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Office of Inspector General

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MEMORANDUM FOR: Vicki B. Bott, Deputy Assistant Secretary, Single Family, HU

Dane M. Narode, Associate General Counsel for Program Enforcement,
CACC

Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

SUBJECT: Alacrity Lending Company, Southlake, TX, Did Not Properly Underwrite a
Selection of FHA Loans

INTRODUCTION

We reviewed 20 Federal Housing Administration (FHA) loans that Alacrity Lending Company (Alacrity) underwrote as an FHA direct endorsement lender. Our review objective was to determine whether Alacrity underwrote the 20 loans in accordance with FHA requirements. This review is part of Operation Watchdog, an Office of Inspector General (OIG) 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 the U.S. Department of Housing and Urban Development's (HUD) Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

We provided our discussion draft memorandum report to Alacrity's president and asked him to provide written comments on our discussion draft memorandum. The president provided written comments to the discussion draft report on July 8, 2010, in which he disagreed with the report. The complete text of the lender's response, along with our evaluation of that response, can be found in appendix C of this memorandum.

SCOPE AND METHODOLOGY

Alacrity is 1 of 15 direct endorsement lenders we selected from HUD's publicly available Neighborhood Watch¹ system (system) for a review of underwriting quality. These direct endorsement lenders all had a compare ratio² 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 Alacrity that defaulted within the first 30 months and were (1) not streamline refinanced, (2) not electronically underwritten by Fannie Mae or Freddie Mac, and (3) associated with an underwriter (usually an individual) with a high number of claims.

BACKGROUND

Alacrity is a nonsupervised direct endorsement lender based in Southlake, TX. FHA approved Alacrity as a direct endorser in January 2007. 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 each of the 15 lenders. The 15 lenders selected for Operation Watchdog 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. Alacrity itself endorsed 2,715 loans valued at more than \$306 million and submitted 167 claims worth more than \$18 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 April 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 Alacrity, consider the results of previous audits, or communicate with Alacrity's management in advance. We did not follow

¹ Neighborhood Watch is a system that aids HUD/FHA staff in monitoring lenders and FHA 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 over 200 percent as a warning sign of a lender's performance.

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

Alacrity did not properly underwrite 19 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 more than \$1.2 million for 14 loans and estimated potential losses of \$374,171 for 5 loans,³ totaling nearly \$1.6 million as shown in the following table.

<i>FHA/loan number</i>	<i>Closing date</i>	<i>Number of payments before first default</i>	<i>Original mortgage amount</i>	<i>Loss to HUD</i>
491-8963664	7/2/07	0	\$108,534	\$76,532
491-9013281	9/7/07	0	87,378	78,529
491-9057781	11/1/07	2	115,324	104,659
491-9147581	3/28/08	7	120,115	71,081 ³
491-9198939	5/29/08	4	73,348	43,406 ³
491-9224552	7/8/08	2	112,610	90,811
492-7781697	4/11/07	4	156,774	92,744 ³
492-7783521	5/17/07	3	128,737	78,142
492-7788223	5/31/07	1	115,192	70,102
492-7801327	4/27/07	4	72,905	62,057
492-7803859	11/21/07	5	116,510	93,477
492-7814448	6/14/07	13	113,567	97,310
492-7815245	6/8/07	3	123,068	98,063
492-7852604	7/20/07	0	113,223	87,532
492-7854686	7/31/07	1	125,127	110,398
492-7866921	11/30/07	0	125,728	90,326
492-7907982	1/24/08	1	191,002	112,534 ³
492-7933323	2/15/08	0	105,641	87,420
493-8414070	9/7/07	0	91,563	54,406 ³
Totals			<u>\$2,196,346</u>	<u>\$1,599,529</u>

³ We estimated loss to HUD for this loan because the foreclosed-upon property had not been sold by HUD. The estimated amount is 60 percent of the unpaid principal balance of the loan, based on the 60 percent loss severity rate published in Fiscal Year 2009 Actuarial Review of the FHA Mutual Mortgage Fund.

The following table summarizes the material deficiencies that we identified in the 19 loans.

<i>Area of noncompliance</i>	<i>Number of loans</i>
Income	9
Excessive ratios	3
Assets	1
Gift funds	8
Credit report	18
Verification of rent	5

Appendix A shows a schedule of material deficiencies in each of the 19 loans. Appendix B provides a detailed description of all loans with material underwriting deficiencies noted in this report.

Income

Alacrity did not properly verify borrowers' income or determine income stability for nine 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. Alacrity 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 492-7866921, Alacrity averaged the borrower's wages from the two most recent employers, which included overtime, to compute an average monthly income of \$4,153. However, the overtime for the prior employer of 12 months was significantly higher than the overtime for the current employer of 7 months. The current employer wages resulted in \$3,269 in monthly income. Consequently, Alacrity used a \$4,153 monthly income amount instead of \$3,269, making the ratios more acceptable. Using the current monthly income caused the ratios to increase to 32 and 55 percent, which are higher than the HUD guidelines of 31 and 43 percent, respectively.

Excessive Ratios

Alacrity improperly approved three loans for which the borrowers' qualifying ratios exceeded FHA's guidelines without identifying strong compensating factors. Effective April 13, 2005, the fixed payment-to-income and debt-to-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 example, for loan number 492-7852604, the mortgage-to-income and fixed payment-to-income ratios reported on the mortgage credit analysis worksheet were 34 and 45 percent, respectively. Alacrity used a minimal increase in housing expense as a compensating factor. However, the housing expense had increased \$438 or 85 percent.

Assets

Alacrity did not properly document the source of the borrower's funds to close loan number 492-7852604. HUD requires the lender to verify and document the borrower's investment in the property (see appendix B for detailed requirements).

The lender did not document the source of the \$1,500 used as funds to close. Although the \$1,500 was less than 2 percent of the loan, the amount was excessive based on the borrower's showing no cash savings on the loan application. Alacrity did not provide bank documents to show that funds were available or that the funds were received by the closing agent. The HUD-1 settlement statement showed that the borrower and a third party received \$1,500 each at closing. Alacrity should have obtained documentation on the source of the borrower's funds and explained the reasons for these disbursements.

Gift Funds

Alacrity did not properly document gift funds received by borrowers for eight loans. HUD requires that the lender be able to determine that gift funds ultimately were not provided by an unacceptable source (see appendix B for detailed requirements).

For example, for loan number 491-9013281, Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer of funds by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

Credit Report

Alacrity did not properly evaluate the borrowers' credit histories for 18 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 491-8963664, the borrower had 117 collection and charge-off accounts with an outstanding balance totaling \$47,429. Seventy-one of these accounts went into collection within 2 years of the loan closing. Alacrity did not document a borrower explanation for the collection and charge-off accounts. It also did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. In addition, it did not identify strong compensating factors to justify accepting the borrower's derogatory credit history when approving the loan.

Verification of Rent

Alacrity did not properly verify borrowers' rental histories for five loans. Since the borrower's housing obligations hold significant importance in evaluating credit, the lender must determine the borrower's payment history of housing expenses (see appendix B for detailed requirements).

For example, for loan number 492-7907982, the loan application showed that the borrower had rented the property being purchased for the prior year and a half. The FHA loan was for the proposed construction of a manufactured home on raw land. The appraisal pictures showed the property as raw land with no structures or trailers. The seller was the borrower's landlord and verified a \$1,000 per month rent payment for the year and a half. Documentation included borrower checks and landlord deposit receipts for rent payments for 2 months. The checks and deposits did not indicate the rental property address, and the deposit receipts did not identify the account holder. Consequently, there was no evidence that the payments and receipts were for the borrower's rent at the current address.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the 19 loans with material underwriting deficiencies for accuracy. Alacrity's direct endorsement underwriters incorrectly certified that due diligence was used in underwriting the 19 loans. 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.

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 Alacrity and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of seven loans that resulted in losses to HUD totaling \$1,599,529, which could result in affirmative civil enforcement action of approximately \$3,341,558⁴.

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

- 1B. Take appropriate administrative action against Alacrity 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.

⁴ Double damages plus a \$7,500 fine for each of the nineteen incorrect certifications.

Schedule of Ineligible Cost 1/

Recommendation <u>number</u>	<u>Amount</u>
1A	\$1,599,529

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.

APPENDIXES

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Unsupported income or questionable employment history	Excessive debt-to-income ratio	Unsupported assets	Insufficient gift documentation	Significant credit-related deficiencies or no credit	Incomplete verification of rent history
491-8963664				X	X	X
491-9013281				X	X	
491-9057781	X				X	
491-9147581	X	X		X	X	X
491-9198939	X	X			X	
491-9224552					X	
492-7781697	X			X	X	
492-7783521				X	X	
492-7788223	X			X	X	
492-7801327	X					X
492-7803859					X	
492-7814448				X	X	
492-7815245					X	
492-7852604	X	X	X		X	
492-7854686					X	
492-7866921	X				X	X
492-7907982	X				X	X
492-7933323					X	
493-8414070				X	X	

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 491-8963664

Mortgage amount: \$108,534

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 2, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$75,343

Summary:

We found material underwriting deficiencies relating to the borrower's gift, credit history, and rent history.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not (1) consider the 117 collections and charge-offs, (2) identify sufficient compensating factors to justify accepting the borrower's derogatory credit history, and (3) authenticate an alternative letter of credit that was faxed by the seller.

A review of the borrower's credit report disclosed 117 collection and charge-off accounts with an outstanding balance totaling \$47,429. Seventy-one of these accounts went into collection within 2 years of the loan closing. In addition, 11 derogatory accounts had a last activity date within 2 years of loan closing. Alacrity did not document borrower explanations for the collection and charge-off accounts. It did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. In addition, it did not identify strong compensating factors to justify accepting the borrower's derogatory credit history.

Alacrity did not authenticate an alternative letter of credit that was faxed by the seller of the manufactured home, Stanford Village Corp. The fax header showed Stanford Village Corp., and the letter was addressed to the president of Stanford Village Corp. and not Alacrity.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Verification of Rent:

Alacrity did not adequately evaluate the borrower's rent history. It did not resolve the discrepancy between the current housing expense on the loan application and the verification of rent. In addition, it improperly used a verification of rent that was faxed from the seller.

The borrower's loan application showed \$809 as current housing expense, and the verification of rent showed \$250 per month. The loan application implied that housing expense would increase only \$166, while the verification of rent showed an increase of \$725. In addition, Alacrity did not authenticate the verification of rent that was faxed by the seller of the manufactured home, Stanford Village Corp. The fax header on the verification of rent showed Stanford Village Corp. and not Alacrity. Alacrity should have determined the borrower's actual rent expense to ensure

that the verification of rent and the loan application agreed. As stated in the Credit section above, HUD/FHA does not allow lenders to accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers).

Loan number: 491-9013281

Mortgage amount: \$87,378

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: September 7, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$73,436

Summary:

We found material underwriting deficiencies relating to the borrower's gift funds and credit history.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not (1) consider the 18 derogatory accounts that included 11 collections and charge-offs, (2) authenticate borrower explanation letters faxed from the seller in this transaction, and (3) identify sufficient compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed 18 derogatory accounts, and 6 of these had balances due. Seven of the accounts showed a last activity within 2 years of loan closing. Five of the accounts were charge-offs, and one account was to a utility. The borrower explanation letters addressed only 6 of the 11 collection and charge-off accounts. Alacrity did not document an analysis of the credit history to determine whether the collection and charge-off accounts were

based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Alacrity did not identify strong compensating factors to justify accepting the borrower's derogatory credit history. It identified two factors: reserves in 401K and minimal increase in housing expense. The 401K statement showed that the period for the report was January 31, through December 31, 2007, and yet the loan closed almost 4 months earlier on September 7, 2007. Alacrity did not resolve this discrepancy. The housing expense increased 22 percent from \$618 to \$757 per month. Since the borrower had shown the inability to manage debt, a 22 percent increase in housing expense is considered significant.

Alacrity did not authenticate borrower explanation letters that were faxed from the seller in this transaction. The fax headers on the explanation letters showed the seller's name.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Loan number: 491-9057781

Mortgage amount: \$115,324

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 1, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Two

Loss to HUD: \$104,657

Summary:

We found material underwriting deficiencies relating to the borrowers' income and credit history.

Income:

Alacrity used excessive income to approve the loan. For one borrower, it used a pay stub gross amount to determine monthly wages instead of developing a trend averaging wages over time. For the second borrower, it used the borrower's current pay rate times a 40-hour week although the hours per week had varied in the past. Also, Alacrity included \$500 per month in Social Security income when documents showed that the borrower received \$535 per month.

Alacrity used a recent weekly pay stub for one borrower showing \$763 gross income although eight pay stubs were included in the file that varied from \$683 to \$1,176 per week. It also used the pay rate for the second borrower times 40 hours per week when the two most recent pay stubs showed that the borrower worked 62.71 hours and 43.94 hours for each 2-week pay period.

Using the Social Security wages and the average wages for both borrowers for calendar year 2006 and year-to-date to October 2007 lowers Alacrity's monthly wage calculation from \$5,288 to \$4,387. As a result, the qualifying ratios increase to 23.48 (\$1,030 mortgage payment divided by \$4,387 average monthly income) and 46.55 percent (\$2,042 total fixed payments divided by \$4,387 average monthly income).

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 we do 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.

Mortgage Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and charge-off accounts or obtain borrower explanations for collections and charge-offs when approving this loan.

A review of the borrowers' credit report disclosed 11 derogatory accounts, and 8 of these had balances due totaling \$3,753. One of the accounts showed a last activity within 2 years of loan closing. Seven of the accounts were collections and charge-offs. Alacrity did not document borrower explanations for the derogatory accounts. In addition, it did not document an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Alacrity did not identify strong compensating factors to justify accepting the borrowers' derogatory credit history. It identified two compensating factors: building on own land and has reserves in 401K. HUD does not consider building on own land an acceptable compensating factor. A 401K fund is an allowable compensating factor. The borrower's 401K statement showed an ending balance on October 26, 2007, of \$8,180. In our opinion, however, this factor alone is not considered strong enough to justify accepting the borrower's derogatory credit history.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that one of the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark is that the borrower has at least 3 months' worth of cash reserves after closing. A compensating factor used to justify mortgage approval must be supported by documentation.

Loan number: 491-9147581

Mortgage amount: \$120,115

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: March 28, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: Seven

Loss to HUD: \$71,082

Summary:

We found material underwriting deficiencies relating to the borrower's income, excessive debt ratios, gift funds, credit history, and rent history.

Income:

Alacrity used excessive income to approve the loan. It used 40 hours per week to calculate monthly base pay instead of 38 hours per week as shown on the borrower's pay stubs. Consequently, monthly income was overstated by \$151 per month.

Alacrity calculation: $\$17.50 \times 40\text{hrs/wk} \times 52 \text{ wks/yr}$ divided by 12 months = \$3,033

Review calculation: $\$17.50 \times 38\text{hrs/wk} \times 52 \text{ wks/yr}$ divided by 12 months = \$2,882

In addition, the fax headers on pay stubs and Internal Revenue Service (IRS) Forms W-2 showed that the documents were faxed by the seller/builder in this transaction. Alacrity should have authenticated these documents before using them to qualify the borrower.

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.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Excessive Debt Ratio:

Alacrity used excessive ratios to approve this loan without identifying sufficient compensating factors and using income and credit documents that may not have been reliable because they were handled by the seller, who had an interest in this transaction.

The borrower’s qualifying ratios exceeded HUD’s allowable ratios of 31 percent for mortgage payment to income and 43 percent for total fixed payment to income. The ratios reported on the mortgage credit analysis worksheet were 34.45 and 45.30 percent. Using the recalculation of income shown above, the qualifying ratios increase to 36.26 and 47.67 percent.

Mortgage Payment-to-Income Ratio:

Mortgage payment	\$1,044.88
Divided by monthly income	<u>\$2,882.00</u>
Ratio percentage	36.26

Total Fixed Payment-to-Income Ratio:

Total fixed payment	\$1,373.88
Divided by monthly income	<u>\$2,882.00</u>
Ratio percentage	47.67

The compensating factors identified by the lender were not sufficient to justify accepting the borrower’s derogatory credit history or the high qualifying ratios. Alacrity identified overtime, building on own land, and good reserves as compensating factors. Overtime is allowable by HUD; however, building on own land is not. Although good reserves is an allowable factor, it is not acceptable in this case because the \$3,379 amount did not represent a reserve. The \$3,379 was the balance of a checking account on February 28, 2008. The checking account transactions from January 7 through February 28, 2008, showed that the account was drawn down to as low as \$214 on January 16, 2008, and \$934 on February 13, 2008. The \$3,379 balance did not appear to have been “reserves.” In our opinion, the overtime compensating factor alone was not sufficient to justify accepting the borrower’s derogatory credit history when approving this loan.

Since the underlying credit and income documents used to determine qualifying ratios were faxed by the seller/builder and Alacrity did not authenticate these documents as required (see Income and Credit sections), the qualifying ratios may not have been accurate.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines include other compensation (such as overtime) not used for qualifying. A compensating factor used to justify mortgage approval must be supported by documentation. Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and charge-off accounts or authenticate credit-related documents faxed by the seller/builder.

The borrower had six collection accounts and one charge-off account. Alacrity did not provide an analysis of the credit history to determine whether the collections and charge-offs were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. In addition, the lender did not identify strong compensating factors that addressed these credit deficiencies (see Excessive Debt Ratio section).

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Verification of Rent:

Alacrity improperly used a verification of rent faxed from the seller. The fax headers on the verification of rent showed that it was faxed by the seller/builder in this transaction. As stated in the Income section above, HUD/FHA does not allow lenders to accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Loan number: 491-9198939

Mortgage amount: \$73,348

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: May 29, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: Four

Loss to HUD: \$43,406

Summary:

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

Income:

Alacrity did not adequately evaluate the borrower's income. It used a verbal verification of employment from the borrower's current employer of 3 months but did not verify that the employment was likely to continue. The borrower was in the military service before the current employment.

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 to analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment.

Excessive Debt Ratio:

Alacrity used an excessive total fixed payment-to-income ratio of 44.75 percent, which is above HUD's guideline of 43 percent, when approving this loan. In addition, it did not identify compensating factors to justify accepting the excessive ratio.

HUD/FHA Requirements:

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

HUD Handbook 4155.1, REV-5, paragraph 2-13, identifies the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding HUD's benchmark guidelines. Underwriters must record in the "remarks" section of the form HUD 92900-WS/HUD 92900-PUR the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and late payment accounts or identify sufficient compensating factors to justify accepting the borrower's derogatory credit history when approving this loan.

The borrower had four collection accounts and two accounts with late payments. Three of the six accounts had a last activity within 2 years of closing. The lender did not obtain borrower explanations for five of the six derogatory accounts. Alacrity did not provide an analysis of the credit history to determine whether the collections and late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. In addition, it did not identify compensating factors to justify accepting the borrower's derogatory credit history when approving the loan (see Excessive Debt Ratio section).

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 491-9224552

Mortgage amount: \$112,610

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 8, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: Two

Loss to HUD: \$90,810

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not (1) consider seven derogatory accounts, (2) obtain borrower explanations of collections and charge-offs, (3) identify sufficient compensating factors to justify accepting the borrower's derogatory credit history, and (4) authenticate the alternative letters of credit that were faxed from the seller.

A review of the borrower's credit report disclosed seven collection accounts. Alacrity did not document borrower explanations for the collection accounts. It did not document an analysis of the borrower's derogatory credit history to determine whether the collections were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Alacrity did not identify strong compensating factors to justify accepting the borrower's derogatory credit history. One compensating factor identified by Alacrity was that there was a minimal increase in housing expense. The housing expense had increased from \$800 to \$1,008 or 20 percent. Since the borrower had shown an inability to pay past-due derogatory accounts, a 20 percent increase in housing expense would be considered significant. Alacrity's underwriter also identified excellent job stability, which is not an allowable HUD compensating factor.

Alacrity did not authenticate borrower alternative letters of credit that contained fax headers showing that the letters were faxed by the seller in this transaction.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Loan number: 492-7781697

Mortgage amount: \$156,774

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: April 11, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Four

Loss to HUD: \$92,744

Summary:

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

Income:

Alacrity did not sufficiently document the borrower's income to ensure that it could be reasonably expected to continue through the first 3 years of the mortgage. It also did not obtain a written or verbal verification of employment.

To compute the borrower's monthly pay, Alacrity used the military pay stubs for the months of January and February 2007. These pay stubs showed a gross pay of \$5,393, which included base pay of \$3,393 and allowances of \$1,468. The February pay stub showed gross pay but no net pay, and the deductions for insurance had stopped. These documents and a borrower letter of explanation of a large deposit for accumulated leave and a troop savings account indicated that the borrower may have retired. However, Alacrity did not obtain a written or verbal verification of employment or additional documents to determine when the borrower retired and the amount of retirement pay. The amount of retirement base pay may have decreased, and the \$1,468 in allowances may not have continued into retirement.

Since Alacrity did not adequately verify the borrower's income, the compensating factors used to approve this loan were not reliable. If the borrower did retire and only the prior base pay was used for qualifying, the ratios would increase from 24 and 42 percent to 35 and 62 percent, respectively. The recalculated amounts are higher than HUD's guidelines of 31 and 43 percent.

Alacrity did not document sufficient compensating factors to justify approving this loan with these potentially high qualifying ratios. It identified two compensating factors: good ratios/reserves and nonpurchasing spouse. Good ratios are the basis for approving the loan and not a compensating factor. A nonpurchasing spouse is not considered an allowable

compensating factor. Having good reserves is a HUD-acceptable compensating factor. The borrower had \$30,000 in reserves. However, the borrower spent \$20,000 of a \$50,000 deposit within a month to end up with the \$30,000. In addition, there was a significant increase in housing expense of \$645 per month. Considering the borrower's spending pattern, poor credit history, increase in housing expense, and the inability to determine accurate income and qualifying ratios, it does not appear that the cash reserve alone would be considered a strong enough compensating factor.

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.

HUD Handbook 4155.1, paragraph 2-7, states that the income of each borrower must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. This paragraph also states that if the borrower intends to retire during this period, the effective income must be the amount of documented retirement benefits, Social Security payments, or other payments expected to be received in retirement.

HUD Handbook 4155.1, paragraph 3-1, states that the lender must provide additional explanatory statements to clarify or supplement the documentation submitted by the borrower when the standard documentation does not provide enough information to support the decision to approve the loan. Paragraph 3-1E states that a verification of employment is required and if it is not obtained, the lender must verify by telephone the current employer.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that one of the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines is that the borrower has at least 3 months' worth of cash reserves after closing.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collections, charge-offs, and late payments when approving this loan.

The borrower had 25 derogatory accounts with a past-due amount totaling \$10,964. The lender did not document an analysis to determine whether the 25 collections, charge-offs, and late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. The borrower explanation letter stated that a divorce caused the derogatory accounts. The borrower had \$30,000 in the bank as of March 5, 2007, and was willing to incur an increase in housing expense of \$645 instead of paying past-due derogatory accounts. The borrower appeared to have a disregard for financial obligations and an inability to manage debt. Alacrity did not identify sufficient compensating factors to justify accepting the borrower's derogatory credit history (see Income section).

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7783521

Mortgage amount: \$128,737

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: May 17, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: \$78,141

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collections when approving this loan. In addition, it did not document sufficient compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed seven derogatory accounts, and four of these were in collection. Alacrity did not document borrower explanations for two collections. It documented a borrower explanation letter covering four of the derogatory accounts. The letter explained that one was for a utility that was supposed to have been shut off but evidently had not been, another the borrower did not recognize, and two others were supposed to have a balance owed. Accepting the borrower's explanation that debts were not owed or recognized does not meet HUD's standard for determining that the borrower explanations make sense. The borrower

said that he would check into the derogatory comments, but there was no confirmation that the lender did anything to verify the borrower comments.

The compensating factors identified by Alacrity are not considered strong compensating factors to justify accepting the borrower's derogatory credit history. One compensating factor listed was a nonpurchasing spouse, which is not a compensating factor. The other compensating factor identified was a minimal increase in housing expense, which is an acceptable compensating factor. In our opinion, this factor alone is not considered strong enough to justify accepting the borrower's derogatory credit history when approving this loan.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7788223

Mortgage amount: \$115,192

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: May 31, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: \$70,100

Summary:

We found material underwriting deficiencies relating to the borrowers' income, gift funds, and credit history.

Income:

Alacrity improperly used borrower employment documents faxed by the seller. The pay stubs passed through the builder/seller as evidenced by the fax transmission information printed on the documents. Alacrity did not document the justification for accepting these documents.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrowers' credit history. It did not document the reason(s) for not considering collections when approving this loan. In addition, it did not document sufficient compensating factors to justify accepting the borrowers' derogatory credit history.

A review of the borrowers' credit report disclosed 11 derogatory accounts, and 6 of these had balances due. There were five collection accounts and a charge-off account. The charge-off account had a balance of \$6,245. Alacrity did not document the reasons for approving the loan with collection and charge-off accounts.

The compensating factors listed by Alacrity are not considered strong compensating factors to justify accepting the borrowers' derogatory credit history when approving the loan. We discuss the factors below:

Minimal increase in housing expense: This is an allowable factor; however, the housing increased from \$400 to \$965, which is significant. In addition, Alacrity did not resolve the differences between the housing expense identified on the loan application as \$400 and on the verification of rent, which stated \$748.

Good ratios/reserves: Good ratios are a basis for approving the loan and not a compensating factor. Good reserves is an allowable factor; however, the reserves must be at least 3 months' worth of mortgage payments. The mortgage payment was \$955, and 3 times \$955 equals \$2,865, which is greater than the reserve amount of \$2,421.

Child support paid and received between borrowers: The borrowers were married and then divorced and got back together again. The payment by one of the borrowers was an income to the other and, therefore, would not be a valid compensating factor.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that two of the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark is that the borrower has a minimal increase in housing expense and has at least 3 months' worth of cash reserves after closing. A compensating factor used to justify mortgage approval must be supported by documentation

Loan number: 492-7801327

Mortgage amount: \$72,905

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: April 27, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Four

Loss to HUD: \$62,055

Summary:

We found material underwriting deficiencies relating to the borrower's income and rent history.

Income:

Alacrity improperly used borrower employment documents faxed by the seller. The IRS Forms W-2, pay stubs, and verification of employment documents passed through the builder/seller as evidenced by the fax transmission information printed on the documents. Alacrity did not document the justification for accepting these documents.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Verification of Rent:

Alacrity did not resolve the discrepancies on documents related to the borrower's previous housing expense. The loan application stated that the borrower lived for free at the current address and showed no housing expense. However, a letter from his father stated that he and the borrower were paying \$500 each to the landlord at the current address shown on the loan application. The address used on the current pay stubs and an IRS Form W-2 for 2006 wages was different from the current address. However, an earlier IRS Form W-2 for 2005 showed the current address. Since housing obligations are significant in evaluating a borrower's credit, Alacrity should have obtained additional information to confirm the borrower's current address and housing expense.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the payment history of the borrower's housing obligations holds significant importance when evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report or verification of rent directly from the landlord with no identity of interest with the borrower.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that when standard documentation does not provide enough information to support the decision to approve the loan, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower.

Loan number: 492-7803859

Mortgage amount: \$116,510

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 21, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Five

Loss to HUD: \$93,476

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collections when approving this loan. In addition, it did not document sufficient compensating factors to justify accepting the borrower's derogatory credit history.

A review of the borrower's credit report disclosed seven derogatory accounts. Two accounts were in collection, and five were charged off. Alacrity did not document the reasons for approving the loan with derogatory collection and charge-off accounts.

Alacrity identified reserves in 401K as a compensating factor, which is an allowable compensating factor according to HUD guidelines. The balance of the borrower's 401K account was \$25,565. However, in our opinion, this compensating factor alone was not sufficient to justify approving the loan with the borrower's derogatory credit history showing a disregard for financial obligations and the inability to manage credit.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written

explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7814448

Mortgage amount: \$113,567

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 14, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: 13

Loss to HUD: \$97,308

Summary:

We found material underwriting deficiencies relating to the borrower's gift funds and credit history.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and charge-off accounts or identify strong compensating factors to justify accepting the borrower's derogatory credit history when approving the loan.

The borrower had two accounts in collection within 2 years of the loan closing with a balance due of \$14,446. The borrower also had one account charged off with a balance due of \$11,135. The borrower's explanation letter did not address one of the collections and the account charged off. Alacrity did not document an analysis of the credit history to determine whether the collections and late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. It did not identify strong compensating factors to justify accepting the collection and charge-off accounts.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7815245

Mortgage amount: \$123,068

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 8, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Three

Loss to HUD: \$98,063

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not (1) document the reason(s) for not considering collection and late payment accounts, (2) identify compensating factors to justify accepting the borrower's derogatory credit history, and (3) document the borrower's explanation for all of the collection and charge-off accounts and for the 15 credit inquiries made 90 days before the credit report date.

The borrower's credit report showed 14 derogatory accounts. Twelve of these were collection accounts, one was a charge-off, and one was a late payment. Two of the collections with a past-due balance of \$646 had a last activity date within 2 years of loan closing. The other eight collections had a past-due balance of \$5,473. The borrower's explanation letter only discussed the two collections with a last activity date within 2 years of loan closing. The credit report also showed that the borrower had 15 credit inquiries within 90 days of the report date. Alacrity did not document a borrower explanation for the inquiries. It did not identify compensating factors to justify accepting the borrower's collection and charge-off accounts when approving the loan.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The borrower must also explain in writing all inquiries shown on

the credit report in the last 90 days. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7852604

Mortgage amount: \$113,223

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 20, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$87,530

Summary:

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

Income:

Alacrity did not adequately evaluate the borrower's income. The borrower was employed at the current job for 7 months and had four other employers over the previous 5 months. The lender should have documented the reason for determining that stable employment would continue for at least 3 years. Although the current employer stated that the probability of continued employment was likely, past history showed that the borrower's employment was not stable.

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.

Excessive Debt Ratios:

Alacrity used excessive ratios to approve this loan. It used 34 and 45 percent, which are over the HUD guidelines of 31 and 43 percent, respectively.

Alacrity did not identify sufficient compensating factors to justify accepting the borrower's excessive ratios in approving this loan. It identified a minimal housing increase as a compensating factor. The borrower's current housing expense was \$498 for rent plus a negative rental income of \$19 totaling \$517. The proposed housing expense of \$955, less the current housing expense of \$517, was a \$438 increase. Based on the increase being 16 percent of the

monthly income of \$2,773 and the borrower's inability to manage debt as evidenced by the derogatory credit, the increase is considered significant.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-13, states that one of the compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark is that the borrower has a minimal increase in housing expense. A compensating factor used to justify mortgage approval must be supported by documentation.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

Assets:

The lender did not document the source of the borrower's earnest money deposit. Although the earnest money deposit was less than 2 percent of the loan, the \$1,500 amount was excessive based on the borrower's showing no cash savings on the loan application. In addition, the lender did not provide bank documents to show that funds were available or that the earnest money was received by the closing agent. Further, the borrower and a third party received \$1,500 each at closing. Alacrity should have obtained additional documentation or explained the reasons for these disbursements.

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.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and late payment accounts or identify sufficient compensating factors to justify accepting the borrower's derogatory credit history.

The borrower's credit report showed six collection accounts, four charge-off accounts, and two late payment accounts. The balance of the collection and charge-off accounts totaled \$22,040. Two of the derogatory accounts had a last activity within 2 years of closing. Alacrity did not document borrower explanations for one collection and three charge-off accounts.

Alacrity did not identify sufficient strong compensating factors to justify accepting the borrower's derogatory credit history when approving this loan (see the Excessive Debt Ratio section).

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 492-7854686

Mortgage amount: \$125,127

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: July 31, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: \$109,989

Summary:

We found material underwriting deficiencies relating to the borrowers' credit history.

Credit:

Alacrity did not adequately evaluate the borrowers' credit history. It did not document the reason(s) for not considering collection and late payment accounts or identify compensating factors to justify accepting the borrower's derogatory credit history.

The borrowers' credit report showed 15 collection accounts, 10 charge-offs, and 1 repossession. The borrowers also had a tax lien that was released just before closing. Alacrity did not document strong compensating factors to justify accepting the borrowers' collection, charge-off, and repossession accounts when approving this loan.

The lender did not resolve a discrepancy between the credit report showing recently opened accounts and the borrowers' explanation letter stating that no new accounts had been opened in the past 90 days. The credit report showed two accounts opened in May 2007, 2 months before FHA closing, and one account opened in the same month as the loan closing. All three accounts showed that they were in good standing; however, a borrower explanation letter stated that the borrowers had not acquired new debt in the past 90 days other than one application for a credit card that they opened. The lender should have obtained additional information to resolve this discrepancy.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of

the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The borrower must also explain accounts opened but not included in the loan application. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower.

Loan number: 492-7866921

Mortgage amount: \$125,728

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 30, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$90,326

Summary:

We found material underwriting deficiencies relating to the borrower's income, credit history, and verification of rent.

Income:

Alacrity did not adequately evaluate the borrower's income. It averaged the borrower's wages from the two most recent employers, which included overtime, to compute an average monthly income of \$4,153. However, the overtime for the prior employer of 12 months was significantly higher than the overtime for the current employer of 7 months. The current employer's wages resulted in \$3,269 in monthly income. Consequently, Alacrity used \$4,153 in monthly income instead of \$3,269, making the ratios more acceptable. Using the current monthly income caused the ratios to increase to 32 and 55 percent, which are higher than the HUD guidelines of 31 and 43 percent, respectively.

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.

HUD Handbook 4155.1, REV-5, paragraph 2-7, states that an earnings trend must be established and documented for overtime income. If the trend shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying.

Mortgagee Letter 2005-16, dated April 13, 2005, increased the payment-to-income and debt-to-income ratios 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.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and late payment accounts or identify compensating factors to justify accepting the borrower's derogatory credit history.

The borrower's credit report showed seven collection, four charge-off, and one late payment accounts. The charge-off accounts showed a balance of \$18,797. Three of the accounts had a last activity within 2 years of closing. Alacrity did not document borrower explanations for the collection and charge-off accounts.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Verification of Rent:

Alacrity did not document a resolution of inconsistencies regarding the borrower's current rent expense. The loan application showed that the borrower paid \$700 per month for rent, and the verification of rent showed \$1,100. Alacrity did not document rent payments to determine whether the borrower paid rent, how much, and whether payments were made on time. Consequently, it was not able to evaluate a significant element of the borrower's credit history.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity of interest with the borrower), verification of mortgage directly from the mortgage servicer, or through canceled checks covering the most recent 12-month period.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support this decision, the lender must

provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower.

Loan number: 492-7907982

Mortgage amount: \$191,002

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: January 24, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: One

Loss to HUD: \$112,534

Summary:

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

Income:

Alacrity did not adequately evaluate the borrower's income. There were inconsistencies among the borrower's pay stubs, child support payment history, credit report, and the loan application.

The credit report showed a child support balance of \$65,683, with a minimum due of \$500 and the account was current. The loan application included child support of \$500 as a liability. However, the pay stubs for pay periods in September 2007 showed that the year-to-date total for the child support deduction was the same on each pay stub, indicating that no child support was being deducted. The child support payment history from the State showed that the last payment made to the recipient was on September 17, 2007. The credit report had written comments saying "does not owe" for the derogatory account "ATTYGENERL." The lender should have resolved and documented these inconsistencies to verify the accuracy of the income documents and the monthly liability of the borrower.

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.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not (1) document the reason(s) for not considering collection and late payment accounts, (2) resolve inconsistencies in

the borrower's current rent expense, and (3) identify sufficient compensating factors to justify accepting the borrower's derogatory credit history when approving this loan.

The borrower's credit report showed 26 collection accounts, two charge-off accounts, and two late payment accounts. The charge-off accounts showed a balance of \$10,660. Ten of the accounts had a last activity within 2 years of closing. Alacrity did not document an analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. It did not document borrower explanations for 24 of the 26 collection accounts or the 2 charge-off accounts.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Verification of Rent:

The lender did not document a review of inconsistencies regarding the borrower's current rent expense. The loan application and the telephone verification of rent showed that the borrower had rented the property being purchased for the prior year and a half. The seller was the borrower's landlord, who verified a \$1,000 per month rent payment for a year and a half. The FHA loan was for the proposed construction of a manufactured home on raw land. The appraisal pictures showed the property as raw land with no structures or trailers. Documentation included check and deposit receipts for rent payments in September and October 2007. The check and deposit receipts did not indicate the property address, and the deposits did not identify the account holder. In addition, Alacrity did not authenticate the rent check and deposit receipts that were faxed by the builder in this transaction. Consequently, there was no evidence that the payments and receipts were for the borrower's rent for the current address.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. When standard

documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower.

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Loan number: 492-7933323

Mortgage amount: \$105,641

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: February 15, 2008

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$87,420

Summary:

We found material underwriting deficiencies relating to the borrower's credit history.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering collection and charge-off accounts. In addition, it did not identify sufficient compensating factors to justify accepting the borrower's derogatory credit history.

The borrower's credit report showed four collection accounts and four charge-off accounts. These accounts showed a balance of \$28,003. Four of the accounts had a last activity within 2 years of closing. The lender documented borrower explanations for four of the accounts that were within 2 years of closing. However, the lender did not document borrower explanations for the remaining four collection and charge-off accounts. Alacrity did not document an analysis to determine whether the collections were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.

Alacrity did not identify sufficient strong compensating factors to justify accepting the borrower's collection and charge-off accounts when approving this loan. It identified building on own land, minimal increase in housing expense, and reserves in a 401K as compensating factors. Building on own land is not a HUD/FHA-acceptable compensating factor. Minimal increase in housing expense is allowable by HUD, except Alacrity did not document the \$600 housing cost reported in the loan application. Since the increase in the housing cost could not be verified, this was not a documented compensating factor. Alacrity also identified reserves in a 401K, which is a valid compensating factor. However, with the borrower's derogatory credit history showing either a disregard for financial obligations or an inability to manage debt, this factor alone is not considered sufficient to justify accepting the derogatory credit history.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

Loan number: 493-8414070

Mortgage amount: \$91,563

Section of Housing Act: 203(b)

Loan purpose: Construction

Date of loan closing: September 10, 2007

Status as of April 30, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: \$54,406

Summary:

We found material underwriting deficiencies relating to the borrower's gift funds and credit history.

Gift Funds:

Alacrity did not document the transfer of gift funds from the nonprofit donor to the settlement agent. A gift letter was documented, but the transfer by check, wire transfer, or other method was not documented to ensure that the funds used to close came from an acceptable source.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that regardless of when gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided by an unacceptable source and were indeed the donor's own funds.

Credit:

Alacrity did not adequately evaluate the borrower's credit history. It did not document the reason(s) for not considering the collection and charge-off accounts or identify compensating factors to justify accepting the borrower's derogatory credit history.

The borrower's credit report showed 20 collection accounts and 1 charge-off account. The total balance of the 21 derogatory accounts was \$16,244. Alacrity did not document borrower explanations for the collection and charge-off accounts and credit inquiries made within 90 days of closing. It did not document an analysis to determine whether the collections were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. In addition, it did not identify strong compensating factors to justify accepting the

borrower's derogatory credit history of collection and charge-off accounts when approving this loan.

HUD/FHA Requirements:

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that when delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including disputes with creditors. While minor derogatory information occurring 2 or more years in the past does not require explanation, major indications of derogatory credit including judgments, collections, and other recent credit problems require sufficient written explanation from the borrower. The lender must document its reasons for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states that if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

APPENDIX C

LENDER COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation

Lender Comments

Comment 1



STEVE HOLMES
President, General Counsel

July 8, 2010

Via email tschulze@hudoig.gov

Ms. Tonya E. Schulze
Regional Inspector General for Audit
US Department of Housing and Urban Development
Office of Inspector General
Region IX
611 W. 6th St.
Suite 1160
Los Angeles, CA 90017-31001

Re: Alacrity Lending Company

Dear Ms. Schulze:

I have received your letter dated June 23, 2010 and related materials concerning your office's review of 20 Federal Housing Administration loans underwritten by Alacrity Lending Company. As you know, your report contains various serious allegations that will involve a significant amount of time to address. In my letter dated June 29, 2010, I pointed out to you the difficulties associated with preparing a detailed response and requested an additional length of time within which to prepare complete responses to the report. By e-mail dated July 1, 2010, you informed me no extension of time would be granted.

As stated in my letter of June 29, 2010, we have not had sufficient time to prepare complete, comprehensive responses to the report. I point out we were given approximately 2 weeks to respond to allegations your staff took 6 months to prepare. Especially given the small size of our company and the fact the underwriter who underwrote the files at issue is no longer an employee of this company, I do not think two weeks is a reasonable period of time within which we can be expected to prepare a response to your report. Nevertheless, and as suggested in your e-mail denying our request for an extension of time, we will prepare detailed responses to the allegations contained in your report to share with HUD as soon as we are able to complete our examination.

Notwithstanding the foregoing and in an attempt to state generally what we expect to be able to state specifically with respect to each file, we respectfully disagree with your staff's findings concerning the seven basic areas in which your staff found deficiencies: income; excessive ratios; assets; gift funds; credit report; verification of rent; and incorrect underwriter's certifications.

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Southlake, Texas 76092
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FAX: 214.260.6024
TOLL FREE: 800.251.2818
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Alacrity Lending Company

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Income: When examining a file, our underwriters have always been directed to analyze whether income can be verified, is stable and can reasonably be expected to continue through at least the first three years of the mortgage loan. I am confident after carefully reviewing the nine loans at issue, we will have an appropriate explanation for the income computations use in underwriting these files.

Excessive ratios. Alacrity's underwriting position has always been to insist upon compliance with the applicable qualifying ratios unless strong compensating factors are present. We are confident upon review of the three loans at issue strong compensating factors will be found even if such compensating factors are not clearly articulated in the materials submitted to HUD.

Assets. Alacrity requires proper documentation of the source of borrower's funds to close loans. If the examined file does not show proper sources for the funds at issue, we are confident appropriate sourcing documents can be obtained.

Gift funds. Alacrity has always insisted that any gift funds be only provided by acceptable sources. We are confident that upon review of the eight loans at issue, appropriate documentation can be obtained to establish funds were only paid by acceptable sources.

Credit report. Alacrity considers collection accounts in analyzing a borrower's credit worthiness and requires explanations in writing. After examining the 18 loans at issue, we expect to be able to provide written explanations for any collection activities.

Verification of rent. Alacrity has always carefully examined a borrower's payment history of housing expenses in evaluating loan applications. We are confident upon examination of the five loans at issue, explanations and proper verifications of all rent obligations will be obtained and submitted to HUD.

Incorrect underwriter's certifications. If, after examining the 19 loans at issue, proper certifications concerning the due diligence reviews conducted by our underwriters are not located, such certifications will be properly submitted to HUD.

As stated previously, we will carefully examine all of the files at issue in detail to provide clear explanations for position. Although we think it would be more efficient for us to be given a sufficient amount of time to properly document the results of our examination, as you have suggested in your e-mail of July 1, 2010, we will diligently work with HUD to address the issues associated with each loan examined.

Before closing, there are several items of a general nature I wish to point out. Although we have not had enough time to be able to review all of the files at issue, most, if not all, of the files at issue were underwritten by [REDACTED], a seasoned underwriter with more than 26 years experience underwriting FHA loans. [REDACTED] was our underwriter when Alacrity first underwent its test cases. Out of our 15 test cases, 10 files were approved with no comments or exceptions. Only three of the remaining five files

Alacrity Lending Company

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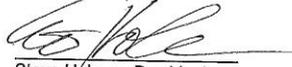
had suspense items while only two of the loans were deficient. When our approval process was completed, [REDACTED], the underwriter at HUD responsible for reviewing our test cases, told us that Alacrity had underwritten our test cases better than any other company [REDACTED] had examined.

With respect to the 20 files you examined, every one of these files was submitted to HUD for insuring purposes and to the best of my knowledge, we received no comments or questions from HUD when these files were submitted for insuring. Even if we did receive comments or questions, such comments or questions must have been resolved to HUD's satisfaction since all of these files were issued a mortgage insurance certificate. If we had received comments or questions from HUD when these files were originally underwritten, we could easily have addressed the same. Although I remain confident we will overcome all reasonable objections you have to these 19 files, it would have been more efficient if we could have been informed of these deficiencies when the loans were originated.

We respect HUD. We look to HUD to help us properly underwrite files. The signal we received as a result of our test cases was that our underwriting was exemplary. This signal was confirmed when all of these files were insured with no comment. For HUD to now, with the benefit of hindsight, audit files that have for any number of reasons not performed as originally anticipated seems to me to be selective enforcement of what we all must agree are arbitrary/discretionary rules.

Our reputation is important to us. If you review our compare ratio over the past year, you will see our delinquent loans have significantly decreased, clearly the direct result of improved underwriting on our part. We intend to learn as much as we can from this process to better underwrite loans but we need HUD's assistance and consistent direction to accomplish our goal of being the best FHA lender we can be. Rest assured we will provide you with detailed explanations of all of our underwriting decisions and vigorously defend the underwriting decisions we made with respect to all of these loans.

Alacrity Lending Company

By: 

Steve Holmes, President
General Counsel

The names were redacted for privacy reasons.

OIG's Evaluation of Lender Comments

Comment 1 The lender disagreed with our report; however, it did not provide any additional documentation to rebut our conclusions. Our review results were based on the documentation contained in the FHA and lender loan files, and therefore, we believe our conclusions are accurate and supported. We will work with HUD and the lender during the audit resolution process to address our conclusions on each of the loans and determine the appropriate action.