Issue Date	July 22, 2011
Audit Report Number	2011-DE-1004

TO: Jenise Hight, Associate Deputy Assistant Secretary for Single Family Housing, HU

//**signed**//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, Kansas City Region, 8AGA

SUBJECT: Mountain States Mortgage Center, Sandy, UT, Did Not Follow HUD's Underwriting, Quality Control, and Advertising Requirements

HIGHLIGHTS

What We Audited and Why

We audited Mountain States Mortgage Center, a Federal Housing Administration (FHA)-approved direct endorsement lender. We reviewed Mountain States to determine whether it underwrote insured loans in compliance with U.S. Department of Housing and Urban Development (HUD) requirements and whether its quality control plan met HUD requirements. We audited Mountain States because the percentage of loans it originated that were seriously delinquent within the first year was 9.46 percent, which is higher than the FHA national rate of 2.85 percent.

What We Found

Mountain States underwrote 41 loans that did not comply with FHA requirements. Of the 41 FHA-insured loans reviewed, one of the loans had a significant underwriting deficiency, and all 41 loans contained minor underwriting deficiencies. For the loan with the significant underwriting deficiency, Mountain States underwrote the mortgage based on an overstated appraisal.

Additionally, Mountain States did not adequately develop or implement its quality control plan. Specifically, its quality control plan did not contain all of the required elements, and it did not ensure that its monthly quality control reviews met HUD requirements.

Mountain States used misrepresentative advertising when marketing its streamline refinance mortgages. Some borrowers relied on a mailer used by Mountain States to advertise its streamline refinance loans. Based on information in the mailer, some borrowers did not know they were working with Mountain States and believed that the new refinanced loan would contain no fees or costs.

What We Recommend

We recommend that the Associate Deputy Assistant Secretary for Single Family Housing require Mountain States to (1) indemnify HUD for the potential loss on the one improperly underwritten loan, (2) implement adequate policies and procedures to ensure that loans are underwritten in accordance with HUD requirements, (3) provide documentation showing that it followed HUD requirements in the use of lender advances and lender credits for the loans identified, (4) develop and implement a written quality control plan in accordance with HUD requirements, and (5) ensure that advertising complies with HUD requirements.

Finally, we recommend that HUD refer Mountain States to the Mortgagee Review Board for consideration of taking appropriate administrative action against the lender for its noncompliance in underwriting FHA loans, disregard for HUD's quality control requirements, and misrepresentative advertising.

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 provided the discussion draft of the audit report to Mountain States on June 20, 2011, and requested a response by July 5, 2011. Mountain States provided written comments on June 30, 2011. It generally disagreed with certain elements of the underwriting and quality control findings. However, Mountain States generally agreed with the misrepresentative advertising finding.

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

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BACKGROUND AND OBJECTIVES

Mountain States Mortgage Center's home office is located in Sandy, UT. Additionally, Mountain States operates branch offices in Utah, Nevada, Arizona, and Ohio. The U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) authorized the home office as a nonsupervised mortgage company on July 12, 1983, and authorized the Sandy branch office on January 2, 2008. A nonsupervised mortgage company is a nondepository financial entity of which the principal activity is the lending or investment of funds in real estate mortgages. The home office underwrites all branch and home office loans.

Before December 22, 2010, Mountain States was an authorized Lender Insurance program mortgagee; however, FHA removed it from the program because its 2-year seriously delinquent compare ratio was 283 percent. Pursuant to Section 256 of the National Housing Act, the Lender Insurance program enables high-performing FHA-approved lenders with acceptable default and claim rates to endorse FHA mortgage loans automatically, without a preendorsement review being conducted by FHA. The acceptable claim and default rate for an approved program participant is defined as at or below 150 percent of the national average.

From January 1, 2009, through December 31, 2010, Mountain States originated 5,203 FHA-insured loans with a total original mortgage amount of more than $850 million. Of the 5,203 loans, 492 (9.46 percent) were seriously delinquent, which is higher than the national rate of 2.85 percent.

The objectives of the audit were to determine whether Mountain States underwrote its insured loans in compliance with HUD requirements and whether its quality control plan met HUD requirements.

RESULTS OF AUDIT

Finding 1: Mountain States Underwrote Loans That Did Not Comply With FHA Requirements

Mountain States underwrote 41 loans that did not comply with FHA requirements. This noncompliance occurred because Mountain States did not have adequate policies and procedures. As a result, the lender placed the FHA insurance fund at increased risk.

Underwriting Did Not Meet FHA Requirements

Of the 41 FHA-insured loans reviewed, 1 had a significant underwriting deficiency, and all 41 loans contained minor underwriting deficiencies.

For the loan with the significant underwriting deficiency, Mountain States underwrote the mortgage based on an overstated appraisal. The comparables used for the property appraisal were not reasonable or comparable. HUD Handbook 4155.2, paragraph 4.1.b, states that the lender is equally responsible, along with the appraiser, for the quality, integrity, accuracy, and thoroughness of the appraisal. Lenders that submit appraisals to HUD that do not meet FHA requirements are subject to the imposition of sanctions by the HUD Mortgagee Review Board. Appendix C contains a detailed narrative for the loan.

For the loans with minor underwriting deficiencies, Mountain States did not follow all of FHA's requirements, but the deficiencies were not necessarily significant enough to affect the overall insurability of the loans. For example, Mountain States paid advances totaling more than $36,000 for 17 loans and lender credits totaling more than $14,000 for 9 loans. However, it was unable to provide documentation showing that it followed HUD requirements regarding advances or credits. Mountain States must follow all applicable HUD requirements to ensure that mortgage loans are underwritten according to FHA requirements. The following chart summarizes the minor deficiencies identified and the number of loans with each type of deficiency.

Minor deficiencies	Number of loans
No pre-insurance review	41
Open-ended lender advances	17
Lack of documentation for advances used to set up escrow accounts	14
Lump-sum lender credit	9
No income certification	8
No late endorsement certification	6
Lack of documentation for credits used to set up escrow accounts	2
Missing file	1
Unallowable fee	1
Borrower had a financial interest in and relationship with lender	1
Borrower paid for appraisal directly	1

Appendix D provides the details of these minor underwriting deficiencies.

Adequate Policies and Procedures Were Lacking

Mountain States did not have adequate policies and procedures in place to ensure that loans were underwritten in accordance with HUD requirements. It did not have written policies or procedures for late endorsements, income certifications, lender advances, lender credits, and a pre-insurance review. In addition, it did not follow the written policies and procedures it had regarding appraisals and disallowable fees.

Although Mountain States management officials said that they had brought these deficiencies to the attention of all Mountain States officers, managers, and department heads, they did not indicate how they planned to address the lack of adequate policies and procedures.

The FHA Insurance Fund Was at Unnecessary Risk of Loss

Mountain States placed the insurance fund at increased risk. Generally, the types of deficiencies identified did not affect the overall insurability of the loans. However, the pervasiveness of these deficiencies contributed to Mountain States' originating loans that generally had high default rates. Of the 5,203 loans originated during our audit period, 492 (9.46 percent) were seriously delinquent, which is higher than the national rate of 2.85 percent. Of the 41 loans reviewed, 28 had 6 or fewer payments made before the first 90-day delinquency was reported.

For the significantly deficient loan, Mountain States placed the insurance fund at unnecessary risk for a potential loss to HUD of $188,483. This is the projected amount of loss to HUD for the one loan which we recommend that HUD require Mountain States to indemnify. To determine the potential loss, we used HUD's calculation for its average loss on disposing of FHA-insured properties, which is 59 percent of the unpaid loan balance for FY2010.

Due to a lack of adequate policies and procedures, Mountain States underwrote 41 loans that did not comply with FHA requirements. This noncompliance placed the insurance fund at increased risk. Although many of the deficiencies were minor, they were pervasive. HUD needs to address these issues to prevent future losses to the insurance fund.

Recommendations

We recommend that the Associate Deputy Assistant Secretary for Single Family Housing

1A. Require Mountain States to implement adequate policies and procedures to ensure that loans are underwritten in accordance with HUD requirements.

1B. Require Mountain States to indemnify HUD for the potential loss on the one improperly underwritten loan. The estimated loss to HUD is $188,483.

1C. Require Mountain States to provide documentation showing that it followed HUD requirements in the use of lender advances and lender credits for the loans identified. If HUD requirements were not followed, the Associate Deputy Assistant Secretary should determine amounts due to the borrowers and require that Mountain States refund those amounts.

1D. Refer Mountain States to the Mortgagee Review Board for consideration of taking appropriate administrative action against the lender for its noncompliance in underwriting FHA loans.

Finding 2: Mountain States Did Not Adequately Develop or Implement Its Quality Control Plan

Mountain States did not adequately develop or implement its quality control plan. This condition occurred because management did not make the quality control process a priority. As a result, the FHA insurance fund was placed at an increased risk of loss.

Mountain States Did Not Develop a Compliant Quality Control Plan

Mountain States did not develop a quality control plan that met HUD requirements. We reviewed Mountain States' written quality control plan, dated September 14, 2009. The quality control plan did not include more than 32 percent of the elements required by chapter 7 of HUD Handbook 4060.1, REV-2. Examples of the missing elements included the following:

- Ensuring that quality control reviews were performed within 90 days from the end of the month in which the loan closed.
- If the lender suspected HUD staff of involvement in fraud, referring the matter to the Office of Inspector General (OIG).
- Setting up the lender's system of analysis for early payment defaults to identify patterns of the same appraiser, loan officer, loan processor, underwriter, and realtor.
- Determining whether the loan files contained all required loan processing, underwriting, and legal documents.
- Determining whether the loan was submitted for insurance within 60 days of closing and if not, including a payment history showing that the loan was current when it was submitted for mortgage insurance endorsement.

Mountain States Did Not Implement a Compliant Quality Control Process

Mountain States did not implement a quality control process that met HUD requirements. To determine whether Mountain States had properly implemented its quality control plan, we reviewed the quality control reports for loans closing from September 2009 through September 2010. Mountain States used a contractor to perform its monthly quality control reviews. The contractor did not always perform the monthly quality control reviews within 90 days from the end of the month in which the loan closed as required by paragraph 7-6A of HUD Handbook 4060.1, REV-2. Specifically, loans closed in October 2010 required completed quality control reviews by January 29, 2011. However, as of February 10, 2011, Mountain States had not received the report from the contractor performing the monthly quality control reviews.

Additionally, for the reviews of the loans closed between September 2009 and September 2010, the contractor did not complete 8 of the 13 monthly reports within the required 90 days. These eight reports were dated between 94 and 158 days after the end of the month being reviewed.

Further, the monthly quality control reviews did not always include 10 percent of the loans originated per month as required by paragraph 7-6C of HUD Handbook 4060.1, REV-2. The samples selected in 5 of the 13 months reviewed were between 7 and 9 percent of the loans originated in that month. Additionally, paragraph 7-6E.3 of HUD Handbook 4060.1, REV-2, requires a desk review for all loans selected each month with an appraisal. Of the five loans requiring desk appraisal reviews, only two included evidence of a desk appraisal review.

Mountain States also did not specifically review all loans with early payment defaults as required by paragraph 7-6D of HUD Handbook 4060.1, REV-2. Our sample of 41 loans included 28 loans with early payment defaults. However, of the 28 early payment default loans, only 22 closed after Mountain States implemented a new quality control plan, dated September 2009. We later found that Mountain States had only reviewed 4 of these 22 early payment default loans.

Management Did Not Make Its Quality Control Process a Priority

The deficiencies described above occurred because management did not make the quality control process a priority. Although Mountain States' management met monthly to discuss the quality control review reports and coordinate corrective action, we noted during our evaluation of the quality control reviews the same types of deficiencies occurring from review to review with little or no documented improvement. This example is an indication of management's not taking corrective action to ensure the resolution of these issues.

The FHA Insurance Fund Was Placed at Increased Risk of Loss

Mountain States could not ensure that it complied with HUD's underwriting requirements consistently and in a timely manner and protected itself and HUD from unacceptable risk, errors, omissions, and fraud. It thereby placed the FHA insurance fund at an increased risk of loss.

Recommendations

We recommend that the Associate Deputy Assistant Secretary for Single Family Housing

2A. Require Mountain States to develop and implement a written quality control plan in accordance with HUD requirements.

2B. Refer Mountain States to the Mortgagee Review Board for disregarding HUD's quality control plan requirements. Specifically, the Mortgagee Review Board should consider the imposition of administrative sanctions and assessment of civil money penalties for Mountain States' knowingly maintaining a deficient quality control plan and continually disregarding deficiencies noted during third-party reviews.

Finding 3: Mountain States Used Misrepresentative Advertising

Mountain States used misrepresentative advertising when marketing its streamline refinance mortgages. This condition occurred because of management's emphasis and reliance on using direct mailing as its primary method of generating business. As a result, homeowners received inaccurate information about the terms of their streamline refinance mortgages.

Misrepresentative Advertising Was Used

Mountain States used misrepresentative advertising when marketing its streamline refinance mortgage. The advertising mailer Mountain States sent had "FHA PROCESSING CENTER" (figure 1) printed at the top, and the signature block contained the title "FHA DEPARTMENT MANAGER" (figure 2). The mailer also stated that the new streamline refinance mortgage would add no costs (***of any kind***) to the loan balance (figure 3). Some borrowers we spoke with believed no costs would be added to their new streamline refinanced loan based on Mountain States' advertising mailer. However, for the loans reviewed, a new upfront mortgage insurance premium plus various fees and costs associated with underwriting and closing the new streamline refinanced mortgage loan were added to the loan balance.

Figure 1:

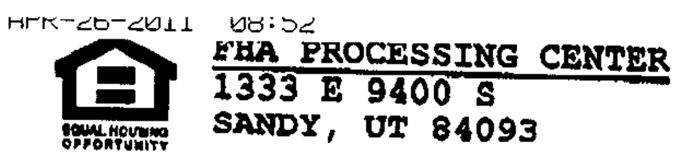

Figure 2:

Figure3:

The FHA Streamline Program 203(b) allows you to lower your monthly mortgage payment and save a substantial amount of money over the life of your loan. This Department of Housing and Urban Development program was created **exclusively for FHA homeowners**, which will allow you to lower your monthly payment and mortgage interest rate **without any title, broker, or lender fees or costs (of any kind) added to your loan balance.**

HUD Handbook 4060.1, chapter 2, states that an approved lender may not use misrepresentative advertising. Specifically, all advertising must emphasize the name of the company and not the government. A lender may not improperly use the name or seal to imply that the advertisement is from or is endorsed by FHA. Finally, when HUD finds advertising abuses, it will take prompt action by referring to the Mortgagee Review Board and may sanction the lender and impose civil money penalties.

Management Relied on Direct Mailing

The condition described above occurred because of management's emphasis and reliance on using direct mailing as its primary method of generating business. During various meetings, Mountain States' management informed us that the primary method of marketing its FHA-insured streamline refinance loans was through the use of direct mailing. Accordingly, the borrowers we spoke with stated that they pursued refinancing their loans with Mountain States after receiving a mailer.

Homeowners Received Inaccurate Information

Homeowners received inaccurate information about the terms of their streamline refinance mortgages. Some borrowers did not know they were working with Mountain States to refinance their loans. Additionally, some borrowers believed they were dealing directly with the Federal Government, not a private mortgage company. Lastly, borrowers believed the new refinanced loan would contain no fees or costs based on the mailer.

Recommendations

We recommend that the Associate Deputy Assistant Secretary for Single Family Housing

3A. Require Mountain States to develop and ensure that advertising complies with HUD requirements.

3B. Refer Mountain States to the Mortgagee Review Board for consideration of taking appropriate administrative action against the lender for its misrepresentative advertising of FHA-insured loans.

SCOPE AND METHODOLOGY

We performed our onsite audit work in February and March 2011 at Mountain States' office at 1333 East 9400 South, Sandy, UT. Our audit period was January 1, 2009, through December 31, 2010.

Mountain States originated 5,203 FHA-insured mortgages from January 1, 2009, to December 31, 2010. We selected a total of 41 loans to review. Of the 41 loans reviewed, 38 were streamline refinance loans, and three were conventional refinance loans.

The 38 streamline refinance loans included 18 randomly selected loans from the 469 loans that were seriously delinquent within 1 year and defaulted within first 3 months.

- All loans (nine) closed after April 1, 2010,[1] and had six or fewer payments before default.
- All loans (two) closed after April 1, 2010,[1] and had paper binders submitted to HUD.
- All loans (nine) were submitted late for endorsement and had paper binders submitted to HUD.

The three conventional refinance loans included

- All loans (two) that were seriously delinquent within 1 year.
- The only loan that was submitted late for endorsement and had a paper binder submitted to HUD

We reviewed all of Mountain States' quality control reports completed under the most current quality control plan, dated September 2009.

To accomplish our objectives, we reviewed

- HUD regulations and reference materials related to single-family requirements.
- Mountain States' underwriting and quality control policies and procedures and interviewed management officials and staff.
- HUD and Mountain States' loan files and interviewed 15 borrowers.
- Mountain States' quality control reviews and corrective actions taken.

We used origination, default, claim, and current loan status data maintained by HUD in the Single Family Data Warehouse and Neighborhood Watch systems for background information and in selecting our sample of loans. We did not rely on the data to base our conclusions. Therefore, we did not assess the reliability of the data.

We classified $188,483 as funds to be put to better use. This is the projected amount of loss to HUD for the one loan which we recommend that HUD require Mountain States to indemnify.

[1] April 1, 2010, date used to allow Mountain States time to implement changes required by Mortgagee Letter 2009-32

To determine the potential loss, we used HUD's calculation for its average loss on the disposition of FHA-insured properties, which is 59 percent of the unpaid loan balance. The 59 percent is based on the Single Family Acquired Asset Management System's Case Management Profit and Loss by Acquisition as of September 2010.

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 objective(s). 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:

- Controls to ensure that FHA-insured loans are underwritten in accordance with HUD requirements.
- Controls to ensure the lender has developed and implemented a quality control plan that complies with HUD requirements.
- Controls to ensure that mailers used to advertise streamline refinance loans comply with HUD requirements.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to 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:

- Mountain States did not have adequate policies and procedures to ensure that FHA-insured loans met HUD underwriting requirements (finding 1).
- Mountain States did not develop and implement a quality control plan that met HUD requirements (finding 2).
- Mountain States did not ensure that its mailer advertising streamline refinance loans met HUD requirements (finding 3).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1B	$188,483

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an 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 recommendation to require Mountain States to indemnify HUD for the one materially deficient loan will reduce the risk of loss to the FHA insurance fund. The amount above reflects the amount of loss HUD may incur for the one loan. We used HUD's calculation for its average loss on disposing of FHA-insured properties, which is 59 percent of the unpaid loan balance. The 59 percent is based on HUD's return on properties sold through its real estate-owned inventory for fiscal year 2010.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Mountain States Mortgage Center®

Financing Your Future

1333 E 9400 S, Sandy, UT 84093 | P (801) 576-1000 F (801) 931-2483

June 30, 2011

Ronald J Hosking
Office of Inspector General
Region VIII Office of Audit
Department of Housing and Urban Development
UMB Plaza Building
1670 Broadway, 24th Floor
Denver, CO 80202-4801

In reply to: Discussion Draft

Mr. Hosking,

Thank you for providing your discussion draft for review in order to give Mountain States Mortgage Centers, Inc the opportunity to provide feedback on your conclusions.

Due to the continued correspondence between MSMC and the auditors, we feel it best to address only the portions of the draft that we have additional input on. Please consider our input in your final audit report.

Finding: <u>Underwriting</u>

- **One loan had a significant underwriting deficiency. Specifically, Mountain States underwrote the mortgage based on an overstated appraisal.**

Comment 1

Response: After further review of the appraisal on property located at 7741 South 2375 East, Cottonwood Heights, UT 84121, MSMC believes that the USPAP standards were used in accordance with HUD Handbook 4150.2, Chapter 4. The indicated value of the subject property is based off of the sales comparison approach (as recommended to be the best indicator of value in Chapter 4).

The sales comparisons used are within the indicated value of the appraisal. We believe the comparables selected/used were acceptable sites as they related to the needs of the prospective occupants of the subject property. All 5 comparables used are competitive to the site and within a 1 mile radius of the subject property. They are all residential and are all similar in accommodations. All comparables were selected from similar neighborhoods with similar market appeal and desirability. The appraiser also indicated that the comparables chosen were deemed to be the best indicators of value for the subject property that were available at the time of inspection. Comparables are all similar in lot size, location, style amenities, design and utility.

Comment 2

The adjustments made to the comparables were necessary and reasonable for the subject market area. Adjustment figures were derived at through a survey of recent market sales data and appraiser's database of existing market data, as well as information from local area builders and realtors.

Comment 3

MSMC believes we ensured quality, integrity and accuracy in its underwriting determination of the subject property, and that the Sales Comparison Approach value of $342,000.00 is the most probable price which the subject property should bring in a competitive and open market under all conditions requisite to a fair sale at the time of underwriting approval.

Comment 4

MSMC believes that the appraisal submitted to HUD does meet FHA requirements. We do not believe we put the insurance fund at risk by writing this loan. <u>We strongly disagree with the recommendation to indemnify HUD of any potential loss as we believe the loan was underwritten properly.</u>

Finding: <u>**Underwriting**</u>

- **We found minor deficiencies in 41 loans. Specifically, it was unable to provide documentation showing that it followed HUD requirements regarding advances and credits.**

Comment 5

Response: Mountain States Mortgage Centers, Inc. followed all of HUD's guidelines as outlined in HUD handbook 4155 in regard to lender credits and advances. Mountain States has been cited for not meeting FHA requirements in the updated HUD handbooks. We believe the auditors have not taken into consideration our response in regard to lender credits and advances and the updates to the HUD insurance program and handbooks throughout the years. As the scope of loans audited extends over years, we believe the auditors are citing us for current guidelines, rather than guidelines in place at the time of underwriting approval.

Comment 6

As Mountain States Mortgage Centers, Inc adapts it's underwriting around current market, program, and investor guidelines, underwriting operates in a 'real time' underwriting stance and uses the most up to date underwriting guidelines available provided by FHA handbooks and effective mortgagee letters. A hard copy of FHA handbooks are not maintained on site as we rely on the 'online' handbooks and mortgagee letters for the most up-to-date underwriting guidelines for our FHA HUD endorsed loans. <u>Mountain States believes HUD requirements were followed in regard to lender credits and advances, and do not believe that any amounts are due to the borrower or that Mountain States should be required to refund any amounts of monies.</u>

Comment 7

We do recognize the other minor underwriting deficiencies identified in the audit. These deficiencies were brought to the attention of all employees of Mountain States Mortgage Centers, Inc. Additional staff training has taken place since we became aware of the deficiencies.

Comment 7

Mountain States Mortgage Centers, Inc. is taking proactive steps to ensure we implement adequate policies and procedures to ensure that loans are underwritten in accordance with HUD requirements. We are currently updating our 'written policies and procedures' to incorporate: a pre-insurance checklist, itemization of lender credits and advances, income certification kept in file for every loan, late endorsement certification kept in file, verification of employment and income certification kept in file, charts of all unallowable fees.

Comment 7

Mountain States Mortgage Centers, Inc would also like to take this opportunity to state that once management became aware of an unallowable fee being charged to the borrower, the monies were refunded to the borrower immediately. We are not in the practice of charging unallowable fees as you will find in our current written policies and procedures. We have put an additional safeguard in place to make sure all employees involved in the production end are aware of what can and cannot be charged on all FHA loans.

Finding: Underwriting

- **Mountain States placed the insurance fund at increased risk.**

Comment 8

Response: The types of underwriting deficiencies identified in the audit DID NOT affect the overall insurability of the loans. The underwriting deficiencies identified did not affect the underwriting approval of the loan. All loans were previously FHA insured loans. Mountain States Mortgage Centers, Inc. primarily originates FHA Streamline refinance mortgages. The FHA Streamline product generally has a higher default rate than other loan programs. We do not believe Mountain States placed the insurance fund at increased risk as we were taking already FHA insured loans and refinancing them to a lower rate that resulted in a more affordable housing payment.

Comment 7

We do, however, recognize the deficiencies identified and are implementing adequate policies and procedures to ensure that loans are underwritten in accordance with HUD requirements.

Finding: Quality Control

- **Mountain States did not develop a quality control plan that met HUD requirements.**

Comment 9

Response: Mountain States Mortgage Centers, Inc relied on a 3rd party company for its quality control plans and manuals. At the time of incorporating these manuals into our company, Mountain States did a review of the manual to determine if they met guidelines as outlined in Chapter 7 of HUD Handbook 4060.1 REV-2. Our compliance officer at the time felt that it did.

This audit has made us aware of how lacking our current quality control plan is. Although we outsource, we cannot use that as an excuse as to the missing elements in our quality control plan. Management has contacted another 3rd party QC company to assist us in bringing our current QC plan within guidelines. The company is [redacted] We are currently in the process of re-writing our plan to comply with ALL guidelines as set forth in Chapter 7 of HUD Handbook 4060.1 REV-2. This is a priority to management at Mountain States and management has been actively involved in bringing our QC plan in compliance with HUD requirements.

Comment 10

Although our QC plan was missing key elements, the processes were completed in our production and day to day activities at Mountain States Mortgage Centers, Inc. More specifically:

- If a loan was not submitted for insurance within 60 days of closing, a payment history showing the loan was current was included in our submission for mortgage insurance.
- Reviewing loans with early payment defaults.

Although it is not written in our QC plan, Mountain States did review loans that went into early payment default. Our compliance officer pulled the file from our archive room and reviewed the loan to determine that underwriting requirements were met. The compliance officer also reviewed the file to identify any patterns that might affect an early payment default (i.e. same appraiser, loan officer, loan processor, underwriter, and realtor). If underwriting deficiencies were found, our compliance officer met one on one with the underwriter of the loan to discuss the deficiencies involved in the file.

Mountain States Mortgage Centers, Inc also took additional steps to contact the borrower to inquire as to why the early payment default.

Finding: **Quality Control**

- **Management Did Not Make Its Quality Control Process a Priority**

Comment 11

Response: We feel that this is a complete misrepresentation of the management at Mountain States Mortgage Centers, Inc. The deficiencies in Mountain States' QC plan occurred because of lack of awareness in the requirements of Chapter 7 of HUD Handbook 4060.1, not because management did not make the quality control process a priority.

We understand that during the evaluation process of the quality control reviews, the same deficiencies occurred from review to review. However, we feel this is more in part because of the large amount of loans originated within the same period that took time to trickle out of our pipeline. Thus, the same deficiencies were reported in quality control reviews from month to month. Management did take corrective action to ensure resolution to these issues. We are requesting the auditors to consider our origination spurts and increases in pipeline before suggesting management did not make quality control a priority.

Finding: **Advertising**

- **Misrepresentative Advertising Was Used**

Comment 12

Response: Mountain States Mortgage Centers, Inc did not realize that the mailer used in direct marketing was misleading to a potential borrower. We have since then taken into consideration the findings in the evaluation and determined this mail piece could mislead a borrower.

Mountain States Mortgage Centers, Inc. has discontinued the use of this mail piece in its marketing campaign. We are also taking corrective action to rework our marketing material so it is not misleading or inaccurate to the home owner.

Comment 13

In conclusion, Mountain States Mortgage Centers, Inc requests you consider this additional input in your final audit report. We feel we have taken corrective action to fulfill your recommendations by developing and implementing adequate policies and procedures to ensure the loans are underwritten in accordance with HUD requirements, develop and implement a written quality control plan in accordance with HUD requirements and ensure that advertising complies with HUD requirements.

Management would also like to take this opportunity to assure both the auditors and HUD that complying with HUD's guidelines IS A PRIORITY to all of us at Mountain States Mortgage Centers, Inc. We recognize areas of growth and are actively pursuing procedures to put in place to ensure the highest quality of loans are produced by our company and officers thereof.

We appreciate all of the hard work that has gone in to this review and would once again like to thank you for providing the discussion audit and allowing us to provide feedback to your findings.

Should you require any further response from our office, please contact me directly.

Sincerely,

JR Green
President/CEO
Mountain States Mortgage Centers, Inc
(801) 580-4242
Jrgreen22@yahoo.com

OIG Evaluation of Auditee Comments

Comment 1 Mountain States believed the comparables selected/used were acceptable sites as they related to the needs of the prospective occupants of the subject property. Nowhere in HUD Handbook 4150.2, Chapter 4 does it state the comparables should "relate to the needs of the prospective occupants of the subject property". The handbook does state the selection of comparable sales for analysis is based on the area in which the property competes and the forces/dynamics that affect the comparable sale properties. The five comparables selected by the appraisers are not similar in location, style, or design.

Comment 2 Mountain States stated the adjustments were necessary and reasonable for the subject market area. As stated in Appendix C, the appraiser did not properly adjust for age or location.

Comment 3 Mountain States agreed with the appraiser that $342,000 is the most probable price which the subject property should bring in a competitive and open market. As we discussed in Appendix C, there was a least one comparable property less than a ¼ mile from the subject property with similar attributes and sold for $262,500; which is a difference of -$79,500. The properties within the immediate subject properties neighborhood, but not used by the appraiser, are more indicative of the actual market value.

Comment 4 The insurance fund was put at risk because the subject property was over-appraised; therefore, it had an inflated market value. HUD should require indemnification on this loan because as Appendix C of this report illustrates, the subject property was FHA-insured for greater than its true market value.

Comment 5 We understand that the FHA handbooks did change during our audit period of January 1, 2009 through December 31, 2010. Even though the criteria citations changed, the requirements remained the same. For ease of reading and understandability of this report we only included the current criteria citation in the report. For clarity, here are the criteria citations and changes:

- HUD Handbook 4155.1, paragraph 5.A.2.i, was effective May 2009. These requirements were changed slightly with the update in January 2011, which is outside our audit period. Prior to May 2009, this requirement was outlined in HUD Handbook 4155.1, section 3; paragraph 1-9.J, which was effective in October 2003.
- HUD Handbook 4155.1, paragraph 6.C.4.a was effective in December 2009, and the requirements were the same as of the last update in March 2011. Prior to December 2009, these requirements were outlined in HUD Handbook 4155.1, section 4; paragraph 1-12.D.7, which was effective October 2003.
- HUD Handbook 4155.2, paragraph 6.B.4.j was effective May 2009. This paragraph references 24 CFR 203.44, which was effective prior to, and during our audit period.

- HUD Handbook 4155.2, paragraph 8.C.5.d was effective May 2009, and the requirements were the same as of the last update in December 2010. Prior to May 2009, these requirements were outlined in HUD Handbook 4165.1, chapter 2, section 1, paragraph 2-6.C, which was effective in April 2005.

Throughout the audit we adjusted our findings when Mountain States was able to provide documentation that showed it met HUD requirements. The remaining findings are those loans that Mountain States was unable to provide documentation to show it met HUD requirements.

Comment 6 During our audit, Mountain States was unable to provide documentation that it followed HUD requirements in the use of lender advances and lender credits for the loans we identified. In working with HUD to resolve these findings, Mountain States will have another opportunity to provide documentation that it followed HUD requirements. As stated in Finding 1, we recommend that HUD review any documentation Mountain States may provide and determine if amounts are due to the borrowers.

Comment 7 As stated in Finding 1, we recommend that HUD ensure adequate policies and procedures are implemented.

Comment 8 Mountain States did place the insurance fund at an increased risk because the principal amount of the new loans with Mountain States were larger than the amount of the prior FHA loans that were paid off. Therefore, the FHA insurance fund was insuring for a larger amount of money than it would have if the loans were not refinanced.

Comment 9 Mountain States does acknowledge that even though it hired a third party contractor to develop the quality control plan and to perform its quality control reviews, Mountain States is ultimately responsible for ensuring that the plan and process met HUD requirements. As stated in Finding 2, we recommend that HUD ensure an adequate quality control plan is developed and implemented.

Comment 10 Please note that 'reviewing all loans that went into early payment default' was an element in Mountain States' quality control plan. The element that was not part of Mountain States' quality control plan was '…The lender's system of analysis for early payment defaults is set up to identify patterns of the same appraiser, loan officer, loan processor, underwriter, and realtor.'

Mountain States did not provide documentation showing that these processes were performed on a daily basis. As stated in Finding 2, we determined Mountain States did review 4 of the 22 early payment default loans during its monthly quality control reviews. However, Mountain States did not provide documentation of the reviews performed by its compliance officer of the loans with early payment defaults. Contacting the borrower of a loan with an early payment default is not a HUD quality control requirement.

Comment 11 If the quality control process was a priority for Mountain States it would have been aware of the requirements listed in HUD Handbook 4060.1, and ensured that these requirements were met. We agree that it takes time for loans to process through the pipeline, and even more so for Mountain States given that it did not always perform its quality control reviews timely. Had they made the reviews a priority and completed them timely, they would have identified the deficiencies sooner and taken immediate corrective action to mitigate the impact to its loan pipeline.

Comment 12 Mountain States generally agreed that the marketing mailer could mislead a borrower.

Comment 13 We recognize Mountain States' willingness to take corrective action to develop and implement adequate policies and procedures in accordance with HUD requirements for underwriting, quality control, and advertising. However, it does not expunge the fact that during the audit period Mountain States had a major underwriting deficiency, an inadequate Quality Control Plan, and used misrepresentative advertising when marketing its streamline loans. Ultimately, the FHA insurance fund was put at unnecessary risk and homebuyer received inaccurate information about the terms of its new loan.

Appendix C

NARRATIVE CASE SUMMARY

HUD case number:	521-6896581
Loan amount:	$330,585
Closing date:	March 9, 2009
Status at time of review:	Active
Unpaid principal balance:	$ 319,462

Mountain States underwrote the mortgage based on an overstated appraisal. The comparables for the property appraisal were neither reasonable nor comparable. The property appeared to have an appraisal price more than $100,000 higher than those of actual comparables.

Not Comparable

HUD Handbook 4150.2, chapter 4, provides the property appraisal valuation process requirements. Section (4-6) states, "…identify the relevant market based on the area in which the property competes and the forces/dynamics that affect that comparable sale properties." The appraiser did not choose properties comparable to the subject property.

Subject Property

Property details

Year built: 1956
Square footage: 2,392'

- First floor: 1,196'
- Basement: 1,196'

Net livable area: 1,196'

Detached garage: 780 square feet (not pictured)

The photo above was obtained from the Salt Lake County assessor's database. The picture illustrates the home's appearance at the time of the appraisal in November 2008.

Appraisal Selected Comparable Example

Property details

Year built: 1971
Square footage: 2,848’
- First floor: 1,424’
- Basement: 1,424’

Net livable area: 1,424’

Attached garage: 378 square feet (not pictured)

Home sold 5/21/2008 for
$349,900

The appraiser comparable was almost 1 mile away from the subject property. It was built in 1971, making it 15 years newer than subject property. It contained 450 more square feet and had an attached, not detached, garage. Additionally, the comparable property appeared to have a gable roof, whereas the subject property appeared to have a flat roof.

Appropriate Comparable Example

An appropriate comparable was selected by the Salt Lake County assessor’s office based on property size, location, market availability, square footage, and appearance.

Property details

Year built: 1956
Square footage: 1,932’
- First floor: 1,932’

Net livable area: 1,932’

Detached garage: 572 square feet
Carport: 288 square feet

Home sold 8/28//2008 for
$262,500

This property was less than 1/4 mile from the subject property. It was built in the same year, and the square footage was closer in comparison. Additionally, this property contained a detached garage and carport, the same as the subject property.

Not Reasonable

HUD Handbook 4150.2, paragraph 4-6(B), states that the appraiser must "account for differences between the subject property and each comparable sale." The comparable data are adjusted to the subject property. The appraiser did not properly adjust the comparable properties to the subject property.

The appraiser did not adjust the comparable properties to the subject property for "actual age" or "location." Two of the three main comparables were 15+ years newer than subject property. Additionally, the comparable properties were in superior locations to the subject property, which was confirmed during an exterior visual inspection by the HUD OIG auditors.

Minor Deficiencies

Along with the overstated appraisal of the subject property, other minor deficiencies were found during the mortgage loan review. The following minor deficiencies were specific to this loan. Additionally, minor deficiencies noted with this loan, as well as with the other loans reviewed, are discussed in appendix D.

Mountain States charged the borrower for a tax service fee. HUD Handbook 4155.1, paragraph 5.A.2.a, states, "…borrowers may not pay a tax service fee." When this deficiency was brought to the attention of Mountain States, it agreed that the fee was unallowable and reimbursed the borrower.

On form HUD-92900-A, the lender certified that "its owners, officers, employees or directors [do not] have a financial interest in or a relationship, by affiliation or ownership, with the builder or seller involved in this transaction." The borrower in this case would be the seller because the borrower was refinancing the original mortgage loan. During the interview with the borrower associated with this mortgage loan, it was stated that the borrower had both a professional and personal relationship with Mountain States. The borrower stated that he worked professionally with Mountain States providing retirement and insurance consulting for its employees. Additionally, the loan officer who initiated the loan process and ordered the appraisal was the daughter of the borrower.

Finally, the borrower paid the appraiser directly upon completion of the appraisal. According to HUD Handbook 4155.2, paragraph 4.4.g, "…the lender is responsible for collecting and promptly paying the appraisers and inspectors." This fact was noted in the FHA case binder and confirmed during an interview with the borrower.

Appendix D

SCHEDULE OF MINOR DEFICIENCIES

FHA case #	No pre-insurance review	No late endorsement certification	No income certification	Open-ended lender advances	Lender avances for escrow	Lump-sum "lender credit"	Lender credits for escrow	Missing file
201-4728487	X		X					
048-5173353	X	X		X	X	X		
201-4433222	X			X	X			
413-5344096	X	X						
495-8304316	X			X	X	X		
052-5524003	X			X	X			
411-4758435	X		X			X		
043-7962807	X			X	X			
495-8089535	X			X	X			
495-8408830	X			X	X			
412-6536054	X			X	X			
262-1915746	X		X					
332-4963986	X							
422-3138295	X							
263-4699661	X			X	X			
461-4928608	X			X	X			
156-0386532	X						X	
048-5179940	X			X		X		
495-8782250	X							
511-0157305	X							
495-8196117	X			X				
137-5881424	X		X					
048-5664645	X			X	X			
492-8663778	X			X	X			
521-6882083	X							X
156-0556517	X		X					
413-5441895	X		X					
431-5112267	X							
494-3649583	X							
493-9588954	X						X	
521-7801924	X	X				X		
591-1184597	X					X		
491-9389157	X	X		X	X	X		
156-0581803	X	X	X					
263-4464082	X			X	X	X		
042-8661077	X							
023-3995479	X							
482-3988218	X			X				
511-0104990	X							
521-6896581	X	X				X		
156-0519989	X		X					
Totals	**41**	**6**	**8**	**17**	**14**	**9**	**2**	**1**

Pre-insurance Review

Mortgagee Letter 2005-36 provides the requirements of lenders participating in the Lender Insurance program. The mortgagee letter stipulates that the same staff that originated the mortgage or underwrote the mortgage for insurance cannot complete the pre-insurance review. The minimum requirements for the pre-insurance reviews consist of 11 elements. Mountain States was a participant in the Lender Insurance program during our audit period; however, during our review of the 41 loan files, we did not note documentation indicating that a pre-insurance review, consisting of the minimum requirements, was performed on any of the 41 loans.

Late Endorsement Certification Not Submitted

HUD Handbook 4155.2, chapter 8, section C, discusses the requirements for late endorsement request certification. When submitting the loan late for endorsement, Mountain States did not always include a dated certification with all required elements on company letterhead.

Employment and Income Certification Not Submitted

Mortgagee Letter 2009-32 provides procedures regarding streamline refinance transactions and was effective for new case numbers assigned on or after 60 days from September 18, 2009. When submitting the loan to HUD for insurance endorsement, Mountain States did not always include a signed and dated cover letter on its letterhead certifying that the borrower was employed and had income at the time of loan application.

Lender Advances

Seventeen of the loans reviewed had lender advances listed on the HUD-1 settlement statement. Mountain States explained that lender advances are amounts it paid on behalf of the borrowers. Mountain States expects the borrower to repay it for the lender advances. HUD Handbook 4155.2, paragraph 6.B.4.j, and 24 CFR (Code of Federal Regulations) 203.44 state that lenders cannot make open-ended advances. Mountain States was unable to provide documentation showing the repayment terms of the advances because no formal agreement is entered into for the repayment of the lender advances. Additionally, paragraph 8.C.5.d of HUD Handbook 4155.2 states that lenders cannot require a borrower to repay an advance if the repayment would jeopardize the borrower's ability to repay the mortgage and potentially cause a default. Fifteen of these seventeen loans had three or fewer payments made before the first 90-day delinquency was reported. Mountain States paid advances for these 15 loans totaling more than $27,000. Mountain States explained that it does not pursue legal recourse if the borrowers do not repay the lender advances; however, it was unable to provide documentation showing that it did not require these borrowers to repay these advances.

HUD Handbook 4155.1, paragraph 6.C.4.a, allows the lender to offer the borrower an interest-free advance to establish a new escrow account. Fourteen loans reviewed listed lender advances to set up escrow accounts on the HUD-1 settlement statement; however, Mountain States was unable to provide documentation supporting that these funds were used to set up the new escrow accounts.

Lender Credits

HUD Handbook 4155.1, paragraph 5.A.2.i, states that the lender may pay the borrower's closing costs and prepaid items by "premium pricing." The funds derived from the premium priced mortgage may not be used for payment of debts, collection accounts, escrow shortages or missed mortgage payments, or judgments. Furthermore, HUD Handbook 4155.1, paragraph 5.A.2.i states the HUD-1 must contain an itemized statement indicating which items are being paid on the borrower's behalf. It is unacceptable to disclose only a lump sum.

When Mountain States listed the amounts it paid on behalf of the borrower as a lump sum with the description of "lender credit," there was no way for HUD to ensure that the funds were not used for unallowable payments. For 9 of the 41 loans reviewed, Mountain States listed the general category of "lender credit" on the HUD-1 settlement statement totaling more than $14,000.

Additionally, two loans reviewed listed lender credits to set up escrow accounts on the HUD-1 settlement statement; however, Mountain States was unable to provide documentation supporting that these funds totaling more than $400 were used to set up the new escrow accounts.

Missing Documentation

HUD Handbook 4155.2, paragraph 8.B.1.f, requires lenders to maintain their origination binder in either hardcopy or electronic format for 2 years from the date of endorsement. Mountain States was unable to provide an origination binder, either in hardcopy or electronically, for FHA loan #521-6882083.