AUDIT REPORT

SAHARA MORTGAGE COMPANY
NON-SUPERVISED MORTGAGEE
LAS VEGAS, NEVADA

2004-LA-1004

JUNE 17, 2004

OFFICE OF AUDIT
PACFIC/HAWAII REGION
LOS ANGELES, CALIFORNIA

audit report

Issue Date	June 17, 2004
Audit Case Number	2004-LA-1004

TO: John C. Weicher, Assistant Secretary for Housing, Federal Housing Commissioner and Chairman Mortgagee Review Board, H

Joan S. Hobbs

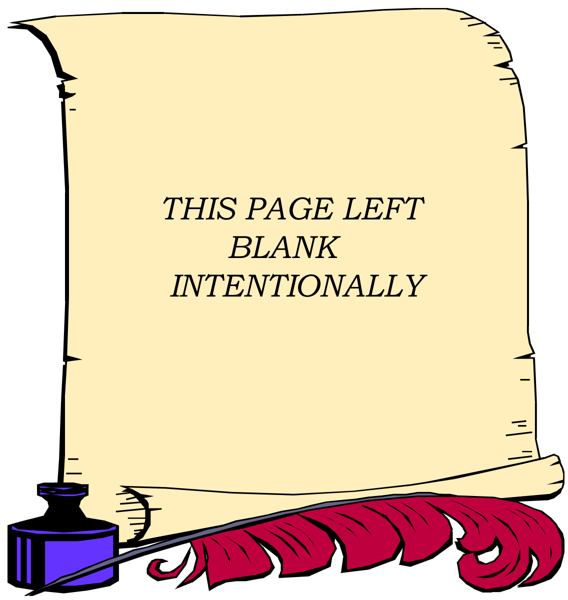
FROM: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

SUBJECT: Sahara Mortgage Company
Non-Supervised Mortgagee
Las Vegas, Nevada

We completed an audit of Sahara Mortgage, a non-supervised mortgagee located in Las Vegas, Nevada. We selected Sahara because of its high default rate. Sahara had the eighth highest default ratio of the 72 active FHA lenders in the Las Vegas area. The objective of the audit was to determine if Sahara originated Federal Housing Administration (FHA) insured mortgages in accordance with prudent lending practices and HUD requirements.

Our report contains four findings with recommendations requiring action by your office. In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us for each recommendation without management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendations without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (213) 894-8016, or Clyde Granderson, Assistant Regional Inspector General for Audit, at (415) 436-8291.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Executive Summary

We completed an audit of Sahara Mortgage (Sahara), a non-supervised direct endorsement mortgagee located in Las Vegas, Nevada. The objective of the audit was to determine if Sahara complied with prudent lending practices and HUD regulations, requirements, and instructions in the origination and underwriting of FHA-insured mortgage loans. The review generally covered the period between January 1, 2001, and December 31, 2003, and consisted of a review of 20 FHA-insured loans that totaled $2,307,225. We found that Sahara engaged in predatory lending, approved loans for unqualified borrowers, and failed to implement a quality control plan. Sahara's president also obtained investment properties with FHA-insured loans. A summary of our review is provided below.

Sahara Engaged In Predatory Lending Practices

Sahara took advantage of first-time homebuyers by charging loan discount points with no corresponding reduction in the interest rate, and by charging higher than par interest rates for which the borrower received no benefit. Borrowers were routinely charged a 1% or 2 % discount fee, but the funds were not applied to lower the loan interest rate. Instead, the funds were simply retained by the lender as profit. Sahara charged a total of $21,479 in discount fees on 18 of the 20 loans we reviewed, and the average discount fee was $1,193. In addition, when Sahara sold the loans to investors, Sahara received an average $2,542 rebate for each loan due to the high interest rates charged. This occurred because Sahara's president, who was also Sahara's primary underwriter during the period covered by the audit, chose to disregard HUD requirements. Sahara's president admitted that Sahara did not lower interest rates in exchange for the discount fees and stated she believed this was standard practice.

Sahara also overcharged for credit reports. Sahara routinely charged $65 for the reports, although the actual costs varied between $12 and $50. The average overcharge to borrowers was $34 per credit report.

Sahara Approved Unqualified Borrowers

Sahara and its underwriter/president did not exercise due diligence in the origination and underwriting of FHA loans, or perform these functions in accordance with HUD requirements and prudent lending practices. As a result, loans were approved for unqualified borrowers, defaults occurred, and HUD paid four claims. HUD resold one house at a net loss of $14,157. HUD retains the other three homes in its inventory.

Our review disclosed that each of these loans had multiple significant underwriting deficiencies. We believe these deficiencies occurred because of Sahara's disregard for HUD/FHA requirements.

Sahara's President Obtained FHA Insured Properties as Investments

The president of Sahara was the secretary and treasurer of Titan Investment, an investment company that obtained ownership of four properties with FHA-insured loans. HUD's tracking systems show the original FHA mortgagors retained title. Sahara's president co-owns Titan Investment with the president of Canyon Lake Mortgage, Sahara's only loan correspondent. Through their actions, they violated FHA's single-family insurance program requirements that generally restrict insured loans to owner-occupied principal residences.

Sahara Did Not Implement Its Quality Control Plan

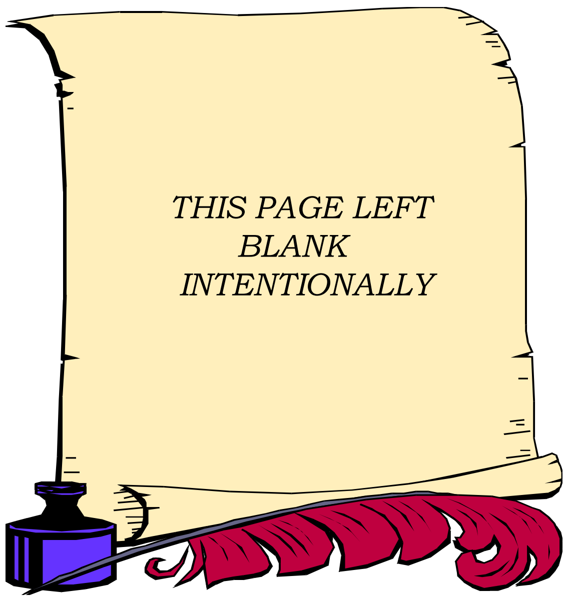
Sahara had not adequately implemented its quality control plan and was deficient in its overall quality control processes. HUD requires lenders to adopt a written quality control plan that will ensure at least 10 percent of all FHA loans are reviewed within 90 days of closing for compliance with HUD requirements for the origination and underwriting of insured loans. In addition, the plan should ensure the lender reviews all loans that go into default before the first six monthly payments are made. At the time of our review, Sahara was a full year behind in its reviews, and management had not taken action to correct deficiencies that were listed in the last two quality control reports it had received. As a result, there was no assurance that Sahara originated and underwrote loans in accordance with HUD's regulations. We believe this occurred because Sahara's president did not make quality control a priority.

Recommendations

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board: (1) take appropriate administrative action against Sahara for not adhering to HUD's program requirements, up to and including removal from participation in HUD's Single Family Mortgage Insurance Program; (2) require Sahara to repay the overcharges for loan discount points and credit reports; (3) require Sahara to pay HUD for the $14,157 sustained loss; (4) require Sahara to indemnify HUD for any losses on 3 loans conveyed but not yet sold, insured for $329,762 and for 13 other loans insured for $1,518,704; and (5) require Sahara's president pay off all loans held with FHA insurance obtained through deed-in-lieu or foreclosure actions. If Sahara is allowed to continue originating FHA-insured loans, we further recommend Sahara provide your office with documentation showing it is current with its quality control reviews and has taken appropriate corrective action on reported deficiencies.

Audit Results Discussed With Auditee – Auditee Comments Not Provided

We discussed the findings with Sahara officials during the audit and at an exit conference held on May 12, 2004. We provided a discussion draft audit report to Sahara on April 27, 2004, prior to the exit conference. Based on discussions at the exit conference, we made minor changes to the report and issued the final draft report on May 24, 2004. A one-week extension to the June 7, 2004, due date was granted. As of June 16, 2004, Sahara's response had not been received. Therefore, the report was issued without auditee comments.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Introduction

Section 203 (b) (1) of the National Housing Act, as amended, authorizes HUD to provide mortgage insurance for single-family homes. HUD must formally approve a mortgagee that originates, purchases, holds or sells FHA-insured loans. Mortgagees must follow the statutory and regulatory requirements of the National Housing Act and HUD instructions, guidelines, and regulations when originating insured loans. Mortgagees that do not follow these requirements are subject to administrative sanctions.

Sahara is a non-supervised, direct endorsement lender, and therefore may originate and underwrite loans. The loan origination process includes taking the initial loan application, initiating the appraisal assignment, obtaining the credit report, and processing verifications of deposit and employment. Based on the information gathered by its loan processors, Sahara underwrites the loan and makes a decision as to whether the borrower represents an acceptable credit risk for HUD.

Sahara's main office, in Las Vegas, Nevada, received FHA approval on October 29, 1996. Currently, Sahara has one approved loan correspondent, Canyon Lake Mortgage. Although Sahara has five FHA approved branches, almost all FHA loans are originated from the main office.

In July 2002, the Quality Assurance Division (QAD) of the Santa Ana Homeownership Center (HOC) did an on-site review of Sahara, including a review of 31 loans. QAD's report included 13 findings, including:

Finding 1: Sahara failed to maintain and implement a quality control plan.

Finding 7: Sahara failed to retain all loan origination case files.

Finding 13: Sahara charged excessive fees to mortgagors.

The other 10 findings consisted of processing and underwriting deficiencies. As a result, the HOC imposed a Limited Denial of Participation on Sahara's underwriter, who is also Sahara's president, and Sahara agreed to indemnify HUD for any losses incurred on 29 of the 31 loans reviewed.

Audit Objectives

The objective of our audit was to determine if Sahara complied with prudent lending practices and HUD regulations, requirements, and instructions when originating and underwriting FHA insured single-family mortgages.

Audit Scope and Methodology

We performed our audit from August through November of 2003. We selected Sahara for audit based on its high number of early defaults.

To accomplish our audit objectives, we:

- Selected and performed in depth reviews on 18 FHA-insured loans originated by Sahara during the period from January 2001 through December 2002.

- Selected and performed limited reviews on two additional Sahara FHA-insured loan files originated between March and October 2001. We are reporting on one additional mortgage for which our review was limited to title transfers and rental information. We reviewed these additional loans when we discovered their titles had transferred to an investment company, but the FHA mortgages were still active.

- Interviewed Sahara management and employees.

- Interviewed FHA borrowers and borrowers' employers to verify information submitted to HUD/FHA as part of the FHA loan files reviewed.

- Verified purported borrower wage information.

- Reviewed settlement agents' escrow files to verify sources and uses of funds for loan closing costs and prepaid expenses.

The audit generally covered the period from January 1, 2001, through December 31, 2003, and the loans reviewed were originated between January 1, 2001, and December 31, 2002. During this period, Sahara originated 228 FHA loans. The audit was conducted in accordance with generally accepted government auditing standards.

Sahara Engaged In Predatory Lending Practices

Sahara used several methods to obtain profits on FHA loans in violation of the Real Estate Settlement Procedures Act (RESPA). Sahara charged its FHA borrowers $21,479 in loan discount fees, an average of $1,193 per mortgage, on 18 of the 20 loans we reviewed, but did not provide any reduction in interest rates. Sahara obtained additional profit by selling its FHA loans at premium prices (also known as rebate pricing), and the rebates on all 12 loans reviewed, totaling $30,501, were not used to pay borrower's closing costs. Finally, Sahara overcharged some borrowers for credit reports. We believe this occurred because Sahara's president chose to disregard the law and HUD requirements. As a result, first-time homebuyers paid more for their loans than necessary and the higher interest rates contributed to mortgage payment defaults and subsequent foreclosures.

Lending Practices, Rules, and Policies

In April 2000, the HUD/Treasury National Predatory Lending Task Force was convened. The Task Force drew its members from a large group of individuals interested in, and affected by, predatory lending, including consumer advocacy groups, industry trade associations, local and state government officials, and academics. In a report issued by the Task Force, it described predatory lending as "… engaging in deception or fraud, or taking unfair advantage of a borrower's lack of understanding of loan terms." The report further stated the "…practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices."

HUD Handbook 4060.1, REV-1, paragraph 2-24B.3 does not allow a lender to "Pay any compensation or fee that is prohibited by the Real Estate Settlement Procedures Act (RESPA)."

The Real Estate Settlement Procedures Act (RESPA) is a consumer protection statute first passed in 1974. Section 8 of RESPA prohibits a person from giving or accepting any part of a charge for services that are not performed.

In 24 CFR 3500.14, Prohibition Against Kickbacks and Unearned Fees, it states, "A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable," and "any violation of this section is a violation of Section 8 of RESPA."

Mortgagee Letter 94-7, states premium rate mortgages, also known as "rebate pricing" mortgages, permit the borrower to pay a higher interest rate in exchange for the lender paying the borrower's closing costs." It also states, "…if a premium rate will result in excess funds (an amount exceeding closing costs and prepaids), the principal balance of the mortgage must be reduced by the overage. A seller may pay the borrower's closing costs (or a portion), with the lender using the funds from a premium to fund the borrower's prepaid expenses or other remaining closing costs."

Discount Point Charges Did Not Result in Lowered Interest Rates

Sahara charged a total of $21,479 in loan discount points on 18 of the 20 loans we reviewed. The discount points were 1 to 2 percent of the loan amount and the average charge for each loan was $1,193 (See Appendix B). It is generally accepted and agreed that loan discount points are paid to reduce the interest rate on a loan. Sahara was unable to provide any evidence it reduced interest rates for these loans. In fact, Sahara's president admitted the rates were not discounted, and told us she believed HUD allowed the lender to earn two points, or two percent of the loan amount, on each loan. Sahara's president also said she believed it was standard practice for lenders to charge one origination point and one discount point. The president's understanding of HUD regulations is erroneous and so is her implication that Sahara only earned two percentage points on each loan. In addition to the origination fee and the loan discount fee, Sahara received profits through premium pricing and overcharges for credit reports.

HUD allows lenders who originate FHA insured loans to charge borrowers a one percent origination fee and eligible closing and prepaid costs; however, additional fees should be for specific services performed beyond the normal loan processing and underwriting. Section 8 of RESPA prohibits giving or accepting any part of a charge for services that are not performed (unearned fees). Since loan discount points were charged and the interest rates were not reduced, we concluded these were unearned fees, a RESPA violation, and a predatory lending practice.

Most of the borrowers we interviewed were first-time homeowners and said they were unaware they had a choice of lenders. Generally, they were directed to Sahara by the developers of new housing or by real estate agents. One borrower had visited other lenders before Sahara and said Sahara was the only lender who would work with her, due to her poor credit history. Most borrowers said they did not know what discount points were and Sahara never explained them. Some were not aware discount points had been paid when their loan closed. Others paid the points, but were not aware they had a choice.

Premium Rate Mortgages

We asked Sahara to provide purchase advices for each of the 20 loans in our sample. The purchase advices show the details of Sahara's sale of loans to investors, including the price the investor paid, rebates for premium pricing, and service release premiums. Sahara's president said she could only find purchase advices for 12 of the 20 loans. Each of the 12 purchase advices Sahara's president provided showed premium rate, or rebate pricing mortgages for which Sahara received $30,501 in loan rebates (See Appendix B).

Premium pricing occurs when the lender sells a loan to an investor with an above par interest rate and receives a rebate from the investor. HUD allows this practice and expects the rebate to be used to pay the borrower's closing costs or prepaid expenses; however, our test results indicated Sahara sold its loans at premium prices and did not apply the rebates to the borrowers' costs. Sahara did not apply rebate credits to closing costs or prepaid expenses, all of which the borrower or the seller had paid. Sahara received an average rebate of $2,542 per loan for those we tested. This was in addition to the service release premiums, which are the customary amounts loan originators receive when they sell the servicing rights to their loans. Sahara received an average of $2,515 in service release premiums for each loan we tested.

Overcharges for Credit Reports

Lenders are allowed to recover actual costs they must pay to outside firms in order to process a loan. These costs include appraisal fees to determine the value of the property and credit reports to determine if the borrower is credit worthy. HUD does not allow the lender to charge the borrower more than the actual cost or more than the amount customary in the area. Sahara routinely charged $65 dollars for credit reports, when actual costs ranged from $12 to $50. The average overcharge to borrowers was $34. In some cases, the borrowers paid the charges and in other cases the sellers paid. (See Appendix C)

Recommendations

We recommend the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board:

1A. Take appropriate action against Sahara up to and including removal from participation in HUD's Single Family Mortgage Insurance Program.

1B. Require Sahara to establish written policies and procedures for when loan discount fees and premium interest rates may be charged, and certify it will not engage in predatory lending practices.

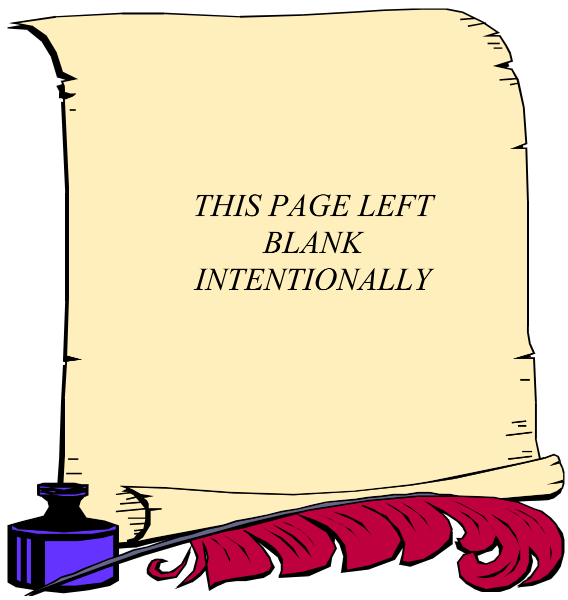
1C. Require Sahara to review and analyze all FHA-insured loans generated by Sahara since August 1, 1999, with loan discount points (including the $21,479 shown in Appendix B) where no interest rate reduction occurred and report the results to the MRB. Refunds should be issued in the following order:

1. If the loan is current, a refund must be made to the borrowers.
2. If the loan is delinquent, a refund must be applied to the delinquency.
3. If a claim has been paid, a refund must be paid to HUD and sent to HUD Single Family Claims.

1D. Require Sahara to review and analyze all FHA-insured loans it generated since August 1, 1999, with premium pricing rebates (including the $30,501 shown in Appendix B) and report the results to the

MRB. Refunds should be issued in the same order shown in recommendation 1C.

1E. Require Sahara to charge for only actual costs for credit reports and refund the $207 in overcharges identified in Appendix C to the respective borrowers.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Sahara Approved Unqualified Borrowers For FHA Insured Loans

Sahara did not comply with HUD's requirements for prudent lending practices in the origination and underwriting of FHA insured loans on 17 of the 20 loans reviewed, valued at $2.3 million. Sahara did not exercise due diligence in the: (1) verification of the borrowers' income or source of funds for down payments and closing costs; (2) review of the borrowers' liabilities and credit characteristics; and (3) analysis of the borrowers' ability to pay. As a result of these deficiencies, Sahara approved mortgagors who were not qualified for FHA-insured loans. Sahara's deficiencies in loan origination and underwriting activities are a result of its noncompliance with HUD requirements and contributed to Sahara's high default rate, which led to claims against the FHA insurance fund.

Loan Origination and Underwriting Requirements

Under HUD's Single Family Direct Endorsement Program, the mortgagee underwrites and closes the mortgage loan without prior HUD review or approval. HUD Handbook 4155.1 REV-4 CHG-1 contains the basic mortgage credit underwriting requirements for single-family mortgage loans.

Section 2-3, *Analyzing the Borrower's Credit*, states in part: "Past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. A borrower who has made payments on previous or current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong offsetting factors will be necessary to approve the loan."

Section 2-12, *Debt to Income Ratios*, states in part: "Ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership, and otherwise provide for the family. The lender must compute two ratios:

A. *Mortgage payment expense to effective income*. If the total mortgage payment does not exceed 29 percent of gross effective income, the relationship of the mortgage payment to income is considered acceptable.

B. *Total fixed payment to effective income*. If the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable."

Section 3, *Funds to Close,* paragraph 2-10, states in part: "The cash investment in the property must equal the difference between the amount of the insured mortgage, excluding any upfront MIP, and the total cost to acquire the property, including prepaid expenses, (see paragraph 1-9). All funds for the borrower's investment in the property must be verified."

Sahara Approved Borrowers with Poor Credit Patterns

Sahara approved loans for borrowers with extremely poor credit patterns and/or excessive current obligations. The borrowers in our sample typically had numerous accounts that were referred for collection and multiple judgments against them. Credit histories for 13 of the 20 mortgagors in our sample indicated an inability to manage money and obligations. Borrowers in 17 out of 20 loans had excessive current obligations that indicated they would have difficulty making monthly mortgage payments (See Appendix D). Predictably, the borrowers defaulted on their FHA insured loans.

In one case, the borrower had 5 collections listed on his credit report, and two were from the last two apartments he had rented prior to purchasing the home. The co-borrower had 19 collections and 1 judgment on her credit report. The file did not document any acceptable compensating factors. Foreclosure was completed on the $130,281 mortgage on November 3, 2003, and HUD's Neighborhood Watch System listed the reason for the default as "excessive obligations."

In another case, the borrower had 21 collections and 3 judgments shown on the credit report. The compensating factors cited on the Mortgage Credit Analysis Worksheet were that the borrower was a "minimum credit user" and had a second job with income of $1,690. The cited compensating factor regarding credit use was apparently not true, and the second job was not verified or supported.

Again, the borrower's reason for default, according to Neighborhood Watch, was "excessive obligations." Foreclosure was completed on the $135,670 loan in May 2003.

Sahara Approved Borrowers, Despite High Debt-to-Income Ratios

In 17 of the 20 loans we reviewed, either the borrowers' mortgage payment-to-income ratios exceeded HUD's guideline of 29% or they exceeded HUD's guideline of 41% for total fixed obligations to effective income (See Appendix D). Review of the loan origination files did not reveal any acceptable compensating factors, such as large cash reserves, large down payments, previous history of making similar payments for housing, or conservative use of credit.

Sahara miscalculated effective income by overstating earnings and/or understating debts in 15 cases.

For one loan, the file documentation showed the borrower paid $701 each month in child support. In its calculations, Sahara used $475 for the child support amount. Sahara did not provide any explanation or support for the change, and had Sahara used the correct amount, it would have calculated the fixed obligations to effective income ratio at 52.6%, more than ten percentage points over HUD's guideline. Foreclosure was completed on the $130,281 loan in November 2003.

In another loan, Sahara included unsupported amounts of $332 in overtime earnings and $347 in child support in its calculation of the mortgagor's effective monthly income. The mortgagor's employer did not verify employment in writing and there was no documentation of child support payments. Wage statements showed sporadic overtime over a period of four months, and the origination file contained a written statement from the mortgagor that she received child support based on a verbal agreement with the child's father. If Sahara had not included the unsupported amounts in its calculations, the mortgagor's ratios would have been 49% for mortgage payment to income and 62% for total fixed payments to income. The loan was in default in February 2002, when Titan Investment took ownership through a deed in lieu of foreclosure..

Funds to Close Were Not Certified

In 17 of the 20 cases in our sample, Sahara also failed to fully verify the borrowers' source of funds to close. Most borrowers received part of their closing funds as a gift from nonprofit organizations, and the sources of gift funds were verified. However, the gifts did not cover all of the closing requirements. Sahara failed to fully verify the source of closing funds attributed to the borrowers. In most cases, the borrowers' funds were deposited into escrow in the form of cashiers' checks. The borrowers' bank statements, which should have shown the withdrawal of the funds, showed that the borrowers never had sufficient funds in the bank to cover the deposits. Sahara also failed to verify any other source for the funds. As a result, there was no assurance the borrowers did not obtain prohibited second loans.

Risk of Losses Increased

We believe Sahara's president, who was the primary underwriter, was more interested in generating profits than in adhering to HUD requirements. She explained her intent was to help people to attain home ownership; however, the mortgagors who defaulted on their loans because of excessive obligations or insufficient income did not benefit from Sahara's lack of due diligence. As a result, the risk of losses increased for HUD's FHA insurance fund.

Recommendations

We recommend the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board require Sahara Mortgage to:

2A. Reimburse HUD for the $14,157 loss on one paid claim (See Appendix F).

2B. Indemnify HUD for future losses on the loans listed in Appendix F (13 loans totaling $1,518,704 and 3 loans in HUD's inventory insured for a total of $329,762).

Sahara's President Obtained Ownership of FHA Insured Properties

The president of Sahara was the secretary and treasurer of Titan Investment, an investment company that obtained ownership of four properties with FHA-insured loans totaling $439,593. Sahara's president co-owned Titan Investment with the president of Canyon Lake Mortgage, Sahara's only loan correspondent. Through their actions, they violated FHA's single-family insurance program requirements, which generally restrict insured loans to owner-occupied principal residences. When the transfers occurred, Sahara's president was also Sahara's primary underwriter, and she was responsible for ensuring Sahara conducted business in accordance with FHA requirements. We believe the co-owners of Titan Investment disregarded FHA regulations in pursuit of personal gain.

Investors Are Prohibited From Obtaining FHA Loans

HUD Handbook 4155.1 REV-4, CHG-1, states in Chapter 1-1 that HUD's single-family FHA programs are generally limited to owner-occupied principal residences. In Chapter 1-2, it states individuals may not obtain more than one FHA mortgage at a time, except for very limited exceptions which included relocations, increase in family size, vacating a jointly-owned property, or a non-occupying co-borrower (where the other borrower is a family member who will occupy the property as a principal residence). Chapter 1-2 explained the one mortgage limit as follows:

> "To prevent circumvention of the restrictions on FHA-insured mortgages to investors, we generally will not insure more than one mortgage for any borrower."

Chapter 1-4 listed the limited exceptions to the ban on FHA loans on investment properties:

- Section 203(k) Rehabilitation loans;
- Purchases of FHA-owned properties (when permitted by the local FHA office selling the property); and

- Streamline refinances without appraisals for properties the investor purchased with an FHA loan prior to the 1989 ban on investors."

Titan Acquired Three Properties through Deeds In Lieu of

Titan Investment did not meet any of the exceptions listed above and all of the loans were originated by Sahara. Three of the loans were in default, with the first legal action to foreclose initiated. The president of Sahara accepted deeds in lieu of foreclosure in the name of Titan Investment, but did not terminate the FHA loans. As a result, HUD was misled to believe the mortgagors had reinstated the loans and retained ownership. Although she was the underwriter for only one of the three defaulted loans, Sahara's president was the primary underwriter for Sahara at the time.

Mortgagors Did Not Qualify for FHA Loans

The loan origination files showed processing and underwriting deficiencies for all of the loans in default. In all three loans, Sahara failed to verify the mortgagors' source of funds for the down payment, and in one, the mortgagor did not meet the requirement to provide at least a 3% investment in the property. For one of these loans, the mortgagor's credit history showed 22 accounts that were in collection and one judgment. Sahara did not identify adequate compensating factors, such as large cash reserves. HUD recommends a maximum mortgage payment-to-income ratio of 29% and a maximum fixed payment-to-income ratio of 41%. For this loan, the mortgagor's ratios far exceeded HUD's guidelines when we recomputed them to be 49% and 62% respectively. Sahara's president underwrote this loan and understated the ratios.

Family Member Transferred Property Back to Titan Investment

The fourth property was purchased by Titan Investment in October 2001 and transferred to a member of Sahara's president's family four days later. The family member obtained an FHA loan from Sahara for the purchase. In April 2002, the family member transferred the property back to Titan but did not terminate the FHA insured loan. Titan transferred the property back to the family member in January 2003, and he obtained a FHA-insured streamline refinance loan.

Titan Investment Rented Properties with owner-occupied loans to Section 8 Tenants

Titan Investment entered into Section 8 Housing Assistance Payment (HAP) contracts with the City of Las Vegas Housing Authority for two of the properties it obtained through deeds-in-lieu and for the property it transferred back and forth to the family member. The Section 8 Program provides HUD funds to assist low-income renters by paying landlords the difference between thirty percent of the eligible renter's income and the contract rent amount. The HAP contract on the family member's property was in effect during the time Titan owned it.

On December 9, 2003, we visited one home and spoke to the Section 8 tenant, who confirmed she has lived there and has been a Section 8 recipient since March 2002. The FHA loan on this property was in default when Titan Investment took possession through a Deed-In-Lieu on February 27, 2002. The president of Sahara Mortgage (and secretary-treasurer for Titan Investment) signed the transfer deed on behalf of Titan. On March 12, 2002, Titan entered into a HAP contract with the City of Las Vegas Housing Authority for a Section 8 tenant. Since then, Titan has been receiving monthly rental payments.

Conclusion

Regarding the FHA insured properties that Titan obtained through deeds in lieu, we believe Sahara's president acted first to prevent Sahara's default rate from increasing and jeopardizing its standing as an FHA lender. At the same time, we believe the president saw an opportunity to profit from the acquisition of investment properties. In the fourth property case, where a family member took title in order to obtain an FHA loan on the property and then transferred the property back to Titan, we can only conclude Sahara's president knowingly ignored HUD's requirements for personal gain. As a result, the FHA insurance program was used for the benefit of investors rather than owner-occupants, as intended.

Recommendations

We recommend the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board:

3A. Require Sahara to immediately pay in full and terminate the four loans with FHA insurance totaling $439,593 (See Appendix F).

3B. Permanently withdraw the underwriter identification approval of Sahara's president.

Sahara Did Not Implement Its Quality Control Plan

At the time of our audit, Sahara was more than a year in arrears in performing required quality control reviews of its origination files. In addition, Sahara had not taken any action on the deficiencies reported in the last two quarterly reports it received from its quality assurance contractor. Unless the quality control plan is fully implemented, there can be no assurance Sahara is originating and underwriting loans in compliance with HUD/FHA requirements or that deficiencies are corrected.

HUD Requirements

Quality control requirements are detailed in HUD Handbook 4060.1 REV-4, Chapter 6. In addition to a review of any loan that goes into default before six payments are made, the handbook states that the selection process for the review of 10% of all other FHA loans must provide assurance that all loan officers, underwriters, and appraisers will have loans subjected to reviews. Further, the handbook requires that lenders have a written quality control plan to ensure the reviews are conducted and management takes appropriate and timely corrective action.

HUD's Quality Assurance Division (QAD) did a review of Sahara in July 2002 and provided the results to Sahara in September 2002. The first of QAD's 13 findings stated, "Sahara failed to maintain and implement a quality control plan in compliance with HUD's requirements." After explaining that Sahara's written quality control plan was inadequate, the report went on to say that the most recent reviews had been performed on loans originated a year earlier, in June 2001. QAD required Sahara to revise its quality control plan to include all elements required by HUD, and to provide HUD with the steps it had taken to assure that quality control reviews were performed within 90 days of loan closing. When Sahara received the results of QAD's review in September 2002, Sahara revised its quality control plan to include these requirements, but Sahara did not implement the plan. A year later, in September 2003, the only periods for which reviews had been completed were the first two quarters of 2002. Further, Sahara's management had not yet taken corrective action on the deficiencies found during the reviews, although they received the results of the reviews in April 2003. As of September 30, 2003, no additional loans had been reviewed.

Sahara's president blamed the delays on poor performance by a quality control firm, which she replaced in January 2003. However, the new firm stated it could usually provide a 30-day turnaround on loan reviews and the last two reports included reviews of only 4 loans each; therefore, there was no reason the reviews for 2003 were not timely. After sending the 8 files for the first two quarters of 2002, Sahara did not send any funding logs to the contractor until September 2003; therefore, the contractor did not select any additional loans to review until September 2003.

As we completed our audit, the contractor was reviewing 8 of Sahara's files for the period July through December 2002, but had not yet selected any files for 2003. Further, for the first half of 2002, we learned that Sahara selected the files for review. The employee who selected the files stated he consciously chose the ones least likely to have deficiencies. The same employee was the loan officer for many of the loans. Although this employee continues to act as a loan officer, he currently also carries the title "Quality Control Manager." The selection method Sahara used obviously violated the intent of the quality control requirements, which is to ensure that all loans are processed and underwritten in compliance with HUD requirements. Further, naming a person who directly participated in the loan's processing as the quality control manager creates a conflict of interest and compromises the integrity of the quality control process.

At the time of our audit, Sahara had not accomplished reviews of any of the loans that had defaulted before six payments were made. Sahara's president said she was unaware of the early default review requirement until HUD's QAD review. She stated that she did not know how to find out when loans went into default, because Sahara sold all of its loans to a warehouse lender and the lender did not provide the information. Sahara amended its contract with the warehouse lender and began receiving default reports in May 2003. Sahara's president said there have been no early defaults since then.

Some of the deficiencies the quality control requirements are designed to prevent and correct were evident in the loan origination files we reviewed. In Findings 1 and 2, we discussed significant deficiencies in Sahara's origination and underwriting processes including: improper and excessive charges for services (Finding 1); approval of unqualified borrowers for FHA loans; and Sahara did not do an adequate job of verifying the source of funds each borrower was required to provide at closing (Finding 2). Therefore, until Sahara fully implements the quality control plan, there is no assurance that it is originating and underwriting loans in accordance with HUD/FHA requirements, or that deficiencies are being corrected.

Recommendations

We recommend the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board require Sahara to:

4A. Provide evidence that its required loan reviews are up to date and management has taken appropriate action to correct deficiencies.

4B. Replace the quality control manager with someone who has no direct participation in the origination or underwriting processes.


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Management Controls

In planning and performing our audit, we considered the management controls of Sahara in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing and controlling its business operations. They include the systems for measuring, reporting and monitoring business performance.

Relevant Management Controls

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

Compliance with Laws and Regulations – Policies and procedures implemented by management to reasonably ensure that its loan origination process is carried out in accordance with applicable laws and regulations.

Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and used during the mortgage loan origination process.

We assessed the relevant controls identified above.

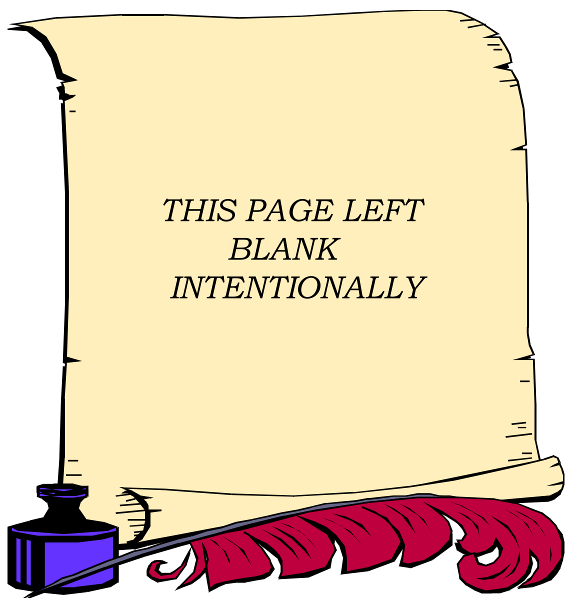
It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling business operations will meet an organization's objectives.

Significant Weaknesses

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

- Compliance with laws and regulations for the loan origination and underwriting processes and the quality control process (Findings 1, 2, 3 and 4).

- Validity and reliability of data (Findings 1 and 2).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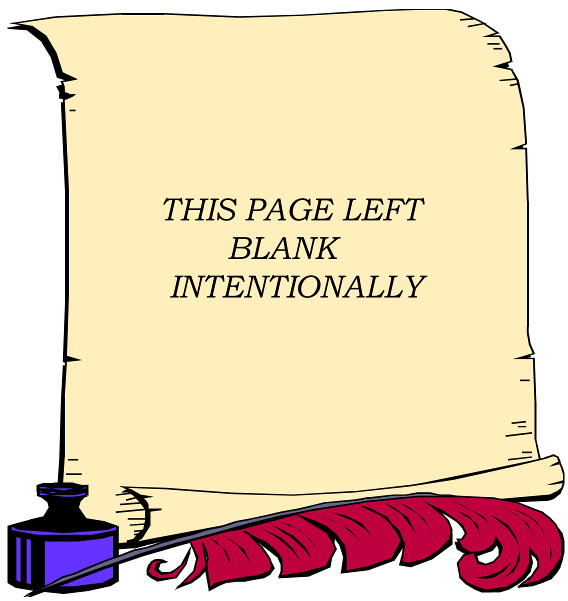
Follow Up On Prior Audits

This is the first HUD Office of Inspector General audit of Sahara. The mortgagee's last two independent audits for the years ending December 31, 2001, and December 31, 2002, did not contain any findings.

HUD's Quality Assurance Division performed a monitoring review of Sahara in July 2002.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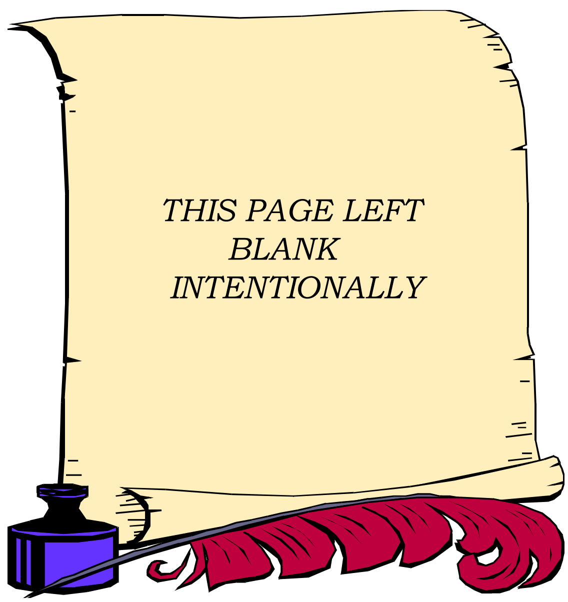
Schedule of Questioned Costs and Funds Put to Better Use

Recommendation Number	Type of Questioned Cost Ineligible 1/	Unsupported 2/	Funds Put to Better Use 3/
1C	$21,479		
1D	30,501		
1E	$207		
2A	$14,157		
2B		$329,762	$1,518,704
3A			$ 439,593

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

2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of the audit. The costs are not supported by adequate documentation or there is a need for legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Funds put to better use are costs that will not be expended in the future if our recommendations are implemented.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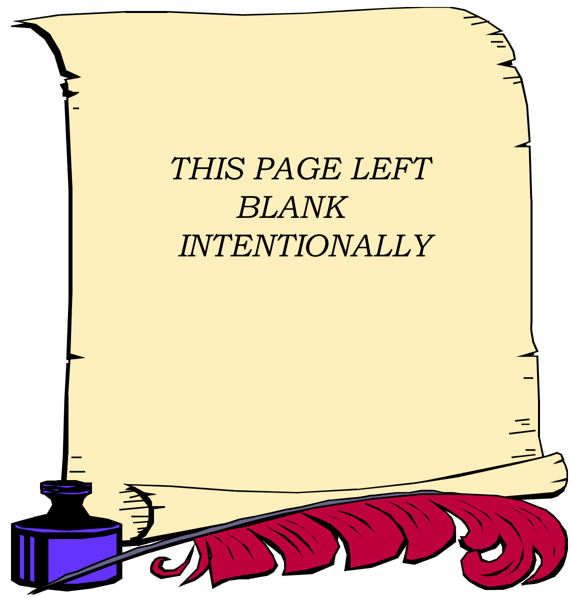
Predatory Lending - Fees Collected By Sahara									
	FHA Case #	Loan Amount	Interest Rate	Loan Origination Fee	Discount Fee	Loan Rebate Points	Loan Rebate Amount	Other Fees**	Total
1	332-3503789	$ 58,362.00	7.500%	$ 575.00	$ 583.62	0.375	$ 218.86	$1,167.24	$ 2,544.72
2	332-3546148	$ 109,520.00	8.125%	$ 1,079.02	$1,095.20	2.5	$2,738.00	$2,409.44	$ 7,321.66
3	332-3549013*	$ 101,559.00	8.000%	$ 1,000.59	$1,048.49			$ 775.00	$ 2,824.08
4	332-3563776	$ 117,059.00	8.375%	$ 1,153.30	$2,341.18	2	$2,341.18	$3,450.30	$ 9,285.96
5	332-3569292	$ 75,617.00	8.250%	$ 745.00	$ 756.17	2.375	$1,795.90	$2,136.11	$ 5,433.18
6	332-3599591*	$ 98,445.00	8.000%	$ 969.90	$ 984.45				$ 1,954.35
7	332-3611149	$ 131,885.00	8.000%	1,298.68	$1,318.16	2.625	$3,457.85	$3,128.53	$ 9,203.22
8	332-3611871*	$ 126,297.00	7.875%	$ 1,244.31	$1,262.97			$ 775.00	$ 3,282.28
9	332-3618755	$ 124,489.00	7.875%	$ 1,226.50	$1,244.89	2.218	$2,759.27	$3,785.56	$ 9,016.22
10	332-3619413	$ 116,866.00	8.000%	$ 1,151.39	$1,168.66	2.625	$3,065.67	$3,601.26	$ 8,986.98
11	332-3638982*	$ 117,151.00	8.000%	$ 1,154.20	$1,171.51				$ 2,325.71
12	332-3663494	$ 96,387.00	8.000%	$ 949.63	$ 963.87	2.5	$2,409.68	$2,383.40	$ 6,706.58
13	332-3689824*	$ 141,518.00	7.875%	$ 1,394.27	$1,415.18			$ 775.00	$ 3,584.45
14	332-3693024*	$ 130,281.00	8.000%	$ 1,283.56	-				$ 1,283.56
15	332-3706997*	$ 118,144.00	8.000%	$ 1,163.99	$1,181.44			$ 775.00	$ 3,120.43
16	332-3707905	$ 135,670.00	7.875%	$ 1,336.66	$1,356.70	2.515	$3,412.10	$4,058.21	$10,163.67
17	332-3756118	$ 123,561.00	7.375%	$ 1,217.35	$1,235.61	2.238	$2,765.30	$3,765.18	$ 8,983.44
18	332-3855375	$ 149,458.00	8.000%	$ 1,472.50	-	3	$4,483.74	$2,989.16	$ 8,945.40
19	332-3867968	$ 120,353.00	7.000%	$ 1,185.75	$1,203.53	0.875	$1,053.09	$2,407.06	$ 5,849.43
20	332-3909365*	$ 114,700.00	7.500%	$ 1,130.05	$1,147.00			$1,000.00	$ 3,277.05

*Sahara would not provide sale information (rebate points, rebate amount) for these 8 loans; therefore total fees collected are understated.

**"Other Fees" includes Service Release Premiums, Loan Processing Fees, Underwriting Fees, and Administrative Fees.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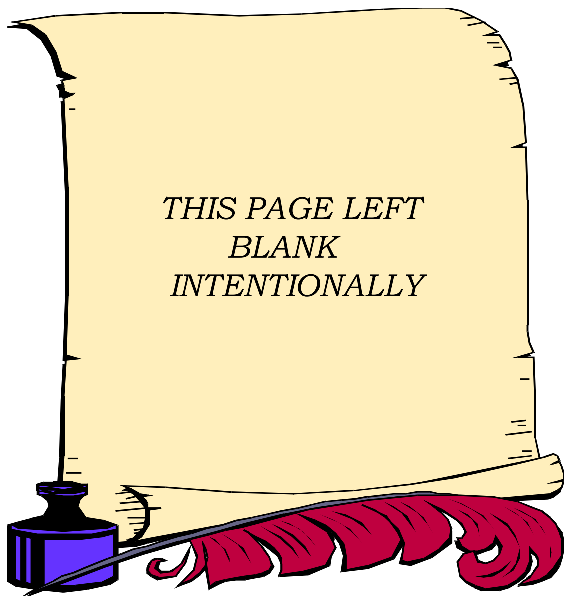
Overcharges for Credit Reports			
FHA# 332-	**Charged to Borrower Per HUD-1**	**Actual Cost**	**Total Overcharged**
3693024	$ 65.00	$ 65.00	$ -
3867968	$ 65.00	$ 37.00	$ 28.00
3707905	$ 65.00	$ 50.00	$ 15.00
3638982	$ 65.00	$ 27.00	$ 38.00
3663494	$ 65.00	$ 12.00	$ 53.00
3855375	$ 65.00	$ 35.00	$ 30.00
3599491	$ 65.00	$ 22.00	$ 43.00
			$ 207.00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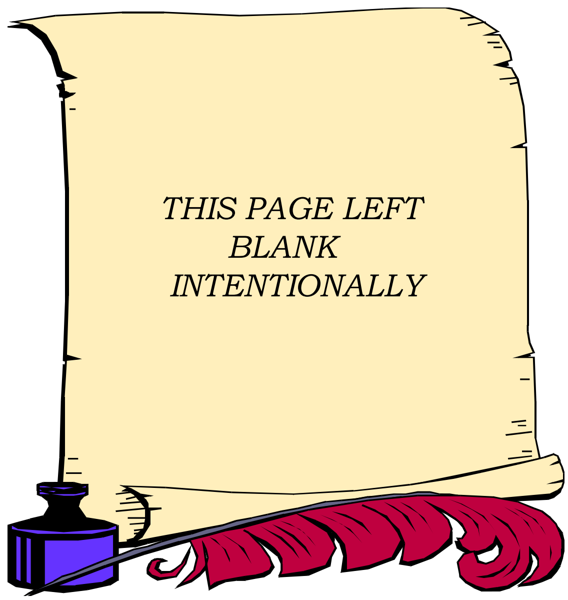
Debt Ratios for Sahara's Borrowers						
		Reported by Sahara		***Calculated by OIG***		
	FHA# 332-	Front Ratio (should not exceed 29%)	Back Ratio (should not exceed 41%)	Front Ratio (should not exceed 29%)	Back Ratio (should not exceed 41%)	Excessive Ratio(s)
1	3693024	25.70%	**47.50%**	25.70%	**52.60%**	X
2	3909365	**31.13%**	35.88%	**31.63%**	35.88%	X
3	3563776	**38.15%**	**48.83%**	**38.86%**	**51.35%**	X
4	3756118	28.20%	32.30%	**65.01%**	**74.49%**	X
5	3867968	**35.58%**	35.58%	**58.79%**	**58.79%**	X
6	3707905	27.45%	35.31%	27.45%	35.31%	
7	3689824	**38.30%**	39.90%	**43.27%**	**45.02%**	X
8	3503789*	N/A	N/A	N/A	N/A	
9	3546148	**39.43%**	**42.52%**	**39.43%**	**60.94%**	X
10	3569292	**29.43%**	**44.67%**	**29.43%**	**75.85%**	X
11	3618755	**42.80%**	**48.30%**	**48.20%**	**54.30%**	X
12	3619413	22.00%	35.50%	28.80%	**46.40%**	X
13	3638982	**37.30%**	**46.60%**	**49.00%**	**62.00%**	X
14	3663494	**46.20%**	**51.50%**	**54.06%**	**60.91%**	X
15	3706997	**41.96%**	**41.96%**	**41.96%**	**41.96%**	X
16	3855375	20.70%	32.68%	20.70%	32.68%	
17	3549013	**32.90%**	33.80%	**32.93%**	33.80%	X
18	3611149	28.85%	33.51%	**36.16%**	**53.39%**	X
19	3599951	**39.76%**	39.76%	**39.76%**	39.76%	X
20	3611871	27.11%	29.33%	**30.03%**	32.49%	X
				Number of loans with excessive ratios		**17**

*This was a streamline finance that did not require calculation of ratios.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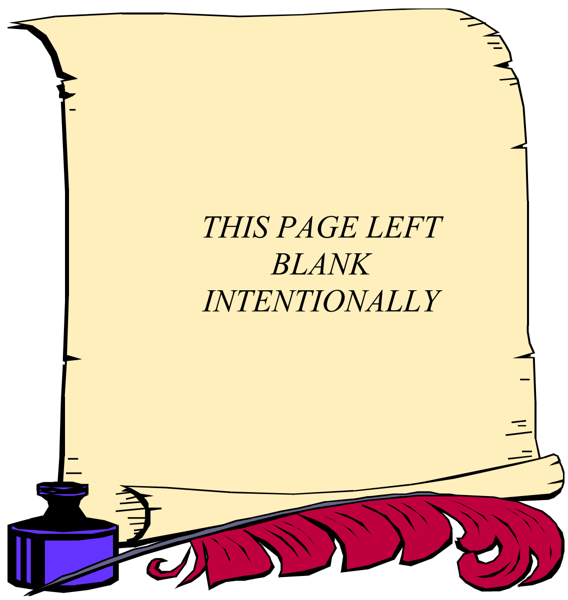
Origination and Underwriting Deficiencies

	FHA# 332-	Loan Amount	High Debt Ratios	Poor Credit Record	Over-stated Income	Under-stated Debts	Source of Funds Not Verified	Status
1	3693024	$ 130,281	X	X		X	X	foreclosed
2	3909365	$ 114,700	X	X	X		X	default
3	3563776	$ 117,059	X		X	X	X	default
4	3756118	$ 123,561	X		X		X	default
5	3867968	$ 120,353	X		X			default
6	3707905	$ 135,670		X			X	foreclosed
7	3689824	$ 141,518	X	X	X		X	default
8	3503789	$ 58,362		X				reinstated
9	3546148	$ 109,520	X	X		X	X	reinstated
10	3569292	$ 75,619	X	X		X	X	default
11	3618755	$ 124,489	X	X	X		X	default
12	3619413	$ 116,866	X	X	X		X	claim
13	3638982	$ 117,151	X	X	X	X	X	deed-in-lieu
14	3663494	$ 96,387	X		X			claim
15	3706997	$ 118,114	X				X	default
16	3855375	$ 149,458		X			X	reinstated
17	3549013	$ 101,559	X	X			X	refi & claim
18	3611149	$ 131,816	X	X	X	X	X	claim
19	3611871	$ 126,297	X		X		X	deed-in-lieu
20	3599591	$ 98,445	X		X		X	deed-in-lieu
Total		**$2,307,225**	**17**	**13**	**12**	**6**	**17**	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Active Loans Sahara Should Indemnify				
	FHA# 332-	**Loan Amount**	**Settlement Date**	**Status**
1	**3693024**	$ 130,281	7/20/2001	Foreclosure Completed
2	**3909365**	$ 114,700	6/12/2002	In Default
3	**3563776**	$ 117,059	2/28/2001	In Default
4	**3756118**	$ 123,561	11/5/2001	In Default
5	**3867968**	$ 120,353	3/13/2002	In Default
6	**3707905**	$ 135,670	10/2/2001	Foreclosure Completed
7	**3689824**	$ 141,518	7/12/2001	In Default
8	**3503789**	$ 58,362	7/20/2001	Reinstated by Mortgagor
9	**3546148**	$ 109,520	1/26/2001	Reinstated by Mortgagor
10	**3569292**	$ 75,619	4/2/2001	In Default
11	**3618755**	$ 124,489	4/11/2001	In Default
12	**3706997**	$ 118,114	8/7/2001	In Default
13	**3855375**	$ 149,458	3/15/2002	Reinstated by Mortgagor
Total		**$ 1,518,704**		

Schedule of HUD Losses Sahara Must Indemnify				
	FHA# 332-	**Loan Amount**	**Loss (Gain) to HUD**	**Status**
14	**3663494**	$ 96,387	Unknown	Claim - property in HUD's inventory
15	**3549013**	$ 101,559	Unknown	Claim - property in HUD's inventory
16	**3611149**	$ 131,816	Unknown	Claim - property in HUD's inventory
Subtotal		$ 329,762		
17	**3619413**	$ 116,866	$14,157	Claim & Loss
Total		**$ 446,628**		

Loans Sahara's President Should Pay in Full				
	FHA# 332-	**Loan Amount**	**Settlement Date**	**Status**
18	**3638982**	$ 117,151	5/1/2001	Investment Property
19	**3611871**	$ 126,297	3/23/2001	Investment Property
20	**3599591**	$ 98,445	5/1/2001	Investment Property
21	**4073536***	$ 97,700	1/31/2003	Investment Property
Total		**$ 439,593**		

* Investment property currently owned by a member of Sahara's president's family
Not included in OIG's review of processing and underwriting.