



Issue Date	September 16, 2005
Audit Report Number	2005-SE-1007

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing
Commissioner, H

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, OAGA

SUBJECT: City Bank – Puyallup, Washington, Branch Did Not Comply with HUD
Requirements in the Origination of Insured Loans

HIGHLIGHTS

What We Audited and Why

We audited City Bank’s Puyallup, Washington, branch office because it had one of the highest defaults to claim percentage for Department of Housing and Urban Development (HUD) approved lenders located within the state of Washington. Our primary audit objective was to determine whether City Bank’s Puyallup branch originated HUD insured loans in accordance with HUD requirements and prudent lending practices.

What We Found

City Bank’s Puyallup branch office (City Bank) did not originate 10 of the 24 loans in our sample in accordance with HUD requirements or prudent lending practices. The 10 loans contained deficiencies that should have precluded their approval. These deficiencies included loans with excessive debt-to-income ratios and no valid compensating factors; lack of borrower income stability; improper source of funds verification, unacceptable borrower credit histories, and deficient appraisal reviews by the underwriter. We attributed these deficiencies to City Bank’s failure to use due care when originating the loans compounded by its

failure to develop and implement an acceptable quality control plan. As a result, City Bank placed HUD's Single Family Insurance Fund at risk for 10 unacceptable loans with original mortgages totaling \$ 1,525,007. Currently, HUD remains at risk or has incurred losses totaling \$1,418,056 relating to these 10 loans.

We recommend that HUD take appropriate administrative action against City Bank as available under the Mortgage Review Board and/or other authority. At a minimum, this action should include seeking appropriate reimbursement and/or indemnification totaling \$1,418,056 for the 10 loans that were improperly originated and underwritten, including \$625 in loss mitigation costs related to one of the 10 loans.

We further recommend that HUD take appropriate steps to ensure that City Bank performs quality control reviews and maintains its quality control plan in accordance with HUD requirements.

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

Auditee's Response

We provided City Bank a draft report on August 9, 2005, and held an exit conference with bank officials on August 19, 2005. City Bank provided written comments on August 25, 2005. Based on our evaluation of City Bank's response to the draft report, substantial changes were made to the final report. 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

The National Housing Act, as amended, established the Federal Housing Administration, an organizational unit within the U. S. Department of Housing and Urban Development, (HUD). The Federal Housing Administration provides approved mortgage lenders with insurance against losses on mortgage loans to qualifying homebuyers. The mortgage insurance program is authorized under title II, section 203b, of the National Housing Act, and is governed by regulations in 24 *Code of Federal Regulations* 203. Most loans are insured under HUD's direct endorsement program, which authorizes lenders to underwrite and close loans without prior HUD review or approval.

City Bank's main office in Mukilteo, Washington, was incorporated January 2, 1974, as a state of Washington for-profit corporation. City Bank operates a branch office located in Puyallup, Washington, which originates HUD-Federal Housing Administration, Department of Veterans Affairs, and conventional mortgage loans for the purchase or refinance of single-family properties.

The Puyallup branch office received its approval from HUD as a Title II supervised direct endorsement lender on September 14, 1995. We reviewed the branch office's loan origination and quality control activities at the branch office located at 2708 East Main Avenue, Puyallup, Washington 98372.

City Bank has not had a prior HUD Office of Inspector General (OIG) audit. However, it has had three prior reviews by HUD's Quality Assurance Division, and in two of those prior reviews, quality control issues were identified.

From January 1, 2003, to December 31, 2004, City Bank originated 541 HUD insured loans totaling \$85,142,839 (13.5 percent of its total loan origination volume). Of these 541 loans, 478 with a total mortgage amount of \$76,485,001 were originated by City Bank's Puyallup branch office.

The audit objectives were to determine whether City Bank complied with HUD requirements when originating and underwriting Federal Housing Administration-insured single-family mortgages, including implementation of a quality control plan as required by HUD.

RESULTS OF AUDIT

Finding 1: City Bank Did Not Follow HUD Requirements or Prudent Lending Practices When Originating HUD Insured Loans

City Bank's Puyallup branch office (City Bank) did not comply with HUD requirements or prudent lending practices in the origination of 10 of the 24 loans included in our review. These 10 loans, originally totaling \$1,525,007, involved origination deficiencies that unnecessarily increased HUD's insurance risk. In this regard, HUD has paid insurance claims on three of these loans¹ and the remaining seven other loans totaling \$1,068,997 remain at risk for losses. Further, HUD has paid loss mitigation incentives totaling \$625 on one of the improperly originated loans. We attribute the problems identified to a failure of City Bank to use due care when originating the loans compounded by its failure to develop and implement an acceptable quality control plan.

HUD Requirements

Federal regulations at 24 CFR [*Code of Federal Regulations*] 202.5(j)(4) require HUD-approved lenders, officers, directors, and employees to conform with generally accepted, prudent, and responsible lending practices. The specific requirements of HUD-insured loan originations are principally described in HUD Handbooks 4000.2, 4000.4, and 4155.1, the Federal Housing Administration Single Family Homeownership Reference Guide, and various mortgage letters.

Additionally, HUD Handbook 4060.1,REV-1, CHG-1, paragraph 6-1, provides that as a condition of HUD-Federal Housing Administration approval, lenders must have and maintain a quality control plan for the origination and servicing of insured mortgages. The quality control plan must be a prescribed function of the lender's operation and assure that the lender maintains compliance with HUD requirements as well as complying with its own policies and procedures.

¹ In regard to the three claims, HUD has resold one of the involved properties for a net loss of \$25,430 and has paid claims totaling \$323,004 for the other two properties which have not yet been resold (see Appendix A for details).

City Bank Originated HUD Loans with Serious Underwriting Deficiencies

We reviewed a total of 24 HUD loans that were originated and underwritten by City Bank that had gone into default and/or were given poor mortgage credit or appraisal ratings during post endorsement reviews by the Santa Ana Homeownership Center's Processing and Underwriting Division. For 10 of the 24 loans reviewed, City Bank did not adhere to prudent lending practices or comply with HUD origination and insurance requirements during its origination and underwriting of the loans (see Appendix C for a summary of these deficiencies and Appendix D for specific details related to each loan). As discussed below, we have categorized the deficiencies noted into five categories: excessive debt ratios; borrower income (stability) issues; improperly verified source of funds; inadequate borrower credit evaluations; and poor underwriter appraisal reviews. These deficiencies in the origination and underwriting process significantly and adversely affected HUD's insurance risk.

Excessive Debt Ratios with Manually Underwritten Loans (Three Cases)

HUD Handbook 4155.1, REV-4, paragraphs 2-12 and 2-13, specify acceptable parameters for debt ratios in the absence of what HUD refers to as "compensating factors" for loans that are manually underwritten by the lender (as opposed to loans in which an automated underwriting system is used). The handbook states that the ratio of the total mortgage payment to effective income (front ratio) may not exceed 29 percent and the ratio of total fixed payments to effective income (back ratio) may not exceed 41 percent unless significant and valid compensating factors are provided.

In three of the loans we reviewed, City Bank failed to provide valid compensating factors when debt-to-income ratios exceeded HUD requirements. In these three instances it provided either compensating factors that were invalid or highly questionable or simply failed to provide compensating factors that, based upon the circumstances, were required for loan approval.

In one case, (561-7730040) the claimed compensating factor was additional income from a non-qualifying spouse who had recently been discharged from bankruptcy. In this instance, the recent bankruptcy brings into question the validity of this income as a compensating factor.

In another case (561-7186849), even though the original file documentation showed a back ratio of 46.43 percent, no valid compensating factors were provided by the lender to justify loan approval.

Income (Stability) Issues Not Resolved (Five Cases)

HUD Handbooks 4155.1, REV-4, CHG-1, paragraph 2-6 and 2-7A, and 4155.1, REV-5, require lenders to analyze and document the probability of borrowers' continued employment. Lenders must also examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. In doing this, the lender must verify the borrower's employment for the most recent two full years.

In five cases, City Bank failed to verify that the borrowers had maintained full-time employment between the time of application and approval of the loan, failed to require support for borrowers' explanations for lengthy periods of unemployment, or failed to provide documentation that fully supported the amount of gross income that was used to qualify the borrowers.

In one case (561-7703080), the borrower's pay stubs did not demonstrate full-time employment. A note in the file stated that the borrower took time off work because a close friend passed away. The event supposedly occurred at the end of November 2002. However, pay stubs in the file indicated that the borrower was only working part time into December. Although the loan did not close until January 31, 2003, no attempt was made to supplement the pay stubs before the end of January 2003 to ensure that the borrower was actually working full time.

In another case (561-7730040), City Bank based the borrower's income on 20 prior months during 2001 and part of 2002. The lender stated that only 20 months were used because the borrower had been off work for four months during the period due to an on-the-job injury. However, there was no evidence in the file that the borrower was disabled for four months. Further, there was conflicting information in the file as to whether the borrower was self-employed or an employee.

In a third case (561-7513076), income used to qualify the borrower was \$5,124 per month. While the borrower's two previous years' income supported this computation, the year-to-date income on the borrower's current pay stubs supported only \$3,721 per month. This actual current income resulted in front and back ratios of 36.67 percent and 47.63 percent, respectively. No compensating factors existed to warrant approval of the loan with these ratios.

Source of Funds Not Properly Verified (Two Cases)

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10, and HUD Handbook 4155.1, REV-5, paragraph 2-10, require the lender to verify all funds used for the borrower's

investment in the property. The funds may come from the borrower's savings or checking account, but if there is a large increase in an account, the lender must obtain an explanation and evidence of the source of funds. Interested third parties are not allowed to provide funds toward the borrower's minimum required investment. In two cases City Bank failed to verify sources of funds in accordance with these HUD requirements.

For example, in case 561-7186849, the mortgage credit analysis worksheet showed that the borrower had \$5,838 in assets available. The document used to support this was an automated teller machine slip. The slip did not show the borrower's name or account number. Also, the last four digits of the card number shown on the slip did not match the card numbers for the borrower's other automated teller machine slips in the file. In accordance with Mortgagee Letter 97-26, use of automated teller machine slips is not an acceptable form of verification as, "These procedures do not permit asset verification by the use of automated teller machine slips. While slips may have some limited use as 'snapshots' of cash assets, they are insufficient in and of themselves for verifying both assets and that improperly borrowed funds are not being used for the cash investment."

In this same case, there was a copy of a cashier's check in the file for \$2,500. The borrower wrote the following note on the copy of the check: "To whom it may concern, this cashier's check was given to me for work done on my mother's house – she does not wish to sign any documents stating so." Without a signed statement from the mother, the actual source of funds is questionable. Further, there was no evidence that the donor had the capacity to gift the funds and that the funds were transferred from the donor's account to the borrower in accordance with HUD requirements.

Inadequate Credit Evaluations (Eight Cases)

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3, and HUD Handbook 4155.1, REV-5, paragraph 2-3, state that the most useful guide in determining a borrower's attitude toward credit obligations is past credit performance. These handbooks require lenders to provide strong offsetting factors to approve loans when borrowers' credit histories reflect continuous slow payments, judgments, and delinquent accounts, despite adequate income to support the obligations. Accordingly, sufficiency of income is not considered a valid compensating factor for a negative credit history.

In eight cases, there were deficiencies in City Bank's evaluation of borrowers' credit histories. The credit histories of the borrower(s) demonstrated significant disregard toward credit obligations that should have precluded their loan approval. Credit reports on these borrowers included adverse information such as bankruptcies, poor credit ratings, and numerous charge-off or collection accounts. In some cases, City Bank obtained letters of explanation from the borrowers. However, many of these letters were not signed by the borrower, did not make logical sense, or were inconsistent with the credit histories themselves. Further, without signed letters of explanation, there was no

assurance as to the validity of the letters or whether the borrowers composed and agreed with the letters' content.

One example where City Bank did not evaluate significant credit factors in a prudent manner was case 561-7730040. In this instance, information submitted with the borrower's rental verification identified several recent late rental payments and related charges. This included a November 2002 late payment for October 2002 (\$45 late fee plus a \$75 attorney fee) and January 2003 late payment fees (\$45 late fee plus \$75 attorney fee). Additionally, in February 2003 it appears there was a rental related judgment and writ with a sheriff's fee of \$250. Such a rent history evidenced a lack of concern for one of the borrower's most elementary needs, the need for housing. In addition, the loan was closed on March 16, 2003, but the borrower's spouse had been discharged from Chapter 7 bankruptcy in February 2003, and had two unsatisfied judgments at the time of closing. Since the spouse signed the deed of trust she would have an interest in the subject property and the outstanding judgments could become liens on the subject property because of her interest.

Poor Appraisal Reviews (Three Cases)

The lender is responsible for obtaining and reviewing independent property appraisals for all HUD insured loans. In addition to the standard appraisal requirements, in the case of a manufactured home, the lender must supplement the appraisal with an engineer's certification that the mobile home complies not only with the appraisal and architectural requirements of HUD Handbooks 4145.1 REV-2 and 4150.2 CHG-1, but also with the additional requirements of HUD Handbook 4930.3G, Permanent Foundation Guide for Manufactured Housing. However, those hired to provide the appraisals and certifications are agents of the lender, and it is the lender's responsibility to appropriately review their appraisals, inspections and certifications, being vigilant for red flags that could indicate problems that could affect the properties' eligibility.

In three cases, City Bank's underwriter did not properly review the appraisal and related documents. In these cases, the underwriter did not always ensure that property requirements necessary for HUD insurance were met; allowed appraisers to use comparables that were higher than the market and did not properly reflect necessary adjustments; and did not obtain adequate explanations for large short-term gains in property values.

In one example, case (561-7953910), the property being purchased was a manufactured home. The engineer's report relating to the manufactured home's rear deck and overhang stated that the rear deck and overhang "are not self-supporting." This was a red flag that should have been resolved, but the reporting format did not lend itself to identifying the problem so it could be identified and resolved during the underwriting process. Properties with this type of uncorrected problem are not eligible for HUD insurance.

Effective Quality Control Plan Not Implemented

The deficiencies in City Bank's loan origination process discussed above went undetected and uncorrected in part because of its failure to implement an effective quality control plan. Under HUD's single-family direct endorsement program, a mortgage loan is underwritten and closed without prior review or approval by HUD. Therefore, it is imperative that lenders have a fully implemented quality control plan that meets HUD requirements. Without a complete and fully implemented quality control plan, City Bank was unable to ensure the accuracy, validity, and completeness of its HUD loan origination activities.

Although City Bank did have a quality control plan in place at the start of our audit, it did not contain the basic elements required by HUD. Further, for a five-month period ending just prior to the start of our audit, City Bank did not conduct any quality control reviews, as its quality control reviewer position was vacant. City Bank did fill the quality control reviewer position in January 2005, and once the deficiencies in its quality control system were brought to management's attention during our audit, steps were taken to bring the plan into compliance with HUD requirements. However, it should be noted that problems with its quality control procedures are not new. Two previous reviews by HUD's Quality Assurance Division identified continuing problems with City Bank's quality control procedures. Because of these continuing problems with City Bank's implementation of an acceptable quality control plan, HUD should take additional steps to ensure that its plan continues to be implemented and meets HUD requirements.

Conclusion

City Bank disregarded HUD requirements when originating and underwriting 10 HUD insured loans. It did not exercise the care expected of a prudent lender and improperly approved the loans even though they contained excessive debt-to-income ratios; unresolved income issues; improperly verified sources of funds; borrowers with poor credit histories; or unacceptable appraisals. City Bank did not identify and correct these origination deficiencies as it had not developed and implemented an effective quality control plan to monitor its origination process.

Recommendations

We recommend that HUD's Assistant Secretary for Housing – Federal Housing Commissioner

- 1A. Seek reimbursement and/or indemnification for HUD's actual and potential losses on the 10 loans detailed in appendix A, totaling \$1,418,056.
- 1B. Require City Bank to provide copies of its quality control reviews to HUD for an appropriate length of time to allow HUD to verify that its quality control plan has been fully implemented and meets HUD requirements.

SCOPE AND METHODOLOGY

City Bank's Puyallup, Washington, branch office was selected for review because it had one of the highest defaults to claim percentage for HUD approved lenders located within the state of Washington.

Using the early warnings capability of HUD's Neighborhood Watch system, we selected a non-representative sample of 24 loans from a listing of 541 loans originated by City Bank's Puyallup, Washington, branch during the period January 1, 2003, through December 31, 2004.

To accomplish our objectives, we

- Reviewed relevant HUD rules, regulations, and guidance.
- Reviewed past reviews that had been conducted by HUD's Quality Assurance Division.
- Reviewed City Bank and HUD case files for the 24 sampled loans.
- Interviewed applicable City Bank and HUD officials.
- Interviewed borrowers and gift donors as necessary.
- Interviewed applicable City Bank employees.

We relied upon computer-processed data contained in HUD's Neighborhood Watch and Single Family Data Warehouse systems. The reliability of the data in the Single Family Data Warehouse system has been assessed by an independent contractor and the HUD OIG and has been found to be adequate. The assessment included relevant general and application controls. Since the data in HUD's Neighborhood Watch system are derived from the Single Family Data Warehouse system, the data in both systems were considered sufficiently reliable to be used in meeting our objectives. During the audit, we did not note discrepancies between information in the 24 loan files and the data in these two automated HUD systems.

The audit fieldwork was performed between January 13 and May 31, 2005. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Underwriting - Policies and procedures that City Bank has in place to reasonably ensure that its loan underwriting process complies with Federal Housing Administration program requirements.
- Quality control - The system of quality control that City Bank has defined and implemented and whether it complies with HUD requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives

Significant Weaknesses

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

- The loan origination process.
- The quality control process.

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	\$26,055	\$323,004	\$1,068,997

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

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when an eligibility determination cannot be made at the time of the audit. A legal opinion or administrative determination may be needed on these costs.

3/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

The table on the next page details the ineligible, unsupported, and funds to be put to better use amounts listed above.

Appendix A (continued)

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

<u>Loan file #</u>	<u>HUD case #</u>	<u>Net loss (ineligible)</u>		<u>Claim paid property not yet resold (unsupported)</u>	<u>Indemnification amount (funds put to) (better use)</u>
		<u>Net claim after property resale</u>	<u>Loss mitigation incentives</u>		
1	561-7703080 ^{2/}		\$ 625		\$ 143,451
2	561-7730040			\$143,659	Claim
3	561-7906831				165,124
4	561-7651322				150,472
5	561-7833987				115,406
6	561-7809560	\$ 25,430			Claim
7	561-7871154				185,045
8	561-7953910				148,223
9	561-7513076				61,276 ^{3/}
10	561-7186849			179,345 ^{3/}	Claim
	Totals	\$ 25,430	\$625		
	Grand totals	\$ 26,055		\$ 323,004	\$ 1,068,997
	Total of sanctions recommended	\$ 1,418,056			

^{2/} This case is recommended for reimbursement of actual losses and indemnification.

^{3/} These two loans' indemnifiable balances are based upon the outstanding loan balance of the most recent non-credit qualifying refinance on each of the respective original loans that were not eligible when they were initially endorsed for HUD mortgage insurance.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

CITYBANK

August 25, 2005

U.S. Department of Housing and Urban Development
Office of Inspector General
Region X
Joan S Hobbs
Regional Inspector General for Audit
Federal Office Building, 909 First Avenue, Suite 126
Seattle, Washington 98104-1000

Subject: Response to Discussion Draft Audit Report
Puyallup, Washington Branch Office Audit
HUD Single-Family Loan Origination Program

Dear Ms Hobbs:

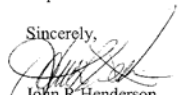
Citybank provides the following in response to both the Draft Audit Report and the discussion of the draft report that took place on August 19, 2005.

The discussion took place in the offices of Citybank. As you know, in attendance from your offices were Robert Woodard, Assistant Regional Inspector General for Audit, Robert Barton, Senior Auditor and Dilip Mathew, Auditor and yourself. Citybank had present Jim Carroll, Executive Vice President and member of Citybank's Board of Directors, Shari Ray, Citybank Compliance Officer, Lisa Massey, Citybank Internal Auditor, Lisa Knudson, Operations Manager, Puyallup Home Loan Office and myself.

Citybank appreciates the input and suggestions by all parties involved in the audit. Our company views compliance with a high priority and attempts to conduct itself in all matters accordingly. During the last two years there has been an increased emphasis by Citybank in this area and it is expected that those efforts will be rewarded by improvements in any future examination.

Part of the discussion reviewed the narrative comments of why Citybank was audited. We had questioned both the source and the wording of the reason. We were told the source of the comment would be provided and that the language would be reviewed. We look forward to that response as well.

Sincerely,



John R Henderson
Senior Vice President

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Comment 1

Included in the loans cited, were 7 loans with a common criticism. This criticism specifically dealt with gift funds from a non-profit agency; Nehemiah.

Although the verbiage varied somewhat, the issue was the timing of the receipt of the gift funds. Citybank's response is the same for all of them. Rather than repeat the response for each of the 7 loans, it will be provided once but pertain to all of the loans cited.

Citybank completes a Nehemiah form and forwards it to Nehemiah. Nehemiah wires funds to escrow prior to loan closing and the conditions under which the funds may be used. Further instructions are included regarding remitting back to Nehemiah after loan closing.

Seller funds are always remitted by escrow, and remitted after closing. That is the only source of funds available to escrow for remittance.

In each case the file contained evidence of the incoming wire transfer from the donor. This evidence included the borrower's name, the amount of the gift and the date the wire was received by escrow. The criticism is that we do not have evidence that these funds were received prior to the remittance by escrow of seller's contribution to Nehemiah.

We also received from Nehemiah a log indicating all FHA loans closed by Citybank during the 2003 year. Six of these 7 loans closed during the 2003 calendar year. The 7th, Case number 561-7239226 was closed in 2001.

That log has 12 columns of data and includes the borrower's name and the amount and date the gift funds were wired by Nehemiah. It also includes the date and amount remitted by the seller of the contribution/fee amount back to Nehemiah. In each case the amount of the gift funds and the date of remittance agrees with that in our loan file for the respective borrower. In those same cases the amount and date of contribution remitted by escrow to Nehemiah on behalf of the seller agree with the seller's name. In every instance all are dated subsequent to the date of remittance to the buyer.

A review of the log reflects that none of the loans closing with Nehemiah funds ever shows the remittance of the contribution pre-dating the gift funds. This log is included with this response.

We are including the borrowers name in this section only because Nehemiah does not reference the case number.

The documentation is also available from the closing agent to support the date and amount of the remittances of the seller contribution.

We are currently adhering to Mortgagee Letter 04-28 as it relates to the transfer of gift funds

We were told the documentation for remittance of the contribution should have been part of our file. The remittance of the seller contribution is not made until after loan closing. This would result in Citybank closing an FHA loan without meeting FHA requirements as they relate to documentation of gift funds from non-profit agencies.

Comment 1

During the Quality Assurance Division (QAD) audit in August 2003, FHA files were reviewed that closed with funds provided by Nehemiah. The QAD auditor was complimentary regarding the information contained in the FHA file supporting the timing of gift funds from the donor. We accepted that as validation as to compliance with HUD requirements of this specific issue.

Case number 561-7703080

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10; Mortgagee Letter 00-28

There was an escrow receipt in file for a Nehemiah gift of \$4,440. However, this is not evidence that the Nehemiah gift funds were wired in accordance with HUD requirements. There were no wire transfers in the insuring package to show that funds were wired directly from the nonprofit entity before the seller provided funds to the nonprofit. Such wire transfer evidence is necessary to comply with Mortgagee Letter 00-28, which states: "regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds"

Case number 561-7906831

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10

There was no wire transfer documentation supporting the transfer of the \$5,067 Nehemiah gift to or from closing escrow. Such documentation is necessary to verify the validity of the gift and ensure that funds were wired directly from the nonprofit entity before the seller provided the funds to the nonprofit.

Case number 561-7693900

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10

There was no wire transfer documentation supporting the transfer of the \$2,737 Nehemiah gift to or from closing escrow. Such documentation is necessary to verify the validity of the gift and ensure that funds were wired directly from the nonprofit entity before the seller provided the funds to the nonprofit.

Case number 561-7651339

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10

Nehemiah gift funds totaling \$3,595 were receipted into escrow on the day before final closing in the form of an escrow receipt and not in the form of a wire transfer. No evidence was provided to show that the funds were received from Nehemiah before any funds were passed from the seller to the gift donor as required by HUD Mortgagee Letter 00-28. The actual deposit of the Nehemiah gift funds was listed on line 204 of HUD-1 settlement statements as "Amount of 2nd New Loan" with no explanation. This description creates further unanswered questions regarding the source of funds.

Case number 561-7809560

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10

The wire transfer receipt documenting the receipt of \$4,890 of gift funds from Nehemiah had a date of June 5, but no time of day was indicated. Accordingly, there is no documentation as to when the gift funds actually came into escrow. Such documentation is necessary to verify the validity of the gift and ensure that funds were wired directly from the nonprofit entity before the seller provided the funds to the nonprofit.

Case number 561-7937504

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10

The \$5,283 wire transfer from Nehemiah contained several dates, and it was unclear as to which date actually applied to the wire transfer. Thus, there was insufficient information to document that gift funds were received into escrow from the nonprofit before the payment by the seller to the nonprofit.

Case number 561-7239226

Source of Funds Not Properly Verified: Referencing HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10, and 4000.2, REV-2 paragraph 3-6E, and HUD Mortgagee Letter 00-28

Documentation in the file supporting the wiring of Nehemiah gift funds into escrow on the day of closing. However, no wiring information was available to document the timing of funds provided by the seller to Nehemiah. Accordingly, HUD can not be assured that Nehemiah provided the gift prior to receiving funds from the seller

Case number 561-7703080

Loan amount \$145,713
Settlement date February 1, 2003
Endorsement date March 13, 2003
Status as of June 1, 2005 Current

Income Issues

Citybank does not dispute this finding.

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

Inadequate Credit Evaluation

Citybank does not dispute this finding.

Comment 2

Case number 561-7730040
Loan amount \$143,659
Settlement date March 14, 2003
Endorsement date March 24, 2003
Status as of June 1, 2005 Claim

Excessive Debt Ratios

Citybank does not dispute this finding.

Income Issues

Citybank does not dispute this finding.

Inadequate Credit Evaluation

Citybank does not dispute this finding.

Case number 561-7906831
Loan amount \$165,124
Settlement date August 29, 2003
Endorsement date September 18, 2003
Status as of June 1, 2005 In Default

Excessive Debt Ratios/Income Issues

In the 2001 year the monthly average was \$2,949, 2002 it was \$4,355 and for the 6 months of 2003 monthly income averaged \$4,915. This would not indicate that the borrower's overtime/income was decreasing, but rather that the overtime/income was increasing.

"The Verification of Employment from the employer must not state categorically that such income is not likely to continue"; it simply indicates, "See W-2's and pay stubs".

This results in a 30-month average of \$3,905 and results in 31/44 ratios at the second year of the Adjustable Rate Mortgage.

These ratios are acceptable for an energy efficient home.

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

Inadequate Credit Evaluation

It is correct that there was no verification of rent. There was a credit report supplement, dated 8/26/2003 evidencing a 31-month review of rent and "paid as agreed". There was no credit

Comment 3

explanation for the borrowers past derogatory credit history; however, this derogatory history is more than 2 years old as of the date of loan closing.

Case number	561-7651322
Loan amount	\$150,472
Settlement date	January 1, 2003
Endorsement date	January 14, 2003
Status as of June 1, 2005	Current

Inadequate Credit Evaluation

Citybank does not dispute this finding.

Poor Appraisal Review

Citybank does not dispute this finding; property probably overvalued by \$10,000

Case number	561-7693900
Loan amount	\$92,929
Settlement date	February 20, 2003
Endorsement date	March 6, 2003
Status as of June 1, 2005	Claim

Excessive Debt Ratios

The debt ratios of 34.1 are not considered excessive since this 34.1 ratio is both the front and back ratios. It is midway between the 29/41-guideline ratios. Additional support is provided by the modest increase in housing expense of \$50 with a potential \$50 increase the following year and the stability of a 2-½ year employment history. Further support is provided by the historical salary increases experienced by the borrower. Monthly salary in 2001 averaged \$1,850, and 2002 the average was \$2,034. The first two weeks of 2003 salary was \$2,965.

Citybank also is providing copies of 2001 and 2002 federal income tax refunds averaging \$4,500, evidencing capacity to save.

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

The borrower claims that he did not have a bank account as he used money orders to pay his bills so that they could be paid on time. "This explanation does not make sense and brings into question the validity of the statement and why it was made".

This statement was included in the loan file to support the lack of VOD and bank statements.

Comment 4

Case number 561-7651339
Loan amount \$117,958
Settlement date January 16, 2003
Endorsement date February 4, 2003
Status as of June 1, 2005 In Default

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

The listing of the Nehemiah funds on Line 204 of the HUD-1 was an administrative error and should have stated "gift funds".

Inadequate Credit Evaluation

There are two issues here: Failure to check the Limited Denial Participation (LDP) list and the reason for loan transfer from another lender.

The question isn't that the lender failed to check the HUD limited denial of participation list and/or the General Services Administration exclusion list, but if the seller, the selling realtor and the listing realtor involved in the transaction is on the list. This was checked and reflected on the HUD 92900-WS/PUR.

The loan was transferred from another lender because of the inability by that lender to close the transaction in the time line required by the borrower. The borrower had to vacate the current residence and moved into the subject property prior to loan closing. The purchase transaction was to close between 11/16/2002 and 11/20/2002. The original HUD approved lender accepted loan application on or before 9/16/02, the appraisal was ordered 10/23/02, completed on 11/10/02 did not close the loan during that time. Our loan originated on 12/5/2002, was approved on 1/3/2003 and closed 1/16/2003. A letter in file from the original HUD approved lender dated 12/6/2002 indicates transferring case number and appraisal to Citybank.

Case number 561-7833987
Loan amount \$115,406
Settlement date June 24, 2003
Endorsement date August 7, 2003
Status as of June 1, 2005 Current

Source of Funds Not Properly Verified

This deficiency was noted during the prior HUD audit and corrected verbiage is currently included in the Gift Letter. Citybank does not dispute this finding.

Comment 5

Case number	561-7809560
Loan amount	\$25,430
Settlement date	June 6, 2003
Endorsement date	June 17, 2003
Status as of June 1, 2005	Claim

Income Issues

There are two issues here: Debt ratios are excessive because of the lack of documentation of overtime and that of child support:

"The lender must develop an average of overtime income for the past two years and the employment verification must not state categorically that such income is not likely to continue". The employer indicated on the Verification of Employment a plus (+) sign after the 40 hours indicated as hours worked per week. The Year To Date actual income is greater than the 28-month average that was used to determine debt ratios.

Although payment shock was not directly noted as a criticism, the borrower was due a Federal Tax Refund in the amount of \$5,936. She did submit a letter, included in the loan file, indicating that she would be changing her withholding to increase after-tax income. This tax refund was evidence of an ability to save.

Child support documentation was in file in the form of 13 months of bank statements. It is accurate that the March 2003 statement did not reflect a deposit for child support. The child support is remitted by military allotment and is generally received on the last day or two of the month. There are months when that date slipped to the first day of the following month. The amount on the bank statement reflects the exact amount indicated by the child support order.

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

Inadequate Credit Evaluation

"The borrower states that the bankruptcy was mainly due to her husband leaving her; however, the Chapter 7 bankruptcy documents showed that most of the borrower's debts were incurred after the divorce."

There are 10 debts reported in the credit report and only three originated after her husband left her.

Poor Appraisal Review

The appraised value was not overstated. The comps used were all within 1 mile of the subject property, very similar in structural nature. Comp 1 and comp 3 had higher adjusted values and closed within 1 month and 4 months of the subject. Comp 2, which adjusted for a lower value, closed 6 months prior to the subject sale.

Comment 6

Case number 561-7937504
Loan amount \$171,299 + \$7,050 partial claim paid
Settlement date October 28, 2003
Endorsement date November 10, 2003
Status as of June 1, 2005 In foreclosure

Source of Funds Not Properly Verified

This criticism is included in and addressed in the opening section of the response.

Case number 561-7871154
Loan amount \$185,045
Settlement date August 1, 2003
Endorsement date September 26, 2003
Status as of June 1, 2005 Claim

Inadequate Credit Evaluation

Citybank does not dispute this finding.

Case number 561-7953910
Loan amount \$148,223
Settlement date December 19, 2003
Endorsement date January 15, 2004
Status as of June 1, 2005 Current

Income Issues

The borrowers have two rental properties, including the current residence at the time of loan closing. There would be no rental income evidenced on an income tax return for that property. Income on the other rental should have been supported by a tax return.

Source of Funds Not Properly Verified

It is agreed that there was no evidence in file for the source of funds to repay \$1,620 in collections between October 3rd and December 2nd, 2003. Based on the borrowers monthly income and expense resources were available to accumulate funds in this amount. Regardless, the repayment of collections is not a requirement of loan approval by HUD.

Poor Appraisal Review

An L&I inspection was warranted.

Comment 7

Case number 561-7513076
Loan amount \$161,276
Settlement date April 22, 2002
Endorsement date May 8, 2002
Status as of June 1, 2005 Active (refinanced under case 561-7718873)

Income Issues

Citybank does not dispute this finding.

Inadequate Credit Evaluation

Citybank does not dispute this finding.

Case number 561-7239226
Loan amount \$153,133
Settlement date April 27, 2001
Endorsement date May 17, 2001
Status as of June 1, 2005 Claim (paid on refinance case 561-7679127)

This loan should not be included because of it was refinanced as a fully credit qualified transaction on 4/29/2003. The refinance was reviewed during this examination and no exceptions were found.

Case number 561-7186849
Loan amount \$179,345
Settlement date August 16, 2000
Endorsement date January 11, 2001
Status as of June 1, 2005 Claim (on refinance case 561-7666718)

Excessive Debt Ratios

Citybank does not dispute this finding.

Income Issues

Citybank does not dispute this finding.

Source of Funds Not Properly Verified

Citybank does not dispute this finding.

Inadequate Credit Evaluation

Citybank does not dispute this finding.

OIG Evaluation of Auditee Comments

Comment 1 Although we continue to have concerns with the documentation maintained by City Bank to support the legitimacy of gift funds provided by non-profit organizations, based upon additional documentation provided, we have revised our report and eliminated this subject as a reportable underwriting deficiency. However, City Bank needs to ensure that in the future documentation required by Mortgagee Letter 2004-28 and HUD Handbook 4155.1 REV-5, paragraph 2-10, including documentation of the wire transfers of gift funds, is obtained and maintained. Such documentation is necessary to verify that the gift funds are actually received from the nonprofit donor and not from an unacceptable third party, such as the property seller.

Comment 2 Case number 561-7906831

Debt Ratios/Income Issues

We concur with City Bank's comments related to income issues and have adjusted our report accordingly. However, we do not agree that qualifying ratios of 31.0 and 44.7 are acceptable without valid compensating factors, which were not present for this loan. In this regard, the property being purchased was not an energy efficient home as claimed by City Bank. Additionally, this was a one-year adjustable rate mortgage. As such, the lender is required to document and justify how the borrower(s) will meet their future obligations as payments increase under this type of mortgage. This was not addressed during the underwriting process.

Inadequate Credit Evaluation

We concur with City Bank's comments related to verification of rent through a credit report supplement and the fact that the derogatory credit discussed in our draft report was more than two years old. Our report has been revised accordingly, removing discussion of these items. However, the borrower's credit file for the 90 days preceding the credit report date contained eight credit inquiries that were unexplained by the borrower. HUD requires lenders to obtain borrowers' written explanation for all inquiries shown on the credit report in the last 90 days.

Comment 3 Case number 561-7693900

Additional information provided by City Bank resolved concerns we had relating to this loan and we have removed it from our report.

Comment 4 Case number 561-7651339

Additional information provided by City Bank resolved concerns we had relating to this loan and we have removed it from our report. However, in the future, City

Bank needs to ensure that its loan files are appropriately documented when it accepts a transfer of an insured loan application from another HUD approved lender.

Comment 5 Case number 561- 7809560

Income Issues

City Bank's response and additional documentation provided resolved our concerns related to borrower income for this case. Accordingly, the issue has been removed from our final report.

Inadequate Credit Evaluation

City Bank did not specifically address our concern regarding inadequate credit evaluation other than stating that seven of the ten debts on the borrower's credit report were originated prior to her husband leaving her. However, this does not address the fact that the borrower had credit problems that occurred after her divorce and which were not addressed during loan processing. This included unpaid phone bills, a collection account for an unexpired lease, and non-sufficient funds checks. Additionally, a significant part of the credit card debt included in the bankruptcy was incurred after her divorce. City Bank had previously claimed that, based upon the opening dates of the accounts, these debts were incurred prior to the divorce. However, although the accounts were opened prior to the divorce, much of the activity resulting in the account balances included in the bankruptcy took place after the divorce.

Poor Appraisal Review

We do not concur with City Bank's claim that the property's appraised value was not overstated. There were numerous indicators that the appraised value (\$166,000) was overstated including documentation in the file showing that the predominate sales price for similar properties in the area was \$155,000 and the fact that the real estate agent's commission was based upon \$157,000, not the \$166,000 sales price as would be typical. It should also be noted that the seller provided over \$10,000 of incentives to the borrower as an inducement to purchase the property. This included over \$5,000 passed through a nonprofit to provide the borrower's downpayment and over \$5,000 for the borrower's closing costs. All these indicators should have led City Bank to question the legitimacy of the appraised value and obtain additional information to validate the value provided. This was not done.

Comment 6 Case number 561-7953910

Income Issues

We agree with City Bank that a rental income history would not have been available for the borrowers' current residence (which was to be leased when they moved to their new residence). However, a valid lease agreement needed to be obtained and used to determine the affect that such a rental property would have on the borrower's income and expenses. Although a prospective lease and purported existing lease were in the loan file, their validity was questionable as neither were signed by the landlord (the borrowers) and the purported renters signed on the landlord's signature line. This discrepancy should have been resolved, and if it could not, then the outlay for that residence should have been handled as strictly an expense/liability, with no income implications. City Bank admits that it should have obtained (but did not) a copy of the borrowers' income tax return(s) to support any claimed income from the earliest lease and to document related expenses of the other rental property. Since the income and expenses related to these rental properties was not properly resolved, the income of the borrowers' was not calculated and supported in accordance with HUD requirements (reference HUD Handbook 4155.1 paragraph 2-7 M).

Source of Funds Not Properly Verified

We concur with City Bank's response to this item and have removed it from our final report.

Comment 7 Case number 561-7239226

We agree with City Bank's response and have removed this case from our final report.

Appendix C

SCHEDULE OF LOAN DEFICIENCIES

Loan number	Excessive debt ratios	Income issues not resolved	Source of funds not properly verified	Inadequate credit evaluation	Poor appraisal review
561-7703080		X		X	
561-7730040	X	X		X	
561-7906831	X			X	
561-7651322				X	X
561-7833987			X		
561-7809560				X	X
561-7871154				X	
561-7953910		X			X
561-7513076		X		X	
561-7186849	X	X	X	X	
Totals	3	5	2	8	3

Appendix D

NARRATIVE CASE SUMMARIES

Case number	561-7703080
Loan amount	\$145,713
Settlement date	February 1, 2003
Endorsement date	March 13, 2003
Status as of June 1, 2005	Current

City Bank underwrote and approved the mortgage despite evidence of income instability, and unexplained inquiries shown on the borrower's credit report within 90 days of closing. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Income Issues

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 2-7. The borrower's pay stubs did not demonstrate full-time employment. A note in the file stated that the borrower took time off work because a close friend passed away. The event supposedly occurred at the end of November 2002. However, pay stubs in the file indicated that the borrower was only working part time in December 2002. Although the loan did not close until January 31, 2003, no attempt was made to obtain supplemental pay stubs in January 2003 to ensure that the borrower was actually working full time.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. There were three inquiries on the borrower's credit report within 90 days of closing. However, the lender did not obtain an explanation for these three inquiries as mandated by HUD requirements.

Recommendations

- Indemnify HUD for the mortgage amount of \$145,713.
- Reimburse HUD \$625 for the loss mitigation incentives paid on this loan.

NARRATIVE CASE PRESENTATION

Case number	561-7730040
Loan amount	\$143,659
Settlement date	March 14, 2003
Endorsement date	March 24, 2003
Status as of June 1, 2005	Claim

City Bank underwrote and approved the mortgage despite high qualifying ratios and a lack of valid compensating factors, income stability issues, and a pattern of delinquency shown on the borrower's verification of rent. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Excessive Debt Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-12, 2-13; HUD Homeownership Center Reference Guide, paragraph 2-12; HUD Mortgagee Letter 97-26. Compensating factors used by the underwriter on the mortgage credit analysis worksheet to support excessive debt ratios were not all valid. The only valid compensating factor was the income of the borrower's non-purchasing spouse (tempered by her recent bankruptcy). This was not sufficient to offset the borrower's front and back ratios of 33.4 percent and 43.1 percent.

Additionally, the loan origination file contained a copy of a check to the borrower from the involved realtor for \$1,200, which stated for "loan" on the lower left hand corner of the check. This was not addressed by City Bank. If it was a loan, the liability should have been disclosed and considered when calculating debt-to-income ratios. Also, the check indicated that the borrower was also known by another name. No name affidavit was in the file to address this inconsistency.

Income Issues

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 2-7.

City Bank based the borrower's income on 20 prior months during 2001 and part of 2002. The lender stated that only 20 months were used because the borrower had been off work for four months during the period due to an on-the-job injury. However, there was no evidence in the file that the borrower was disabled for four months.

Additionally, the final loan application, dated March 14, 2003, stated that the borrower had been working at a business he owned for the past five years. However, there was a worker's compensation claim form for the borrower in the file, dated June 14, 2002, which stated that he had been working at a company with a similar name for the past four years and that he was not an owner, partner, corporate officer, shareholder, or director of that company. The borrower's tax return did not show the name or address of the company he claimed to own. City Bank did not resolve this inconsistency between his

being an owner or employee of the company.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. Information submitted with the borrower's rental verification identified several recent late rental payments and related charges. This included a November 2002 late payment for October 2002 (plus a \$45 late fee and a \$75 attorney fee) and January 2003 late payment fees (\$45 late fee plus \$75 attorney fee). Additionally, in February 2003 it appears there was a rental related judgment and writ with a sheriff's fee of \$250. Such a rent history evidenced a lack of concern for one of the borrower's most elementary needs, the need for housing. In addition, the loan was closed on March 16, 2003, but the borrower's spouse had been discharged from Chapter 7 bankruptcy in February 2003, and had two unsatisfied judgments at the time of closing. Since the spouse signed the deed of trust she would have an interest in the subject property and the outstanding judgments could become liens on the subject property because of her interest.

Recommendation

- Reimburse HUD for any losses incurred when the property is resold. The amount of the claim and expenses to date is \$143,659.

NARRATIVE CASE PRESENTATION

Case number	561-7906831
Loan amount	\$165,124
Settlement date	August 29, 2003
Endorsement date	September 18, 2003
Status as of June 1, 2005	In default

City Bank underwrote and approved the mortgage despite excessive debt ratios without valid compensating factors and a lack of explanation for recent credit inquiries. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Excessive Debt Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-12 and 2-13; HUD Homeownership Center Reference Guide, paragraph 2-12; HUD Mortgagee Letter 97-26. This loan was approved with qualifying ratios, 31.0 and 44.7, that exceeded HUD guidelines (29/41) without valid compensating factors. Additionally, this was a one-year adjustable rate mortgage. As such, the lender is required to document and justify how the borrower(s) will meet their future obligations as payments increase under this type of mortgage. This was not addressed during the underwriting process.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. The borrower's credit file for the 90 days preceding the credit report date contained eight credit inquiries that were not explained by the borrower. HUD requires lenders to obtain borrowers' written explanation for all inquiries shown on the credit report in the last 90 days.

Recommendation

- Indemnify HUD for the mortgage amount of \$165,124.

NARRATIVE CASE PRESENTATION

Case number	561-7651322
Loan amount	\$150,472
Settlement date	January 1, 2003
Endorsement date	January 14, 2003
Status as of June 1, 2005	Current

City Bank underwrote and approved the mortgage without addressing the significant payment shock resulting from the borrower's increased housing cost or performing limited denial of participation/General Service Administration checks on all individuals and companies involved in the transaction. Further, there were indications that the appraisal may have resulted in the overvaluation of the property. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower and the property met HUD qualifying guidelines.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. The borrower indicated that at the time of his loan application he was living at home and not paying any rent. Therefore, the borrower went from zero rent to a monthly housing payment of \$1,237, which could have resulted in a major payment shock to the borrower. This was even more significant as information in the file evidenced that the borrower had a pattern of apparent disregard for, or an inability to manage, his financial obligations. These matters were not addressed by the underwriter as required by HUD.

There was no indication in the file that the required limited denial of participation, suspension, or debarment check was performed on the realtor, construction company, or escrow company involved in this transaction.

Poor Appraisal Review

HUD Handbook 4150.2, CHG-1, "Valuation Analysis for Home Mortgage Insurance for Single-Family One to Four Unit Dwellings – MANUFACTURED HOMES."

Although there were two comparables used in the appraisal that were very similar to the subject property and only 0.2 miles away, the appraiser based his value on a higher priced property located a mile from the subject property. The underwriter commented in her appraisal review that the appraisal was good because the "appraiser took high end of comps as value." In our opinion, based upon the value and minimal required adjustments of the closer, more comparable properties, the subject property was overvalued by approximately \$10,000.

Recommendation

- Indemnify HUD for the mortgage amount of \$150,472.

▪ **NARRATIVE CASE PRESENTATION**

Case number	561-7833987
Loan amount	\$115,406
Settlement date	June 24,2003
Endorsement date	August 7, 2003
Status as of June 1, 2005	Current

City Bank underwrote and approved the mortgage despite the fact the borrowers' source of funds used for down payment and closing costs was not verified. Additionally, the co-borrower listed her name two different ways and there was no name acknowledgement in the file addressing this discrepancy. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Source of Funds Not Properly Verified

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10. There was no documentation in the loan file evidencing that the gift donor had the capacity to provide the \$3,450 gift to the borrowers or that the funds came directly from the donor to the borrower. These gift funds were approximately 96 percent of the borrowers' minimum required investment.

Recommendation

- Indemnify HUD for the mortgage amount of \$115,406.

NARRATIVE CASE PRESENTATION

Case number	561-7809560
Loan amount	\$25,430
Settlement date	June 6, 2003
Endorsement date	June 17, 2003
Status as of June 1, 2005	Claim

City Bank failed to properly address bankruptcy and other derogatory borrower credit issues. There were also indications that the appraisal may have been inflated which was not addressed by the underwriter. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower and the property met HUD qualifying guidelines.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. The borrower stated that her bankruptcy was mainly due to her husband leaving her; however, the Chapter 7 bankruptcy documents showed that many of the borrower's debts were incurred after the divorce.

The borrower's name was misspelled when conducting the excluded parties system check and as a result her clearance was not valid. In addition, there was no documentation in the loan file verifying that the seller, who was the administrator of the estate that was handling the property sale, was checked against the excluded parties system.

Poor Appraisal Review

HUD Handbook 4150.2, CHG-1, "Valuation Analysis for Home Mortgage Insurance for Single-Family One to Four Unit Dwellings." There were indications that the property's \$166,000 appraised value was inflated. Specifically, the real estate agent's commission was based on a lower dollar amount (\$157,000) and other documentation in the file showed that the predominant sale price in the area was approximately \$155,000. Additionally, the appraisal showed that in September 2000, the subject property sold for \$125,700. Thus, over a three-year period, there was a relatively rapid increase in value (\$40,000), which, per HUD requirements should have been explained by the appraiser. These items should have been, but were not, addressed and resolved by the underwriter during the appraisal review.

Recommendation

- Reimburse HUD for the loss of \$25,430.

▪

NARRATIVE CASE PRESENTATION

Case number	561-7871154
Loan amount	\$185,045
Settlement date	August 1, 2003
Endorsement date	September 26, 2003
Status as of June 1, 2005	Claim ³

City Bank underwrote and approved the mortgage without obtaining documentation evidencing that the borrower received permission from the Chapter 13 bankruptcy court to accrue an additional mortgage liability and without specific mention of a discharge of the bankruptcy. In addition, there was no borrower explanation in the file for the eight recent credit inquiries shown on the credit report. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3, 2-4. There was no evidence in the file documenting that the borrower obtained the permission of the Chapter 13 bankruptcy court to accrue an additional mortgage liability. Also, there was no specific mention in the file of a discharge of the bankruptcy by the court. Finally, there were eight credit inquiries on the credit report that were not explained by the borrower.

Recommendation

- Indemnify HUD for the mortgage amount of \$185,045.

³ Gross claim paid by HUD was \$185,045. This claim was handled under the accelerated claim disposition program.

▪ NARRATIVE CASE PRESENTATION

Case number	561-7953910
Loan amount	\$148,223
Settlement date	December 19, 2003
Endorsement date	January 15, 2004
Status as of June 1, 2005	Current

City Bank underwrote and approved the mortgage despite unsupported income computations and a poor appraisal review. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower and the property met HUD qualifying guidelines.

Income Issues

HUD Handbooks 4155.1, REV-4, CHG-1, paragraphs 2-6, 2-7, 2-12, and 2-13; Mortgagee Letter 97-26; and HUD Homeownership Center Reference Guide, paragraph 2-12. Both the borrower and the co-borrower contended that they had rental income. However, there were no tax returns or copies of rental receipts and deposits to support such rental income. City Bank handled the claimed rental income as an offset against related mortgage payments. This method of income and offsets does not meet HUD requirements and accordingly, without additional documentation, the net effect of the rental properties on the borrowers' incomes cannot be determined. Thus, the borrowers' qualifying income to debt ratio is not supported.

Poor Appraisal Review

HUD Handbook 4150.2, CHG-1, "Valuation Analysis for Home Mortgage Insurance for Single-Family One to Four Unit Dwellings." The property being purchased was a manufactured home. The engineer's report relating to the manufactured home's rear deck and overhang stated that the rear deck and overhang "are not self-supporting." This was a red flag that should have been addressed, but the reporting format did not lend itself to identifying the problem so it could be identified and resolved during the underwriting process. Properties with this type of uncorrected problem are not eligible for HUD insurance.

Recommendation

- Indemnify HUD for the mortgage amount of \$148,223.

NARRATIVE CASE PRESENTATION

Case number	561-7513076
Loan amount	\$161,276
Settlement date	April 22, 2002
Endorsement date	May 8, 2002
Status as of June 1, 2005	Active (refinanced under case 561-7718873)

City Bank underwrote and approved the mortgage despite unsupported income that significantly affected the qualifying ratios. In addition, the underwriter did not address the borrowers' lack of sufficient resources to withstand a substantial increase in monthly housing expenses nor the borrowers' derogatory credit. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrowers met HUD qualifying guidelines.

Income Issues

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6, and Mortgagee Letters 98-01 and 97-26. The income used to qualify the borrowers was \$5,124 per month. While the borrower's two previous years' income supported this amount, the year-to-date income on the current pay stub supported only \$3,721 per month. This reduced income resulted in front and back ratios of 36.67 percent and 47.63 percent, respectively. No compensating factors existed to warrant approval of this loan with these ratios. Additionally, this loan was an adjustable rate loan. There was no indication that the borrowers' income would be increasing to support an escalating payment, just the opposite, there were indications (as previously discussed) that the borrower's income was decreasing. Further, the borrowers' housing expense was increasing from \$750 per month rent to \$1,224 per month the first year of their mortgage with increasing payments possible thereafter. The borrowers lacked sufficient cash reserves or income to withstand this kind of increase.

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3 and 2-4. The borrowers had a prior bankruptcy that was discharged in May 1998. They also had numerous late payments after the bankruptcy, including 30-, 60-, and 90-day late payments, last reported in October and November 2001, which were within 12 months of the date the file was underwritten and approved. In addition, recent inquiries reflected on the credit report were not addressed.

Recommendation

- Indemnify HUD for the mortgage amount of \$161,276.

NARRATIVE CASE PRESENTATION

Case number	561-7186849 (original loan)
Loan amount	\$179,345
Settlement date	August 16, 2000
Endorsement date	January 11, 2001
Status as of June 1, 2005	Claim (on refinance case 561-7666718)

City Bank approved the mortgage despite the borrower's high back ratio and the lack of valid compensating factors to offset the high ratio. In addition, the source of the borrower's funds used for the down payment and loan closing was not adequately verified and several credit issues were not addressed. Therefore, HUD insured the loan based on City Bank's inaccurate representation that the borrower met HUD qualifying guidelines.

Excessive Debt Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-12, 2-13; HUD Homeownership Center Reference Guide, paragraph 2-12, and HUD Mortgagee Letter 97-26. The mortgagor's back ratio, as computed by City Bank, was 46.43 percent, but there were no valid compensating factors on the mortgage credit analysis worksheet to offset this high ratio (also see Income Issues discussed below).

Income Issues

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 2-7. The borrower's income used for loan qualification was overstated. According to the verification of employment, the borrower earned \$26 per hour or approximately \$4,544 per month. (There was also a note in the file that the borrower's 19-month average equaled \$4,110 per month). The underwriter used an unsupported income of \$4,749 per month for qualification purposes. With corrected income, the borrower's back ratio increased to 48.5 percent, exceeding HUD's recommended maximum of 41 percent. This loan was manually underwritten, but City Bank provided no compensating factors for the excessive back ratio as mandated by HUD requirements.

Source of Funds Not Properly Verified

HUD Handbooks 4155.1, REV-4, CHG-1, paragraph 2-10, and 4000.2, REV-2, paragraph 3-6E, and HUD Mortgagee Letter 00-28. There was a copy of a cashier's check in the file for \$2,500. The borrower wrote the following note on the copy of the check: "To whom it may concern, this cashier's check was given to me for work done on my mother's house – she does not wish to sign any documents stating so." Without a signed statement from the mother, there is a question as to the source of these funds. Further, there was no documentation evidencing that the donor had the capacity to gift the funds or that the funds were transferred from the donor's account to the borrower.

In addition, the mortgage credit analysis worksheet showed that the borrower had \$5,838 in available assets. However, the document used to support this \$5,838 in assets was an automated teller machine slip. The slip did not show the borrower's name or account number. Also, the last four digits of the card number on the slip did not match the card numbers for other automated teller machine slips in the file. HUD requirements, as set out in Mortgagee Letter 97-26, do not allow the use of teller receipts as supporting documentation, i.e. "These procedures do not, however, permit asset verification by the use of automated teller machine slips. While slips may have some limited use as 'snapshots' of cash assets, they are insufficient in and of themselves for verifying both assets and that improperly borrowed funds are not being used for the cash investment."

Inadequate Credit Evaluation

HUD Handbook 4155.1, REV-4, CHG-1, Paragraphs 2-3 and 2-4. The borrower's credit report showed that his credit card payment was 30 days late one time, 60 days late one time, and 90 days late twice. The credit card payment was last past due in April 2000, approximately four months prior to loan closing. There was no explanation in the file regarding these derogatory items. In addition, some credit accounts that were shown as "paid off" on the borrower's credit report used for the original loan (HUD case file 561-7186849) were shown as not having been paid off on the credit report used for the refinance loan (HUD case file 561-7195032), bringing into question the accuracy of the credit information used in the original loan analysis.

The uniform residential loan application stated that the borrower had been paying rent at his current address for two years, but the letter from the his landlord stated that the borrower had been renting for only a year. This discrepancy was not resolved and documented in the file. Accordingly, the required two-year rental payment history was not provided. Further, the letter from the borrower's landlord was not dated and markings showed that it was faxed from "Source Financial." The loan appeared to have been transferred from "Source Financial"; however, no explanation regarding the transfer was in the file.

Finally, there was no quitclaim deed for the property in the file from the borrower's spouse, from whom he was separated.

Recommendation

- Reimburse HUD for any losses incurred when the property is resold. The amount of the claim and expenses to date is \$179,345.