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MEMORANDUM NO:
2010-CH-1806

July 15, 2010

MEMORANDUM FOR: Vicki Bott, Deputy Assistant Secretary for Single Family, HU
Dane M. Narode, Associate General Counsel for Program Enforcement, CACC

FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: 1st Advantage Mortgage, LLC, Lombard, IL, Did Not Properly Underwrite a Selection of FHA Loans

INTRODUCTION

We reviewed 20 Federal Housing Administration (FHA) loans that 1st Advantage Mortgage, LLC (1st Advantage), underwrote as an FHA direct endorsement lender. Our review objective was to determine whether 1st Advantage underwrote the 20 loans in accordance with FHA requirements. This review was conducted as part of our Operation Watchdog initiative to review the underwriting of 15 direct endorsement lenders at the suggestion of the FHA Commissioner. The Commissioner expressed concern regarding the increasing claim rates against the FHA insurance fund for failed loans.

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

We provided our discussion draft memorandum report to 1st Advantage's legal counsel during the review. We asked 1st Advantage to provide written comments on our discussion draft memorandum report by June 29, 2010. 1st Advantage's legal counsel provided written comments to the discussion draft report, dated June 28, 2010. The legal counsel generally disagreed with our finding and recommendations, but agreed that mistakes were made and claimed that 1st Advantage wanted to mitigate the damages to the FHA insurance fund for the losses sustained. The complete text of the lender's comments, along with our evaluation of that response, can be found in appendix C of this report.

METHODOLOGY AND SCOPE

1st Advantage is 1 of 15 direct endorsement lenders we selected from the U.S. Department of Housing and Urban Development's (HUD) publicly available Neighborhood Watch[1] system (system) for a review of underwriting quality. These direct endorsement lenders all had a compare ratio[2] in excess of 200 percent of the national average as listed in the system for loans endorsed between November 1, 2007, and October 31, 2009. We selected loans that had gone into claim status. We selected loans for 1st Advantage that defaulted within the first 30 months and were (1) not streamline refinanced and (2) for manually underwritten loans, associated with an underwriter (usually an individual) with a high number of claims.

BACKGROUND

1st Advantage was a nonsupervised direct endorsement lender based in Lombard, IL. FHA approved 1st Advantage as a direct endorser in September 1997 and terminated this approval in February 2010 for failure to submit audited financial statements. FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers that might not be able to meet conventional underwriting requirements by protecting the lender against default. The direct endorsement program simplifies the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. Lenders are responsible for complying with all applicable HUD regulations and are required to evaluate the borrower's ability and willingness to repay the mortgage debt. Lenders are protected against default by FHA's mutual mortgage insurance fund, which is sustained by borrower premiums.

The goal of Operation Watchdog is to determine why there is such a high rate of defaults and claims. We selected up to 20 loans in claim status from the 15 lenders. The 15 lenders selected for our review endorsed 183,278 loans valued at $31.3 billion during the period January 2005 to December 2009. These same lenders also submitted 6,560 FHA insurance claims with an estimated value of $794.3 million from November 2007 through December 2009. During this period, 1st Advantage endorsed 2,648 loans valued at more than $381 million and submitted 68 claims worth more than $8 million.

Our objective was to determine whether the 20 selected loans were properly underwritten and if not, whether the underwriting reflected systemic problems.

We performed our work from January through May 2010. We conducted our work in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information systems controls of 1st Advantage, consider the results of previous audits, or communicate with 1st Advantage's management in advance. We

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[1] Neighborhood Watch is a system that aids HUD/FHA staff in monitoring lenders and its programs. This system allows staff to oversee lender origination activities for FHA-insured loans and tracks mortgage defaults and claims.

[2] HUD defines "compare ratio" as a value that reveals the largest discrepancies between the direct endorser's default and claim percentage and the default and claim percentage to which it is being compared. FHA policy establishes a compare ratio of more than 200 percent as a warning sign of a lender's performance.

did not follow standards in these areas because our objective was to aid HUD in identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing in poor-performing lenders that led to a high rate of defaults and claims against the FHA insurance fund. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

RESULTS OF REVIEW

1st Advantage did not properly underwrite 8 of the 20 loans reviewed because its underwriters did not follow FHA's requirements. As a result, FHA's insurance fund suffered actual losses of $325,452 on the eight loans, as shown in the following table.

FHA loan number	Closing date	Number of payments before first default	Original mortgage amount	Actual loss to HUD
261-9102016	8/28/06	6	$83,341	$96,276
361-3030073	6/28/06	22	89,203	27,035
421-4233347	8/14/06	2	61,514	39,455
421-4238265	10/13/06	9	46,631	28,600
492-7646642	7/7/06	14	127,991	38,810
492-7676492	7/28/06	17	83,686	48,008
492-7844383	7/13/07	18	98,124	36,843
495-7563145	11/20/06	11	49,508	10,425
	Totals		$639,998	$325,452

The following table summarizes the material deficiencies that we identified in the eight loans.

Area of noncompliance	***Number of loans***
Income	6
Assets	3
Credit report	2
Excessive ratios	1

Appendix A shows a schedule of material deficiencies in each of the eight loans. Appendix B provides a detailed description of all loans with material underwriting deficiencies noted in this report.

Income

1st Advantage did not properly calculate borrowers' income or determine income stability for six loans. HUD does not allow income to be used in calculating a borrower's income ratios if it cannot be verified, is not stable, or will not continue. 1st Advantage is required to analyze whether income is reasonably expected to continue through at least the first 3 years of the mortgage loan (see appendix B for detailed requirements).

For example, for loan number 421-4233347, 1st Advantage approved this loan although the borrower had a history of full-time employment and income for only 77 days, from May 29, 2006, to the loan closing date. This was borrower's first full-time employment, as the borrower's previous employments were all part time. According to documentation in the loan file, the borrower's average monthly earnings were $282 for 2004 and $325 for 2005. In addition to approving the loan based on just 77 days of full-time employment, 1st Advantage included overtime pay to calculate total monthly income of $1,755. HUD requires the overtime to be earned for the past 2 years to be included as income. By not including the overtime income, the borrower's qualifying ratios would increase to 34.4 and 46.1 percent.

For loan number 421-4238265, the borrower did not have a history of stable employment and income for a period of 24 months before loan closing. The borrower had employment history for approximately 15 months, 3.5 months of full time and the remaining 11.5 months as part time. The borrower started his full-time job with the current employer on June 28, 2006, about 3.5 months before loan closing. The borrower worked for two different employers from July 2005 to April 2006. The borrower did not have an employment record before July 2005. According to the Internal Revenue Service Forms W-2 in the loan file, the borrower's total earnings for 2005 were $3,146 or approximately $262 per month. 1st Advantage approved this loan based on the borrower's current rate of pay of $7.50 per hour or $1,300 per month.

Assets

1st Advantage did not properly document the source of the borrowers' funds to close for three loans. HUD requires the lender to verify and document the borrower's investment in the property (see appendix B for detailed requirements).

For example, for loan number 261-9102016, 1st Advantage did not obtain an explanation for the source of funds for the earnest money deposit of $2,520. It was 3 percent of the sales price and appeared excessive based on borrower's history of savings, as shown by the bank statements in the loan file. To document the earnest money deposit amount, the borrower provided a copy of a $2,520 bank check, dated July 18, 2006. The money for the bank check came from the borrower's bank account. The bank statement showed a deposit of $2,520 on July 18, 2006. The deposit was withdrawn on the same day, and the bank check for the earnest money was obtained on the same day. The source of these funds was not detailed in the loan file or the bank statements. Therefore, there was a lack of documentation to ensure that the borrower did not obtain the earnest money deposit funds via an undocumented loan, funds from an interested party, or funds from another excludable source.

For loan number 421-4238265, 1st Advantage did not obtain an explanation for the source of funds for the borrower's earnest money. The loan file included a copy of a cancelled check for $250 as an earnest money deposit. The check was not written from the borrower's account but from an account of the person with the same name as borrower's landlord.

Credit Report

1st Advantage did not properly evaluate the borrowers' credit history for two loans. HUD requires the lender to consider collection accounts in analyzing a borrower's creditworthiness. The lender must explain all collections in writing (see appendix B for detailed requirements).

For example, for loan number 421-4238265, 1st Advantage approved the loan when the borrower had a limited credit history. The credit report showed only two accounts. Both of the accounts showed zero balances. One showed a high balance of $3,000, and the other had a high balance of zero. The credit report contained statements from the three major credit reporting agencies indicating that no score was assigned because the subject did not have sufficient credit. Further, the credit report indicated that the borrower paid $100 per week in rent; however, no documentation was included in the loan file to support the rental payments. To establish credit for the borrower, 1st Advantage should have obtained documentation for the rental payment history.

For loan 492-7646642, 1st Advantage approved the loan despite the borrower having a poor credit history, as the borrower's credit history reflected continuous delinquent and unpaid accounts. According to the credit report, the borrower had 9 collection accounts for revolving credit, rental payments, and utility payments; 10 collection accounts for medical expenses; and 3 accounts that were charged off for automobile repossession or utility bills. Two of the nine collection accounts were for rental payments for housing for two different apartment complexes. In a letter found in the loan file, the borrower claimed that the derogatory credit was due to immaturity and ignorance, as well as her divorce.

Excessive Ratios

1st Advantage improperly approved one loan when the borrower's ratios exceeded FHA's requirement. Effective April 13, 2005, the mortgage payment-to-effective income and total fixed payment-to-effective income ratios were increased from 29 and 41 percent to 31 and 43 percent, respectively. If either or both ratios are exceeded on a manually underwritten mortgage, the lender is required to describe the compensating factors used to justify the mortgage approval (see appendix B for detailed requirements).

For loan number 492-7646642, the borrower's mortgage payment-to-effective income ratio exceeded HUD's qualifying ratio of 31 percent. The ratio reported on the mortgage credit analysis worksheet[3] was 33 percent. 1st Advantage's underwriter used a compensating factor and recorded in the worksheet's remarks section that the borrower received child support payments of $597, which were not included in her income. However, there was no documentation in the loan file to support this compensating factor.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the eight loans with material underwriting deficiencies for accuracy, seven manually underwritten loans and one automated underwritten loan. 1st Advantage's direct endorsement underwriters incorrectly certified that due diligence was used in underwriting the seven manual loans and incorrectly certified to the integrity of the data used to determine the quality of the loan in underwriting the automated loan. When underwriting a loan manually, HUD requires a direct endorsement lender to certify that it used due diligence and reviewed all associated documents during the underwriting of a loan, and when underwriting a

[3] The mortgage credit analysis worksheet is used to analyze and document mortgage approval.

loan using an automated system, HUD requires a direct endorsement lender to certify to the integrity of the data used to determine the quality of the loan.

The Program Fraud Civil Remedies Act of 1986 (231 U.S.C. (United States Code) 3801) provides Federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy (1) to recompense such agencies for losses resulting from such claims and statements; (2) to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and (3) to deter the making, presenting, and submitting of such claims and statements in the future.

RECOMMENDATIONS

We recommend that HUD's Associate General Counsel for Program Enforcement

1A. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against 1st Advantage and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of eight loans that resulted in losses to HUD totaling $325,452, which could result in affirmative civil enforcement action of approximately $710,904[4].

We recommend that HUD's Deputy Assistant Secretary for Single Family

1B. Take appropriate administrative action against 1st Advantage and/or its principals for the material underwriting deficiencies cited in this report once the affirmative civil enforcement action cited in recommendation 1A is completed.

Schedule of Ineligible Cost 1/

Recommendation number	Amount
1A	$325,452

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. The amount shown represents the actual loss HUD incurred when it sold the affected properties.

[4] Double damages plus a $7,500 fine for each of the eight incorrect certifications.

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Unsupported income or questionable employment history	Unsupported assets	Significant credit-related deficiencies or no credit	Excessive debt-to-income ratio
261-9102016		X		
361-3030073	X			
421-4233347	X			
421-4238265	X	X	X	
492-7646642	X		X	X
492-7676492	X			
492-7844383	X			
495-7563145		X		

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 261-9102016

Mortgage amount: $83,341

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 28, 2006

Status: Claim

Payments before first default reported: Six

Loss to HUD: $96,276

Summary:

We found a material underwriting deficiency relating to the borrower's assets.

Assets:

1st Advantage did not obtain an explanation for the source of funds for the earnest money deposit of $2,520. It was 3 percent of the sales price and appeared excessive based on the borrower's history of accumulating savings, as shown by the bank statements in the loan file. To document the earnest money deposit amount, the borrower provided a copy of a $2,520 bank check, dated July 18, 2006. The money for the bank check came from the borrower's bank account. The bank statement showed a deposit of $2,520 on July 18, 2006. The deposit was withdrawn on the same day, and the bank check for the earnest money was also obtained on the same day. However, documentation in the loan file did not identify the source of these funds from a review of the loan file or the bank statements.

The borrower maintained a low balance in his bank account, usually below $1,000, and the bank statements clearly identified direct deposits for payroll. The payroll deposits were on a biweekly basis and were below $1,500. There was a payroll deposit of $1,232 on July 12, 2006, and the account balance on July 17, 2006, was $41. As it was not a payroll deposit, 1st Advantage should have verified the source of funds for the earnest money to ensure that the borrower did not obtain an undocumented loan, funds from an interested party, or funds from another excludable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that 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, the lender must verify with documentation the deposit amount and the source of funds.

Loan number: 361-3030073

Mortgage amount: $89,203

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 28, 2006

Status: Claim

Payments before first default reported: 22

Loss to HUD: $27,035

Summary:

We found a material underwriting deficiency relating to the borrower's income.

Income:

1st Advantage used questionable income to approve the loan. The borrower's income increased from an average of $2,028 per month for the previous employer to $3,500 per month just 23 days before loan closing. The borrower worked for the previous employer for 10.67 months, from July 5, 2005, to May 26, 2006.

1st Advantage's underwriter used an income of $3,500 per month on the mortgage credit analysis worksheet. The income amount was based on an employment verification letter, dated May 24, 2006, stating that the borrower would begin to work for a salary of $3,500 per month on June 5, 2006. This information was supported in the loan file by three paystubs for pay periods June 6 to June 12, June 11 to June 17, and June 19 to June 26, 2006. The paystubs were questionable and contained discrepancies which were not resolved. For example, the pay period dates on two of the three paystubs overlapped. Further, the last paystub showed lower year-to-date earnings and taxes withheld than the previous paystub.

Based on unreliability of income, 1st Advantage's underwriter should have noticed the discrepancies and not used the $3,500 per month as income. Using the borrower's previous income of $2,028 per month would have increased the mortgage payment-to-effective income ratio to 36.8 percent and the total fixed payment-to-effective income ratio to 72.04 percent.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, Foreword, states that lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA.

HUD Handbook 4155.1, REV-5, paragraph 2-12, and Mortgagee Letter 2005-16 state that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios were raised to 31 and 43 percent, respectively. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years. Paragraph 2-7 states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan.

Loan number: 421-4233347

Mortgage amount: $61,514

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 14, 2006

Status: Claim

Payments before first default reported: Two

Loss to HUD: $39,455

Summary:

We found a material underwriting deficiency relating to the borrower's income.

Income:

1st Advantage approved this loan although the borrower did not have a history of full-time employment and income for a period of 24 months before loan closing. The borrower had worked for his current employer for only 77 days, from May 29, 2006, to the loan closing date. It was borrower's first full-time employment. From March 7 to May 25, 2006, the borrower worked for a previous employer as a part-time employee. Before March 2006, the borrower had worked for two different employers, also on a part-time basis. The borrower's total earnings according to the documentation available in the loan file for 2005 was $3,895, or an average of $325 per month, and $3,380 for 2004, or an average of $282 per month.

In addition to approving the loan based on just 77 days of full-time employment history, 1st Advantage included overtime pay to calculate the average monthly income of $1,755. HUD requires the overtime to be earned for the past 2 years to be included in income. The borrower's rate of pay was $9.00 per hour or $1,560 per month. By not including the overtime income, the qualifying ratios would increase to 34.4 and 46.1 percent, which exceed HUD's allowable ratios.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years. Paragraph 2-7 states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. The lender must develop an average of bonus or overtime income for the past 2 years.

HUD Handbook 4155.1, REV-5, paragraph 2-12, and Mortgagee Letter 2005-16 state that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios were raised to 31 and 43 percent, respectively. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Loan number: 421-4238265

Mortgage amount: $46,631

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: October 13, 2006

Status: Claim

Payments before first default reported: Nine

Loss to HUD: $28,600

Summary:

We found material underwriting deficiencies relating to the borrower's income, unsupported assets, and credit history.

Income:

1st Advantage should not have approved this loan because the borrower did not have a history of stable employment and income for a period of 24 months before loan closing. The borrower had employment history for approximately 15 months, 3.5 months of full time and the remaining 11.5 months as part time. The borrower started her full-time job with the current employer on June 28, 2006, about 3.5 months before loan closing. The borrower worked for two different employers from July 2005 to April 2006. The borrower did not have an employment record before July 2005.

1st Advantage approved this loan based on the borrower's current rate of pay of $7.50 per hour or $1,300 per month. This pay had recently increased from $6.75 per hour or $1,170 per month for the same employer. Documentation in the loan file showed that the borrower was about 18 years old at the time of loan closing and had graduated from high school on May 26, 2006. According to the W-2s in the loan file, the borrower's total earnings for 2005 were $3,146 for an average of $262 per month.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years. Paragraph 2-7 states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. The lender must develop an average of bonus or overtime income for the past 2 years.

<u>Assets</u>:

1st Advantage did not obtain an explanation for the source of funds for the borrower's earnest money. The loan file included a copy of a cancelled check for $250 as the earnest money deposit. The check was not written from borrower's account but from an account of a person with the same name as the borrower's landlord. 1st Advantage's underwriter should have noticed this discrepancy and asked the borrower to provide an explanation.

<u>HUD/FHA Requirements</u>:

HUD Handbook 4155.1 REV-5, paragraph 2-10A, states that if the amount of the earnest money deposit appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and source of funds. Satisfactory documentation includes a copy of the borrower's canceled check. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made, the average balance was sufficient to cover the amount of the earnest money deposit.

<u>Credit</u>:

The borrower had a limited credit history, and her credit report in the loan file showed only two accounts. Both of the accounts showed zero balances. One showed a high balance of $3,000, and the other had a high balance of zero. The credit report contained statements from the three major credit reporting agencies indicating that no score was assigned because the subject did not have sufficient credit.

The credit report indicated that the borrower paid $100 per week in rent. To establish credit for the borrower, 1st Advantage should have obtained documentation to support the rental payment history.

<u>HUD/FHA Requirements</u>:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that for those borrowers without an established credit history or for those who do not use traditional credit, the lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. The lender must document that the providers of nontraditional credit do, in fact, exist and verify the credit information.

Loan number: 492-7646642

Mortgage amount: $127,991

Section of Housing Act: 203(b)

Loan purpose: Construct Home

Date of loan closing: July 7, 2006

Status: Claim

Payments before first default reported: 14

Loss to HUD: $38,810

Summary:

We found material underwriting deficiencies relating to the borrower's income, credit, and excessive ratios.

Income:

1st Advantage approved the loan based on income which was earned for only 2.5 weeks before loan closing. Further, the loan file did not contain employment history for 2 years, as required by HUD. It only contained history for about 18 months, from February 2005 to July 2006.

The borrower started her employment with the current employer on June 19, 2006, and had received payment for 2 weeks of $1,610. The paystub and a letter from the employer showed the bimonthly salary of $1,771. 1st Advantage used this information to calculate the borrower's monthly income of $3,541. The stability of this income was questionable because the borrower earned much less from her previous two employers.

Before the current employer, the borrower worked for two different employers from February 2005 to June 16, 2006. According to W-2s in the loan file, the borrower earned $15,516 in 2005. From January 1 to May 26, 2006, the borrower earned $13,538. Based on the income data available in the loan file for 2005 and 6 months of 2006, we calculated the borrower's average monthly income as $1,804 ($15,516 plus $13,538 plus $1,610 divided by 17 months). Using this average for the previous 17 months would increase the mortgage payment-to-effective income ratio from 33 to 65.4 percent ($1,180 mortgage payment divided by $1,804 monthly income).

In a letter in the loan file, the borrower explained that she had been employed with her current employer for more than a year, was employed with her previous employer for 2.5 years, and before that was employed with a different employer for 3 years. However, this employment explanation was not consistent with the documentation in the loan file. The borrower was only employed for 2.5 weeks with the current employer and approximately 7.5 months with the previous employer. 1st Advantage's underwriter should have noticed this discrepancy and resolved it.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years.

HUD Handbook 4155.1, REV-5, paragraph 2-12, and Mortgagee Letter 2005-16 state that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios were raised to 31 and 43 percent, respectively. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Credit:

1st Advantage should not have approved this loan because the borrower had poor credit history. The borrower's credit history reflected continuous delinquent and unpaid accounts.

According to the credit report in the loan file, the borrower had 9 collection accounts for revolving credit, rental payments, and utility payments; 10 collection accounts for medical expenses; and 3 accounts that were charged off for automobile repossession or utility bills. Two of the nine collection accounts were for rental payments for housing for two different apartment complexes. In a letter in the loan file, the borrower claimed that the derogatory credit was due to the borrower's immaturity and ignorance, as well as her divorce. There was no documentation to support the borrower's explanations.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-1, states that the purpose of underwriting is to determine a borrower's ability and willingness to repay the mortgage debt, thus limiting the probability of default and collection difficulties, and to examine the property offered as security for the loan to determine whether it is sufficient collateral.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments and delinquent accounts, strong compensating factors will be necessary to approve the loan. The lender must document its analysis regarding whether the late payments were based on disregard for financial obligations or otherwise. Further, paragraph 2-3C states that collections and judgments must be considered in the analysis of creditworthiness, with the lender documenting its reasons for approving a mortgage when the borrower has collection accounts and judgments. The borrower must explain in writing all collections and judgments.

Excessive Ratio:

The borrower's mortgage payment-to-effective income ratio exceeded HUD's qualifying ratio of 31 percent. The ratio reported on the mortgage credit analysis worksheet was 33 percent. 1st Advantage's underwriter used a compensating factor and recorded on the worksheet's remarks section that the borrower received child support payments of $597, which were not included in her income. There was no documentation in the loan file to support this compensating factor.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-12, and Mortgagee Letter 2005-16 state that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios were raised to 31 and 43 percent, respectively. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Loan number: 492-7676492

Mortgage amount: $83,686

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 28, 2006

Status: Claim

Payments before first default reported: 17

Loss to HUD: $48,008

Summary:

We found a material underwriting deficiency relating to the borrower's income.

Income:

1st Advantage's underwriter overstated the borrower's gross monthly income by $279 by overestimating the overtime income. Despite having an employment and wage history of more than 2 years (27.35 months) with the same employer, the underwriter calculated the borrower's average overtime income of $942 per month by using only 17.83 months (12 months of 2005 plus 5.83 months of 2006). For calculating the qualifying ratio of mortgage payment to effective income, the underwriter used gross income of $2,578 per month ($1,636 base wages plus $942 in overtime). The qualifying ratio was 31.17 percent on the mortgage credit analysis worksheet.

We calculated the borrower's overtime income of $663 per month using the complete wage and income data for the 27.35-month period, which was available in the loan file. As a result, we calculated the borrower's gross monthly income as $2,299 ($1,636 base wages plus $663 in overtime pay). The most recent paystub in the loan file showed that the borrower's year-to-date earnings for the first 5.83 months of 2006 were $13,484, an average gross monthly income of $2,305. This amount was close to our calculation of average gross income of $2,299 for the 27.35-month period.

Using the average gross monthly income of $2,299 increased the mortgage payment-to-effective income ratio to 34.92 percent, above the allowable ratio of 31 percent.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years. Paragraph 2-7 states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. The lender must develop an average of bonus or overtime income for the past 2 years.

HUD Handbook 4155.1, REV-5, paragraph 2-12, and Mortgagee Letter 2005-16 state that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios were raised to 31 and 43 percent, respectively. This change will allow a larger number of deserving families to purchase their first home while not increasing the risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Loan number: 492-7844383

Mortgage amount: $98,124

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 13, 2007

Status: Claim

Payments before first default reported: 18

Loss to HUD: $36,843

Summary:

We found a material underwriting deficiency relating to the borrower's income.

Income:

1st Advantage used overtime income of $932 per month although the borrower had not earned this income for 2 years. Instead, the borrower had earned this income for only 14 months. This loan was processed through the automated underwriting system, using the FHA Total Scorecard. 1st Advantage did not meet one of the approval conditions required by the system. The condition stipulates that the overtime income may be used if the borrower has received it for approximately 2 years.

The borrower started employment with his current employer on May 12, 2006, approximately 14 months before loan closing. The borrower had earned overtime income with this employer for approximately 14 months. However, there was no documentation to support that the borrower earned overtime before May 12, 2006. As the overtime income was for less than 2 years, 1st Advantage should not have used this income. The loan file did not contain documentation from 1st Advantage justifying the reason for using the income for qualifying purposes. Excluding the overtime income would increase the qualifying total fixed payment-to-effective income ratio to 54.6 percent.

HUD/FHA Requirements:

Approval condition number 22 in the automated underwriting system stated that overtime or bonus income was used to underwrite the loan. Both may be used to qualify the borrower if the borrower has received such income for approximately 2 years and there is reasonable prospect of its continuing.

HUD Handbook 4155.1, REV-5, section 2, states that income may not be used in calculating the borrower's income ratios if it comes from a source that cannot be verified, is not stable, or will not continue. Paragraph 2-6 states that HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent 2 full years. Paragraph 2-7 states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. The lender must develop an average of bonus or overtime income for the past 2 years.

Loan number: 495-7563145

Mortgage amount: $49,508

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 20, 2006

Status: Claim

Payments before first default reported: 11

Loss to HUD: $10,425

Summary:

We found a material underwriting deficiency relating to the borrower's assets.

Assets:

1st Advantage did not ensure that the borrower made the required minimum investment in the purchased property. The borrower obtained $5,000 in downpayment assistance from the City of Harlingen, TX's downpayment assistance program. However, the program required the borrower to make a minimum investment of $525. The documentation in the loan file showed that the borrower did not make this investment.

The borrower initially paid $850, $500 as an earnest money deposit and $350 for the appraisal fee. The borrower did not have a bank account, and 1st Advantage did not verify the source of these funds. According to the HUD-1 settlement statement, the borrower received $712 at closing, thus bringing the borrower's investment down to $138 ($850 minus $712).

HUD/FHA Requirements:

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

APPENDIX C

LENDER COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation **Lender Comments**

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June 28, 2010

VIA FEDERAL EXPRESS AND FASCIMILE

Muhammad Akhtar
Supervisory Forensic Auditor
United States Department of HUD – Office of Inspector General
77 West Jackson Boulevard, Suite 2646
Chicago, IL 60604

Dear Mr. Akhtar:

We represent 1st Advantage Mortgage, LLC ("1AM LLC"), a former Federal Housing Administration ("FHA") nonsupervised mortgagee with FHA ID# 10995. On January 12, 2010, 1AM LLC received a subpoena (the "Subpoena") from the U.S. Department of Housing and Urban Development's ("HUD") Office of Inspector General ("OIG") in connection with twenty FHA-insured loans originated through 1AM LLC's wholesale channel in 2006-2007. 1AM LLC responded to the Subpoena in February. On June 15, the OIG delivered to 1AM LLC a discussion draft memorandum (the "Memorandum") in response to 1AM LLC's February Subpoena response. This letter hereby responds to the Memorandum.

Executive Summary

Comment 1

1AM LLC always viewed its participation in the FHA loan program as a privilege. It recognized that the strength of FHA's mortgage insurance fund (the "Fund") depends on FHA lenders focusing on the integrity of their originations and the performance of their loans, and it aimed to originate high quality, well-performing FHA loans. 1AM LLC acknowledges that certain mistakes were made with respect to the underwriting, documentation and/or file retention practices of the loans identified in the Memorandum. It regrets these mistakes, and is committed to working with HUD to mitigate the losses that the Fund incurred with respect to these loan files to the extent that it is able.

Comment 2

It should be noted that the loans at issue were originated during a time in which FHA encouraged lenders to be flexible in their underwriting to permit individuals who historically had not qualified for mortgage loans to become homeowners. Many of FHA's underwriting standards were subjective, which permitted such flexibility. Further, due to the timing of 1AM LLC's exit from the mortgage business, its compare ratio was artificially elevated because 1AM LLC could not enjoy the positive effects that the more stringent underwriting standards and credit overlays it was implementing would have had on future originations.

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History of 1AM LLC

1AM LLC was founded in 1997 as an Illinois-based mortgage brokerage firm, with Paul Lueken as its Managing Member and President. It obtained FHA loan correspondent approval that same year.

1AM LLC acquired the assets and personnel of Mortgage Services of Illinois d/b/a MSI in 2004. MSI was a Bloomington, Illinois-based mortgage lender that was approved by FHA as a nonsupervised mortgagee. As a result of the acquisition, MSI's employees became employees of 1AM LLC. Mark Young, who served as the President of MSI, became an Executive Vice President of 1AM LLC and was responsible for supervising 1AM LLC's wholesale operations, including all underwriting and quality control functions. Susan Verplank became 1AM LLC's Vice President of Underwriting, and Rebecca Crain became 1AM LLC's Vice President of Compliance with responsibility for the company's quality control function. Mses. Verplank and Crain reported to Mr. Young.

1AM LLC converted from an FHA-approved loan correspondent to a nonsupervised mortgagee in 2005. In 2006, it expanded into Texas, with Robert Gerrard as the Vice President of 1AM LLC with responsibility for Texas operations. Mr. Gerrard oversaw all activities from origination through closing, including the processing and underwriting functions, for all loans that originated from Texas. Lisa Taylor, Operations Manager, oversaw the underwriting function, and reported to Mr. Gerrard. Post-closing quality control functions related to loans that originated in Texas were performed from Illinois, at the direction of Mr. Young and Ms. Crain.

In Spring 2007, Mr. Young resigned from 1AM LLC to form Mortgage Services III d/b/a MSIII, a residential mortgage lending company. MSIII hired approximately 30 employees from 1AM LLC, including Mses. Verplank and Crain. As a result of these departures, in Fall 2007, 1AM LLC consolidated its underwriting and quality control functions in its Lombard, Illinois office, except for underwriting that was performed in Texas.

In Spring 2008, 1AM LLC sold certain of its assets and the trade name "1st Advantage Mortgage" to Draper and Kramer Mortgage Corporation ("DKMC"). This transaction was solely an asset purchase by DKMC, not a stock purchase or merger of the two entities. As a result, DKMC is not liable for any pre-acquisition liabilities of 1AM LLC. 1AM LLC ceased operating as a going concern when it completed the transaction with DKMC.

DKMC applied with HUD to transfer certain of 1AM LLC's offices and employees to DKMC in Spring 2008. 1AM LLC's FHA authority remained in effect for a short time following this transfer in order to close loans in 1AM LLC's pipeline and to transfer other pipeline loans to DKMC. Following the asset sale and transfer of authority, 1AM LLC remained a separate entity without formally dissolving, although it maintained only its officers (but no employees) and only nominal assets.[1]

[1] Unbeknownst to 1AM LLC, its 2008 transfer of office locations to DKMC's authority did not automatically effect the surrender of 1AM LLC's FHA approval. On January 25, 2010, after receiving the Subpoena and becoming aware that its FHA approval was not previously surrendered, 1AM LLC sent a formal voluntary withdrawal request

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It should be noted that 1AM LLC went out of business at the height of the financial crisis, and was in the process of implementing more stringent standards and credit overlays to improve its portfolio's performance. At the time that 1AM LLC stopped making FHA loans, it had a favorable compare ratio. However, its compare ratio declined as the financial crisis deepened and the only loans included in its compare ratio were loans made under pre-crisis underwriting standards. Unlike many other FHA lenders who remained in the program, 1AM LLC was not able to repair its declining compare ratio with new originations based on heightened underwriting criteria.

Loan Files at Issue

When it was a going concern, 1AM LLC was committed to originating FHA loans that complied, in all respects, with FHA requirements. Its employees had ready access to HUD's written guidance, and received training on FHA compliance issues. Moreover, 1AM LLC separated its quality control function from the origination and processing functions, and had policies and procedures in place to identify and report any fraud or suspected fraud.

1AM LLC's quality control staff performed ongoing reviews of the company's underwriting decisions and loan file documentation, and from time-to-time, 1AM LLC engaged the services of third-party quality control firms to ensure the integrity of the company's internal quality control processes. The conclusion of quality control reviews were communicated to senior management for its consideration. Senior management used this information to identify the causes of any recurring deficiencies, as well as to authorize corrective action plans to cure any such deficiencies.

Unfortunately, some mistakes were made in the underwriting and/or documentation of the eight loans identified in the Memorandum. In addition, there were recordkeeping issues that made it difficult for 1AM LLC to rebut certain of the allegations in the Memorandum. As a result, we cannot show at this time that these loans comported with 1AM LLC's high standards for loan origination integrity. 1AM LLC regrets these mistakes and would like to explore mitigating the losses that the Fund incurred with respect to these loan files to the extent of its financial ability.

Comment 3

Nevertheless, it should be noted that while the OIG has alleged with respect to FHA Loan Nos. 361-3030073, 492-7676492, and 492-7844383 that 1AM LLC did not properly calculate the borrowers' income or determine income stability, no default occurred on these loans until after the borrowers made 17-22 payments. The borrowers were able to make the payments on these loans for a significant period of time, suggesting that it was not underwriting errors that led to the

to HUD's Lender Approval and Recertification Division (the "Division"), informing the Division that (i) 1AM LLC received the Subpoena from the OIG, (ii) was in the process of responding to the Subpoena, and, (iii) its request to withdraw its FHA authority would not affect its commitment to fully cooperate with the OIG. On February 2, 2010, 1AM LLC received from the Mortgagee Review Board (the "MRB") a Notice of Administrative Action dated January 27, 2010 which informed it of the MRB's decision to immediately withdraw 1AM LLC's FHA approval for a period of one year. The MRB informed 1AM LLC that its withdrawal was based upon violations of HUD/FHA recertification requirements. 1AM LLC did not submit recertification materials in 2009 because it thought that it had already surrendered its FHA approval.

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borrowers' default, but instead, external factors that were beyond 1AM LLC's control. It is important to remember the broader context in which these loans defaulted – a period of unprecedented economic downturn.

It also should be noted that many of FHA's underwriting guidelines are subjective in nature, and at the time that the subject loans were made, FHA was stressing its mission of expanding homeownership to persons who in the past were unable to become homeowners and providing homeowners the opportunity to consolidate debt at a time of historically low interest rates.

By way of example, in late 2005, FHA revised its cash-out refinance rules to "provide expanded alternatives for homeowners wishing to refinance their mortgages, and offer greater flexibility to mortgagees in processing and underwriting certain refinance transactions." Mortgagee Letter 2005-43. 1AM LLC went out of business at the height of the financial crisis, and as a result, was not able to implement more stringent standards and credit overlays to improve the performance of its loan portfolio as was done by other lenders that re-tooled their lending platforms to adapt to changing market conditions.

DKMC

As noted above, DKMC purchased certain of 1AM LLC's assets and the trade name in Spring 2008. This was solely an asset purchase agreement, in which DKMC did not assume 1AM LLC's liabilities.

DKMC is an FHA-approved nonsupervised mortgagee with FHA ID# 77678 that has been an FHA lender since 1937. DKMC's FHA lending record has been stellar for the 70-plus years that it has been involved in the program.

At the time that DKMC purchased certain of 1AM LLC's assets, many of 1AM LLC's employees became employees of DKMC, including Mr. Lueken, who became the President of DKMC's residential mortgage lending operation. Mr. Lueken and other DKMC employees under his leadership have continued DKMC's tradition of responsible FHA lending.

For example, in response to market conditions in 2008, DKMC tightened its standards and implemented credit overlays that went well beyond HUD's minimum requirements. Additionally, because DKMC's review of its loan performance data revealed that loans originated through the wholesale channel did not perform nearly as well as retail originations, DKMC changed its business model over an 18-month period starting in 2008 from 80% wholesale production to 85% retail production. Further, the remaining wholesale group (which constitutes approximately 15% of overall production) consists only of long-time business relationship with outstanding quality records. This shift was an enormous business risk, as well as a massive undertaking, for DKMC.

Moreover, in early 2010, DKMC decided to centralize underwriting in its Lombard, Illinois office because loans that were underwritten in Texas were experiencing higher rates of default than those originated in Illinois. We understand that Mr. Gerrard responded to this decision by resigning from DKMC and taking the approximately 140 employees from DKMC's Texas

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operation, including Ms. Taylor, with him to Overland Mortgage Corporation. This resulted in DKMC closing its Texas operations.

While DKMC's above-described decisions were costly for it to make, they ensured that DKMC would continue to produce high quality loans.

DKMC does not have relationships with the brokers that originated the loans identified in the Memorandum for 1AM LLC. Likewise, none of the 1AM LLC employees who were directly involved in the origination or quality control of the loans identified in the Memorandum are currently employed by DKMC. As noted above Mr. Young and Mses. Verplank and Crain left 1AM LLC in 2007 to form MSIII and were never employed by DKMC. Mr. Gerrard and the origination, processing, and underwriting employees from Texas, including Ms. Taylor, left DKMC for Overland Mortgage Corporation in apparent response to DKMC's quality improvement initiatives.

As a result of DKMC's proactive approach to identifying risks and carrying out measures to counteract such risks, DKMC has achieved loan quality and performance that exceeds the loan quality and performance of the majority of other FHA lenders. For the June 1, 2008 through May 31, 2010 time period – the most recent time period for which compare ratio data is available – DKMC's compare ratio is only 72 percent, which is far lower than the national average.

Recommendations

Comment 4

The OIG has recommended that HUD's Associate General Counsel for Program Enforcement determine the legal sufficiency of bringing a Program Fraud Civil Remedies Act (the "Act") claim against 1AM LLC and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of the eight subject loans. We respectfully submit that it would be inappropriate for HUD to bring claims under the Act against 1AM LLC or Mr. Lueken, given that the knowledge element of such a claim is not satisfied. In addition, 1AM LLC has expressed its desire to mitigate damages to the Fund to the extent of its ability, without the need for legal action.

Under the Act, HUD may seek an assessment for a "false claim" where it has paid a claim. However, under the Act, to prove that a false claim has been made, HUD must prove that a "person who makes, presents, or submits, or causes to be made, presented, or submitted, a claim that the person **knows or has reason to know**: (i) Is false, fictitious, or fraudulent; (ii) Includes or is supported by a written statement which asserts a material fact which is false, fictitious, or fraudulent; (iii) Includes or is supported by any written statement that: (A) Omits a material fact; (B) Is false, fictitious, or fraudulent as a result of the omission; and (C) Is a statement in which the person making, presenting . . . ." 24 C.F.R. § 28.10(a)(1) (emphasis added).

Under the Act, HUD may also seek an assessment for a "false statement." To prove that a "false statement" has been made, HUD must prove that a person "makes, presents, or submits, or causes to be made, presented, or submitted, a written statement that the person **knows or has reason to know**: (A) Asserts a material fact which is false, fictitious, or fraudulent; or (B)(1) Omits a material fact; and (2) Is false, fictitious, or fraudulent as a result of such omission; (ii) In the case of a statement described in (b)(1)(A)(ii) of this section, is a statement in which the

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person making, presenting, or submitting such statement has a duty to include such material fact; and (iii) Contains or is accompanied by an express certification or affirmation of the truthfulness and accuracy of the contents of the statement." 24 C.F.R. § 28.10(b)(1) (emphasis added).

Any errors in the underwriting and/or documentation of the loans at issue were unknown to Mr. Lueken at the time that claims were submitted for insurance. Additionally, there was no reason that Mr. Lueken would know of such errors because, as described above, 1AM LLC had in place numerous policies and procedures to ensure the integrity of its originations and it relied on its underwriting and quality control managers to carry out those policies and procedures. Mr. Lueken had no knowledge that such policies and procedures were not fully complied with.

Comment 5

The OIG also has recommended that HUD's Deputy Assistant Secretary for Single Family take appropriate administrative action against 1AM LLC and/or its principals for the findings cited in the Memorandum. Such action should not be necessary, as 1AM LLC has indicated its intent to work with HUD to mitigate its losses resulting from the subject loans.

Conclusion

1AM LLC viewed its participation in FHA lending as a privilege and recognizes the importance of origination integrity and loan performance to the Fund. It regrets any mistakes that were made with respect to the underwriting, documentation and/or recordkeeping of the eight loans identified in the Memorandum and hopes to work with HUD to mitigate HUD's losses resulting from these loans.

Sincerely yours,

Clinton R. Rockwell

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OIG's Evaluation of Lender Comments

Comment 1 1st Advantage agreed that some mistakes were made in the underwriting and/or documentation of the eight loans identified in the memorandum report. 1st Advantage also expressed its willingness to work with HUD to mitigate the losses to the extent that it is able.

Comment 2 1st Advantage believed that at the time the loans were originated, FHA encouraged lenders to be flexible in their underwriting to permit individuals who historically had not qualified for mortgage loans to become homeowners. 1st Advantage also believed that many of FHA's underwriting standards were subjective, which permitted flexibility. However, FHA requires lenders to meet specific underwriting requirements and establish a borrower's ability and willingness to repay the mortgage debt. According to FHA guidelines, lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans.

Comment 3 1st Advantage contended that FHA loan numbers 361-3030073, 492-7676492, and 492-7844383 did not default until the borrower made between 17 and 22 payments. Therefore, it suggested that it was not underwriting errors that led to the borrower's default. These loans contained material underwriting deficiencies. For example, as stated in our review, for FHA loan number 361-3030073, the underwriter used questionable income to approve the loan. The borrower's income increased from an average of $2,028 per month for the previous employer to $3,500 per month just 23 days before loan closing. The pay stubs were also questionable and contained discrepancies which were not resolved. Due diligence was not performed by 1st Advantage as evidenced by the material underwriting deficiencies identified in these loans.

Comment 4 1st Advantage believes that our recommendation for remedies under the Program Fraud Civil Remedies Act is not appropriate because certain elements to prove false claims were not satisfied. We did not change our recommendation, as this recommendation is appropriate based on the issues citied in the memorandum. Violations of FHA rules are subject to civil and administrative action.

Comment 5 1st Advantage believes that our recommendation to HUD's Deputy Assistant Secretary for Single Family is not appropriate because 1st Advantage intends to work with HUD to mitigate its losses resulting from the subject loans. We did not change our recommendation, as HUD's Deputy Assistant Secretary will determine the appropriate action.