides that a front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors are documented.

FHA case number: 352-6131878

Loan amount: $274,725

Loan purpose: Refinance cash-out

Settlement date: February 20, 2009

Status as of August 31, 2011: Special forbearance

Payment before first default reported: 10

Summary: The loan evidenced underwriting deficiency relating to a judgment paid with loan proceeds.

Judgment Paid With Loan Proceeds

The loan was processed as a cash-out refinance with the borrower receiving $37,499 at closing. However, a credit report, dated December 17, 2008, listed a judgment in the amount of $907, while at the same time, the file documentation reported that borrower assets were $433. The judgment was included on the HUD-1 and paid off with the new FHA-insured mortgage contrary to HUD-FHA requirements. However, other than the HUD-1 Settlement Statement reporting that the judgment would be paid off from the loan proceeds, there was no documentation in the loan file that the judgment had been satisfied.

HUD-FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3C, requires that court-ordered judgments be paid off before the mortgage loan is eligible for FHA insurance endorsement, and FHA Total Mortgage Scorecard User Guide, chapter 2, provides that evidence of the payoff for any outstanding judgments shown on the credit report must be obtained before endorsement. Further, the desktop underwriting system used by MLD officials noted that that evidence of the payoff of the $907 debt needed to be in the loan file as a condition of the loan approval.

FHA case number: 352-6060237

Loan amount: $155,168

Loan purpose: Refinance no cash-out

Settlement date: February 11, 2009

Status as of August 31, 2011: First legal action to commence foreclosure

Payment before first default reported: 11

Summary: The loan evidenced an underwriting deficiency related to inadequate support for employment.

Inadequate Support for Employment

The loan file did not have written or verbal verifications of employment for the borrower's two current employers as required. For the first employer, there was a pay stub for the period ending November 15, 2008, with a handwritten note stating "November 2007" and a 2007 W-2. For the second employer, there was a pay stub for the period ending November 15, 2008, with a handwritten note stating "February 2008." Consequently, the borrower's employment was not verified as required.

HUD-FHA Requirements

FHA TOTAL Mortgage Scorecard User Guide, chapter 2, states that the lender must obtain the single most recent pay stub (showing year-to-date earnings of at least 1 month) and any of the following to verify current employment: written verification of employment, verbal verification of employment (lender or service provider must document the individual verifying the employment), or electronic verification acceptable to FHA.

FHA case number: 352-6269737

Loan amount: $194,342

Loan purpose: Refinance cash-out

Settlement date: May 8, 2009

Status as of August 31, 2011: Delinquent

Payment before first default reported: 12

Summary: The loan evidenced an underwriting deficiency related to approval of a cash-out refinance with late payments.

Approval of Ineligible Loans

The HUD-1, dated March 26, 2009, reported cash back to the borrower of $1,151. However, the mortgage payoff statement in the file listed uncollected late charges of $49.69, which were not listed on the credit report. There was no indication in the file that an explanation was obtained for this conflicting information; if there were late mortgage payments, the borrower would not have been eligible for a cash-out refinance loan.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 3B(2)(b), provides that borrowers, who are delinquent, are in arrears, or have suffered any mortgage delinquencies within the most recent 12-month period under the terms and conditions of their mortgages, are not eligible for cash-out refinances.

Mortgagee Letter 92-5 prohibits the lender from processing loans without reconciling discrepancies in the file documentation.

FHA case number: 352-5829040

Loan amount: $607,413

Loan purpose: Refinance no cash-out

Settlement date: January 17, 2009

Status as of August 31, 2011: Delinquent

Payment before first default reported: 13

Summary: The loan evidenced underwriting deficiencies relating to inadequate support for employment and inadequate verification of assets.

Inadequate Verification of Employment

The file contained a written verification of employment from the borrower's current employer (dated October 16, 2008) with a hire date of January 2, 2008. In addition, there were two verbal verifications of employment from the current employer (dated November 26, 2008, and January 16, 2009) reporting a hire date of March 2008 and January 2, 2008, respectively. The final loan application (dated January 17, 2009) showed that the borrower worked for the prior employer from November 5, 2005, to September 3, 2007; however, the file did not contain a verification of employment for this prior employer. As a result, we could not determine the borrower's 2-year employment history as required.

HUD-FHA Requirements

HUD Handbook 4155.1, section 2-6, states that the lender must verify the borrower's employment for the most recent 2 full years. In addition, the borrower must explain any gaps in employment spanning 1 month or more.

Mortgagee Letter 92-5 prohibits a lender from processing loans without reconciling discrepancies in the file documentation.

Inadequate Verification of Assets or Funds To Close

The loan file contained the following bank statements: July 28 to August 26, 2008, August 27 to September 25, 2008, and November 25 to December 26, 2008. We excluded the bank statement for July 28 to August 26, 2008, because the statements were more than 120 days old. Therefore, the file was missing bank statements from September 26 to November 24, 2008, which would have provided a 3-month verification of the borrower's asset history

The bank statement listed 8 accounts, 5 of which were uniform gift to minor accounts, for which the borrower and coborrower were custodians, with a total balance of $62,270, of which $60,622 was in the five uniform gift to minor accounts. In 3 of the 8 accounts, there were excessive deposits totaling $13,520 which weren't sourced. Since the HUD-1 (dated January 17, 2009) showed cash required from the borrowers of $11,186 these deposits were needed for the borrower to close and should have been properly sourced.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 3-1F, provides that if documents are not more than 120 days old when the loan closes, they do not have to be updated. In addition, as an alternative to obtaining a verification of deposit, the lender may obtain original bank statements covering the most recent 3-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the most recent, consecutive statements.

HUD Handbook 4155.1, REV 5, section 2-10, provides that all funds for the borrower's investment in the property must be verified and documented. HUD Handbook 4155.1, REV 5, paragraph 2-10B, requires that if there is a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

FHA case number: 352-6127981

Loan amount: $325,752

Loan purpose: Purchase

Settlement date: February 11, 2009

Status as of August 31, 2011: Special forbearance

Payment before first default reported: 14

Summary: The loan evidenced underwriting deficiencies relating and inadequate verification of the earnest money deposit.

Inadequate Verification of Earnest Money Deposit

The HUD-1 listed an earnest money deposit of $8,425, which exceeded 2 percent of the sales price. While the file contained a copy of a $1,000 check, there was no documentation to support the payment and source of the remaining $7,425 deposit needed.

HUD-FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10A, provides that if the amount of the earnest money deposit exceeds 2 percent of the sale price or appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds.

HUD Handbook 4155.1, paragraph 1B(1)(g), provides that when standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower.

FHA case number: 352-6086467

Loan amount: $358,160

Loan purpose: Purchase

Settlement date: May 29, 2009

Status as of August 31, 2011: Ineligible for loss mitigation

Payment before first default reported: 14

Summary: The loan evidenced an underwriting deficiency relating to incorrect calculation of income and liabilities.

Incorrect Calculation of Income and Liabilities

The borrower's monthly employment income on the FHA loan underwriting and transmittal summary was listed as $3,431; however, our calculation of the monthly employment income was $3,408, resulting in an overstatement of monthly income of $23. The coborrower's monthly employment income on the FHA loan underwriting and transmittal summary was listed as $2,109; however, our calculation of the monthly employment income was $2,083, resulting in monthly base income being overstated by $25. In addition, the FHA loan underwriting and transmittal summary listed alimony of $589 as other income; however, review of the bank statement indicated that alimony would be $975. Therefore, alimony was understated by $386. Further, a bank statement, dated March 6, 2009, reported a GMAC payment of $453; however, this payment was not included on the credit report, and no explanation was obtained for the conflicting information. If the increased income and a potential debt were included in the ratio calculation, the borrower's front ratio would decrease from 39.73 to 37.96 percent, and the back ratio would increase from 52.59 to 56.21 percent.

HUD-FHA Requirements

HUD Handbook 4155.1, paragraph 1B(1)(g), states that when standard documentation does not provide enough information to support the approval decision, the lender must provide additional, explanatory statements that are consistent with information in the application. The explanatory statements must clarify or supplement the documentation submitted by the borrower. FHA TOTAL Mortgage Scorecard User Guide, chapter 2, states that the lender is responsible for documenting and verifying the accuracy of the amount of the income being reported.

HUD Handbook 4155.1 paragraph 4.F.3 provides that a front ratio exceeding 31 percent, and a back ratio exceeding 43 percent, may be acceptable only if significant compensating factors are documented.