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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: Alethes, LLC, Lakeway, TX, Did Not Properly Underwrite a Selection of FHA Loans

INTRODUCTION

We reviewed 20 Federal Housing Administration (FHA) loans Alethes, LLC (Alethes), underwrote as a FHA direct endorser. Our review objective was to determine whether Alethes underwrote the 20 loans in accordance with FHA requirements. This review was 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 U.S. Department of Housing and Urban Development (HUD) Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the review.

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

Alethes is one of 15 direct endorsers we selected from HUD's publicly available Neighborhood Watch[1] system (system) for a review of underwriting quality. These direct endorsers all had a compare ratio[2] in excess of 200 percent of the national average as listed in the system for loans endorsed between November 1, 2007, and October 31, 2009. We selected loans that had gone into claim status. We selected loans for Alethes that defaulted within the first 30 months and (1) that were not streamlined refinanced, (2) that were not electronically underwritten by Fannie Mae or Freddie Mac, and (3) in which an association existed with an underwriter (usually an individual) with a high number of claims.

BACKGROUND

Alethes was a nonsupervised direct endorsement lender based in Lakeway, TX. FHA approved Alethes as a direct endorser in July 2001; however, Alethes' direct endorsement approval was withdrawn for 3 years by the Mortgagee Review Board in May 2010. 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 20 loans in claim status for 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. During this period, Alethes endorsed 8,162 loans valued at more than $944 million and submitted 801 claims worth $92.6 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 June 2010. We conducted our work in accordance with generally accepted government auditing standards, except that we did not

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[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 of more than 200 percent as a warning sign of a lenders performance.

consider the internal controls or information systems controls of the lenders reviewed, consider the results of previous audits, or communicate with lender management in advance. We did not follow standards in these areas because our objective was to aid HUD in identifying FHA single-family insurance program risks and patterns of underwriting problems or potential wrongdoing in poor-performing lenders that led to a high rate of defaults and claims against the FHA insurance fund. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our audit results.

RESULTS OF REVIEW

Alethes did not properly underwrite 19 of the 20 loans reviewed because its underwriters did not follow FHA's requirements. As a result, the FHA insurance fund suffered actual losses of more than $1 million, as shown by the following table.

FHA/loan number	Closing date	Number of payments before first default	Original mortgage amount	Actual loss to HUD
491-8729593	1/9/2006	0	$109,061	$42,852
491-8747204	11/23/2005	9	$161,665	$88,177
491-8766328	4/21/2006	3	$96,425	$72,032
491-8817515	6/28/2006	1	$111,072	$51,782
491-8842946	8/4/2006	0	$79,170	$51,177
491-8846382	9/26/2006	0	$148,724	$70,908
491-8856548	8/23/2006	1	$135,178	$95,916
491-8875185	10/26/2006	2	$52,584	$39,424
491-8913905	1/23/2007	2	$95,057	$72,375
491-8927014	3/7/2007	12	$143,939	$59,749
491-8932218	3/19/2007	0	$126,500	$61,236
491-9013914	8/27/2007	1	$137,837	$35,618
491-9042939	10/5/2007	10	$125,874	$43,392
491-9052920	11/15/2007	8	$158,543	$26,748
491-9067953	1/11/2008	0	$185,095	$66,613
491-9081188	1/3/2008	2	$114,991	$50,464
492-7753781	1/24/2007	2	$141,479	$70,991
492-7916830	11/15/2007	1	$137,944	$26,570
492-7963491	3/12/2008	0	$107,315	$30,423
Totals			$2,368,453	$1,056,447

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

Area of noncompliance	***Number of loans***
Income	6
Liabilities	4
Excessive ratios	8
Assets	8
Gift funds	10
Credit history	18
Verification of rent	1

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

Alethes improperly included unsupported income in calculations of borrowers' ratios in six loans. It did not properly document part-time income, child support income, overtime income, Supplemental Security Income (SSI), and employment history. HUD requires that employment be verified for 2 full years and income be analyzed to determine whether it is expected to continue through at least 3 years (see appendix B for detailed requirements).

For example, for loan number 491-8856548, the borrower held a part-time job for only 17½ months. Since the job was not held, uninterrupted, for the past 2 years, the income could only be used as a compensating factor. Alethes improperly included $1,320 in the borrower's monthly income.

For loan 491-9081188, the borrower's three latest pay stubs included in the file showed no overtime income earned but showed year-to-date overtime of $3,835. No overtime should have been included in the borrower's monthly income since there was no documented evidence that the borrower would continue to earn overtime income.

Liabilities

Alethes did not properly assess the borrowers' financial obligations for four loans. HUD requires lenders to consider debts that would affect the borrowers' ability to make mortgage payments during the months immediately after loan closing, obligations of a nonpurchasing spouse in a community property State, and projected student loan payments to begin within 12 months of the mortgage loan closing in its underwriting analysis (see appendix B for detailed requirements).

For example, for loan number 491-9081188, the borrower's credit report revealed an account with an outstanding balance of $3,800 and eight remaining monthly payments of $475 that was not included in the qualifying ratios. All recurring charges extending 10 months or more must be included in computing the debt-to-income ratios, and debts lasting less than 10 months must be included if the monthly amount affects the borrower's ability to make mortgage payments immediately after closing. We considered this payment to be significant because it was 21.3 percent of the borrower's supported monthly income of $2,227 and would most likely have affected the borrower's ability to make the mortgage payment during the months immediately after loan closing.

For loan number 491-8747204, the borrower's spouse had a $13,323 debt on her credit report for past-due child or family support payable to an attorney general's office with a monthly payment of $365. Since the property being purchased was in a community property State, this debt should have been included in the calculation of the borrower's debt-to-income ratios.

Excessive Debt Ratios

Alethes improperly approved eight loans in which the borrowers' qualifying ratios exceeded FHA's guidelines without identifying strong compensating factors. Effective April 13, 2005, the mortgage payment-to-income and total debt-to-income ratios were increased 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 491-8747204, Alethes calculated the borrower's debt-to-income ratios at 34.303 and 43.345 percent but did not list compensating factors. After our review of the FHA file and all documents provided by the lender in response to the subpoena issued as part of Operation Watchdog[3], we found no documentation to support any of the acceptable compensating factors. Income earned by the nonpurchasing spouse could have been used as a compensating factor if the income had been documented sufficiently.

For loan 492-7963491, Alethes approved the loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income and total debt-to-income ratios were 39.85 percent. The lender inappropriately used an incorrect mortgage payment amount when calculating the qualifying ratios. The mortgage credit analysis worksheet[4], dated February 29, 2008, used $989 as the mortgage payment including taxes and insurance. However, the truth in lending statement, dated March 12, 2008, and first payment letter indicated a mortgage payment including taxes and insurance of $1,132. The mortgage payment-to-income and total debt-to-income ratios, as recalculated after considering the $1,132 mortgage payment, increased to 45.63 percent. Alethes' underwriter listed four compensating factors, but none were documented, acceptable compensating factors.

Assets

Alethes did not properly verify borrowers' assets for eight loans. HUD requires lenders to verify the source of earnest money deposits that are more than 2 percent of sales price or that appear excessive based on the borrower's history of accumulating savings. HUD also requires lenders to obtain a verification of deposit or, alternatively, the borrower's bank statements listing the ending balance of a 3-month period and obtain a credible explanation for any large increase in an account (see appendix B for detailed requirements).

For example, for loan number 492-7963491, the borrower's earnest money deposit of $1,500 was excessive based on his savings. The borrower's bank statement showed that his ending balance one day before the earnest money deposit was made was only $150. The bank statement also did not show additional transactions supporting the earnest money deposit. The lender did not otherwise verify the source of funds used for the earnest money deposit.

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[3] Each of the 15 lenders selected under Operation Watchdog was served an Inspector General subpoena for all files and documents related to the loans reviewed.

[4] The mortgage credit analysis worksheet is used by a lender to record calculations, comments, and other information considered in determining whether a borrower has the funds to close and the capacity to repay a mortgage.

For loan number 491-9013914, Alethes did not document the source of two large deposits to the coborrower's checking account totaling $2,335. All funds for the borrower's investment in the property must be verified and documented. A deposit of $885 on May 30, 2007, required an explanation since it was $200 more than any other deposit listed on the statement. A deposit of $1,450 on May 25, 2007, required explanation because it exceeded all of the other deposits on the statement by more than $700. All of the other large deposits shown on the statements were from the coborrower's employer. The beginning and ending balances in the account between April 27 and June 26, 2007, did not exceed $2,129. These two deposits were 41.6 and 68.1 percent of this amount, respectively. The lender must obtain a credible explanation of the source funds if there is a large increase in an account.

Gift Funds

Alethes did not document the transfer of gift funds to the borrower for 10 loans. HUD requires evidence that gift funds are transferred from the donor's account to the borrower or to the settlement company on behalf of the borrower and that these funds came from an acceptable source (see appendix B for detailed requirements).

For example, for loan number 491-8846382, the gift letter indicated that the borrower received a $5,000 gift from DPA Alliance Corporation. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

For loan number 491-9042939, the gift letter indicated that the borrower received a gift of $7,612 from Nehemiah Corporation of America. The transfer of the funds from the donor to the settlement company on behalf of the borrower was not documented in the file.

Credit History

Alethes did not properly evaluate the borrowers' credit histories for 18 loans. It did not document its reason(s) for accepting a number of collections, charge-offs, and judgments, especially those for housing and utilities (see appendix B for detailed requirements).

For example, for loan number 491-8932218, the borrowers had 62 collection accounts and 15 charge-offs. Of these 62 collections, 15 accounts were opened within the 24 months preceding the loan closing. The borrower had two charged-off accounts for electric service and three judgments filed by an apartment complex. The borrower explained the majority of these delinquent debts, and Alethes' underwriter listed five compensating factors, but only one was acceptable and documented.

For loan number 491-9067953, the borrowers' credit report listed 36 collection accounts. Sixteen of these were opened within 24 months of loan closing. The borrowers' credit report also showed 10 charge-offs, with 1 of the 10 being opened within 24 months of loan closing. Older collections and charge-offs for electric and phone service also appeared on the borrowers' credit report. The borrowers explained the majority of these debts, but Alethes did not provide strong, supported compensating factors, given the borrowers' credit history.

Verification of Rent

For loan number 491-8766328, Alethes did not properly verify the borrowers' rental history for 12 months, as required by HUD. The lender only verified the borrower's and coborrower's previous rental history for 9 months, and several different addresses were used as the borrowers' current residence on the forms in the loan file without explanation.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the 19 loans with material underwriting deficiencies for accuracy. Alethes' 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 Alethes and/or its principals for incorrectly certifying to the integrity of the data or that due diligence was exercised during the underwriting of 19 loans that resulted in losses to HUD totaling $1,056,447, which could result in affirmative civil enforcement action of approximately $2,255,394.[5]

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

1B. Take appropriate administrative action against Alethes 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.

[5] Double damages plus a $7,500 fine for each of the 19 infractions.

Schedule of Ineligible Cost 1/

Recommendation number	Amount
1A	$1,056,447

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.

Appendix A

SUMMARY OF MATERIAL UNDERWRITING DEFICIENCIES

FHA loan number	Unsupported income or questionable employment history	Underreported liabilities	Excessive debt-to-income ratio	Unsupported assets	Insufficient gift documentation	Significant credit-related deficiencies or no credit	Incomplete verification of rent history
491-8729593	X		X	X			
491-8747204		X	X		X	X	
491-8766328	X		X	X		X	X
491-8817515		X	X		X	X	
491-8842946						X	
491-8846382					X	X	
491-8856548	X	X	X	X	X	X	
491-8875185					X	X	
491-8913905					X	X	
491-8927014					X	X	
491-8932218						X	
491-9013914				X		X	
491-9042939	X			X	X	X	
491-9052920			X			X	
491-9067953				X		X	
491-9081188	X	X	X	X	X	X	
492-7753781						X	
492-7916830						X	
492-7963491	X		X	X	X	X	

Appendix B

LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Loan number: 491-8729593

Mortgage amount: $109,061

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 9, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $42,852

Summary

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

Income

Alethes overstated the borrower's child support income by $328.90 per month. The borrower received monthly child support payments of $150 for one child and $286.16 for another child. The $150 per month child support payments were adequately documented and supported by a court order, corresponding deposits to the borrower's bank account, and payment records from the Texas Attorney General for the preceding 12-month period. However, the $286.16 child support payments were supported only by deposits of $143.08 from the Texas Attorney General twice a month as shown on the borrower's bank statements. A note in the FHA file on the borrower's bank statement indicated that the $143.08 child support payment twice a month would not be counted. Nevertheless, both monthly payments were "grossed up" to $172.50 and $328.90 per month, respectively, and included as other income in calculating the borrower's debt-to-income ratios. Recalculating the borrower's ratios without considering $328.90 in child support income results in ratios of 34.5 and 51 percent. Both of these ratios exceed HUD's acceptable ratios of 31 and 43 percent. However, the property purchased was a newly constructed energy-efficient home (EEH). The benchmark qualifying ratios may both be exceeded by up to 2 percentage points when the borrower is purchasing an EEH according to

HUD Handbook 4155.1, paragraph 2-19. Both of the recalculated ratios still exceeded 33 percent and 45 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7F, states that child support income may be considered as effective if such payments are likely to be consistently received for the first 3 years of the mortgage. The borrower must provide a copy of the final divorce decree, legal separation agreement, or voluntary payment agreement, as well as evidence that payments have been received during the last 12 months. Mortgagee Letter 2005-16 states that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios are raised to 31 and 43 percent. Mortgagee Letter 2005-16 also states that properly documented child support can be grossed up under the same terms and conditions as other nontaxable income sources. HUD Handbook 4155.1, REV-5, paragraph 2-19, states that the benchmark qualifying ratios may both be exceeded by up to 2 percentage points when the borrower is purchasing an EEH.

Excessive Debt Ratios

Alethes calculated the borrower's debt-to-income ratios at 30.85 and 45.61 percent, respectively, but still listed three compensating factors to justify approving the mortgage. The compensating factors listed on the mortgage credit analysis worksheet were either not acceptable according to HUD Handbook 4155.1, paragraph 2-13, or not supported by documentation included in the file. The compensating factors listed were (1) potential pay increase, (2) first-time home buyer, (3) new construction-EEH, and (4) minimum increase in house expense. The borrower's potential for pay increase was not supported by evidence of job training or education in the borrower's profession. First-time home buyer is not an acceptable compensating factor. New construction-EEH is not an acceptable compensating factor listed in the handbook. However, since the property purchased was a newly constructed EEH, the benchmark ratios could be exceeded up to 2 percent, resulting in maximum ratios of 33 and 45 percent according to HUD Handbook 4155.1, paragraph 2-19. The borrower's housing expense increased by $211 per month or 28 percent. No compensating factors were supported by documentation in the file.

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 (mortgage credit analysis worksheet) the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Assets

Alethes did not document the source of the borrower's earnest money deposit as required when the deposit seems excessive based on the borrower's history of accumulated savings. The borrower's earnest money deposit was a $500 money order. However, the borrower's checking account balance was less than $25 on the day the money order was purchased. Also, the earnest money deposit was made before the borrower received an $800 gift from her cousin.

HUD/FHA Requirements

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

Loan number: 491-8747204

Mortgage amount: $161,665

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 23, 2005

Status as of June 2, 2010: Claim

Payments before first default reported: Nine

Loss to HUD: $88,177

Summary

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

Liabilities

Alethes improperly omitted the debt of a nonpurchasing spouse from liabilities used to calculate the borrower's qualifying debt-to-income ratios. The borrower's spouse had a $13,323 debt on her credit report for past-due child or family support payable to an attorney general's office with a monthly payment of $365. The borrower's total recurring expenses of $763 ($398 plus $365) should have been used in calculating the borrower's debt-to-income ratios. Recalculation of the borrower's total fixed payment-to-income resulted in a ratio of 51.636 percent. Texas is a community property State.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-2D, states that except for the obligations specifically excluded by State law, the debts of the nonpurchasing spouse must be included in the borrower's qualifying ratios if the borrower resides in a community property State or the property to be insured is located in a community property State. Although the nonpurchasing spouse's credit history is not to be considered a reason for credit denial, a credit report must be obtained for the nonpurchasing spouse to determine the debt-to-income ratio.

Excessive Debt Ratios

Alethes calculated the borrower's debt-to-income ratios at 34.303 and 43.345 percent but did not list compensating factors. After our review of the FHA file and all documents provided by the lender in response to the subpoena, we found no documentation to support any of the acceptable compensating factors listed in HUD Handbook 4155.1, paragraph 2-13. Income earned by the nonpurchasing spouse could have been used as a compensating factor if the income had been documented sufficiently.

HUD/FHA Requirements

Mortgagee Letter 2005-16 states that for manually underwritten mortgages for which the direct endorsement underwriter must make the credit decision, the qualifying ratios are raised to 31 and 43 percent. HUD Handbook 4155.1, REV-5, paragraph 2-13, states that a compensating factor used to justify mortgage approval must be supported by documentation.

Gift Funds

Alethes did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $4,485 gift from The Genesis Foundation, Inc. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and charged-off accounts, especially those for housing and utilities. The borrower's credit report listed 12 accounts in collections. Three of the twelve collection accounts were opened less than 24 months before the loan closed. Two of the three accounts were medical debts; the third account was for telephone service. The borrower explained that the telephone account was prepaid and should never have appeared on his credit report. The borrower did not give an explanation for the medical debts. Two of the older collection debts were for past apartments rented by the borrower. The borrower explained that his debt to one apartment complex resulted from fees for carpet and cleaning charged when he moved out. The debt was $1,621, and the borrower explained that the apartment complex also kept his deposit. The borrower's explanation for his other debt owed on an apartment he rented was that he had to move in with his parents to get on his feet and get a better job.

The borrower also had four charged-off accounts on his credit report. Two of the four charge-offs were for electric service. The borrower explained that he called to disconnect service when he moved out, but the service was not disconnected, and the utility charged the borrower for service provided to the new resident. The borrower explained that he was not sure what the second account was for. One of four charged-off accounts was an auto loan. The borrower explained that he returned the car in lieu of repossession and did not expect to owe the remaining balance of $12,654. The remaining charged-off debt was to a jeweler who the borrower explained accelerated his loan, but the borrower could not pay in full and continued to make monthly payments.

No compensating factors were documented to support Alethes' decision to approve this loan with the borrower's credit history.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8766328

Mortgage amount: $96,425

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: April 21, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: Three

Loss to HUD: $72,032

Summary

We found material underwriting deficiencies relating to the borrowers' income, debt-to-income ratios, assets, credit history, and rental history.

Income

Alethes improperly used the coborrower's $693.45 SSI income in calculating monthly income. The SSI was documented by only the first page of a multiple page document from the Social Security Administration (SSA) and refers to figures listed on later pages. The first page did not indicate whether or for how long the income was to continue and was dated more than 120 days before loan closing. Since there was no documentation verifying that the SSI income would continue for a full 3 years, it should not have been used to calculate monthly income. No newer documents from SSA were found in the FHA or lender file. Recalculation of the borrowers' ratios without considering this income resulted in ratios of 39.007 and 56.373 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7, states that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. Paragraph 2-7E states that retirement and Social Security income require verification from the source (former employer, SSA) or Federal tax returns. If any benefits expire within the first full 3 years, the income source may be considered only as a compensating factor. Paragraph 3-1 states that all documents may be up to 120 days old at the time the loan closes (180 days for new construction) unless this or other applicable HUD instructions specify a different timeframe or the nature of the document is such that its validity for underwriting purposes is not affected by being older than the number of prescribed days (e.g., divorce decrees, tax returns). Updated, written verifications must be obtained when the age of the documents exceeds these limits.

Excessive Debt Ratios

Alethes did not list acceptable compensating factors supported by documentation to justify approving the loan with ratios that exceeded the benchmarks set by HUD as required by HUD Handbook 4155.1, paragraph 2-13. The ratios reported by Alethes were 30.250 and 43.720 percent. The following compensating factors were listed: (1) potential growth, (2) first-time home buyer, (3) good rental, and (4) raise in April 2006. Potential growth is assumed to mean potential growth in income; however, there was no evidence of job training or education in the file to support this compensating factor. First-time home buyer is not an acceptable compensating factor listed in HUD Handbook 4155.1. Good rental is assumed to refer to a minimal increase in housing expenses or a demonstrated ability to pay higher housing expenses. Neither was documented in this file. Rather, the borrowers' housing expense increased by $360 per month. There was no documentation from the borrower's employer to indicate that the borrower received a raise in April 2006, the month that the loan closed.

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Assets

Alethes improperly verified the borrowers' assets. All funds for the borrower's investment in the property must be verified and documented. The file contained a bank statement for only 1 month. The file did not contain a verification of deposit or at least 2 months of bank statements as required.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 3-1, states that a verification of deposit and most recent bank statements are to be provided. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statement(s) covering the most recent 3-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements. Paragraph 2-10 states that all funds for the borrower's investment in the property must be verified and documented.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections and charged-off accounts, especially those for housing and utilities. The borrowers had 19 collection accounts listed on their credit reports. Two of these collection accounts were opened by the borrowers in the 24 months before the loan closed. The borrowers' credit reports also listed two charged-off accounts.

One of the borrowers' collection accounts was for an apartment. Another collection account was for telephone service. Both charged-off accounts were for electric service. The borrowers explained that illness and caring for a grandchild were the reasons for their collections and charge-offs.

Alethes did not list acceptable compensating factors supported by documentation to justify loan approval, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13 (see Excessive Debt Ratios section above).

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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

Alethes did not properly verify the borrowers' rental history for 12 months as required. The lender only verified the borrower's and coborrower's previous rental history for 9 months. A verification of rent was missing for the remainder of the 12 months required. There were also some discrepancies noted with the borrower's and coborrower's addresses listed on the forms in the FHA case file. Several different addresses were used as the borrowers' current residence.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3A, 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) or verification of mortgage directly from the mortgage servicer, or canceled checks covering the most recent 12-month period.

Loan number: 491-8817515

Mortgage amount: $111,072

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: June 28, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: One

Loss to HUD: $51,782

Summary

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

Liabilities

Alethes improperly omitted a liability of $1,232 with a corresponding monthly payment of $402. This payment should have been included in the calculation of the borrower's ratios because it would have affected the borrower's ability to make mortgage payments in the months immediately after loan closing, even though the borrower vehemently explained her plan to have the debt paid in full by the time her first mortgage payment was due. Including this payment in the borrower's total fixed payment-to-income ratio would have resulted in a ratio of 52.336 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-11A, states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all additional recurring charges extending 10 months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing; this is especially true if the borrower will have limited or no cash assets after loan closing.

Excessive Debt Ratios

Alethes did not list sufficient, acceptable compensating factors supported by documentation to justify approving the loan with ratios that exceeded the benchmarks set by HUD as required by HUD Handbook 4155.1, paragraph 2-13. Alethes calculated the borrower's ratios at 37.990 percent and listed two compensating factors: (1) paying debt as scheduled, allowing more income toward housing, and (2) receives documented income-not used for qualifying. The first compensating factor listed is not an acceptable compensating factor listed in HUD Handbook 4155.1. The second compensating factor listed is an acceptable compensating factor supported by documentation in the file. However, we do not consider this single compensating factor strong enough to overcome the borrower's recalculated ratios.

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Gift Funds

Alethes did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $2,850 gift from The Genesis Foundation, Inc. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections and charged-off accounts, especially those for housing and utilities. The borrowers had 15 collection accounts listed on their credit reports. Six of these accounts were placed for collection in the 24 months before the loan closed. The borrowers' credit reports also listed two charged-off accounts.

Two of the borrowers' collection accounts were for apartments. One of the borrowers explained that she broke her lease because her unit had been broken into and she was assured that she would not be held responsible for what was owed for the remainder of the lease. Another collection account was for telephone service. The borrower explained that this bill may have been from the apartment that she left and may have been overlooked. One of the two charged-off accounts was for electric service, but the borrower claimed that she had not had service from the electric company that placed the account for collection.

Alethes did not list acceptable compensating factors supported by documentation to justify loan approval, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13 (see Excessive Debt Ratios section above).

<u>HUD/FHA Requirements</u>

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8842946

Mortgage amount: $79,170

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 4, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $51,177

Summary

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

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and charged-off accounts, especially those for utilities. The borrower had nine collection accounts listed on his credit report and a history of late payments. Of these nine collection accounts, four accounts were opened within the 24 months preceding the loan closing. One of the four accounts was for telephone service. The other three accounts were for medical debts and a debt to a public library. The borrower did not provide an explanation for these four collection accounts.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) first-time home buyer, (2) year-to-date income is higher than the average used to qualify, (3) limited credit user, and (4) potential for bonus income. First-time home buyer is not an acceptable compensating factor listed in HUD Handbook 4155.1. Income higher than the average used to qualify is also not a valid compensating factor and any potential for increased earnings must be supported by documentation of job training or education. The borrower was not a limited credit user as evidenced by the multiple collection accounts on his credit report. To be eligible for a bonus, the borrower must not be absent from work or late for work and have no accidents, injuries, or disciplinary actions during the year. The borrower received a bonus of only $134 in 2005.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states 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: 491-8846382

Mortgage amount: $148,724

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: September 26, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $70,908

Summary

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $5,000 gift from DPA Alliance Corporation. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and charged-off accounts, especially those for housing and utilities. The borrower had 32 collection accounts and six charge-offs listed on her credit report. Of these 32 collections, 4 accounts were opened within the 24 months preceding the loan closing. One of the four accounts was for a condominium complex. One older collection was for gas service, and two charged-off accounts were for electric service. The other three recent collections were for medical and other debts.

No explanations were found in the FHA file. The lender file included the borrower's explanation that she experienced an illness between 2000 and 2005. The borrower recovered at the end of 2005. The borrower's pay was also cut between 2004 and 2005. The borrower explained that her insurance should have paid medical bills listed on her credit report.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) growth in wages, (2) limited credit user, and (3) good rental. The potential for growth in the borrower's wages was not supported by evidence of job training or education. The borrower was not a limited credit user as evidenced by the multiple collection accounts on her credit report. Good rental is not an acceptable compensating factor, since the borrower's housing expense increased more than $400 per month.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8856548

Mortgage amount: $135,178

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 23, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: One

Loss to HUD: $95,916

Summary

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

Income

Alethes improperly included the borrower's $1,319.82 monthly part-time employment income in the calculation of her debt-to-income ratios. The borrower had not been working the part-time job uninterrupted for the past 2 years, and Alethes did not justify and document that she would continue to work the part-time job. Since the part-time position had been held for only 17½ months, the income earned could only be used as a compensating factor. In addition to improperly including the part-time income, Alethes overstated the borrower's income from her primary employment. The monthly income listed in the file was $2,866, but the documents in the file did not support this figure. The supported monthly income was $2,509.75, listed on the verification of employment and all pay stubs included in the file. Recalculation of the borrower's ratios using only $2,509.75 monthly income results in ratios of 55.044 and 56.439 percent, while HUD's benchmark ratios are 31 and 43 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7B, states that part-time/second job income may be used in qualifying if the lender documents that the borrower has worked the part-time job uninterrupted for the past 2 years and will continue to do so. Income from a part-time position that has been received for less than 2 years may be included as effective income, provided the lender justifies and documents that the income's continuance is likely. Income from part-time positions not meeting these requirements may be considered as a compensating factor only.

Liabilities

Alethes improperly excluded the borrower's obligation to repay student loans from the calculation of debt-to-income ratios. The borrower had $35,554 total student loan debt. The file contained documentation showing that the borrower was enrolled in graduate school for the spring 2006 semester. The first payment on the borrower's student loan would likely be due in November 2006, only 3 months after loan closing, if the spring semester ended in May 2006. The lender did not obtain evidence of a planned graduation date from the university the borrower attended. Without evidence that the loans would be deferred until at least 12 months after loan closing, the monthly payment should have been included in calculating the borrower's ratios. A 5 percent monthly payment on the student loans of $1,777.70 was used to recalculate the borrower's total fixed payment-to-income ratio of 76.309 percent, compared to the ratio listed on the mortgage credit analysis worksheet of 33.840 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-11C, states that if a debt payment, such as a student loan, is scheduled to begin within 12 months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis, unless the borrower provides written evidence that the debt will be deferred to a period outside this timeframe. HUD Handbook 4155.1, REV-5, paragraph 2-11A, states that if the account shown on the credit report has an outstanding balance, monthly payments for qualifying purposes must be calculated at the greater of 5 percent of the balance or $10 (unless the account shows a specific minimum monthly payment).

Excessive Debt Ratios

Alethes' underwriter calculated the borrower's qualifying ratios at 33 and 33.84 percent and listed the following compensating factors: (1) greater income potential, (2) 3 percent salary increase-September 2006, (3) receive annual bonus of $1,200 in November, (4) not heavy credit user, (5) has received ownership counseling, (6) increase in hours on part-time job. Only two of these factors were supported by documentation in the file. The verification of employment from the borrower's primary employer did indicate that the borrower was to receive a 3 percent rate increase shortly after loan closing, and the borrower's part-time job can be used as a compensating factor. Greater income potential was not documented with evidence of job training or education in the borrower's profession. There was no evidence in the file documenting a history of bonuses received by the borrower. The borrower did not have a conservative attitude toward the use of credit since her credit report included 30 accounts with some collections and charge-offs. Attendance of housing counseling is not an acceptable compensating factor listed in HUD Handbook 4155.1, paragraph 2-13.

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Assets

Alethes did not obtain a credible explanation of the source of a $2,000 deposit to the borrower's savings account. Since this was a large increase in the borrower's balance, Alethes was required to verify the source of the funds.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10B, states that if there is a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

Gift Funds

Alethes also did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $5,300 gift from DPA Alliance Corporation. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections, charge-offs, and a judgment, especially those for housing and utilities. The borrower had three collection accounts and four charged-off accounts on her credit report. One collection account opened within the 24 months preceding the loan closing was for gas service. The borrower explained that she had no knowledge of this account and was disputing it. Two of the borrower's charged-off accounts were for electric service. The borrower explained that these debts resulted from her separation from her husband; she thought that he had taken care of the accounts. The borrower also had a judgment showing on her credit report filed by a housing authority. The borrower paid the judgment approximately 1 month before loan closing.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13 (see Excessive Debt Ratios section above).

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8875185

Mortgage amount: $52,584

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: October 26, 2006

Status as of June 2, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $39,424

Summary

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrowers as required. The gift letter indicated that the borrowers received a $1,590 gift from Alta Crossing, Inc. The transfer of these funds to the settlement company on behalf of the borrowers was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections and charged-off accounts, especially those for utilities. The borrowers had 22 collection accounts and one charge-off listed on their credit report. Of these 22 collections, 11 accounts were opened within the 24 months preceding the loan closing. Nine of the eleven accounts were for medical debts, and two were for cell phone debts. The borrowers' charged-off account was for electric service.

The borrowers explained that they had a family emergency that required them to move back to Texas from Wisconsin and they made payment arrangements on the largest recent medical debt, as well as one of the cell phone bills. The other cell phone bill was to be paid off at loan close. There were no explanations given for the other older debts.

Alethes did not provide strong, supported compensating factors, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) borrower has excellent rental history, (2) borrower receives overtime income not used in qualifying, and (3) coborrower's Social Security income was not grossed up. Two of the compensating factors are valid. The borrower did earn overtime pay that was not used in calculating debt-to-income ratios, and the coborrower's SSI was not grossed up. However, good rental history is not an acceptable compensating factor listed in HUD Handbook 4155.1. Nevertheless, documented overtime was seldom more than 15 hours per pay period at a rate of $11 per hour ($165), coupled with the benefits of not paying tax on SSI of less than $550 per month, in our opinion, does not overcome the borrowers' credit history.

<u>HUD/FHA Requirements</u>

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states 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: 491-8913905

Mortgage amount: $95,057

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 23, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $72,375

Summary

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $4,382.12 gift from Alta Crossing, Inc. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and charged-off accounts, especially those for housing and utilities. The borrower had 25 collection accounts, three charge-offs, and one repossession listed on her credit report. Of these 25 collections, 12 accounts were opened within the 24 months preceding the loan closing. Seven of the twelve accounts were for medical debts. The borrower explained that she was out of work and did not have medical insurance. One of the twelve accounts was for insurance. The borrower explained that she paid the insurance company but it did not get her check. One of the twelve accounts was for a cell phone debt. The borrower explained that the debt was for three phones that she returned. One of the twelve accounts was for a debt to the U.S. Department of Education. The borrower explained that she was not aware that her loan was no longer in deferment. The borrower settled this debt before loan closing. One of the twelve accounts was for residential telephone service. The borrower explained that she was not aware of the debt but paid it before closing. The last 1 of the 12 accounts was for a debt owed to an apartment complex. The borrower explained that the debt resulted from an apartment that she moved out of but did not have a chance to clean before the locks were changed.

Two of the borrower's charged-off accounts were for revolving debts, and the third was for a utility account opened less than 24 months before the loan closed. The borrower explained that she did not receive a bill for the balance on this account. The borrower's car was also repossessed within 24 months before loan closing. The borrower explained that her car was repossessed because she was laid off and her new job paid less, so she was not able to keep up with her obligations.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) good rental history, (2) reserves after closing, (3) borrower gets overtime not used in qualifying, and (4) child support not grossed up for qualifying. Two of the compensating factors are valid. The borrower did earn overtime pay that was not used in calculating debt-to-income ratios, and the child support received by the borrower was not grossed up. However, good rental history is not an acceptable compensating factor listed in HUD Handbook 4155.1. For cash reserves to be used as a compensating factor, the borrower must have enough reserves to cover at least three mortgage payments according to HUD Handbook 4155.1, paragraph 2-13G. The borrower's bank statement, dated December 1, 2006, showed a balance of $1,092.80, but the borrower was required to have at least $1,709.73 to use cash reserves as a compensating factor. Nevertheless, during the 5 months the borrower had been working for her latest employer, she earned only $440.28 in overtime, an average of $88 per month, coupled with the benefits of not paying tax on child support of $440 per month, in our opinion, does not overcome the borrowers' credit history.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8927014

Mortgage amount: $143,939

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: March 7, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: 12

Loss to HUD: $59,749

Summary

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrowers as required. The gift letter indicates that the borrowers received a $4,570 gift from Nehemiah Corporation of America. The transfer of these funds to the settlement company on behalf of the borrowers was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections and charged-off accounts, especially those for utilities. The borrowers had five collection accounts and three charge-offs. Of these five collections, four accounts were opened within the 24 months preceding the loan closing. These four collections were for a cell phone debt, two debts for residential telephone service, and a debt to the U.S. Department of Education. The coborrower explained that he canceled cellular service after erroneous charges for calls to Mexico were not taken off his bill and refused to pay for the calls. The coborrower also explained that one of the residential telephone debts resulted from service he had in college in 2002 when he was not working and could not make the payments. The other residential telephone debt was for service the coborrower established for his brother, who did not make the payments and the service was canceled. The borrower explained that she did not complete a class and was charged for it, resulting in the debt to the U.S. Department of Education. This debt was paid before loan closing.

The borrowers' three charged-off accounts were for electric service and a furniture purchase credit account. The coborrower explained that he opened what he thought was a secured credit card account but later found out that the credit was only good for the purchase of furniture, and he was charged a monthly fee. The coborrower instructed his bank not to pay the monthly fee from his bank account, and that resulted in the accumulation of the debt. The borrower explained that she was charged a fee for not maintaining electric service for 1 year. The borrower paid the fee when she found out about it. The coborrower did not explain his charged-off account for electric service.

Alethes did not provide strong, supported compensating factors, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter did not list compensating factors. The underwriter only pointed out that the property being purchased was new construction, allowing the debt-to-income ratios to exceed HUD's benchmarks by 2 percent because the property qualified as an EEH according to HUD Handbook 4155.1, paragraph 2-19.

<u>HUD/FHA Requirements</u>

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-8932218

Mortgage amount: $126,500

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: March 19, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $61,236

Summary

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

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections, charged-offs and judgments, especially those for housing and utilities. The borrower had 62 collection accounts and 15 charge-offs. Of these 62 collections, 15 accounts were opened within the 24 months preceding the loan closing. Of these 15 accounts, 14 were medical debts. The borrower explained that she had medical insurance and these accounts should have been paid by her insurance provider. One of the 15 collection accounts was for an installment loan. The borrower explained that the account had been paid but did not explain why the debt became a collection.

The borrower's credit report listed 15 charged-off accounts. She had two charged-off accounts for electric service. The borrower explained that she got one account in her name for her sister, who did not pay; the borrower did not know that the account was on her credit report. She claimed that the other account had been paid. The borrower also had three judgments filed against her by an apartment complex. She explained that she rented an apartment for her sister, who had just broken up with her husband. Her sister left the apartment in good standing. These judgments were paid.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) employment stability, (2) limited credit user, (3) bonus income that is not indicated ($76.13), (4) minimal housing increase, and (5) retirement ($225). Only one of the listed compensating factors is supported. There were yearly bonuses documented on the borrower's verification of employment with an average of $96.96. The other four compensating factors are not acceptable or supported by documentation. Employment stability is not an acceptable compensating factor listed in HUD Handbook 4155.1; employment stability is required for loan approval. The borrower credit report listing 80 derogatory accounts did not support the claim that she was a limited credit user. The borrower's housing expense increased by $213.74 or 21.4 percent. The borrower had $375.01 in a retirement account. However, only 60 percent of the balance in the account can be counted as cash reserves, and evidence of redemption is required according to HUD Handbook 4155.1, paragraph 2-10K. This compensating factor can only be used if cash reserves are enough to cover three mortgage payments according to HUD Handbook 4155.1, paragraph 2-13G. In this case, three mortgage payments would be $2,524.83, and there was no evidence in the file that funds had been withdrawn for the retirement account.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-9013914

Mortgage amount: $137,837

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: August 27, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: One

Loss to HUD: $35,618

Summary

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

Assets

Alethes did not document the source of two large deposits to the coborrower's checking account totaling $2,335.42. All funds for the borrower's investment in the property must be verified and documented. A deposit of $885.42 on May 30, 2007, required an explanation since it was $200 more than any other deposit listed on the statement. A deposit of $1,450 on May 25, 2007, required explanation because it exceeded all of the other deposits on the statement by more than $700. All of the other large deposits shown on the statements were from the coborrower's employer. The beginning and ending balances in the account between April 27 and June 26, 2007, did not exceed $2,129.36. These two deposits were 41.6 and 68.1 percent of this amount, respectively.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections and charged-off accounts, especially those for utilities. The borrowers had 16 collection accounts and 10 charge-offs. Of these 16 collections, six accounts were opened within the 24 months preceding the loan closing. Of these six accounts, three were medical debts, two were revolving credit accounts, and one was a cell phone debt. No explanation letters were included in the FHA file but were found in the lender file. The borrowers' explanation letter found in the lender file did not explain these debts. The letter only explained late payments on a mortgage the coborrower had with her ex-husband and the coborrower's collection on an auto loan. Three of the borrowers' 10 charged-off accounts were for electric service. These accounts were also not explained.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) borrower will receive pay increase-see letter from employer, and (2) good reserves-see 401(k). There was a letter in the FHA file from the borrower's employer stating that the borrower "will have the potential for a 5% merit increase" 2 months after loan closing. However, for this compensating factor to be valid, the potential for increased income must be based on job training or education in the borrower's profession. The borrower had $2,190.73 in a retirement account. Only 60 percent of the balance can be called cash reserves, and evidence of redemption is required according to HUD Handbook 4155.1, paragraph 2-10K.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-9042939

Mortgage amount: $125,874

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: October 5, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: 10

Loss to HUD: $43,392

Summary

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

Income

Alethes did not obtain verifications of employment from one of the borrowers' employers. This loan closed on October 5, 2007. Both borrowers had been working for their current employer since March 2007. Both of the borrowers also listed Applebees as an employer in 2007 on their loan application. However, this employment was not verified. No verifications of employment or pay stubs from Applebees dated in 2007 were in the loan file. Both of the borrowers previously worked for Applebees in 2005, and this employment was documented with Internal Revenue Service W-2 forms.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, 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.

Assets

Alethes did not verify the source of the borrowers' $1,000 earnest money deposit. The borrowers' bank statements included in the file showed balances of $816.55 on September 19, 2007, $5.56 on July 10, and $835.33 on June 7. The borrowers' bank statement covering their August 19, $1,000 money order was not included in the file. No other source of accumulated assets was documented in the file.

HUD/FHA Requirements

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrowers as required. The gift letter indicated that the borrowers received a $7,612 gift from Nehemiah Corporation of America. The transfer of these funds to the settlement company on behalf of the borrowers was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections, especially for housing. The borrowers had 11 collection accounts on their credit report. Of these 11 collections, four accounts were opened within the 24 months preceding the loan closing. Of these four accounts, two were medical debts and the other two resulted from debts to an apartment complex. The borrowers explained that the medical debts were from when the borrower was 16 and should have been paid by his parents' insurance. The borrowers explained that they moved out of the apartment complex because it was water damaged and bug infested and they believed it was a health hazard, but the apartment management did not take care of the problems after the borrowers' many complaints.

Alethes did not provide strong, supported compensating factors, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed only that the property purchased was new construction on the mortgage credit analysis worksheet. No acceptable, supported compensating factors were listed to justify mortgage approval.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-9052920

Mortgage amount: $158,543

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 15, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: Eight

Loss to HUD: $26,748

Summary

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

Excessive Debt Ratios

Alethes' underwriter calculated the borrower's qualifying ratios at 35.095 and 44.203 percent. The property purchased was new construction qualifying as an EEH and, therefore, the debt-to-income ratios are allowed to exceed benchmark ratios by 2 percent (33 percent and 45 percent) according to HUD Handbook 4155.1, paragraph 2-19. However, the underwriter did not list compensating factors to justify mortgage approval with a mortgage payment-to-income ratio of 35.095 percent as required by HUD Handbook 4155.1, paragraph 2-13.

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and charge-offs (including utilities) and a foreclosure. The borrower had six collection accounts, one charge-off, and a foreclosure on his credit report. Of these six collections, one was for residential telephone service. The charged-off account was for electric service. The foreclosure was in July 2004, and the new FHA loan closed on November 15, 2007. However, a foreclosure more than 3 years earlier does not disqualify a borrower. The borrower explained that his hours were reduced and he fell behind on his bills and could not sell his house or his car. However, Alethes' underwriter did not list compensating factors to justify mortgage approval with the borrower's credit history as required by HUD Handbook 4155.1, paragraph 2-13.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 491-9067953

Mortgage amount: $185,095

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 11, 2008

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $66,613

Summary

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

Assets

Alethes did not adequately verify the borrowers' assets. A verification of deposit or bank statements covering the most recent 3-month period were not obtained as required. The lender only obtained the December 2007 bank statement. The borrower also provided the November 2007 bank statement; however, the account was opened on November 9, 2007, and the beginning and ending balances were both zero.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 3-1F, states that verification of deposit and most recent bank statements are to be provided. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower original bank statement(s) covering the most recent 3-month period.

Credit

Alethes did not adequately document its reason(s) for accepting the borrowers' history of collections and charge-offs, especially for utilities. The borrowers' credit report listed 36 collection accounts. Of these 36 collections, 16 were opened within 24 months of loan closing. Fourteen of the sixteen recent collections were for medical debts. The borrowers explained that these medical debts resulted from major injuries to the coborrower and their son from a car accident in June 2001. The loan officer analyzed the borrowers' credit and reported in the file that "these medical collections have been recycled over a number of years." However, the debt was still owed. The other two collections were for orthodontics and Internet service. The borrowers explained that these recent debts resulted from an error by the orthodontics provider and the previous car accident. One older collection was for phone service. The borrowers' credit report also showed 10 charge-offs, with 1 of the 10 being opened within 24 months of loan closing. This charged-off debt was for an installment loan. The borrowers did not explain this charge-off. Three older charged-off accounts were also for phone service and electric service.

Alethes did not provide strong, supported compensating factors, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13. The underwriter listed two compensating factors: (1) low ratios and (2) minimal housing increase. Having low ratios is not an acceptable compensating factor listed in HUD Handbook 4155.1; low ratios are necessary for loan approval. There was only a minimal increase in the borrowers' monthly housing expense. This is an acceptable, documented compensating factor, but in our opinion, it alone is not strong enough to overcome the borrowers' credit history.

<u>HUD/FHA Requirements</u>

HUD Handbook 4155.1, REV-5, paragraph 2-3, states the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 492-9081188

Mortgage amount: $114,991

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 3, 2008

Status as of June 2, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $50,464

Summary

We found material underwriting deficiencies relating to the borrower's income, liabilities, excessive ratios, compensating factors, assets, gift funds, and credit history.

Income

Alethes improperly included overtime in the borrower's monthly income used to calculate debt-to-income ratios. While the borrower's pay stub for the period ending November 4, 2007, indicated year-to-date overtime earnings of $3,835, no overtime had been earned by the borrower during that pay period and the four previous weekly pay periods. There was no documentation in the file to indicate that the overtime would continue.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7A, states that both overtime and bonus income may be used to qualify if the borrower has received such income for the past 2 years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past 2 years, and the employment verification must not state that such income is unlikely to continue. Periods of less than 2 years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

Liabilities

Alethes improperly omitted a liability extending less than 10 months. The borrower's credit report revealed an account with an outstanding balance of $3,800 and related monthly payment of $475 that was not included in qualifying ratios. This payment was to continue for another 8 months; however, the monthly payment of $475.00 is considered significant at 21.3 percent of the borrower's supported monthly income of $2,227.33 and most likely affected the borrower's ability to make the mortgage payment during the months immediately after loan closing.

<u>HUD/FHA Requirements</u>

HUD Handbook 4155.1, REV-5, paragraph 2-11A, states that debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing.

<u>Excessive Debt Ratios</u>

Alethes' underwriter calculated the borrower's qualifying ratios at 39.73 and listed the following compensating factors: (1) limited credit user and (2) reserves. Neither of these compensating factors was supported by documentation included in the file. The borrower was not a limited credit user. He had a total of 29 accounts listed on his credit report. The mortgage credit analysis worksheet listed $2,095 cash reserves, enough to cover 2 months' housing expenses of $1,024.03. However, to use cash reserves as a compensating factor, the borrower must have at least three times the amount of his monthly housing expenses according to HUD Handbook 4155.1, paragraph 2-13G.

<u>HUD/FHA Requirements</u>

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 are those listed in the handbook. Underwriters must record in the "remarks" section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation.

<u>Assets</u>

Alethes did not adequately verify the source of funds for the earnest money deposit. According to the sales contract, the borrower provided earnest money of $500 on November 21, 2007, in the form of a money order. However, a copy of the money order was not included in the file. The bank statement provided indicated that the borrower opened his bank account on November 27, 2007. The borrower's girl friend wrote in a letter that she allowed the borrower to have his pay direct deposited to her bank account. However, no bank statements from the girl friend's account appeared in the file. No other documents in the file provided evidence of the borrower's accumulated savings before November 27, 2007.

<u>HUD/FHA Requirements</u>

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

Gift Funds

Alethes did not document the transfer of gift funds to the borrower as required. The gift letter indicated that the borrower received a $5,715 gift from DPA Alliance Corporation. The transfer of these funds to the settlement company on behalf of the borrower was not documented in the FHA file or the lender file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections and a charge-off, especially for housing. The borrower had 29 accounts listed on his credit report. Of these, 19 were collections, and one was a charge-off. Three of the borrower's 19 collection accounts were opened within 24 months of loan closing. These three accounts were for medical debts. One older collection was for a debt owed to an apartment complex. None of the borrower's collection or charged-off accounts were explained in the file.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. (The compensating factors listed by the underwriter are discussed in the Excessive Debt Ratios section for this loan.)

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason for approving a mortgage when the borrower has collection accounts or judgments.

Paragraph 2-3 also states 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: 492-7753781

Mortgage amount: $141,479

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: January 24, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: Two

Loss to HUD: $70,991

Summary

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

Credit

Alethes did not document its reason(s) for accepting the borrowers' history of collections, charge-offs, and a judgment, especially those for housing and utilities. The borrowers had 20 collections listed on their credit report, two of them occurring less than 24 months earlier. Both were medical debts. One older collection account was to a utility company. The borrowers also had 11 charged-off accounts on their credit report with one being less than 24 months earlier. This debt was on an installment loan. In addition, the borrowers had a judgment on a debt owed to an apartment complex. No explanation of these debts was found in the FHA file. The borrowers' explanation letter was found in the lender file. The borrowers' explanation letter stated that due to severe medical issues, the borrowers amassed great debt to the extent that they had to move back into their parents' house to get back on their feet. Although the borrowers identified severe medical issues as the cause of their indebtedness, they did not identify a resolution to their problems and stated that their medical obligations had increased since their son had recently been diagnosed with additional severe medical issues.

Alethes did not provide strong, supported compensating factors, given the borrowers' credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter did not list compensating factors to justify loan approval, as required.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 492-7916830

Mortgage amount: $137,944

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: November 15, 2007

Status as of June 2, 2010: Claim

Payments before first default reported: One

Loss to HUD: $26,570

Summary

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

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections, charge-offs, and a judgment, especially those for utilities. The borrower had 21 collections listed on her credit report, two of them occurring less than 24 months earlier. One of the recent collections was on a debt for gas service, and the other was for residential telephone service. The borrower explained that she was not aware of one debt and had paid the other debt late but in full. The borrower also had three charge-offs, one of them being approximately 26 months earlier. This charged-off account balance was $9,628. The borrower explained that the debt resulted from voluntarily returning a car when she could no longer afford the payments. A December 2005 judgment was also listed on the borrower's credit report. The judgment was paid approximately 3 months before the loan closed.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. Alethes' underwriter listed the following compensating factors to justify mortgage approval: (1) borrower has potential for increase in income, (2) borrower had credit established, (3) borrower has good ratios, (4) there is only a minimal increase in the borrower's proposed monthly housing, (5) minimal debt user, and (6) new construction. The loan file contained evidence supporting only one of the listed compensating factors-there was only a minimal increase in the borrower's housing expense-since the borrower's housing expense increased from $1,200 to $1,384.66. The file contained documentation to support an additional, acceptable compensating factor not listed: the borrower has substantial nontaxable income. The borrower received child support ranging from $550 to $620 per month that was not used in computing her ratios. However, the corresponding compensating factor was correctly not listed on the mortgage credit analysis worksheet since the borrower had been receiving child support for 7 years before the loan and did not maintain a good credit history. There was no evidence of the borrower's continuing education or training in her profession in the file to support her potential for increased income. The other compensating factors listed on the worksheet are not acceptable, according to HUD Handbook 4155.1. Although, since the property was new construction, the borrower's debt-to-income ratios were allowed to exceed HUD's benchmarks by 2 percent according to HUD Handbook 4155.1, paragraph 2-19. However, the single, acceptable compensating factor listed on the worksheet (there was only a minimal increase in the borrower's housing expense), in our opinion, is not strong enough to overcome the pattern of disregard for her financial obligations shown in the borrower's credit history.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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: 492-7963491

Mortgage amount: $107,315

Section of Housing Act: 203(b)

Loan purpose: Purchase

Date of loan closing: March 12, 2008

Status as of June 2, 2010: Claim

Payments before first default reported: Zero

Loss to HUD: $30,423

Summary

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

Income

Alethes overstated the borrower's effective income by including overstated overtime income. Instead of using the overtime year-to-date earnings found in the most recent pay stub, the lender should have taken an average of overtime income earned over the past 21 months. The lender documented 21 months of overtime: $2,094 for 8 months of 2006, $6,379 for all of 2007, and $429 for 1 month of 2008. Over 21 months, the average overtime was $424, $108 less than that determined by the lender. Recalculation of the borrower's ratios considering less overtime income results in the 39.85 percent ratios rising to 41.65 percent.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-7A, states that both overtime and bonus income may be used to qualify if the borrower has received such income for the past 2 years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past 2 years, and the employment verification must not state that such income is unlikely to continue. Periods less than 2 years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

Excessive Debt Ratios

Alethes approved the FHA loan with excessive ratios and inadequate compensating factors. As originally calculated, the mortgage payment-to-income and total debt-to-income ratios were 39.85 percent. The lender inappropriately used an incorrect mortgage payment amount when calculating the qualifying ratios. The mortgage credit analyses worksheet, dated February 29, 2008, used $988.80 as the mortgage payment including taxes and insurance. However, the truth in lending statement, dated March 12, 2008, and first payment letter indicated a mortgage payment including taxes and insurance of $1,132. The mortgage payment-to-income and total debt-to-income ratios, as recalculated after considering the $1,132 mortgage payment, increased to 45.63 percent.

Alethes included four compensating factors: (1) first-time home buyer, (2) outstanding advancement and income potential, (3) good rental history, and (4) married for less than a year and spouse will be seeking employment. First-time home buyer is not an acceptable compensating factor listed in HUD Handbook 4155.1. The borrower’s potential for increased income is not documented by job training or education in the borrower’s profession. Good rental history is not an acceptable compensating factor, and the borrower was paying only $675 in monthly rent compared to his $1,132 mortgage payment. Being newly married and having possible future income of a spouse are not valid compensating factors listed in HUD Handbook 4155.1, paragraph 2-13.

HUD/FHA Requirements

Mortgagee Letter 2005-16 increased the mortgage payment-to-income and debt-to-income ratios from 29 and 41 percent to 31 and 43 percent, respectively. It stated that 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, Chapter 2, Section 5, states that there is a danger of “layering flexibilities” in assessing mortgage insurance risk, and simply establishing that a loan transaction meets minimal standards does not necessarily constitute prudent underwriting. The lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan. HUD Handbook 4155.1, REV-5, paragraph 2-13, lists compensating factors that may be used to justify approval of mortgage loans with ratios exceeding FHA benchmark guidelines. Underwriters must record in the “remarks” section of the form HUD-92900 the compensating factor(s) used to support loan approval. A compensating factor used to justify mortgage approval must be supported by documentation

Assets

Alethes did not adequately verify the source of funds used as earnest money. The borrower’s earnest money deposit of $1,500, made on January 15, 2008, was excessive based on the borrower’s savings. The borrower’s bank account activity showed an ending balance of $150 on January 14, 2008, but did not show transactions supporting the earnest money deposit. No other documentation of accumulated assets was found in the file.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower’s investment in the property must be verified and documented. If the amount of the earnest money exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulated savings, the lender must verify with documentation the deposit amount and the source of funds.

Gift Funds

Alethes did not properly document gift funds received by the borrower. The gift letter indicated that the borrower was to receive $5,715 at closing from DPA Alliance Corporation. However, the lender did not provide evidence that the gift funds were transferred from the donor's account to the settlement company on behalf of the borrower.

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-10C2, states that regardless of when the gift funds are made available to the home buyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

Credit

Alethes did not document its reason(s) for accepting the borrower's history of collections, charge-offs, and a judgment, especially those for housing and utilities. The borrower had nine collection accounts on his credit report. Of these nine collections, four accounts were opened within the 24 months preceding the loan closing. Of these four accounts, two were medical debts, one was for an auto loan, and one was for residential telephone service. The borrower did not provide an explanation of these collections. The borrower's credit report also showed five charged-off accounts. One of the charged-off accounts was for electric service. The borrower did not provide an explanation of these charge-offs. In addition, the borrower had a judgment on his credit report for a debt owed to an apartment complex. This judgment was paid in the month before loan closing. The borrower explained that he rented the apartment for his sister and her children, but he was not aware of that his sister moved out of the apartment still owing 2 month's rent.

Alethes did not provide strong, supported compensating factors, given the borrower's credit history, as required by HUD Handbook 4155.1, paragraph 2-13. (The compensating factors listed by the underwriter are discussed in the Excessive Debt Ratios section for this loan.)

HUD/FHA Requirements

HUD Handbook 4155.1, REV-5, paragraph 2-3, states that the basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts. 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 delayed mail delivery or 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 reason 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**

Aug 27 2010 4:16PM HAYS OWENS L.L.P. 5124723883 p.2

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August 27, 2010

Ms. Tanya Schulze
Regional Inspector General for Audit
611 West Sixth Street
Los Angeles, CA 90017-3101

Via Facsimile (213) 894-8115 and U. S. Mail

Re: Alethes, LLC

Dear Ms. Schulze:

We represent Alethes, LLC, and have been asked to forward to you its response to your letter of August 12, 2010 containing the Discussion Draft Audit Report of 20 FHA loan files.

Comment 1

Because Alethes is shut down, it does not have the employee or other resources at this time to independently review the 20 loan files that are the subject of this audit and to offer specific comments in connection with the draft report. Mr. Smith informed us that 17 of these loans were underwritten by two former underwriters that were terminated in September and October of 2008. Therefore, Mr. Smith does not have ready access to those former employees in order to obtain a timely response from the underwriters for these files.

Mr. Smith believes it is very important for HUD to consider the insuring method used by Alethes on these and its other FHA loans. Mr. Smith outlined that the process for submission of these loans was as follows:

Alethes sent "paper" case binders to HUD for insuring.

These loans were individually reviewed by HUD for any deficiencies. If a deficiency was noted, FHA would provide a Notice of Rejection, or NOR, for

Ms. Tanya Schulze
August 27, 2010
Page 2

the file before it was insured and sold by Alethes. Alethes chose to insure its files this way instead of the direct insuring format to provide a double check and balance on the underwriting process.

Mr. Smith believes that every one of these files was signed off on by a Denver HUD H.O.C. insuring specialist before FHA insured the loans. Mr. Smith believes that the files reviewed by HUD that are the subject of this audit would have contained the same information as that cited in the draft report, and thus any alleged deficiency should have been apparent to HUD prior to the issuance of insurance.

Mr. Smith will continue to cooperate with HUD in its review of these files, and he remains available for either telephone or in person meetings as desired.

Yours very truly,

John C. Fleming

JCF:acr

cc: Mr. Danny Smith

OIG's Evaluation of Lender Comments

Comment 1 The lender reports that it is "shut down" and does not have the resources at this time to provide specific comments, but the president believes that "every one of the files was signed off on by a Denver HUD H.O.C insuring specialist before FHA insured the loans." However, there is no evidence of underwriting reviews conducted by the Denver HOC in any of the 19 loan files with reported underwriting deficiencies. The Denver HOC has confirmed that no pre-endorsement underwriting reviews were conducted in these loans. According to HUD Handbook 4165.1, REV-2, Endorsement for Insurance for Home Mortgage Programs (Single Family), paragraph 2-15, Pre-Endorsement Review - General, FHA will do a limited review of each document to ascertain compliance. No further review is required or authorized unless FHA has reason to suspect fraud or misrepresentation (including negligent misrepresentation), in any of the documents submitted.

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.