Issue Date June 24, 2011	
Audit Report Number 2011-AT-1010	

TO: Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU

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FROM: James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Crossfire Financial Network, Miami, FL, Did Not Follow HUD Requirements in Approving FHA Loans and Implementing Its Quality Control Program

HIGHLIGHTS

What We Audited and Why

We audited Crossfire Financial Network, Inc., d/b/a CFN Mortgage Capital (Crossfire), a Federal Housing Administration (FHA)-approved direct endorsement lender located in Miami, FL. The audit objectives were to determine whether the lender followed U.S. Department of Housing and Urban Development (HUD) requirements when (1) originating and underwriting loans and (2) implementing its quality control program. We selected this lender because it underwrote more than 600 loans for a 2-year period in the HUD Miami area and its default rate of 6 percent was higher than the Miami HUD office area average default rate of 4 percent.

What We Found

Crossfire did not follow HUD requirements when it underwrote 10 loans for FHA insurance based on inaccurate and unsupported information. This condition occurred because the lender did not act with due care when originating and underwriting these loans. As a result, Crossfire approved loans that were not eligible for FHA insurance and increased the risk to the FHA insurance fund of more than $1.3 million.

In addition, Crossfire did not implement a quality control program that complied with HUD requirements. It did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain the required provisions. These conditions occurred because Crossfire disregarded HUD requirements. As a result, the effectiveness of Crossfire's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished. Specifically, Crossfire increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Crossfire to indemnify HUD for the 9 ineligible FHA loans with an estimated potential loss of more than $1.1 million and reimburse HUD for the $210,453 in claims paid on 3 of the 10 loans. In addition, we recommend that HUD refer Crossfire to the Mortgagee Review Board for consideration of administrative actions against the lender for not having a compliant quality control program in place. We also recommend that HUD require Crossfire to develop, implement, and enforce a quality control program that complies with HUD requirements.

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

Auditee's Response

We discussed our review results with Crossfire and HUD officials during the audit. We provided a copy of the draft report to Crossfire on May 20, 2011 for its comment. Crossfire provided its comments on May 31, 2011. The auditee generally did not agree with finding 1 and its recommendations, and agreed with the finding 2.

The complete text of Crossfire's response, along with our evaluation of the response, can be found in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

Crossfire Financial Network, Inc., d/b/a CFN Mortgage Capital (Crossfire) is a Federal Housing Administration (FHA)-approved nonsupervised direct endorsement lender based in Miami, FL. Under the direct endorsement program, the U.S. Department of Housing and Urban Development (HUD) authorizes approved lenders to underwrite FHA loans without HUD's prior review and approval. A nonsupervised lender is an institution which has as its principal activity the lending or investing of funds in real estate mortgages. It may submit applications for mortgage insurance and may originate, underwrite, purchase, hold, and service insured loans or sell mortgages.

Crossfire became an FHA-approved lender in June 1997 and currently has four active branch offices located in California, Colorado, and Florida. The lender has sponsored 27 loan correspondents, served as the principal for 7 authorized agents, and acted as an authorized agent for 7 other principal lenders. A loan correspondent may process an application and submit it to one of its sponsors for underwriting. The loan correspondent must close the loan in its own name or in the name of the sponsor that underwrote the loan. The principal-authorized agent relationship provides the lender the flexibility to collaborate with another FHA lender to originate FHA loans. An authorized agent may perform any part of the loan origination process, including underwriting, on behalf of its principal; however, the loan must be closed in the name of the principal lender. As of May 2011, Crossfire no longer sponsors any loan correspondents, serves as the principal for six authorized agents, and acts as an authorized agent for one other principal lender.

According to HUD's Neighborhood Watch system[1], from December 2008 through November 2010, Crossfire underwrote 657 loans in the HUD Miami office jurisdiction. As of November 30, 2010, 40 of the 657 loans (6 percent) with mortgage amounts totaling more than $7.4 million were in default.

Our audit objectives were to determine whether the lender followed HUD requirements when (1) originating and underwriting loans and (2) implementing its quality control program.

[1] The HUD Neighborhood Watch is intended to aid HUD in monitoring lenders. The system is designed to highlight exceptions, so that potential problems are readily identifiable. In particular, the system gives the ability to identify and analyze patterns, by geographic area or originating lender, in loans which became 90 days delinquent during the first 2 years.

RESULTS OF AUDIT

Finding 1: Crossfire Did Not Follow HUD Requirements When Originating and Underwriting Loans

Crossfire did not follow HUD requirements when originating and underwriting loans for FHA insurance. It used inaccurate and unsupported information to qualify borrowers for 10 FHA loans. This condition occurred because the lender did not exercise due care when originating and underwriting these loans for FHA insurance. As a result, Crossfire approved loans that did not qualify for FHA insurance and placed the FHA insurance at risk for more than $1.3 million.

Loans Had Significant Originating and Underwriting Deficiencies

Crossfire did not follow HUD requirements when originating and underwriting 10 loans. Specifically, it used inaccurate employment information, did not support the borrower's asset information, and relied on an invalid appraisal report to qualify borrowers for three of the six purchase loans reviewed. In addition, Crossfire approved 7 of the 32 cash-out refinance loans reviewed with previous mortgage delinquencies occurring less than 12 months before the refinancing.

All FHA lenders must follow all applicable statutes, regulations, and HUD's written instructions, including program handbooks and mortgagee letters. Specifically, lenders must follow HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans," when underwriting FHA loans. The lender is responsible for eliciting a complete picture of the borrower's financial situation, source of funds for the transaction, and intended use of the property. Its decision to approve the loan must be documented, supported, and verifiable.

The table below shows the summary of deficiencies identified for the 10 loans.

No.	FHA case no.	Inaccurate employment income	Unsupported source of funds	Invalid appraisal report	Cash-out refinance with previous mortgage delinquencies
1	095-1353467	X			
2	095-1135143		X		
3	095-0770109	X		X	
4	095-0932148				X
5	095-0911262				X
6	095-0937700				X
7	095-0970905				X
8	095-1002059				X
9	095-0942848				X
10	095-0973194				X
Total		**2**	**1**	**1**	**7**

The following two sections discuss some examples of the originating and underwriting deficiencies.

Loans Contained Inaccurate Employment Income Information

The lender did not accurately verify or support borrowers' employment information for two loans. HUD Handbook 4155.1, paragraph 4.D.1.a, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Qualifying debt-to-income ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved with homeownership. The lender must compute two ratios: (1) mortgage payment expense to effective income and (2) total fixed payment to effective income. The first ratio considers the total mortgage payment to the borrower's income while the second ratio considers all of the borrower's debts, including the mortgage payment, to the borrower's income. According to Mortgagee Letter 2005-16, the qualifying ratios generally should not exceed 31 and 43 percent, respectively, without acceptable compensating factors for loans underwritten manually. HUD Handbook 4155.1, paragraph 4.F.3.a, states that loans approved using an automated underwriting system may be allowed to reasonably exceed the benchmarked qualifying ratios without compensating factors. The lender is responsible for the integrity of the data entered in the automated underwriting system used to approve the loan.

For FHA case number 095-1353467, the lender used $4,767 as the borrower's monthly income to qualify the borrower for an FHA-insured mortgage totaling $265,109. The lender used this income amount to calculate the borrower's qualifying debt-to-income ratios of 47.0 and 47.4 percent, respectively. However, verifications with the borrower and the borrower's employer showed that the borrower's monthly income was $3,813. The borrower stated that she did not provide the pay stubs found in the loan file with the inaccurate employment income amount. The borrower's employer stated that it did not complete or sign the verification of employment form with the inaccurate employment income amount contained in the loan file. The lender stated that it relied on the originating lender to process the loan and did not perform additional verifications of the employment income. Our recalculation of the borrower's qualifying loan ratios based on the verified monthly income of $3,813 equaled 58.7 and 59.2 percent, respectively. Given the inaccurate employment income information and higher loan ratios, the borrower would not have qualified for the FHA mortgage loan.

Crossfire Underwrote Cash-Out Refinance Loans with Previous Mortgage Delinquencies

The lender did not consider the borrowers' payment histories with their previous mortgages when underwriting seven cash-out refinance loans. HUD Handbook 4155.1, paragraph 3.B.2.b, states that borrowers who are delinquent or in arrears or have suffered any mortgage delinquencies within the most recent 12-month period under the terms and conditions of their mortgages are not eligible for cash-out refinance loans.

For FHA case number 095-0911262, the lender qualified this FHA-insured cash-out refinance loan of $309,320 that closed in November 2008. The credit report and the previous mortgage transaction payment history found in the lender's loan file showed that the borrower had delinquencies with the previous mortgage. The credit report showed that the borrower was delinquent in September 2007 and March 2008 on the previous mortgage. As a result, the borrower did not qualify for the $309,320 cash-out refinance loan, and the loan was ineligible for FHA insurance. This loan is now in the foreclosure process.

From the refinanced loan, the borrower received $77,176 after paying off the original mortgage on the property. The borrower used $41,397 to pay off a home equity line of credit and $25,704 to pay off credit card accounts and received $10,075 in cash.

Crossfire Did Not Exercise Due Care in Approving Loans

Crossfire did not exercise due care when originating and underwriting these loans for FHA insurance to ensure compliance with HUD requirements. As a direct endorsement lender, Crossfire was allowed to endorse a mortgage loan for FHA insurance without a detailed technical underwriting review by HUD. In approving loans for FHA insurance, the lender certified that the mortgage loan documents were personally reviewed and the mortgage was found to be eligible for FHA insurance.

The lender stated that it relied on the originating lenders (loan correspondents, authorized agent, and principals) to process the loans, which included verifying the employment income information. Generally, the lender would contact the borrowers' employers to ensure that the borrowers were employed there; however, the employment income amounts were not revalidated directly with the employers. HUD Handbook 4060.1, paragraph 2-13, states that lenders are allowed to outsource the processing functions as long as it does not materially affect the underwriting decision or increase the risk to the FHA insurance fund. The lender remains responsible for the quality of the mortgage and must ensure compliance with program requirements.

Regarding the issue found with the cash-out refinance loans, the lender contended that it was not responsible for personally evaluating the borrowers' credit histories for loans underwritten and approved by the automated underwriting system. HUD Handbook 4155.1, paragraph 6.A.1.b, states that regardless of the risk assessment provided by the automated underwriting system, the lender remains accountable for compliance with FHA's eligibility requirements, as well as any credit, capacity, and documentation requirements not covered by the system. In addition, the underwriter associated with all seven loans was aware that cash-out refinance loans were not allowed to have any mortgage delinquencies occurring less than 12 months before the refinance. However, 7 of the 32 cash-out refinance loans reviewed had previous mortgage delinquencies. Therefore, the lender did not act with due care when originating and underwriting these loans for FHA insurance.

Conclusion

Crossfire did not follow HUD requirements when originating and underwriting 10 FHA loans. The deficiencies occurred because the lender did not exercise due care to ensure that the loans were originated and underwritten in accordance with HUD requirements. As a result, Crossfire approved and insured 10 loans that were not eligible for FHA insurance. As of March 31, 2011, three of the loans were in the foreclosure process, four loans were delinquent, one loan was in the repayment process, one loan was recently reinstated, and one loan had its property sold in a preforeclosure sale. The loans placed the FHA insurance fund at risk for more than $1.1 million in potential losses should the properties be foreclosed upon and resold for less than the unpaid principal balances. In addition, HUD paid claims totaling $210,453 on 3 of the 10 ineligible loans. Therefore, HUD should seek indemnification from Crossfire for the 9 loans and reimbursement for the claims paid on 3 of the 10 loans.

Appendix C contains a schedule of the indemnification and repayment amounts required for the 10 loans. Appendix D contains information on the seven cash-out refinance loans, and appendix E contains the loan details for the three purchase loans.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Crossfire to

1A. Indemnify the nine ineligible loans[2] with an estimated loss of $1,142,100. The estimated loss was based on the loss severity rate of 59 percent of the total unpaid principal balances of $1,935,762 as of March 31, 2011.

1B. Reimburse HUD $210,453 for the actual loss HUD incurred on the principal loan reduction and claims paid for FHA case numbers 095-0911262, 095-0942848, and 095-1135143 as of March 31, 2011.

[2] We recommend indemnification for 9 of the 10 ineligible loans. One of the ten loans (FHA case number 095-1135143) was sold in a preforeclosure sale, resulting in an actual loss and claim paid by HUD. The claim paid on this loan, totaling $166,222, is questioned as ineligible costs in recommendation 1B. See Appendix A for further explanation.

Finding 2: Crossfire Did Not Follow HUD Requirements When Implementing Its Quality Control Program

Crossfire did not implement a quality control program that complied with HUD requirements. Specifically, it did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain the required provisions. These conditions occurred because Crossfire disregarded HUD requirements. As a result, Crossfire increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

As a condition of receiving and maintaining FHA approval, Crossfire must implement and continuously have in place a quality control program. HUD Handbook 4060.1, REV-2, paragraph 7-2, states that lenders must design their quality control program to meet the basic goals of ensuring compliance with FHA's and the lender's origination and servicing requirements; protecting FHA and the lender from unacceptable risk; guarding against errors, omissions, and fraud; and ensuring swift and appropriate corrective action. The lender's quality control program contained deficiencies in its quality control reviews and its written quality control plan.

Quality Control Reviews Did Not Comply With HUD Requirements

Crossfire hired a quality control contractor to perform its post-quality control reviews from August 1997 through May 2008. Another contractor was hired to review the loans that closed between June and October 2008 because Crossfire's audited financial statement reports cited a deficiency with its quality control reviews performed by the first contractor. Crossfire management stated that it was not satisfied with the results of the second contractor and reverted back to the prior contractor in the beginning of 2009. Crossfire did not maintain the quality control review reports performed by the second contractor to support that reviews were performed from June through October 2008. As a result, the lender did not comply with HUD requirements because it could not support that it had a quality control program in place for the loans that closed between June and October 2008.

Crossfire underwrote 825 loans nationally from November 2008 through December 2010. The first contractor performed quality control reviews of 77 FHA loans. We analyzed the quality control reviews performed and determined that Crossfire did not perform its quality control reviews according to HUD requirements. Our review found the following deficiencies:

Loans Not Reviewed Within Time Limit
HUD Handbook 4060.1, REV-2, paragraph 7-6(A), states that loans must be reviewed within 90 days from the end of the month in which the loan closed. Quality control reviews were not performed within the 90-day limit for 57 of the 77 quality control reviews conducted. The elapsed days ranged from 91 to 207.

Frequency of Reviews Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6(B), states that for lenders closing more than 15 loans monthly, quality control reviews must be conducted at least monthly and must address 1 month's activity. Lenders closing 15 or fewer loans monthly may perform quality control reviews quarterly. Based on the lender's loan activity from November 2008 through September 2010, it should have performed monthly reviews. From October through December 2010, the lender could have performed reviews quarterly. However, no reviews were performed for the month of December 2008. Therefore, the lender did not perform quality control reviews with the frequency required by HUD.

Early Payment Default Loans Not Reviewed
HUD Handbook 4060.1, REV-2, paragraph 7-6(D), states that all early payment default loans must be reviewed. Early payment default loans are loans that have defaulted within the first six payments and become 60 days past due. From November 2008 through December 2010, Crossfire had at least 12 early payment default loans. None of the 12 early payment default loans was reviewed.

Credit Reports Not Obtained
HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(1), states that a new credit report must be obtained for each borrower whose loan is included in a quality control review unless the loan was a streamline refinance or was processed and approved by an automated underwriting system. Two of the seventy-seven loans reviewed were not approved by an automated underwriting system and were not streamline refinance loans. Thus, for the two loans, new credit reports should have been obtained for the borrowers. However, new credit reports were not obtained.

Document Reverifications Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(2), states that documents contained in the loan file, such as documents relating to borrower's income, gifts, or sources of funds, should be checked for sufficiency and subjected to written reverification.

We reviewed 10 of the 77 quality control reviews to determine whether reverifications were performed for the documents in the loan files. For all 10 loans, the borrower's employment income, sources of funds, and/or gift funds were not properly reverified. There was no support to show that any of the reverification documents were sent for the 10 loans reviewed. For the reverifications of the borrowers' sources of funds, the external contractor explained that reverifications were not sent to some of the financial institutions because they charged a verification fee. In addition, it did not attempt to contact the sources by telephone if a written reverification could not be obtained.

Field Appraisal Not Performed

HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(3), states that lenders are expected to perform field reviews of 10 percent of the loans selected per year during the sampling process. Since the lender performed quality control reviews of 46 FHA loans during 2009 and 30 loans in 2010, at least 4 field appraisals should have been performed in 2009, and 3 performed in 2010. However, there were no field appraisals performed in 2009, and only two field appraisals were performed in 2010.

Occupancy Verification Not Performed

HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(4), states that in cases in which the occupancy of the subject property is suspect, the lender must attempt to determine whether the borrower is occupying the property. The external contractor stated that the verifications of property occupancy were not performed for any FHA-insured loans. From our review of 10 loans, at least 1 should have had an occupancy verification. The borrower owned a total of four real estate properties, which raises questions regarding whether the FHA-insured property was occupied by the borrower as a-primary residence. No occupancy verifications were performed on any of the 10 quality control reviews selected for review.

The Written Plan Did Not Contain Required Provisions

Crossfire's written quality control plan did not contain HUD-required provisions. HUD Handbook 4060.1, REV-2, paragraph 7-6(G), requires that each loan selected for a quality control review be reviewed to determine whether (1) conditions required for closing were met, (2) the closing and legal documents were accurate and complete, (3) the seller was the owner of record or was exempt, and (4) the loan closed and funds were disbursed according to instructions. Crossfire's written quality control plan did not contain the last two provisions. In addition, paragraph 7-3I requires findings to be reported to lender senior management within 1 month of completion, and management must take prompt action to deal with any material findings. However, this requirement was missing from the written plan. Crossfire management stated that it was an oversight that these provisions were not included in the plan and that they could be added to the plan.

The Lender Disregarded HUD Requirements

Crossfire disregarded the HUD requirement to implement and continuously have in place a compliant quality control program. The lender did not evaluate the work of the external contractor to ensure that the quality control reviews followed HUD requirements.

Crossfire stated that it relied on the contractor and did not know that the reviews were not being performed in compliance with HUD requirements. The lender reviewed the quality control review reports but only focused on the findings cited in those reports. The quality control review reports were not reviewed for compliance with HUD requirements. Although the lender stated that it relied on its external quality control contractor to perform the quality control reviews in accordance with HUD requirements, the lender remains responsible for ensuring that the reviews complied with HUD requirements regardless of whether the reviews were performed by the lender or an external contractor.

Although the lender stated that it was not aware that quality control reviews were not in compliance, its audited financial statement reports for the years 2007 through 2010 noted that the reviews did not meet the 10 percent field appraisal requirement. Not only was the lender aware of at least one issue with its quality control reviews, but the same issue was also continuously cited for 4 consecutive years.

In addition, Crossfire stated that it was not aware that quality control reviews had to meet certain requirements such as timeliness of the reviews, reviews of early payment default loans, and credit documentation reverifications. However, the lender prepared the written quality control plan that specifically discussed the quality control review requirements cited above.

Crossfire management contended that the quality control program was a waste of time and resources because it did not focus reviews only on the nonperforming loans. However, the lender’s quality control reviews were not performed on any of its 12 early payment default loans (loans that defaulted within the first six payments).

Conclusion

Crossfire did not follow HUD requirements when implementing its quality control program. The lender disregarded HUD requirement to implement and have a continuous quality control program that complied with HUD requirements. As a result, the effectiveness of Crossfire's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished. Specifically, Crossfire increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

2A. Refer Crossfire to the Mortgagee Review Board for consideration of administrative actions against Crossfire for failure to implement and continuously have in place a quality control program in compliance with HUD requirements.

2B. Require Crossfire to develop, implement, and enforce a quality control program that complies with HUD requirements. Specifically, the lender needs to establish a written plan with the required provisions, ensure that quality control reviews meet HUD requirements, and enforce and maintain its quality control program on a continual basis.

2C. Review Crossfire's quality control program within 9 months to determine whether the required provisions have been included in its written plan and quality control reviews are conducted in compliance with HUD requirements.

SCOPE AND METHODOLOGY

To accomplish the audit objectives, we

- Reviewed applicable HUD handbooks and mortgagee letters;
- Reviewed Crossfire's written policies and procedures for originating and underwriting loans;
- Reviewed Crossfire's loan files;
- Verified the accuracy of the information from the loan files with the borrowers and borrowers' employers;
- Reviewed Crossfire's written quality control plan;
- Analyzed Crossfire's post-quality control review reports;
- Interviewed Crossfire's employees, management, and external quality control contractor, and
- Reviewed new credit reports and other documentation provided by Crossfire for the cash-out refinance loans.

We accessed HUD's Neighborhood Watch system to obtain information about the lender and its loans. Crossfire underwrote 657 loans within the jurisdiction of the Miami HUD office between the amortization dates of December 1, 2008, and November 30, 2010. As of November 30, 2010, 40 loans with mortgage amounts totaling $7.4 million were in default. We selected seven loans for review based on various risk factors including loans (1) with mortgage amounts of $300,000 or greater, (2) that defaulted within 6 months of closing, and (3) that recently defaulted. The original mortgages of the seven loans totaled approximately $1.86 million, and the unpaid principal balances totaled approximately $1.9 million. The results of our review apply only to the loans reviewed and cannot be projected to the universe of loans.

One of the seven loans reviewed showed that the lender did not consider the previous mortgage delinquencies of its cash-out refinance loans as required by HUD. As a result, we expanded our review of the lender's cash-out refinance loans to determine whether previous mortgage delinquencies occurred less than 12 months before the refinance. A total of 51 refinance loans were underwritten, and 47 of those loans were cash-out refinance loans. We selected an additional 31 loans for review based on various risk factors including loans (1) with mortgage amounts greater than $100,000, (2) that had a credit report dated 2 months or more from the closing date and a mortgage between $100,000 and $175,000, or (3) that did not have a credit report dated within the same month as the closing date and a mortgage greater than $175,000. The original mortgages of the 31 loans totaled approximately $6.68 million.

Crossfire's external contractor performed quality control reviews of 77 loans that closed between November 2008 and December 2010. We reviewed the 77 quality control review reports for compliance with HUD requirements related to timeliness, frequency, sample size, early payment defaults, credit report, and field appraisals. We selected 10 of the 77 quality control review reports based on loans (1) that were delinquent, or (2) with mortgages totaling about $300,000 or greater. The ten loans were evaluated for compliance with credit document reverification, desk appraisal review, and occupancy verification requirements, as well as corrective actions taken on material findings cited in the quality control review reports. The results of our review apply only to the quality control reports reviewed and cannot be projected to the universe of reports.

We used data maintained on two systems-HUD's Neighborhood Watch system and the external contractor's quality control system. HUD's system is designed to highlight exceptions so that potential problems are readily identifiable. In particular, the system provides the ability to identify and analyze patterns, by geographic area or originating lender, in loans that became 90 days delinquent during the first 2 years. The external contractor's quality control system contains information from the quality control reviews and is used to track the review process. We did not rely on the data as a basis for our conclusions.

During the course of the audit, we clarified HUD regulations and discussed potential issues with the headquarters and the Atlanta Homeownership Center Quality Assurance Division. We also discussed the findings with Crossfire management.

We classified more than $1.1 million as funds to be put to better use and $210,453 as questioned costs. This is 59 percent of the total unpaid principal balances of approximately $1.9 million as of March 31, 2011, for the nine loans. We used 59 percent because it has been determined that upon the sale of the mortgage properties, FHA's average loss was about 59 percent of the unpaid principal balance. The questioned costs of $210,453 were incurred by HUD for claims paid and the principal loan reduction for FHA case numbers 095-0911262, 095-0942848, and 095-1135143 as of March 31, 2011. HUD paid claims on 3 of the 10 loans found to have originating and underwriting deficiencies. FHA case number 095-0911262 had a $750 claim paid for a loan modification. FHA case number 095-0942848 had a $750 claim paid for a loan modification and a $42,731 claim paid to reduce the principal of the loan, which reduced the unpaid principal balance of the loan. FHA case number 095-1135143 had a claim of $166,222 paid as a result of a preforeclosure sale, which is the loss HUD incurred for the sale of the property.

Our review generally covered the period January 1, 2008, through December 31, 2010, and was extended as necessary. We conducted our fieldwork from January through March 2011 at Crossfire's offices in Miami, FL, and at various other locations in the Miami-Dade and Broward County areas to conduct interviews with the borrowers, employers, and the external quality control contractor.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Program operation – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- Crossfire did not follow HUD requirements when originating and underwriting FHA loans (see finding 1).

- Crossfire did not follow HUD requirements when implementing its quality control program (see finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		$ 1,142,100
1B	$ 210,453	
Total	$ 210,453	$ 1,142,100

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

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Implementation of our recommendations to require Crossfire to indemnify HUD for the nine ineligible loans will reduce the risk of loss to the FHA insurance fund. The amount above reflects HUD's estimated loss of 59 percent of the loans' unpaid principal balance of $1,935,762 as of March 31, 2011.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

CFN Mortgage Capital

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Phone: 305-270-5522 / Fax: 888-227-3806

May 28, 2011

US Department of Housing and Urban Affairs

Region 4, Office of the Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW Room 330
Atlanta, Ga. 30303-3388

Thank you for the opportunity to respond to your audit of our company. I would like for t to be noted that at no time was it ever the intent or desire to disregard any rules or guidelines as established by HUD. It has never been acceptable to us to originate and close loans that did not make reasonable effort to assure the insurability of any FHA loan we closed.

Clearly, due to the housing collapse , the need for clarity in the rules and improvement in quality control tools available to the small and mid-sized lender have been a welcome addition.

Although we have unintentionally had missing procedures from our written QC plan, we have corrected it to reflect the request of the audit findings. These items, as discussed were that we were only having our third party QC vendor checking our loans every quarter instead of monthly when we closed the designated about of loans that would require a monthly review and we did not request from our third party vendor that they test for specific loans that had early delinquencies. This should not occur again.

Comment 1

Finding 1 says that we used "inaccurate and unsupported" information to qualify borrowers on 10 loans. In our review, only one loan was found and substantiated to have used less then accurate information. The review of that loan, a TPO loan, showed that the borrower was employed by the employer stated but received less income that what was documented to us. We are not aware of any other loans were that occurred.

Comment 2

The second loan shown on the table as inaccurate employment information, we documented the information supplied to us was accurate subsequent to the information given to the auditor from the employer who gave inaccurate information to the auditor that conflicted with our initial loan file.

Only on 1 loan was there an issue of assets not being supported. This was a circumstance where the borrower was to receive a gift at closing. The borrower did get that gift and we verified that the donor had the funds to give, we are just missing the proof that those particular funds were used for the gift.

Comment 3

At no time are we aware of using “invalid” appraisal reports. All appraisals were ordered and received from independent third party appraisers. At no time during the audit was this an issue or was brought to our attention to address.

Comment 4

The refinance loans that are referred to as having a late pay within the previous 112 months before approval is correct. However, none of these loans were manually underwritten. All received DU (Scorecard) approval. All were scrutinized by our lenders prior to purchase by them. When the AU system for FHA approval was introduced, we were clear that the system could and would overwrite many of the requirements of 4155 based on the overall information of the loan. It could overwrite the DTI, the need for previous residence history verification, the need for some verification of income documents as well as many previous guidelines that we would not exceed with manual underwriting. I fully understand that the caveat is always that the handbook guides all decisions but in the case of the automated system, I believe it has been the understanding of the industry at that time, as well as the intention of HUD and the system's developers that other than a case of a scorecard decision that was given with false information, an approval by the system was meant to exceed the manual underwriting standards. It was also to recognize that the underwriter of that loan “ZFHA””, was to demonstrate significant decision authority of the system, something that a qualified DE underwriter may not have approved based on the handbook. As long as the information supplied to the FHA automated system was accurate and complete, we accept the decision. In all cases of this refinance loans stated in the finding where this applied, the credit report loan histories were presented to DU for the approved/eligible decision, which we followed.

Comment 5

We did and do reverify employment information with the borrower's employer over the phone but in all cases the employer will not give or reverify income information over the phone. Considering we have paystubs and W-2's that confirm the income we are using, we felt, also as the automated system concurred, we had what we needed for an accurate underwrite. I believe our efforts to do a preclosing verification with the employer, which is neither required nor even recommended by the handbook or DU shows that we take our responsibility to FHA and our investors very seriously and do not approach lending in any callous manner.

It is true that we went from our own post-closing QC to an outside (third party) since 1997. We did attempt to us a second independent post-closing QC individual for a short time but we were

Comment 6

not happy with the service or results because we paid for the service but were never given back what was promised. We quickly ended that relationship and have had the same contractor (QualiMae) since then. We have emphasized the need for a quicker response from them and the need for the review of any EPD's that we may have in the future. We have informed them that 2 out of the 77 loans reviewed omitted QC generated reports. The requirement for 1 field review was addressed by us to them. I was never aware that because a borrower owned other properties at the time of the loan closing, we should require verification that the borrower has occupied the property after the closing as stated in the "Occupancy Verification Not Performed".

We have added to our QC plan those items missing from our QC plan as recommended by the auditor.

At no time did we ever suggest that the quality control program was a waste of time and resources and I strong object to that statement. The auditor and I had a conversation which she represented to me was outside of the audit as to what I felt was good and what I might change if I had the responsibility to change it.

It is true that I suggested as a way of refining the process that if resources were limited, as everybody's are these days, that a more effective way to diagnose and subsequently improve the way loans are underwritten would be to focus on loans that default rather than loans that are performing. This would give a better overview of the why and the way things go bad and how to perhaps better identify the potential causes before they become an issue for the lender and HUD. Again, this was not a criticism of the current system, only a suggestion, at the request of the auditor on how the system might be improved, never suggesting the QC guidelines in their present form are a "waste of time and resources" and I strongly object to the inference of that statement.

I cannot suggest that we are perfect. We are constantly looking at ourselves, trying to balance our commitment to the areas we serve, the families we try to help and our responsibilities to our investors and particularly to the FHA and HUD. We will implement the corrections and suggested by the auditor which we find helpful and necessary. We will (and have) look at all Scorecard approvals in regards to the intended compliance which the handbooks and mortgagee letters as well as the individual investor's risk layering requirements that exceed the FHA/HUD requirements.

Comment 7

I respectfully request that we are not referred to the FHA Mortgagee Review Board. I wish to point out changes that we have made since the origination of the loans in question. Throughout 2010 we eliminated all TPO's and we no longer accept them. We have increased our reverification of loans by requesting VOE's and VOD''s on many files and requiring the UTC-6 form from the State whenever we feel the need for additional income documentation.

I do not feel that the recommendations for losses to HUD are a direct result of the findings of our actions on the particular loans or the omissions in our post-closing quality review are fair or called for. We welcome a review of our QC program in 9 months by HUD, as well as our loans' performances. Like most of the loans that were written in the 2006-2009 era, it is clear that falling valuations and loss of jobs are the main reasons for loans to default. I believe that the constant bombardment of advertisements by firms recommending that borrowers default because of the length of time it takes to foreclose on them they would be better off paying these firms for their help in delaying foreclosures that making their mortgage payments. Has also been a contributor to the mess.

I would also like to point out the improvement in our NHW numbers which through April of this year, going back 2 years in the US, our compare ratio is 100% and out 1 year number is -0%-. I believe this reflects our dedication to improve ourselves and protect FHA/HUD.

I hope that you will favorably review this response and take this into consideration when making your decisions. We are a small company trying very hard to do business the right way. We did not close our company when things got very difficult like so many others that simple closed and reopened under a different name with a different principal. I believe our ownership and employees were very open to the auditor and gave whatever cooperation she requested.

Thank you for your consideration and long partnership,

Haydee and Mitchell Tepperman
The Crossfire Financial Network, Inc.
Lender #10671

OIG Evaluation of Auditee Comments

Comment 1 The lender stated that it was aware of only 1 of 10 loans that used inaccurate employment income information to qualify the borrower for the loan.

Finding 1 states that Crossfire used inaccurate employment information, did not support the borrower's asset information, and relied on an invalid appraisal report to qualify borrowers for three of the six purchase loans reviewed. In addition, it approved 7 of the 32 cash-out refinance loans reviewed with previous mortgage delinquencies occurring less than 12 months before the refinancing. The table in the report identifies the specific deficiencies found for each of the 10 loans. The deficiencies were also discussed with Crossfire officials throughout the audit.

Comment 2 The lender's response stated that it provided documentation to show the employment information for one loan in question was accurate. This document was provided to the auditor subsequent to the initial information given to the auditor.

For FHA case #095-0770109, we served a subpoena to the borrower's employer requesting specific employment documentation to verify the borrower's employment information in the loan file. The employer responded to our subpoena with a letter stating that the company had no record of the borrower ever being employed at the company. On March 25, 2011, we discussed this issue with the lender. Subsequently, on May 3, 2011, the lender provided us with another letter from the borrower's employer stating that the borrower was employed at the company. However, no additional documentation was provided to support this; specifically, none of the employment documents originally requested in the subpoena were included with this letter. We contacted the employer to confirm the authenticity of the letter provided by the lender and obtain the documents requested in the subpoena. The employer has not confirmed the authenticity of the letter or provided us with the employment documents requested in the subpoena. Therefore, the lender cannot support that it used accurate employment information to qualify the borrower for the loan.

Comment 3 The lender stated that it was not aware of any invalid appraisal reports used to qualify loans.

For FHA case #095-0770109, an invalid appraisal was used to qualify the loan. This issue was discussed with the lender on March 25, 2011 and May 3, 2011. At the time of our discussion, the lender acknowledged that the appraisal report used had exceeded its allowable validity period per HUD requirements. The lender stated that the appraisal should not have been used due to the extended amount of time that passed between the loan application and the loan closing. The appraisal report was dated June 28, 2008 and the loan closed on December 31, 2008 or over 6 months later. This issue was also discussed with HUD and it agreed that the appraisal report was not valid.

Comment 4 The lender stated it relied on the automated underwriting system to approve all seven of the cash-out refinance loans discussed in the report. It was not aware of any inaccurate or incomplete information used by the system to generate the approval results.

The lender's loan files contained credit reports for 4 of the 7 cash-out refinance loans that showed the borrowers had previous mortgage delinquencies within 12 months prior to the refinancing. Therefore, the lender had the mortgage delinquency information at the time the loans were reviewed and did not use the correct information when processing the loan through the automated underwriting system. As a result, the system relied on inaccurate information for the approval of these loans. (FHA case # 095-0932148, #095-0911262, #095-0937700, and # 095-0973194). For the remaining three cash-out refinance loans, the lender did not account for gaps (from 3 to 8 months) between the time of the credit reviews of the borrowers and the refinance closing.

Comment 5 The lender stated that it verified employment information over the phone, but not all employers verified income amounts over the phone. Instead, it relied on the employment documents such as the paystubs and W-2 forms and believed it was adequate.

The lender did not verify the employment income information directly with the employers for loans originated by another entity. The lender's loan files contained the verbal employment verification form which did not have a section for the employment income to be verified. Therefore, the lender did not ensure accurate employment income was used to qualify the borrowers for their loans.

Comment 6 The lender generally agreed with the finding on the quality control program and was unaware of the specific conditions in which an occupancy review would be required for a loan selected for review. The lender also stated that it did not make a statement about the quality control program and that the conversation in question was understood by the lender to be outside the context of the audit.

During the post quality control review, the lender is required to consider occupancy verifications on loans in which occupancy status is suspect. Although HUD requirements do not list all of the specific conditions of occupancy suspicion, the lender is required to consider such verifications on FHA insured properties, such as if a borrower owned multiple properties. The quality control contractor stated that occupancy verifications were not performed for any FHA insured loans. Our review of all 77 quality control review reports found no support to show any of the loans were verified or questioned for occupancy. Therefore, the lender did not consider occupancy verifications on loans in which occupancy status is of suspect.

We did not make any representation that discussions related directly to the audit findings would be outside of the audit. The discussion of the quality control program with the lender in this case was to determine why the quality control reviews did not follow HUD requirements. The lender was informed that its responses are directly incorporated into the audit report.

Comment 7 The lender requested not to be referred to the Mortgagee Review Board. It has made changes to its origination and underwriting process.

We recognize the changes the lender has made to its origination and underwriting process. However, the lender is being referred to the Mortgagee Review Board because of the deficiencies found with its quality control program. Therefore, the recommendation will remain.

Appendix C

SCHEDULE OF INDEMNIFICATION AND REPAYMENT AMOUNTS FOR THE 10 LOANS

No.	FHA case no.	Original mortgage amount	Unpaid mortgage balance	Indemnification amount[a]	Claims Paid by HUD[b]	Status of loan as of March 31, 2011
1	095-1353467	$ 265,109	$ 263,143	$ 155,254	$ -0-	Foreclosure process
2	095-1135143	$ 264,127	$ -0-	$ -0-	$ 166,222	Preforeclosure sale
3	095-0770109	$ 216,601	$ 216,208	$ 127,563	$ -0-	Delinquent
4	095-0932148	$ 272,690	$ 265,827	$ 156,838	$ -0-	Repayment process
5	095-0911262	$ 309,320	$ 362,961	$ 214,147	$ 750	Foreclosure process
6	095-0937700	$ 137,362	$ 135,479	$ 79,933	$ -0-	Delinquent
7	095-0970905	$ 189,458	$ 185,083	$ 109,199	$ -0-	Delinquent
8	095-1002059	$ 238,095	$ 235,496	$ 138,943	$ -0-	Foreclosure process
9	095-0942848	$ 195,868	$ 154,884	$ 91,381	$ 43,481	Reinstated
10	095-0973194	$ 119,861	$ 116,681	$ 68,842	$ -0-	Delinquent
	Totals	**$ 2,208,491**	**$ 1,935,762**	**$ 1,142,100**	**$ 210,453**	

[a] We classified $1,142,100 as funds to be put to better use. This is 59 percent of the $1,935,762 in unpaid principal balances for the nine loans as of March 31, 2011. The 59 percent is the estimated percentage of loss HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management System's Case Management Profit and Loss by Acquisition as of September 2010.

[b] We classified $210,453 in claims paid by HUD as ineligible costs that would be required to be repaid to HUD. The loans were not eligible for FHA insurance and, therefore, not entitled to any claim payments. Any claims paid for the ineligible loans are required to be repaid to HUD.

Appendix D

LOAN DETAILS FOR THE SEVEN CASH-OUT REFINANCE LOANS

No.	FHA case no.	Closing date	Previous 12-month mortgage delinquencies	Mortgage amount	Cash equivalent* benefited by borrower	Cash received by borrower	Status of loan as of March 28, 2011
1	095-0932148	1/14/2009	11/2008	$ 272,690	$ 19,863	$ 3,398	Repayment process
2	095-0911262	11/7/2008	3/2008	$ 309,320	$ 67,101	$ 10,075	Foreclosure process
3	095-0937700	12/22/2008	1/2008	$ 137,362	$ 4,822	$ 78,336	Delinquent
4	095-0970905	2/4/2009	1/2009, 2/2009	$ 189,458	$ 1,580	$ -0-	Delinquent
5	095-1002059	12/30/2008	5/2008-12/2008	$ 238,095	$ 18,952	$ 16,019	Foreclosure process
6	095-0942848	12/12/2008	11/2008-12/2008	$ 195,868	$ -0-	$ 2,639	Reinstated
7	095-0973194	2/27/2009	4/2008	$ 119,861	$ 7,050	$ 67,264	Delinquent
			Totals	**$ 1,462,654**	**$ 119,368**	**$ 177,731**	

*Cash equivalent is defined as funds obtained from the refinance loan that were used to pay for other items, such as credit card debts, that were not directly related to the previous primary mortgage debt and general closing costs associated with a loan.

Appendix E

LOAN DETAILS FOR THE THREE PURCHASE LOANS

FHA case #: 095-1353467

Mortgaged amount: $265,109

Date of loan closing: 9/8/2009

Unpaid principal balance: $263,143

Loan purpose: Purchase - existing

Default status: First legal action to commence foreclosure

Inaccurate Employment Income

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, paragraph 4.D.1.a., states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Documents contained in the loan file, such as the loan application, verification of employment, and pay stubs, indicated that the borrower earned a monthly income of $4,766.67. Using the income amount of $4,766.67 from the loan file, the lender calculated the housing payment-to-income and debt-to-income ratios of 47.0 and 47.4, respectively.

Our reverifications with the borrower and the borrower's employer showed that the borrower's monthly income was $3,813.33. The borrower stated that she did not provide the pay stubs found in the loan file with the inaccurate employment income amount. The borrower's employer stated that she did not complete or sign the verification of employment form with the inaccurate employment income amount that was found in the loan file. Using our verified income amount of $3,813.33, we calculated the qualifying ratios of 58.7 and 59.2 percent. Given the inaccurate employment income and the higher ratios, the borrower would not have qualified for the FHA mortgage loan.

FHA case #: 095-1135143 | Mortgaged amount: $264,127

Date of loan closing: 5/21/2009 | Unpaid principal balance: $ -0-

Loan purpose: Purchase - existing | Default status: Preforeclosure sale

Unsupported Source of Funds

The lender did not verify or show support that the source of funds used at closing was from an acceptable source. The total cash investment of $9,065 was paid at closing; however, there was no documentation in the loan file to show the source of the funds. The loan file showed that the borrowers' funds from their bank accounts totaled $1,597. There was also a gift letter from one of the borrowers' relative stating that a gift of $10,000 would be made to the borrower. However, there was no evidence in the loan file that the gift funds had been deposited or transferred into the borrowers' bank accounts or that the funds provided at closing were from the gift donor or another acceptable source.

HUD Handbook 4155.1, paragraph 5.B.4.d, states that the lender is responsible for verifying the acceptability of the gift fund sources and that the funds were not provided by an unacceptable source. If the funds were paid at closing, the lender is responsible for verifying that the closing agent received the funds from the donor for the amount of the gift and that the funds were from an acceptable source. Paragraph 5.B.4.b states that acceptable sources would include but not limited to the borrower's relative, employer or labor union, charitable organization, and governmental agency that provides home ownership assistance. Paragraph 5.B.4.c states that unacceptable sources would include but not limited to the seller, real estate agent or broker, builder, or an associated entity. The lender was not able to provide documentation to support the source of funds used at the loan closing. As a result, this loan was not eligible for FHA insurance. The property was sold in a preforeclosure sale, and HUD suffered a loss of $166,222.

FHA case #: 095-0770109 Mortgaged amount: $216,601

Date of loan closing: 12/31/2008 Unpaid principal balance: $216,208

Loan purpose: Purchase - existing Default status: Delinquent

Inaccurate Employment Information

The lender did not perform due diligence when verifying the borrower's employment income. HUD Handbook 4155.1, paragraph 4.D.1.a., states that income may not be used in calculating the borrower's qualifying ratios if it comes from a source that cannot be verified, is not stable, or will not continue.

Documents contained in the loan file, such as the loan application, verification of employment, and pay stubs, indicated that the borrower and coborrower earned a total monthly income of $6,633.47. Using the income amount of $6,633.47 from the loan file, the lender calculated the housing payment-to-income and debt-to-income ratios of 27.5 and 38.5, respectively.

Our verification with the borrower's employer disclosed that the borrower had not been employed at that company. The coborrower's employer disclosed that the coborrower earned $13,013 in 2008, or $1,084 per month. Using the monthly income amount of $1,084, we calculated the qualifying ratios of 168.0 and 235.4 percent. Given the inaccurate employment information and the resulting substantially higher ratios, the borrowers would not have qualified for this FHA mortgage loan.

Invalid Appraisal Report

The lender did not adequately review the appraisal report used for the approval of this loan. The lender is responsible for the integrity, accuracy, and thoroughness of the appraisal used for a loan. Mortgagee Letter 2009-30 states that the validity period for an appraisal for the purchase of an existing property is 6 months from the date of the appraisal for a loan that had a case number issued before January 1, 2010. The lender acknowledged this requirement by signing the form HUD-92800.5B, Conditional Commitment Direct Endorsement Statement of Appraised Value. In signing this statement, the lender agreed to general commitment conditions, which included that the validity of the appraised value would expire 6 months from the appraisal issue date.

This loan had its case number issued in July 2008, and the appraisal report was dated June 28, 2008. Therefore, the appraisal report was valid up to December 28, 2008. The loan closed on December 31, 2008, which was after the allowable validity date. We discussed this loan with HUD staff members, who said that this appraisal was invalid due to the elapsed time. As a result, the appraisal report with the value of $220,000 used to approve this loan was not valid, and, therefore, reliance on it would have made this loan ineligible for FHA insurance.