
AUDIT REPORT



FIRST UNITED MORTGAGE COMPANY, INC.
NON-SUPERVISED MORTGAGEE
CRANFORD, NEW JERSEY

2005-NY-1002

DECEMBER 28, 2004

OFFICE OF AUDIT
NEW YORK/NEW JERSEY REGION



Issue Date	December 28, 2004
Audit Case Number	2005-NY-1002

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

Alexander C. Malloy

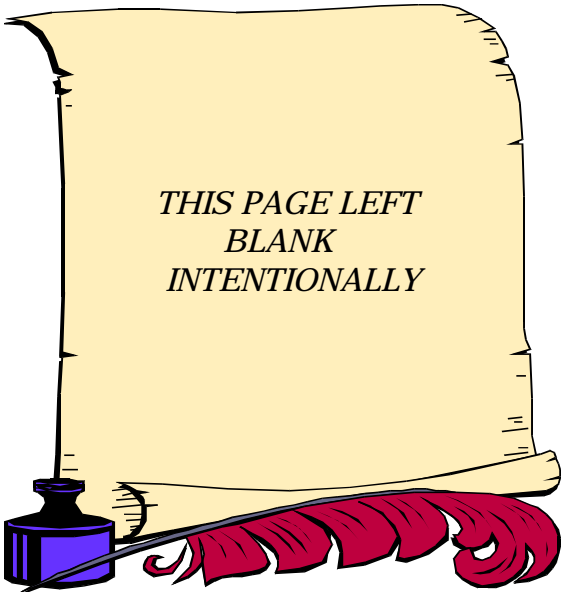
FROM: Alexander C. Malloy, Regional Inspector General for Audit, 2AGA

SUBJECT: First United Mortgage Company, Inc.
Non-supervised Mortgagee
Cranford, NJ

We audited First United Mortgage Company, Inc. (First United), a non-supervised mortgagee located in Cranford, NJ, because of its high default rate. First United had a default rate (90 days delinquent within the first two years of origination as reported in the U.S. Department of Housing and Urban Development (HUD) Neighborhood Watch Early Warning System) of 8.43 percent as of January 31, 2004, while the statewide rate was 3.49 percent for the same period. The objectives of the audit were to determine whether First United (1) originated and underwrote loans insured by the HUD/Federal Housing Administration in accordance with HUD requirements, which specify following prudent lending practices, and (2) designed and implemented a quality control plan in compliance with HUD requirements.

Our report contains two 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 a 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 the report is issued 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 or John Harrison, Assistant Regional Inspector General for Audit, at (212) 264-4174.



Executive Summary

We audited First United Mortgage Co, Inc. (First United), a non-supervised mortgagee located in Cranford, NJ. The objectives of the audit were to determine whether First United (1) originated and underwrote loans insured by the U.S. Department of Housing and Urban Development (HUD)/Federal Housing Administration in accordance with HUD requirements, which specify following prudent lending practices, and (2) designed and implemented a quality control plan in compliance with HUD requirements. The review generally covered the period between February 1, 2002, and January 31, 2004, and involved a review of 25 HUD/Federal Housing Administration-insured loans with mortgage amounts totaling \$3,073,370. A summary of the results of our review is provided below.

Noncompliance with HUD Requirements

Our review of 25 HUD/Federal Housing Administration-insured loans disclosed that First United did not follow prudent lending practices as prescribed by HUD regulations. We found at least one underwriting deficiency in 23 of the 25 loans. In addition, we found that First United charged fees that were unsupported and/or prohibited by HUD regulations in 24 of the 25 cases.

Origination and Underwriting Deficiencies

HUD regulations prescribe the types of income and liabilities to include in determining a potential borrower's creditworthiness, as well as debt to income ratios and compensating factors to consider in qualifying a borrower during the underwriting process. We found noncompliance with these regulations in 23 cases. As a result, unnecessary risk was incurred by the HUD/Federal Housing Administration Insurance Fund. Some of the underwriting deficiencies we identified were as follows:

- Debt to income ratios that exceeded guidelines without compensating factors.
- Inadequate verification of deposits, debt payments, and/or gifts.
- Inadequate credit analysis.
- Inadequate support for income calculations and/or employment.
- Inadequate disclosure of liabilities.
- Inadequate funds to close.
- Closing not in compliance with loan approval.

Ineligible and Unsupported Fees

HUD regulations specify the fees and expenses that may be charged to a borrower. We found that First United charged ineligible and/or unsupported fees in 24 cases. These fees included ineligible commitment fees, credit report fees, and shipping charges. Consequently, borrowers incurred

unnecessary costs.

We believe that these underwriting deficiencies occurred because of inadequate quality control processes that did not ensure that loans were approved in accordance with all HUD requirements. As a result, HUD assumed an unnecessary insurance risk because mortgages were approved for questionable borrowers, and borrowers incurred unnecessary cost burdens as a result of being charged ineligible fees.

Weaknesses in Quality Control Plan Implementation

First United did not implement its quality control plan in accordance with HUD and its own requirements. Indications of this noncompliance included the failure to (1) keep the Quality Control Specialist independent of the loan originating process, (2) select loans that defaulted within 6 months for quality control review, (3) examine gift documentation for loans selected for review, and (4) properly select appraisals for review. In addition, quality control requirements were not always completed in a timely manner, and quality control files were not properly documented and retained.

These failures occurred because First United did not establish procedures to ensure that its quality control plan was properly designed and implemented. Consequently, First United was not fully using its quality control plan, which is designed to enhance and maintain the accuracy, validity, and completeness of its loan origination process.

Recommendations

We recommend that First United indemnify HUD for \$2,482,438 against future losses on 20 of the 25 loans identified in appendix A of this report. We also recommend that First United reimburse borrowers charged ineligible (\$3,773) and unsupported (\$2,504) fees. We further recommend that First United provide your office with a corrective action plan containing assurances that all guidelines pertaining to underwriting Federal Housing Administration-insured loans will be followed by its underwriting staff. We are also recommending specific actions that First United should take to implement its quality control plan in compliance with HUD requirements.

While our audit disclosed significant deficiencies relating to loan underwriting and quality control, we noted that First United has restructured its operations and begun to address some of these deficiencies. For instance, First United has closed two of its branch offices, which originated 11 of the 25 loans in which we found deficiencies. First United has

also recently revised its quality control plan design. Nevertheless, it must address the deficiencies noted in this report to ensure that HUD does not continue to assume an unnecessary insurance risk.

Exit Conference

The results of our audit were discussed with First United officials throughout the course of the onsite audit work. We forwarded a copy of the draft report for review and comment to First United on November 1, 2004, and held an exit conference on November 16, 2004, at First United's offices. First United provided written comments to our draft report on November 30, 2004. We included excerpts of the comments with the findings and provided the complete text in appendix D of this report.

First United disagrees that it failed to adhere to prudent lending practices or that it did not process loans in accordance with applicable HUD requirements for the majority of the loans reviewed. As explained in our evaluation of First United's comments contained in appendix B, we believe that First United did not always adhere to applicable HUD/FHA underwriting requirements, thus causing HUD/FHA to assume an unnecessary risk. First United did not specifically address the finding on quality control, but did indicate that it will continue to work to improve its quality control practices, reporting, and managerial responses. We agree that First United needs to take the actions we recommended to ensure that its quality control plan implementation is effective.

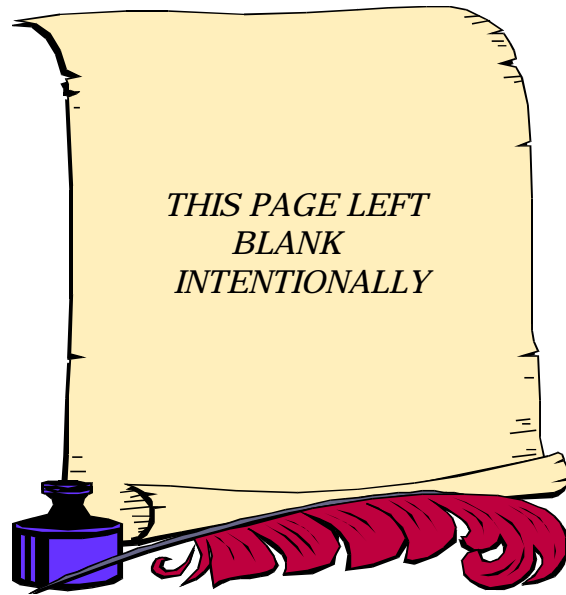


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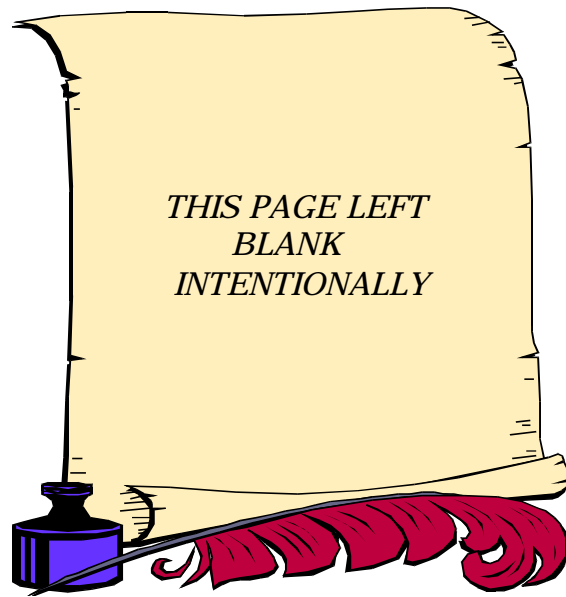
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Introduction

Section 203(b)(1) of the National Housing Act, as amended, authorizes the U.S. Department of Housing and Urban Development (HUD) to provide Federal Housing Administration mortgage insurance for single-family homes. HUD must formally approve a mortgagee that originates, purchases, holds, or sells Federal Housing Administration-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.

First United Mortgage Company, Inc. (First United), located in Cranford, NJ, is a non-supervised, direct endorsement lender that is approved to originate and underwrite loans. First United currently underwrites both Federal Housing Administration and conventional loans. The loan origination process includes taking an 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, First United underwrites loans and decides whether borrowers represent an acceptable credit risk for HUD.

First United originated a total of 610 insured loans with beginning amortization dates during our audit period of February 1, 2002, through January 31, 2004, at its home office in Cranford and at two branch offices in Morrestown and Manasquan, NJ. The total mortgage amount of the 610 loans was \$94,860,372. As of March 8, 2004, 55 of the 610 loans had a default status.

Audit Objectives

The objectives of the audit were to determine whether First United (1) followed prudent lending practices and approved insured loans in accordance with HUD rules and regulations and (2) designed and implemented a quality control plan in compliance with HUD requirements. We selected First United for audit because of its 8.43 percent default rate (90 days delinquent within the first two years of origination as reported in the HUD Neighborhood Watch Early Warning System) as of January 31, 2004, while the statewide rate was 3.49 percent for the same period.

Audit Scope and Methodology

The purpose of our review was to confirm the accuracy of the material information used as a basis for underwriting and closing loans. We obtained background information by

- Reviewing relevant HUD regulations, requirements, and mortgagee letters.
- Examining reports and information maintained on Neighborhood Watch and Lexis-Nexis, a third-party research tool.

- Interviewing officials of First United and obtaining information from members of HUD's Philadelphia Homeownership Center.

To accomplish our audit objectives, we selected a sample of 25 insured loans from Neighborhood Watch with beginning amortization dates between February 1, 2002 and January 31, 2004. In selecting our sample we focused on loans that went into default within the first 12 months. The 25 loans in our sample totaled \$3,073,370. The results of our detailed testing only apply to the 25 loans selected and cannot be projected to the universe of 610 Federal Housing Administration loans underwritten by First United.

Our analysis of the cases was based upon a review of loan origination/underwriting files maintained by both HUD and First United. HUD Handbook 4155.1, REV-4, CHG-1, chapter 3, stipulates that all information required to process and underwrite Federal Housing Administration-insured mortgages must be verified and documented. However, First United was unable to locate files for two of its cases. Alternatively, First United obtained files from the purchaser of the mortgages for these two cases, which, while not containing all lender-required documents, we used to supplement our review of the applicable HUD files.

Our file review and audit procedures included (a) analysis of borrowers' income, assets, and liabilities; (b) verification of selected data on the settlement statements; (c) confirmation of employment and gifts; (d) interviews with selected closing attorneys; and (e) discussions with members of HUD and First United staffs.

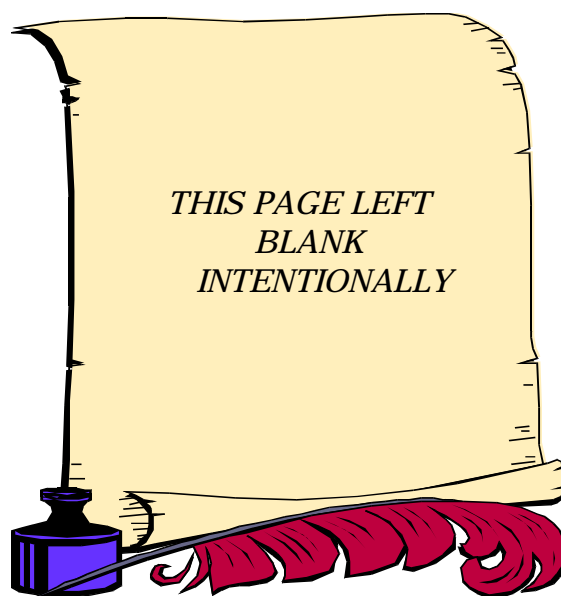
As part of our assessment of First United's quality control plan, we obtained and reviewed its plan and recent HUD reviews of the plan. In addition, we reviewed the nine quarterly quality control reports for the period January 1, 2002, through March 31, 2004, and the specific quality control files for 11 of the loans examined during this period.



Audit Period

We performed the audit fieldwork between April and July 2004. Our audit pertained to loans originated between February 1, 2002, and January 31, 2004. Our audit work was performed at First United's office in Cranford, NJ.

The audit was conducted in accordance with generally accepted governmental auditing standards.



Loan Underwriting Practices Resulted in Unnecessary Risk to the Federal Housing Administration Insurance Fund

Our review disclosed that First United did not follow prudent lending practices and regulations prescribed by HUD in its loan origination and underwriting in 23 of 25 cases we reviewed. Also, borrowers were charged ineligible and/or unsupported fees in 24 of the 25 loans reviewed. These deficiencies occurred because First United personnel did not assure that the loans were processed in accordance with all applicable HUD requirements. As a result, mortgages were approved for questionably qualified borrowers, causing HUD to assume an unnecessary insurance risk.

HUD Origination and Underwriting Criteria

Section 2-1 of HUD Handbook 4000.4, REV-1, Single Family Direct Endorsement Program, requires mortgagees to conduct business operations in accordance with accepted sound mortgage lending practices. Section 2-5 requires the mortgagee to obtain and verify information with at least the same care that would be exercised in originating the loan if the mortgagee were entirely dependent on the property as security to protect its investment.

HUD Handbook 4155.1, REV-4, Mortgage Credit Analysis for Mortgage Insurance, prescribes basic underwriting requirements for single-family mortgage loans. For each HUD-insured loan, the lender must ensure that the borrower has the ability and willingness to repay the mortgage debt. Four major elements are typically evaluated in assessing a borrower's ability to repay mortgage debt: qualifying ratios and compensating factors, stability and adequacy of income, funds to close, and credit history. This assessment must be based on sound underwriting principles in accordance with the guidelines, rules, and regulations described in Handbook 4155.1 and be supported by sufficient documentation.

Section 3-1 of the same handbook advises that the application package must contain sufficient documentation to support a lender's decision to approve a mortgage. While this decision will involve some subjectivity, as discussed below, First United did not always follow the above requirements in its loan origination and underwriting

in 23 of the 25 loans we reviewed.

Origination and
Underwriting Deficiencies

Our examination of 25 loans with beginning amortization dates between February 1, 2002, and January 31, 2004, disclosed origination and underwriting deficiencies in 23 of the 25 loans. First United did not (1) exercise due diligence in the verification of borrowers' income, employment, and/or source of funds for down payment and closing costs and the analysis of borrower's liabilities, credit history, and/or ability to pay or (2) fully comply with HUD underwriting regulations. Consequently, as shown below and in appendix A, we found a variety of underwriting deficiencies in the 23 loans. The deficiencies noted below are not independent of one another, as many of the loan files contained more than one deficiency.

Areas of Deficiency	Number of Loans
Qualifying ratios and compensating factors	17 of 25 loans
Inadequate verification of income/employment	12 of 25 loans
Inadequate verification of funds to close	18 of 25 loans
Inadequate verification of credit history	8 of 25 loans
Other processing procedures	6 of 25 loans

Specific examples of inadequate underwriting are as follows:

- Case number 351-4271956 was approved with a total fixed payment to effective income ratio of 47.955 percent, without documented compensating factors to justify the high ratios. Further, (1) income and liabilities weren't properly evaluated, (2) sufficient verification of borrowers' employment was not obtained, (3) the gift fund needed for closing was not adequately verified, and (4) the loan was not closed in compliance with loan approval requirements. The loan defaulted after seven payments, and the reason reported was curtailment of income.
- Case number 352-4446481 was approved without proper evaluation of the borrowers' ability to repay the mortgage. There was inadequate support for the borrowers' employment. For instance, each of the two borrowers provided paychecks that were not cashed, and the pay stubs contained mathematical errors. In

one case, the pay stub did not reconcile with the corresponding check. Additionally, (1) no underwriting analysis of a cosigner was performed, (2) explanations and analysis of derogatory credit were not obtained, (3) support for a \$3,200 gift was inadequate, and (4) the loan did not close in compliance with loan approval requirements. The loan defaulted after three payments.

- Case number 351-4737106 was approved with a mortgage payment expense to effective income ratio of 34.526 percent and a total fixed payment to effective income ratio of 45.191 percent, without documented compensating factors to justify the high ratios. Further, (1) support for gift funds, which were the only funds the borrower had for closing, was inadequate; (2) no explanation was obtained for inconsistent employment information; (3) while one underwriter rejected the loan, which had been previously approved by another underwriter, the loan was processed based upon the first underwriter's decision without explanation; and (4) the loan did not close in accordance with loan approval requirements. The loan defaulted after six payments, and the reason reported was a curtailment of income. In addition, the closing attorney retained \$920 of trust account funds and was reimbursed \$1,013 in excess of documented expenses.
- Case number 352-5002658 was approved with both a mortgage payment expense to effective income and a total fixed payment to effective income ratio of 42.72 percent. Compensating factors were listed as "conservative use of credit" and "excellent savings pattern." These compensating factors were not justified because an alternative credit history was not obtained for the co-borrower. In addition, verification of third-party payment of borrower's debt was not explained, and a mortgage cosigner's income and creditworthiness were not determined. The loan defaulted after one payment, and the reason reported was excessive obligations.

Appendix A to this report provides a summary of the loan underwriting deficiencies noted during our review, while appendix B provides a description of the origination and underwriting deficiencies for each of the loans. The deficiencies occurred because First United representatives

did not follow HUD requirements or comply with prudent lending practices. The deficiencies resulted in the approval of mortgages for questionably qualified borrowers, which has caused HUD to assume an unnecessary insurance risk.

As of August 31, 2004, 18 of the 25 loans were in default, and 7 of the loans were current. We are requesting indemnification for the 20 loans with significant underwriting deficiencies. These loans are insured for \$2,482,438 (see appendix C). Indemnification of these loans would preclude a potential future claim against the Federal Housing Administration Insurance Fund, resulting in funds to be put to better use. The remaining 3 of the 23 loans involved a failure to itemize lender credits, which, while violating HUD regulations, would not affect a borrower's ability to pay; thus, we are not requesting indemnification from any future losses on those loans.

Borrowers Charged
Ineligible/Unsupported
Fee Origination and
Underwriting

First United charged ineligible fees and/or unsupported fees in 24 of the 25 cases. Mortgage Letter 94-7, section IV, provides that a commitment or lock-in fee must be in writing and guarantee the mortgage interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Handbook 4000.2, REV-2, Section 5-3, identifies the types of costs that a lender is allowed to charge a borrower and provides that it should be the actual cost. We found that borrowers were charged the following ineligible and unsupported fees:

Type of Ineligible/Unsupported Fee	Number of Loans	Amount of Fee
Ineligible commitment fee	17 of 25 loans	\$4,765
Ineligible shipping fee	2 of 25 loans	\$ 108
Total ineligible fees		\$ 4,873
Unsupported credit report fee	19 of 25 loans	\$ 571

A prior HUD review of First United also identified and requested reimbursement for \$1,100 of ineligible commitment fees in four of the cases we reviewed. Since First United has already reimbursed the borrowers for these costs, we deleted the \$1,100 from our determination, leaving \$3,773 in ineligible fees to be reimbursed to borrowers (see appendix C).

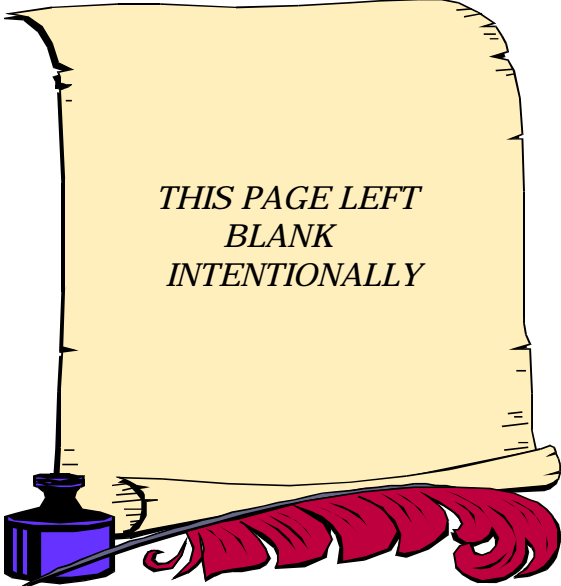
Auditee Comments

First United's comments are presented in their entirety in appendix D. Specific case comments and our evaluation of those comments are included with the individual narrative case presentations in appendix B. Appendix A, Summary of Underwriting Deficiencies, has been adjusted to reflect First United's comments.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgage Review Board, require First United to

- 1A. Reimburse the borrowers \$3,773 of ineligible fees and \$571 of unsupported credit report fees that they were charged.
- 1B. Reimburse the borrower for the \$1,933 of unsupported closing attorney costs and funds remaining in trust.
- 1C. Indemnify HUD against potential future losses on 20 loans totaling \$2,482,438, which are considered as funds to be put to better use since indemnification prevents future claims against the Federal Housing Administration insurance fund.
- 1D. Provide your office with a corrective action plan to assure compliance with all HUD guidelines regarding the origination and underwriting of Federal Housing Administration-insured loans.



Lack of Quality Control Procedures Resulted in Weaknesses in Plan Implementation

Our review disclosed weaknesses in the implementation of First United's quality control plan. First United did not ensure that the Quality Control Specialist was independent of the loan origination process and that quality control reviews complied with HUD requirements to analyze loans that default within the first 6 months, verify gifts, and sample desk review appraisals. In addition, First United did not complete all quality control requirements in a timely manner or properly document and retain quality control files. These weaknesses occurred because First United did not establish procedures to ensure that its quality control plan was properly designed and implemented. Consequently, the effectiveness of its quality control plan was lessened, and First United was not assured of the accuracy, validity, and completeness of its loan origination process.

Plan Implementation Weaknesses

Our review of First United's implementation of its quality control plan found noncompliance with both HUD and its own requirements. Paragraph 6-1 of HUD Handbook 4060.1, REV-1, requires that a quality control plan be sufficient in scope to enable the mortgagee to evaluate the accuracy, validity, and completeness of its loan origination and servicing operations. The plan design must provide for independent evaluation of the significant information gathered for use in the loan origination and underwriting decision-making. Specific implementation weaknesses we found were as follows:

- The Quality Control Specialist was not independent of the loan origination process as required by HUD Handbook 4060.1, REV-1, section 6-1A. Our review of quarterly quality control review reports for the period January 2002 through December 2003 disclosed that the Quality Control Specialist was also involved in the loan origination process during the period July 2002 through June 2003. Loan origination activity conducted by the Specialist included ordering credit reports on borrowers, verifying borrowers' employment, and conducting limited denial participation checks.

- Loans defaulting within 6 months had not been adequately reviewed as required by HUD Handbook 4060.1, REV-1, section 6-1D. We found that First United had selected for quality control review 3 of the 17 loans in our sample of 25 that had defaulted within 6 months. Further, these three were apparently randomly selected, as opposed to being selected because they defaulted within 6 months. Quality control reviews of these early defaulted loans can provide valuable information about the causes of default that may indicate inadequate underwriting.
- Quarterly quality control reports lacked adequate documentation that gifts were reviewed. None of the quarterly quality control reports we reviewed indicated that gifts were reviewed in accordance with HUD Handbook 4060.1, REV-1, paragraph 6-4J.
- Desk review appraisals were being completed on 15 percent of the selected quality control sample, rather than on all sampled loans as required by HUD Handbook 4060.1, REV-1, section 6-1C.

First United acknowledged that the Quality Control Specialist had performed loan origination activities but noted that it was for only a short time. It further acknowledged that it lacked a system to properly identify loans defaulting within 6 months and that it relied upon the direct endorsement underwriter to examine proper gift documentation.

Untimely Review and Follow-up

As of August 19, 2004, we found that First United had not reported on its quarterly quality control review for the period ending March 31, 2004. Additionally, our review of quality control documents disclosed that follow-up was not always adequate. For instance, there was no response from First United management regarding quality control findings in the quarterly reports for the periods ending June 2002 and September 2003. Further, there was no response to the finding in the quarterly report for the periods ending March and September 2002 that follow-up on delinquent loans needed more emphasis.

Inadequate File Retention and Documentation

First United did not comply with its own requirement that quality control files be maintained for the current and 2 prior years. We requested 11 quality control files to assess

whether applicable quality control reports were adequately supported; however, First United was unable to provide us with any of the requested files. As a result, we could not determine whether quality control reviews were conducted in accordance with HUD Handbook 4060.1.

We also found that First United could not provide reports produced by the outside investors upon whom it relied to perform quality control services. First United also did not have written reports that specified the investors' responsibilities for the period that it relied upon outside investors for quality control functions, October 2002 through December 2003. Examples of various quality control functions conducted by outside investors were the re-verification of a borrower's credit, income/assets, and the review of appraisals. HUD Regulation 4060.1, section 6-1E, holds the mortgagee responsible for ensuring that HUD requirements are met regarding quality control. In addition, section 6-1E requires that the mortgagee obtain written reports from investors regarding the results of quality control testing.

Auditee Comments

First United did not address the specific findings relating to implementation of its Quality Control Plan, but did note that it will continue to work to improve its quality control practices, reporting and documented managerial responses.

**OIG Evaluation of
Auditee Comments**

Our review disclosed specific weaknesses in First United's implementation of its quality control plan as a result of a failure to establish procedures to ensure that its quality control plan was properly designed and implemented. While not addressing each deficiency, First United noted that it will continue to improve quality control practices. We agree that First United needs to take the actions we recommended to ensure that its quality control plan implementation is effective.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board, require First United to

2A. Implement quality control procedures to ensure that:

- The Quality Control Specialist is independent of the loan originating process.
- All loans that default within the first six payments are properly reviewed.
- Proper gift verification is performed for loans selected for quality control review.
- Appraisal desk reviews are sampled in accordance with HUD requirements.
- Quality control reviews and appropriate management responses are completed in a timely manner.
- Quality control files are properly documented and retained, including assurance of compliance with HUD requirements by outside investors relied upon to conduct quality control.

Management Controls

In planning and performing our audit, we considered the management controls of First United 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 program operations. Management controls include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding Resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and Reliability of Data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed all 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 program operations will meet an organization's objectives.

Significant Weaknesses

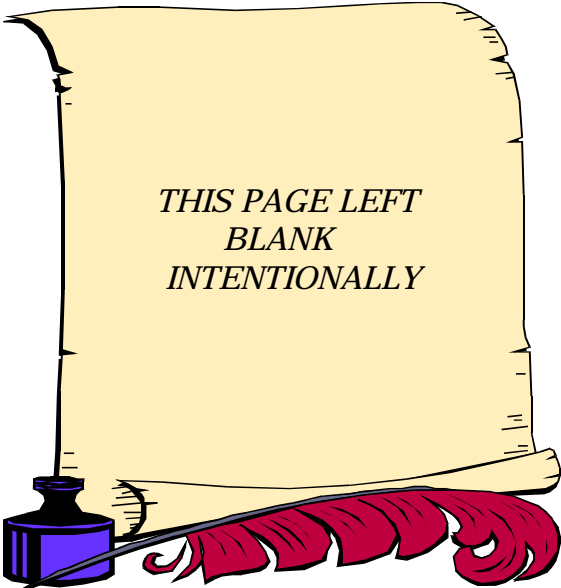
Significant weaknesses exist in the following management controls: Program Operations and Compliance with Laws and Regulations. These weaknesses are described in the two findings of this report and summarized below.

- First United did not assure that certain loans were processed in accordance with all applicable HUD requirements (see finding 1).

- First United did not design and implement its quality control plan to ensure compliance with HUD requirements (see finding 2).

Follow-up on Prior Audits

This is the initial Office of Inspector General (OIG) audit report on First United.



Summary of Underwriting Deficiencies (1)

(page 1 of 4)

	1	2	3	4	5	6	7	8	9	10	11	12	13
Case #	351-4271956	351-4245405	352-4737106	352-4446481	351-4166768	352-4624970	352-4713314	351-4258438	352-4705394	351-4248193	351-4271037	352-4639998	352-4592520
Mortgage amount (\$)	\$152,605	\$105,154	\$234,000	\$104,139	\$71,050	\$157,700	\$167,779	\$118,044	\$104,250	\$102,159	\$134,893	\$147,530	\$109,112
Payments before first default reported	7	9	6	3	3	11	3	8	9	7	5	11	4
Areas of Deficiencies:									1/	2/			
Qualifying Ratios and Compensating Factors													
Excessive debt to income ratios without compensating factors	X		X		X	X					X	X	
Inaccurate debt to income ratios	X				X	X	X	X				X	X
Inadequate compensating factors							X		X				
Inadequate disclosure of liabilities	X	X			X					X			X
Inadequate underwriting requirements for temporary interest rate buydown													X
Subtotal:	3	1	1	0	3	2	2	1	1	1	1	2	3
Inadequate Verification of Funds To Close													
Verification of cash gift not obtained	X		X	X		X						X	
Verification of debt payments not obtained													
Verification of deposit not obtained				X	X	X		X		X	X	X	X
Verification of paid outside closing cost not obtained	X			X	X							X	X
Inadequate bank account documentation						X					X		X
Inadequate earnest money deposit documentation			X				X	X					
Inadequate funds to close on HUD-1 Settlement Statement				X	X						X		X
Inadequate funds to close on Mortgage Credit Analysis Worksheet	X		X	X		X		X					
Closing not in compliance with loan approval requirements	X		X	X				X					
Subtotal:	4	0	4	6	3	4	1	4	0	1	3	3	4
Inadequate Verification of Income/Employment													
Inadequate support for income calculation	X	X				X	X	X				X	
Inadequate support for employment	X		X	X		X	X						
Subtotal:	2	1	1	1	0	2	2	1	0	0	0	1	0

Summary of Underwriting Deficiencies (1)							(page 2 of 4)						
	1	2	3	4	5	6	7	8	9	10	11	12	13
Case #	351-4271956	351-4245405	352-4737106	352-4446481	351-4166768	352-4624970	352-4713314	351-4258438	352-4705394	351-4248193	351-4271037	352-4639998	352-4592520
Mortgage amount (\$)	\$152,605	\$105,154	\$234,000	\$104,139	\$71,050	\$157,700	\$167,779	\$118,044	\$104,250	\$102,159	\$134,893	\$147,530	\$109,112
Payments before first default reported	7	9	6	3	3	11	3	8	9	7	5	11	4
Inadequate Documentation of Credit History													
Inadequate credit analysis		X		X	X			X		X			
Subtotal:	0	1	0	1	1	0	0	1	0	1	0	0	0
Other Processing Procedures													
Inadequate origination analysis of non-processed borrower				X									
Unsigned sales contract			X										
Subsequently rejected Mortgage Credit Analysis Worksheet disregarded without justification			X										
Non-itemized lender credit													
Subtotal:	0	0	2	1	0	0	0	0	0	0	0	0	0
Ineligible/Unsupported Fees													
Unsupported credit report fee	X	X	X	X	X	X	X		X	X	X	X	X
Ineligible commitment fee			X	X	X		X	X		X	X	X	X
Ineligible shipping fee			X										
Subtotal:	1	1	3	1	2	1	2	1	1	2	2	2	2
Deficiency count for each case	10	4	11	11	9	9	7	8	2	5	6	8	9
Indemnification recommended	X	X	X	X	X	X	X	X	X	X	X	X	X

Note: 1/ First United could not locate its case file.

2/ While Neighborhood Watch reported this loan paid in full as of September 30, 2004, Federal Housing Administration Insurance was reported as still in effect.

Summary of Underwriting Deficiencies (2)

(page 3 of 4)

	14	15	16	17	18	19	20	21	22	23	24	25	Total
Case #	351-4268219	352-5002658	351-4255346	352-4821402	352-4187932	352-4840266	352-4567838	352-4903996	352-4787988	352-4635690	351-4317276	352-4660882	
Mortgage Amount (\$)	\$95,207	\$123,373	\$88,152	\$73,841	\$74,600	\$156,300	\$162,550	\$132,762	\$137,583	\$133,168	\$47,958	\$139,461	\$3,073,370
Payments Before First Default	3	1	6	0	4	3	1	5	3	3	8	3	
Areas of Deficiencies:					1/								
Qualifying Ratios and Compensating Factors													
Excessive debt to income ratios without compensating factors			X										7
Inaccurate debt to income ratios		X				X	X						10
Inadequate compensating factors		X											3
Inadequate disclosure of liabilities	X												6
Inadequate Underwriting Requirements for Temporary Interest Rate Buydown													1
Subtotal:	1	2	1	0	0	1	1	0	0	0	0	0	27
Inadequate Verification of Funds To Close													
Verification of cash gift not obtained	X												6
Verification of debt payments not obtained	X	X											2
Verification of deposit not obtained	X					X							10
Verification of paid outside closing cost not obtained	X			X	X								8
Inadequate bank account documentation		X			X								5
Inadequate earnest money deposit documentation	X												4
Inadequate funds to close on HUD-1 Settlement Statement	X			X									6
Inadequate funds to close on Mortgage Credit Analysis Worksheet													5
Closing not in compliance with loan approval													4
Subtotal:	6	2	0	2	2	1	0	0	0	0	0	0	50
Inadequate Verification of Income/Employment													
Inadequate support for income calculation		X				X	X						9
Inadequate support for employment	X												6
Subtotal:	1	1	0	0	0	1	1	0	0	0	0	0	15

Summary of Underwriting Deficiencies (2)													(page 4 of 4)
	14	15	16	17	18	19	20	21	22	23	24	25	Total
Case #	351-4268219	352-5002658	351-4255346	352-4821402	352-4187932	352-4840266	352-4567838	352-4903996	352-4787988	352-4635690	351-4317276	352-4660882	
Mortgage Amount (\$)	\$95,207	\$123,373	\$88,152	\$73,841	\$74,600	\$156,300	\$162,550	\$132,762	\$137,583	\$133,168	\$47,958	\$139,461	\$3,073,370
Payments Before First Default	3	1	6	0	4	3	1	5	3	3	8	3	
Inadequate Documentation of Credit History													
Inadequate credit analysis	X	X		X									8
Subtotal:	1	1	0	1	0	0	0	0	0	0	0	0	8
Other Processing Procedures													
Inadequate origination analysis of non-processed borrower		X											2
Unsigned sales contract													1
Subsequently Rejected Mortgage Credit Analysis Worksheet disregarded without justification													1
Non-itemized lender credit	X								X	X			3
Subtotal:	1	1	0	0	0	0	0	0	1	1	0	0	7
Ineligible/Unsupported Fees													
Unsupported credit report fee	X		X	X	X	X	X				X		19
Ineligible commitment fee			X	X	X	X		X	X	X	X		17
Ineligible shipping fee												X	2
Subtotal:	1	0	2	2	2	2	1	1	1	1	2	1	38
Deficiency count for each case	11	7	3	5	4	5	3	1	2	2	2	1	145
Indemnification recommended	X	X	X	X	X	X	X						\$2,482,438

Note: 1/ First United could not locate its case file.

2/ As of September 30, 2004, Neighborhood Watch reports that this loan was paid in full, yet Federal Housing Administration insurance was reported as in effect.

Case Number: 351-4271956
Loan Amount: \$152,605
Settlement Date: September 27, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed debt to income ratios of 20.7 and 47.955 percent, respectively, without listing any compensating factors.

B. Inaccurate Debt to Income Ratios

C. Inadequate Support for Income Calculation

D. Inadequate Disclosure of Liabilities

The ratios calculated by First United are incorrect due to an overstatement of income by \$991 and a \$545 understatement of liabilities. After considering these deficiencies, we calculated the debt to income ratios to be 24.45 and 66.6 percent, respectively.

First, from the documents in the file we could not determine how First United calculated the borrower's estimated monthly income of \$2,315. We calculated a monthly income of \$1,973, based on the hourly rate indicated on the verification of employment provided by the borrower's employer. Second, overtime should not have been considered for the co-borrower because the verification of employment for both borrowers stated that the continuance of the overtime was not guaranteed. HUD Handbook 4155.1, REV-4, CHG 1, section 2-7A, states that overtime may be used as qualifying income if the borrower has received such income for approximately the past 2 years and there are reasonable prospects of its continuance. The lender must develop an average of overtime income for the past 2 years, and the employment verification must not state categorically that such income is not likely to continue. Periods of less than 2 years may be acceptable provided that the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes. Third, no justification was given by the underwriter to conclude that the overtime should be included as qualified income if earned less than 2 years. The Mortgage Credit Analysis Worksheet included the co-borrower's monthly overtime income of \$649.

Further, there was inadequate disclosure of liabilities. First, a \$545 monthly payment for consolidated debts was not considered. HUD Handbook 4155.1, REV-4, CHG-1, section 2-11A, states that the mortgagee must include monthly housing expense and all other additional recurring charges, including child support, installment accounts, and revolving accounts, when computing debt to income ratios. Second, the borrower's credit report disclosed an outstanding state tax lien of \$2,940, which was neither listed on the loan

application nor considered when computing debt to income ratios. No explanation for the omission was documented. First United did not comply with HUD Handbook 4155.1, REV-4, CHG 1, section 2-3B, which states that a satisfactory explanation must be provided by the borrower for the omission of any significant debt shown on the credit report but not listed on the loan application

E. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet

The Mortgage Credit Analysis Worksheet reported a \$4,047 negative balance. This negative balance should have prevented First United from approving the loan.

F. Closing Not in Compliance with Loan Approval

HUD Handbook 4155.1 REV-4, CHG 1, section 3-12B, requires that the loan close in the same manner in which it was underwritten and approved. The HUD-1 Settlement Statement in the file listed a seller concession of \$7,000, which was \$1,602 higher than the \$5,398 amount listed on the Mortgage Credit Analysis Worksheet.

G. Verification of Cash Gift Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10C, requires that the lender obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit into the borrower's bank account. Paragraph 2-10C further provides that if the funds are not deposited to the borrower's account before closing, the lender must obtain verification from the closing agent that funds were received from the donor for the amount of the gift. The file contained a gift letter for \$5,000. The donor provided a cancelled check for \$1,000, made payable to the borrower's realtor, along with evidence of deposit by the realtor. However, the donor also made a \$4,000 cashier's check, payable to the borrower on closing day, but there was no documentation to verify that the closing agent received these funds.

H. Inadequate Support for Employment

HUD Handbook 4155.1, REV-4, CHG 1, section 2-6, requires the lender to verify employment for the most recent 2 full years. The file contained verification of employment from the borrowers' current employer; however, the borrowers had worked for that employer less than 2 years. Additional employment verification should have been obtained.

I. Verification of Paid Outside Closing Cost Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 Settlement Statement in the file reported that the borrower paid \$50 for a credit report and a \$375 appraisal fee outside closing. The file contained a check deposit sheet made by First United and a copy of a non-canceled check for \$425 made to First United by the

gift donor. As a result, the documentation was insufficient to prove that the paid outside closing items had been paid before closing, without reducing the funds available to close.

J. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the actual costs of credit reports. The file reported credit report costs of \$40. However, the borrowers were charged \$50 for credit reports on the HUD-1 Settlement Statement. Consequently, the \$10 is an unsupported fee.

First United's Comments

- A. First United did not comment on the issue of excessive debt to income ratios without compensating factors.
- B. First United agreed that the reasoning for the use of overtime and the basis for the
- C. income calculation should have been documented in the file. However, First United disagreed that the borrowers' income was overstated by \$991 based upon use of overtime income, because the verifications of employment for both borrowers only indicated that the overtime was "not guarantee" instead of categorically stating that the overtime income was "not likely to continue."
- D. First United agreed that debt was incorrectly excluded by the underwriter and that the existence of the state tax lien and its prior disposition were not properly documented.
- E. First United agreed that the MACAW reported inadequate funds to close.
- F. First United did not comment about the issue that the loan did not close in compliance with loan approval.
- G. First United did not comment about the issue of inadequate gift verification.
- H. First United agreed that the file lacked complete documentation of employment.
- I. First United did not comment about the issue of inadequate verification of costs paid outside closing.
- J. First United agreed that credit report fees were not supported.

OIG's Evaluation of First United's Comments

- A. First United did not comment.
- B. First United concurred with the finding that underwriter did not provide adequate
- C. justification of the borrowers' income calculation.
- D. First United concurred.

- E. First United concurred.
- F. First United did not comment.
- G. First United did not comment.
- H. First United concurred.
- I. First United did not comment.
- J. First United concurred.

Case Number: 351-4245405
Loan Amount: \$105,154
Settlement Date: August 29, 2002
Status: Currently in Default

Pertinent Details

A. Inadequate Support for Income Calculation

Handbook 4155.1, REV-4, CHG-1, section 2-7, provides that overtime and bonus income may be used to qualify if the borrower has received such income for approximately 2 years and there are reasonable prospects for continuance. If bonus income varies significantly from year to year, a period of more than 2 years must be used to calculate average income. First United appeared to include bonus income in the borrower's base income. However, since there was a significant variance in bonus income over the 3-year period provided, the bonus income should have been averaged over 3 years. This would have caused total monthly wage income to decrease from \$4,231 to \$4,123.

B. Inadequate Credit Analysis

Handbook 4155.1, REV-4, CHG-1, section 2-3, provides that major indications of derogatory credit problems require a sufficient written explanation from the borrower. First United did not obtain a satisfactory explanation for a \$284 balance that was in collections. The conditional commitment in the file indicated that evidence had to be provided before closing that this amount had been paid in full, but there was no documentation that the \$284 balance had been paid.

C. Closing Not in Compliance with Loan Approval

Handbook 4155.1, REV-4, CHG 1, section 3-12B, states that the loan must close in the same manner in which it was underwritten and approved. The Mortgage Credit Analysis Worksheet had total seller's contribution as \$166, while the actual seller's contribution at closing on the HUD-1 Settlement Statement was \$2,000.

D. Inadequate Underwriting Documentation

Documents in the file contain discrepancies for the borrower's residence. The borrower's loan application, bank statements, payroll tax form, and driver's license indicate a residence at 1657 N. Robinson Street. The July 18, 2002, credit report indicates an address of 1957 N. Robinson Street but also indicated association with 1657 N. Robinson Street. In the July 26, 2002, explanation for credit report delinquencies, the borrower stated an address of 1957 N. Robinson Street. An August 27, 2002, lease, effective September 1, 2002, was used to support future monthly rental income of \$500 per month at 1297 N. Robinson Street. Lastly, on the deed for the purchase of the Federal Housing Administration-insured property that occurred on August 29, 2002, the borrower listed 1457 N. Robinson Street as his post office address. These discrepancies for the addresses of both the borrower and the rental

property raise questions as to whether the rental income and potential debt with the prior residence were properly verified.

E. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of credit reports. The file contained two credit reports at a cost of \$5 for each report. However, the borrower was charged \$50 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$10. Consequently, the \$40 is an unsupported fee.

First United's Comments

- A. First United disagrees that the income calculation was incorrect, noting that the figure used for bonus income was the average for the two previous years.
- B. First United states that the credit supplement to document payment of a debt in collection was not copied into the loan file. First United will pursue obtaining this supplement to provide HUD.
- C. First United agrees that the MCAW in its file incorrectly reported the seller contribution, but that the final 1003 reflected the correct amount as reported on the HUD-1 Settlement Statement.
- D. First United agreed variant house numbers should have been corrected or explained in the file.
- E. First United stated that actual invoicing for credit reports will occur in future files.

OIG's Evaluation of First United's Comments

- A. Support for the income calculation was inadequate. First United indicates that it averaged bonus income for the previous two years. The borrower's bonus income increased more than \$8,000 from calendar year 2001 to 2002. Handbook 4155.1 REV-4, CHG 1 requires the use of a period of more than two years to calculate average income if bonus income varies significantly from year to year.
- B. The loan file lacks documentation that the debt was paid.
- C. As noted by First United, the loan file MCAW was not updated to reflect what was on the HUD-1 Settlement Statement. Nevertheless, OIG has determined that the HUD-1 Settlement Statement per the HUD file did reflect the correct seller contribution amount as reported on the HUD-1 Settlement Statement. Consequently, we eliminated the deficiency that closing was not in compliance with loan approval requirements.
- D. First United concurred.

E. First United concurred.

Case Number: 352-4737106
Loan Amount: \$234,000
Settlement Date: October 2, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13 state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed debt to income ratios of 34.526 and 45.191 percent, respectively, without listing compensating factors.

B. Subsequently Rejected Mortgage Credit Analysis Worksheet Disregarded Without Justification

The loan was underwritten based upon the Mortgage Credit Analysis Worksheet, dated September 12, 2002, with debt to income ratios of 34.526 and 45.191. However, the file contained a second worksheet, dated September 27, 2002, prepared by a different underwriter with debt to income ratios of 33 and 42.9 percent. Although these ratios were lower than those on the previous worksheet, this underwriter rejected the loan. However, the loan was approved, based upon the previous worksheet, with no explanation for disposition of the most recent and rejected worksheet.

C. Verification of Cash Gift Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10C, requires that the lender obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit into the borrower's bank account. Also, if the funds are not deposited to the borrower's account before closing, the lender must obtain verification that the closing agent received the funds from the donor for the amount of the gift. The gift letter in the file reported a gift of \$26,900. We found supporting documents for \$18,000 of the \$26,900 gift amount. The remaining \$8,900 was supported by a check made by the donor to an unrecognized third party on April 16, 2002 (more than 5 months earlier than the closing date). No documentation was obtained showing the fund transfer from the donor's account to the borrower's account. We also noted that the gift fund was required for the borrower to close.

D. Inadequate Earnest Money Deposit Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10A, provides that if the amount of any earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's savings history, the lender must verify the deposit amount and

the source of funds. The Mortgage Credit Analysis Worksheet in the file showed that the earnest money deposit was \$29,400, which was greater than 2 percent of the sales price. The application reported that these funds were held in escrow by the seller's attorney (\$8,900) and borrower's attorney (\$20,500). However, the letters from the attorneys indicated that they held escrows of \$9,900 (seller's attorney) and \$18,000 (borrower's attorney). Therefore, the remaining \$1,500 earnest money was not documented as deposited. Further, we noted that the borrower had no assets other than the gift funds of \$26,900, as indicated on the gift letter (of which \$8,900 was inadequately supported as noted in section C). We also noted that assets available were reported as \$26,900 on the rejected Mortgage Credit Analysis Worksheet, dated September 27, 2002. Moreover, the HUD-1 Settlement Statement indicated that the earnest money was \$9,900. Therefore, First United did not obtain sufficient verification for the earnest money deposit, which was required to close.

E. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet

The Mortgage Credit Analysis Worksheet, dated September 12, 2002, reported that the borrower needed cash in the amount of \$29,053 to close. The borrower had no assets other than the \$26,900 gift, as indicated on the gift letter (which included an unsupported amount of \$8,900 as noted in section C). Since the borrower evidently did not have enough funds to close, First United did not comply with HUD Handbook 4155.1, REV-4, CHG 1, section 2-10A, which requires that the lender estimate the settlement requirements to determine the cash required to close.

F. Closing Not in Compliance with Loan Approval

HUD Handbook 4155.1, REV-4, CHG 1, section 3-12B, requires that the loan close in the same manner in which it was underwritten and approved. We found that the closing attorney's records did not reconcile with the HUD-1 Settlement Statement, which reported more costs than documentation disclosed was actually paid. Further, there were surplus funds in the attorney's trust fund, which were not returned to the borrower.

G. Inadequate Support for Employment

Handbook 4155.1, REV-4, CHG 1, paragraph 3-5, requires the lender to ask sufficient questions to obtain a complete picture of the borrower's financial situation, the source of funds for the transaction, and the intended use of the property. The borrower's credit report in the file indicated that the borrower had been employed with five different firms, none of which reconciled to the firm name provided on the loan application, at which the borrower reported he had been self-employed for 5 years. No explanation was obtained for the inconsistent employment information. HUD Handbook 4155.1, REV-4, CHG 1, section 2-9B, provides that a year-to-date profit-and-loss statement and balance sheet are required for self-employed borrowers. While a profit-and-loss statement was obtained, a balance sheet was not.

H. Ineligible Commitment Fee

Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. A commitment fee of \$275 was included on the HUD-1 Settlement Statement, which was paid by the borrower on October 2, 2002 (closing date). However, the lock-in confirmation document, dated August 2, 2002, indicated that the borrower did not choose a lock-in. Therefore, the \$275 is an ineligible fee.

I. Ineligible Shipping Fee

The borrower was charged \$58 for a UPS Express fee, which is not listed on the approved listing of closing costs and other fees in HUD Handbook 4000.2, REV-2, section 5-3.

J. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower actual costs of credit reports. The file contained a credit report at a cost of \$33. However, the borrower was charged \$43 for the credit report on the HUD-1 Settlement Statement. Thus, the \$10 is an unsupported fee.

K. Inadequate Underwriting Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1H, states that the sales contract and any amendments or other agreements and certifications should be included in the case binder. The file contained an incomplete and non-executable sales contract that was not signed by either the borrower or seller.

First United's Comments

- A. First United agreed that compensating factors to justify ratios in excess of HUD guidelines should have been documented, and that this will be implemented as a standard procedure. However, First United believed that a 93 percent loan to value ratio would give strength to justifying the loan.
- B. First United agreed that the previous MCAW by another underwriter should not have remained in the loan file.
- C. OIG stated that the file contained documentation for \$18,000 of the \$26,900 gift, but that documentation for the remaining \$8,900 was a donor check made payable to an unrecognized third party. First United asserts that the unrecognized third party was the attorney for the transaction, and that the \$8,900 was reflected on the HUD-1 Settlement Statement as a downpayment.

- D. First United disagrees that earnest money was not properly documented. First United states that the initial \$8,900 portion of the gift, plus a \$1,000 deposit made at contract signing, was held by the seller's attorney. Further, First United states that the \$18,000 balance of the gift was also properly documented.
- E. First United disagreed that the borrower did not have sufficient funds to close. First United noted that the loan file documented an additional \$2,500 gift, but acknowledged that a copy of the additional gift letter was not in the file. First United stated that it would attempt to obtain the gift letter.
- F. Concerning the OIG conclusion that the closing attorney's record did not reconcile with the HUD-1 Settlement Statement, and that there were surplus funds in the attorney's trust fund which were not returned to the borrower, First United stated that it is not privy to the closing agent's records and therefore cannot respond to the statements without first contacting with the attorney. First United will be pursuing this avenue of action.
- G. First United disagreed that there was inadequate support for the borrower's employment. First United stated that the credit report can not be used as confirmation of employment. Further, First United stated that the borrower's self-employed status was clearly documented because the absence of a balance sheet would not affect the calculation of income and or alter the underwriting decision.
- H. First United agreed that the file did not contain documentation to support the commitment fee.
- I. First United stated that the shipping fee was charged by the closing agent despite written instruction that it was not an allowable fee.
- J. First United agreed that the supplemental credit report fees were not properly supported in the file.
- K. First United agreed that the sales contract within the loan file was incomplete due to copying error, and would attempt to secure a complete copy.

OIG's Evaluation of First United's Comments

- A. First United concurred that justification for excessive ratios was lacking. In addition, HUD Handbook 4155.1, REV-4, CHG 1 does not list the loan to value ratio as a compensating factor.
- B. First United concurred.
- C. We do not believe that First United adequately verified the cash gift as required by HUD Handbook 4155.1, REV-4 CHG 1, section 2-10C. Documentation in the loan file does not support First United's contention that the third party who received the \$8,900 check was either the seller's or buyer's attorney. Further, we cannot conclude

from documentation in the loan file that the \$8,900 down payment on the HUD-1 Settlement Statement was disbursed from a source other than the \$18,000 held by the buyer's attorney.

- D. First United disagreed that earnest money was inadequately documented. As explained in item C, there is no evidence that the \$8,900 held in escrow by the seller's attorney was not part of the \$18,000 verified gift fund. Since the gift amount provided funds required to close, we do not believe that the earnest money was adequately documented.
- E. First United concurred that the file did not document the \$2,500 gift, but stated that the transfer of the funds was documented in the loan file. OIG review did not find documentation for the transfer.
- F. First United stated the need to contact the closing attorney to validate the facts in the report. We agree.
- G. While the credit report should not be used for confirmation of employment, we believe that apparent discrepancies should be questioned. Further, Section 2-9B provides that balance sheet is required for self-employed borrowers.
- I. First United concurred.
- J. First United concurred.
- K. First United concurred.
- L. First United concurred.

Case Number: 352-4446481
Loan Amount: \$104,139
Settlement Date: March 03, 2002
Status: Reinstated by Mortgagor Who Retains Ownership

Pertinent Details

A. Inadequate Support for Employment

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1E, provides that pay stubs must show the borrower's name, Social Security number, and year-to-date earnings. In addition, section 3-1 states that when standard documentation does not provide enough information to support a decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower. We found the support for employment to be inadequate. The file contained pay stub summaries for both borrowers that were generated by the same employer. The pay stub summaries, which covered an identical 4 weeks of employment for each borrower, contained mathematical mistakes and were not in sequence by check number. In addition, each sequential week of employment listed on each of the pay stub summaries contained four corresponding un-cashed paychecks, and net pay and deduction amounts on one paycheck did not reconcile to the related pay stub. With these discrepancies, additional explanatory statements should have been obtained from the borrowers to support their employment.

B. Verification of Cash Gift Not Obtained

Mortgagee Letter 00-28 provides that the donor must furnish conclusive evidence that the funds given to the borrower came from the donor's own funds and were not provided directly or indirectly by the seller, real estate agent, builder, or any entity with an interest in the sales transaction. In addition, the mortgagee remains responsible for obtaining verification that the closing agent received the funds from the donor for the amount of the purported gift and that the deposit was properly documented in the borrower's account.

The file contained a gift letter for \$3,200, dated February 20, 2002, and a \$3,200 gift check, written to the co-borrower dated December 21, 2001 (6 weeks before the gift letter). Further, the file did not contain documentation to substantiate the deposit of the gift. Lastly, the file provided a bank statement from the gift donor that listed a \$3,200 deposit on December 20, 2001 (1 day before the \$3,200 gift withdrawal on December 21, 2001). Consequently, the documentation that the gift funds came from the donor's own funds and that the borrower received the funds was inadequate.

C. Verification of Deposit Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The co-borrower's bank statements contained unexplained deposits of \$900 on March 14, 2002,

and \$3,200 on December 5, 2001. It should also be noted that these unexplained deposits represented funds needed to close.

D. Inadequate Credit Analysis

HUD Handbook 4155.1, REV-4, CHG 1, section 2-3, provides that indications of derogatory credit problems require a sufficient written explanation from the borrower. The file contained copies of bank statements of the co-borrower that listed many “non sufficient funds” charges for the co-borrower’s automobile loan payments. Further, these payments amounted to \$623 per month, which was more than the required monthly \$310 payment as listed on the co-borrower’s credit report. As a result, the increased liability due to the nonpayment for the car could significantly increase the debt to income ratios of the borrower and co-borrower. We also could not locate any evidence in the file to document that the co-borrower made an actual car payment, which raises the question as to whether the co-borrower was in default for car payments at the closing. Further, we could not locate any explanation in the file regarding adverse ratings for four other accounts of the co-borrower. Consequently, analysis of credit was inadequate.

E. Closing Not in Compliance with Loan Approval

HUD Handbook 4155.1, REV-4, CHG 1, section 3-12B, states that the loan must close in the same manner as it was underwritten and approved. The file contained a HUD-1 Settlement Statement, which included an origination fee of \$1,026 and a non-realty item of \$275 that were not included on the Mortgage Credit Analysis Worksheet during the underwriting process. The omission of these two items could have a significant impact on the borrower’s ability to have enough assets to close. In addition, an Initial Escrow Account Disclosure Statement, contained in the file, requested an escrow cushion of \$586 representing 2 months of real estate taxes and hazard payments. The HUD-1 Settlement Statement, however, listed \$293 collected, which represents only 1 month real estate tax and hazard premium.

F. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, provides that the cash investment in the property equal the difference between the amount of the insured mortgage, excluding any up-front Mortgage Insurance Premium, and the total cost to acquire the property, including prepaid expenses. In addition, Handbook 4155.1, REV-4, CHG 1, section 1-9, provides that the lender must estimate the settlement requirements to determine the cash required to close. The file contained a Mortgage Credit Analysis Worksheet that did not include closing costs of \$1,456 and a non-realty item amounting to \$275, as stated on the good faith estimate. The HUD-1 Settlement Statement indicates that the \$1,026 origination fee and the \$275 non-realty item were charged on the HUD-1 Settlement Statement at closing. With the additional closing costs charged on the HUD-1 Settlement Statement, the borrower would have a negative cash reserve of \$677, instead of \$624 as reported.

- G. Inadequate Funds To Close on HUD-1 Settlement Statement
- H. Verification of Paid Outside Closing Costs Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. The borrower did not appear to have sufficient funds to close. There was no documentation to show that paid outside closing items totaling \$520 had been paid before closing without reducing the funds available to close. Cash due from the borrower on the HUD-1 Settlement Statement was \$4,100. If the total \$520 paid outside closing amount is added to the \$4,100 owed by the borrower and then offset against the remaining \$3,941 in assets, the borrower has a \$679 deficit at closing.

- I. Inadequate Origination Analysis of Non-processed Borrower

HUD Handbook 4155, section 2-2A, refers to "cosigners," who don't take ownership interest but must execute the loan application and mortgage note, and noted that they become liable for the repayment of the obligation. The Handbook also states that the cosigner's income, assets, liabilities, and credit history are included in the determination of creditworthiness. The file contained a HUD-1 Settlement Statement and Mortgage that listed a borrower who was not included in the underwriting process. The loan should have been underwritten with this non-processed borrower.

- J. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower the actual costs of credit. The file contained two credit reports at costs of \$20 and \$35. However, the borrower was charged \$86 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$55. Accordingly, the \$31 is an unsupported fee.

- K. Ineligible Commitment Fee

Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. A commitment fee of \$275 was included on the HUD-1 Settlement Statement, which was paid by the borrower on March 22, 2002 (closing date). However, the lock-in confirmation document, dated January 16, 2002, indicated that the borrower did not choose a lock-in. Therefore, the \$275 is an ineligible fee.

First United's Comments

- A. First United agrees that the underwriter should have questioned the mathematical errors on both borrowers' paystubs, and that the paystub and paycheck for one borrower did not reconcile, but disagrees that there was inadequate support for the borrowers' employment. Specifically, First United does not see the relevance of the

sequential order of checks issued the borrowers, nor believe that it should have inquired about when the borrowers cashed their paychecks.

- B. First United disagrees that verification of a cash gift was not obtained. First United states that it is required to see donor ability and the transfer of gift funds, both of which are contained in the loan file. Additionally, First United believes that it is impractical and an undue burden to request that the donor source the funds.
- C. First United disagrees that deposits were not verified. First United states that the \$900 deposit is not excessive and does not need to be sourced, and that the \$3,200 deposit represents a gift.
- D. First United disagrees that there was inadequate credit analysis. First United maintains that the borrower's credit report confirms that the borrower's payments were current, and that the borrower remitted two payments during the time frame covered by the bank statements.
- E. First United disagrees that the loan was not closed properly. First United stated that the first tax payment would be in May, with both June and July payments being made prior to the third quarter due date in August. First United did not comment on the \$1,026 origination fee and \$275 non-realty item that were not listed on the Mortgage Credit Analysis Worksheet, but were listed on the HUD-1 Settlement Statement.
- F. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- G. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- H. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- I. First United disagrees that an unprocessed borrower should have been underwritten. Auditee states that the non-processed borrower is required by law to sign the Mortgage and TIL, but not the Note, and is not obligated on the loan.
- J. First United concurs with this issue.
- K. First United concurs with this issue.

OIG's Evaluation of First United's Comments

- A. Given the discrepancies documented in our review of the loan file, we believe that First United should have questioned the borrowers' employment, and obtained additional explanatory statements to reconcile the discrepancies in accordance with HUD Handbook 4155.1, REV-4, CHG 1, section 3-1.

- B. Documentation that the gift came from the donor's own funds, and that the borrower received the funds was inadequate per Mortgagee Letter 00-28. The loan file identifies a \$3,200 deposit on December 5, 2001 into the borrower's checking account as a "gift". Documentation also shows that the borrower's savings account contained a deposit of \$3,200 on December 21, 2001, which was a transfer of funds from the borrower's checking account. However, documentation for the donor bank statements disclosed a \$3,200 deposit on December 20, 2001, which was one day prior to a \$3,200 withdrawal and date of a \$3,200 bank check, which was identified as the gift check. Consequently, the documentation that the gift funds came from the donor's own funds was inadequate.
- C. We believe that HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B requires that the deposits be verified. The \$900.00 deposit on March 14, 2002 is not explained, and, as explained in B above, it is unclear whether the \$3,200 deposit is a gift.
- D. HUD Handbook 4155.1, REV-4, CHG 1, section 2-3, provides that indications of derogatory credit problems require a sufficient written explanation from the borrower. The file contained copies of co-borrower's bank statements listing many "non sufficient funds" charges for the co-borrower's automobile loan payments. Furthermore, these car payments amounted to \$623 per month, which was more than the required monthly \$310 payment as listed on the co-borrower's credit report. This indicates that the co-borrower may have been having difficulty meeting car payments, which should have been questioned. Further, we could not locate any explanation in the file regarding adverse ratings for three other accounts of the co-borrower. Consequently, the analysis of the borrower's credit was inadequate.
- E. The loan file contained a HUD-1 Settlement Statement listing an origination fee of \$1,026 and a non-realty item of \$275 that were not disclosed on the Mortgage Credit Analysis Worksheet during the underwriting process as required by HUD Handbook 4155.1, REV-4, CHG 1, section 3-12B. The omission of these two items could have a significant impact on the borrower's ability to have enough assets to close.
- F. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- G. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- H. First United states that a thorough review of actual and estimated costs needs to be completed in order to properly address this item.
- I. HUD Handbook 4155, section 2-2A requires that the loan should have been underwritten with the non-processed borrower.
- J. First United concurred.
- K. First United concurred.

Case Number: 351-4166768
Loan Amount: \$71,050
Settlement Date: March 26, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed front and back ratios of 33.074 percent, without noting any compensating factors.

B. Inaccurate Debt to Income Ratios

C. Inadequate Disclosure of Liabilities

D. Inadequate Credit Analysis

HUD Handbook 4155.1, REV-4, CHG 1, paragraph 2-11A, states that the mortgagee must include the monthly housing expense and all other additional recurring charges, including child support, installment accounts, and revolving accounts, when computing debt to income ratios. The ratios calculated by First United are incorrect because a \$209 monthly installment debt payment, reported in the credit report, was not considered in calculating the ratios. Further, while the handwritten loan application disclosed this debt, the final typed loan application did not. Additionally, the borrower had provided an explanation of why this account had two 30-day late payments. Inclusion of this debt raises the fixed payment to income ratio to 42.449 percent.

E. Verification of Deposits Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, paragraph 2-10B, provides that if there is a large increase in a bank account amount or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a recently opened bank account and bank statements that indicated non-payroll deposits, without an adequate written explanation from the borrower as to the source of the funds. The checking account was opened on February 8, 2002, with a deposit of \$1,797. The borrower explained that these funds came from paychecks. A \$700 deposit was made on February 22, 2002, without any explanation. On February 26, 2002, the borrower deposited \$2,200, derived from 401K loan proceeds, to the checking account. Additionally, a \$250 commitment fee was paid outside closing by a money order on February 5, 2002, before the establishment of the checking account. There was no explanation as to the source of these funds.

F. Inadequate Funds To Close on HUD-1 Settlement Statement

G. Verification of Paid Outside Closing Cost Not Obtained

The HUD-1 Settlement Statement listed \$1,462 due at closing from the borrower and \$399 paid outside closing on March 23, 2003, for hazard insurance. Therefore, the borrower needed \$1,861 to close. The borrower's final checking account balance before closing was \$1,639. Therefore, all the unexplained deposits were required for closing, and there was no indication that additional funds would be borrowed.

H. Closing Not in Compliance with Loan Approval

HUD Handbook 4155.1, REV-4, CHG 1, section 3-12B, requires that the loan close in the same manner in which it was underwritten and approved. The Mortgage Credit Analysis Worksheet listed a total seller's contribution of \$1,654, while the actual seller's contribution at closing on the HUD-1 Settlement Statement was \$2,300.

I. Ineligible Commitment Fee

Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. A commitment fee of \$275 was paid. The mortgagor declined an interest rate lock-in in the lock-in confirmation document on February 5, 2002. Accordingly, the \$275 commitment fee is ineligible because there was no documentation to show the mortgagor agreed to a lock-in agreement.

J. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower actual costs of credit reports. While the file contained one credit report at no recorded cost to the borrower, the borrower was charged \$50 for credit reports on the HUD-1 Settlement Statement. Accordingly, the \$50 is an unsupported fee.

First United's Comments

- A. First United agrees that compensating factors should have been listed for the excessive mortgage payment to effective income ratio.
- B. Without a copy of the credit report, First United could not determine whether the
- C. unreported debt should have been included in the ratio calculation. First United is
- D. attempting to obtain a copy of the credit report.
- E. First United disagrees that there were large deposits that needed to be verified.
- F. First United states that it is logical and conceivable that an additional paycheck would
- G. have covered the funds needed to close. First United stated that it is not reasonable or possible to verify funds to close in an account up to the day prior to closing.
- H. First United agrees that the MCAW in its file incorrectly reported the seller contribution, but that the final 1003 reflected the correct amount as reported on the HUD-1 Settlement Statement.

- I. First United agrees that documentation to support a commitment fee was lacking.
- J. First United agrees that documentation to support credit report fees was lacking.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. First United should have included in its ratio calculation the debt listed on the
- C. borrower's credit report, and obtained an explanation for two 30-day late payments on
- D. this debt.
- E. HUD Handbook 4155.1 REV-4 CHG 1, paragraph 2-10B, provides that if there is a large increase in a bank account amount or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. Since, the borrower opened the bank account less than two months before the closing, evidence should have been obtained regarding the source all the funds and the \$250 commitment fee that was paid before the bank account was established.
- F. HUD Handbook 4155.1, REV-4, CHG 1, section 2-10 requires that all of the funds
- G. for the borrower's investment in the property must be verified and documented.
- H. As noted by First United, the loan file MCAW was not updated to reflect what was on the HUD-1 Settlement Statement. OIG has determined that the HUD-1 Settlement Statement per the HUD file did reflect the correct seller contribution amount as reported on the HUD-1 Settlement Statement. Consequently, we eliminated the deficiency that closing was not in compliance with loan approval requirements.
- I. First United concurred.
- J. First United concurred.

Case Number: 352-4624970
Loan Amount: \$157,700
Settlement Date: April 24, 2002
Status: Reinstated by Mortgagor Who Retains Ownership

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed debt to income ratios of 29.69 and 47.52 percent, respectively, without listing any compensating factors.

B. Inaccurate Debt to Income Ratios

C. Inadequate Support for Income Calculation

The ratios calculated by First United are incorrect because the borrower's income was overstated as discussed in the following paragraph. First United calculated the borrower's estimated monthly income as \$2,782, which included base income, overtime income, and bonus income of \$2,583, \$136, and \$63, respectively. Handbook 4155.1, REV-4, CHG 1, section 2-7A, states that overtime and bonus income may be used as qualifying income if the borrower has received such income for approximately the past 2 years and there are reasonable prospects of its continuance. The lender must develop an average of overtime or bonus income for the past 2 years, and the employment verification must not state categorically that such income is not likely to continue. Periods of less than 2 years may be acceptable, provided that the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes. There was no verification that the borrower received the overtime and bonus incomes for the past 2 years or whether there were reasonable prospects of its continuance. Therefore, overtime and bonus income should not be included as qualifying income for the borrower. As a result, we calculated the debt to income ratios to be 30.82 and 49.32 percent, respectively.

D. Verification of Cash Gift Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10C, requires that the lender obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. Further, if the funds are not deposited to the borrower's account before closing, the lender must obtain verification that the closing agent received funds from the donor for the amount of the gift. The gift letter in the file stated a gift of \$2,500. The gift donor's bank withdrawal statement indicated that the donor deposited \$3,000 the day before closing and withdrew \$2,500 on the same day. In addition, the file

did not contain evidence indicating the borrower received the funds. Consequently, the source and receipt of the gift were not adequately documented.

E. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet

HUD Handbook 4155.1, REV-4, CHG 1, section 1-9, states that the lender must estimate the settlement requirements to determine the cash required to close. The Mortgage Credit Analysis Worksheet reported a gift of \$6,100, which was \$3,600 more than the documented gift letter amount of \$2,500. In addition, the worksheet did not include a \$1,000 cash deposit held by the realtor. Adding the \$1,000 deposit to the reported borrower's assets of \$6,383 and deducting the \$3,600 overstated gift reduces the cash reserve from \$1,581 to a deficit of \$1,019.

F. Inadequate Bank Account Documentation

G. Verification of Deposit Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, states that if there is a large increase in a bank account amount, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. Paragraph 3-1F indicates that as an alternative to obtaining a verification of deposit, the mortgagee may choose to obtain the borrower's original bank statements for the most recent 3-month period. The file contained two incomplete bank statements, disclosing deposits of \$2,200 on February 4, 2002, and \$1,159 on March 22, 2002, which were not explained. Also, the bank statement listed a deposit of \$6,500 on March 18, 2002, for which the borrower's explanation letter stated that \$6,000 of the \$6,500 deposit was a redeposit of a previous \$6,000 withdrawal from the same account. The borrower's explanation was inadequate due to the incompleteness of the bank statements during the timeframe of the withdrawal.

Lastly, First United explained that the residual \$500 of the \$6,500 deposit was cash on hand of the borrower. Handbook 4155.1, REV-4, CHG 1, section 2-10M, states that borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the homebuyer's cash assets for closing, the money must be verified, and the asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. The lender must determine the reasonableness of the accumulation of the funds based on the borrower's income stream, the period during which the funds were saved, the borrower's spending habits, documented expenses, and the borrower's history of using financial institutions. Adequate verification of the \$500 cash on hand was not obtained.

H. Inadequate Support for Employment

HUD Handbook 4155.1, REV-4, CHG 1, section 2-6, requires that the lender verify the borrower's employment for the most recent 2 full years. Handbook 4155.1, REV-4, CHG 1, paragraph 3-1E, provides that as an alternative to obtaining verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day

period, along with original payroll tax forms from the previous 2 years. Also, Mortgage Letter 97-26 states that the lender may perform telephone verification of current employment when the alternate income documentation procedure is used. The only verification of employment for the borrower was two biweekly pay stubs, covering a recent 30-day payment history, and no telephone verification of the borrower's current employment was conducted. First United obtained only one verification of employment from the co-borrower's current employer, for which employment was only 1 month. Both borrowers provided payroll tax forms for 2001 and tax returns for 2000. The mortgagee did not comply with the regulations.

I. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower actual costs of the credit reports. The file contained three credit reports at a cost of \$12.50, \$20 and \$5 respectively. However, the borrowers were charged \$50 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$37.50. Accordingly, the \$12.50 is an unsupported fee.

First United's Comments

- A. First United agreed that compensating factors should have been listed.
- B. First United disagreed that overtime and bonus income were inadequately
- C. supported. First United justified including overtime in income because the borrower was in a skilled trade with both the opportunity and likelihood of advancement.
- D. First United agreed that documentation of the gift was incomplete.
- E. First United agreed that documentation that the borrower had sufficient funds to close was incomplete.
- F. First United did not comment on inadequate bank account documentation.
- G. First United did not comment about inadequate deposit verification.
- H. First United disagreed that the borrower's employment was not adequately supported. First United stated that, although there was no verbal verification of employment, the file contained a letter from the employer confirming a raise, two consecutive paystubs documenting the raise, and an updated paystub within 30 days of closing date. First United agreed that the file did not contain verification for the prior employment due to inadequate copying.
- I. First United agreed that the file lacked the supporting documentation for itemized credit report billings.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. We disagree with First United because the file did not contain verification that the
- C. borrower received the overtime and bonus incomes for the past two years as required by HUD Handbook 4155.1 REV-4, CHG 1, section 2-7A.
- D. First United concurred.
- E. First United concurred.
- F. First United did not comment.
- G. First United did not comment.
- H. We disagree that the borrower's employment was adequately verified. First United did not provide two-year W-2 form and verbal verification as required by HUD Handbook 4155.1 Rev-4, CHG 1, section 3-1E, and Mortgage letter 97-26 respectively. A tax return is not an acceptable substitute for a W-2 because it does not provide required information, such as the employer's name and the period working with the employer.
- I. First United concurred.

Case Number: 352-4713314
Loan Amount: \$167,779
Settlement Date: August 28, 2002
Status: Currently in Default

Pertinent Details

A. Inadequate Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. First United computed ratios of 36.677 and 48.484. The spouse's income is listed as a compensating factor on the Mortgage Credit Analysis Worksheet; however, since the spouse is not a co-borrower, this is not an allowable compensating factor as defined in paragraph 2-13.

B. Inaccurate Debt to Income Ratios

C. Inadequate Support for Income Calculation

HUD Handbook 4155.1, REV-4, CHG-1, section 2-7, provides that unemployment income is acceptable if it is expected to continue for 3 years and requires a 2-year documentation of its receipt and reasonable assurance of its continuance. This may be appropriate for individuals employed on a seasonal basis. The ratios calculated by First United are incorrect because the borrower's income was overstated as discussed. The income on the Mortgage Credit Analysis Worksheet included \$420 in unemployment per month, based on a 2-year average. However, the file indicates the borrower's explanation attributed the unemployment to illness, which may not have been seasonal and, thus, is unallowable as income. Disallowing this income, we computed ratios of 35.8007 and 47.3253, which would require justification with compensating factors.

D. Inadequate Support for Employment

The borrower claimed self-employment, and employment confirmation appears to have been done as if the borrower were self-employed. However, income for several years was associated with two employers, for which the borrower provided payroll tax forms. Nevertheless, the verification of employment was sent to the borrower's home address without any phone confirmation with the employer. Additionally, the verification of employment confirmed income from only the primary employer. The income with both employers should have been confirmed directly and not via the borrower.

HUD Handbook 4155.1, REV-4, CHG 1, paragraph 3-1, requires that the application package contain sufficient documentation to support the lender's decision to approve the mortgage loan. When standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements. Lenders are required to obtain verification of employment and a most recent pay stub. As an alternative to obtaining a verification of employment, the lender may choose to obtain from

the borrower original pay stub(s) covering the most recent 30-day period, along with original copies of the previous 2 years' payroll tax forms. The file contained copies of payroll tax forms from both employers for the previous 2 years but did not have original pay stubs for the most recent 30-day period.

E. Inadequate Earnest Money Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The borrower's spouse, who was not a co-borrower, borrowed \$2,700 on June 3, 2002, from her 401-K account and deposited these funds into her account on June 7, 2002. Then a \$2,435 earnest money deposit was made on June 14, 2002. The explanation in the file from the borrower stated that he had borrowed the \$2,700 from his 401-K account and had deposited the funds into his bank account. However, the documents in the file do not support the explanation provided by the borrower. A proper explanation for this deposit and determination as to whether it was a gift by the spouse should have been made.

F. Ineligible Commitment Fee

Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. A commitment fee of \$275, listed on the HUD-1 Settlement Statement, was paid by the borrower on August 28, 2002, the closing date. However, the mortgagor declined an interest rate lock in the lock-in confirmation document on July 2, 2002. The \$275 represents an ineligible fee.

G. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower actual costs of the credit reports. While the file contained one credit report at a cost of \$33, the borrower was charged \$43. Consequently, the \$10 is an unsupported fee.

First United's Comments

- A. First United agrees that spousal earnings are not listed as a compensating factor in the handbook, but states that contributing income of a spouse, even though not obligated on the loan, is a practical and logical compensating factor.
- B. First United stated that a history of receipt of unemployment income is documented
- C. with no reason to think it will not continue.
- D. First United disagrees that there was inadequate support for employment. First United states that the borrower was treated as a self-employed, and thus the loan was conservatively underwritten with the use of net rather than gross income.
- E. First United states that the earnest money came from an account of the borrower's

spouse, to which the borrower had full access.

F. First United agrees that documentation to support a commitment fee was lacking.

G. First United agrees that documentation to support credit report fees was lacking.

OIG's Evaluation of First United's Comments

A. HUD Handbook 4155.1, REV-4, CHG 1 does not allow the income of a spouse who is not a co-borrower as a compensating factor.

B. The borrower's explanation indicated that he missed a lot of work due to illness in the two years that he collected unemployment. However, there was no evidence in the file that the borrower received disability or that unemployment income was seasonal and could reasonably be expected to continue. Without this expectation, we do not believe that this income should have been expected to continue.

D. Employment verification was inadequate whether the borrower was treated as self-employed or as an employee. A verification of employment was sent to the borrower's home, and requested verification from only one of the two sources of income. While the previous two years' pay stubs were obtained, pay stubs for the most recent 30-day period were not.

E. HUD Handbook 4155.1 REV-4, CHG 1, Paragraph 2-10B, provides that if there is a large increase in a bank account, or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The borrower explained that the earnest money came from his 401-K account, while documentation in the file indicates it came from the spouse's account. Since the explanation provided by the borrower as to the source of the funds was inconsistent with that in the file, the lender should have obtained clarification as to the source of the funds.

F. First United concurred.

G. First United concurred.

Case Number: 351-4258438
Loan Amount: \$118,044
Settlement Date: October 24, 2002
Status: Currently in Default

Pertinent Details

- A. Inaccurate Debt to Income Ratios
- B. Inadequate Support for Income Calculation

Handbook 4155.1, REV 4, CHG 1, chapter 2, section 5, states that the lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan. First United computed debt to income ratios of 24.671 and 39.076 percent, respectively. The ratios calculated by First United are incorrect as discussed in the following paragraph.

First United estimated monthly income of \$4,526, composed of a base income of \$2,796 and other earnings of \$1,730. Based upon our review of the file, we calculated other earnings of \$1,638, based on the hourly rate and weekly work hours provided by the employer. This reduces the estimated monthly income to \$4,434.

- C. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet

Handbook 4155.1, REV-4, CHG 1, section 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close. The Mortgage Credit Analysis Worksheet erroneously counted a \$2,500 gift twice and omitted discount points of \$2,361 and residual prepaid expenses of \$640 shown on the good faith estimate. As a result, we calculated total cash reserves on the Mortgage Credit Analysis Worksheet to be a negative \$669.

- D. Verification of Deposits Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10B, states that if there is a large increase in a bank account amount or the account was opened recently, an explanation and evidence of source of funds must be obtained by the lender. The file contained bank statements from two financial institutions. One bank account was opened on September 15, 2002 (closing date October 24, 2002), with unexplained deposits of \$200 on September 16, 2002, and \$1,000 on September 23, 2002. The other bank statement listed three unexplained deposits of \$1,000 on July 19, 2002, \$1,000 on August 2, 2002, and \$1,049 on August 23, 2002. It is important to note that these deposits were needed for closing.

- E. Inadequate Earnest Money Deposit Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10A, provides that if the amount of the earnest money deposit appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. The HUD-1 Settlement Statement in the file indicated that the

borrower made a \$1,000 earnest money deposit, which was supported by a copy of a \$1,000 money order dated July 12, 2002. However, the borrower's bank statement reported a balance of \$9 until July 19, 2002. In addition, the bank account indicated a balance of \$5,069 as of October 16, 2002 (composed of a \$5,000 gift and three unexplained deposits as stated in section E). The borrower's savings history, as indicated by a \$9 balance, raises a question about an ability to accumulate savings. Therefore, the earnest money deposit should have been verified because there may not have been enough funds to purchase the money order on July 12, 2002, without other sources.

F. Closing Not in Compliance with Loan Approval

Handbook 4155.1 REV-4, CHG 1, section 3-12B, states that the loan must close in the same manner in which it was underwritten and approved. The HUD-1 Settlement Statement in the file listed a seller concession of \$3,000, which was \$639 higher than the amount of \$2,361 indicated on the Mortgage Credit Analysis Worksheet.

G. Inadequate Credit Analysis

HUD Handbook 4155.1, REV-4, CHG-1, section 2-3, provides that major indications of derogatory credit problems require a sufficient written explanation from the borrower. The borrower's derogatory credit records were not fully explained because the borrower's explanation letter did not address delinquencies with Provident Financial and Universal Citi. In addition, the borrower's credit report showed many other late payments and collections, which the borrower explained were the unpaid bills of his girl friend. The borrower's explanation of the derogatory credit was insufficient.

H. Ineligible Commitment Fee

Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. The borrower paid a \$275 commitment fee on October 24, 2002 (closing date); however, in the lock-in confirmation document on September 5, 2002, the borrower chose not to lock in. Therefore, the fee is ineligible.

First United's Comments

- A. First United agreed that the file contained a mathematical error, but stated that it
- B. would not have affected the quality of the underwriting decision because the ratios were still within HUD guidelines.
- C. Concerning inadequate funds to close, First United agreed that the \$2,500 gift was erroneously counted twice, however, First United disagreed that funds to close should include \$2,361 in discount points because the discount points were paid by the seller.
- D. First United disagreed that verification of deposits was not obtained. First United maintains that the borrower's deposits appear to establish a pattern of consistent saving of earnings without any excessive amounts.

- E. First United disagrees with the issue that earnest money deposit was not adequately documented. First United states that the borrower obviously had funds for the earnest money from earnings that had not been consistently deposited, but cashed.
- F. First United agreed that the loan was not closed in compliance with the loan approval due to a typographical error on the MCAW that reflected a seller concession of \$2,361. First United stated that the actual concession on the HUD-1 Settlement Statement was \$3,000, and that the final 1003 reflected the correct concession.
- G. First United agreed that the credit analysis was inadequate because two accounts were not addressed in the borrower's explanation, but stated that this oversight in the explanation would not have effected the credit decision.
- H. First United agreed that the loan file did not contain documentation to support the lock-in fee.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. First United concurred.
- C. We disagree with First United that adequate funds to close were documented. OIG's calculation already included the \$2,361 seller concession with the borrower's funds to close, which resulted in a negative cash reserve of \$669.
- D. We disagree with First United regarding verification of deposits. HUD Handbook 4155.1 REV-4 CHG1, Section 2-10B requires verification of the source of the deposits in new accounts and large deposits in established accounts. The file did not contain evidence that the deposits were from the borrower's earnings. In addition, we believe that a \$1,000 deposit is excessive compared to the borrower's account balance and saving history.
- E. We disagree with First United regarding the issue of earnest money deposit. The file did not contain adequate documentation to support that the borrower had adequate funds from earnings for the deposit.
- F. The loan file documents that the final MACAW listed a seller concession of \$2,361. We are not sure of the relevance of the "final 1003" noted by First United.
- G. First United agreed that the borrower's credit history explanation was incomplete. We do not know what affect this omission may have had on the underwriter decision.
- H. First United concurred.

Case Number: 352-4705394
Loan Amount: \$104,250
Settlement Date: September 6, 2002
Status: Reinstated

Pertinent Details

A. Case File Not Provided

Handbook 4155.1, REV-4, CHG-1, chapter 3, states that all information required in processing and underwriting Federal Housing Administration-insured mortgages must be verified and documented. First United was not able to locate a copy of the file for this case. Consequently, we had to use the Homeownership Center file as the only resource for our review.

B. Inadequate Compensating Factors

Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratio. First United computed ratios of 31.309 percent and 49.879 percent, respectively. A good loan to value ratio was noted on the Mortgage Credit Analysis Worksheet as a compensating factor. However, a good loan to value ratio is not listed as a valid compensating factor in Handbook 4155.1, REV-4, CHG 1, section 2-13. Further, this was a section 203-k loan, so the good loan to value ratio was not solely due to a large investment by the borrower but is also a factor of a formula that is used to increase the value by 10 percent.

C. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. The Homeownership Center file contained one credit report at a cost of \$33. However, the borrower was charged \$43 for credit reports, as opposed to the actual cost of \$33. Consequently, the \$10 is an unsupported fee.

First United's Comments

- A. First United stated that a case file did not exist due to circumstances beyond its control.
- B. First United disagrees that sound equity is not a valid compensating factor, and maintains that the cited 85 percent loan to value ratio is a valid compensating factor.
- C. First United agreed that the file lacked an itemized charge for credit fees.

OIG's Evaluation of First United's Comments

- A. This was not counted as an underwriting deficiency.
- B. Handbook 4155.1 REV-4, CHG 1 does not list a good loan to value ratio as a compensating factor to justify approval of mortgage loans with ratios that exceed the 29 and 41 percent guidelines.
- C. First United concurred.

Case Number: 351-4248193
Loan Amount: \$102,159
Settlement Date: February 4, 2003
Status: Paid in Full

Pertinent Details

- A. Inadequate Credit Analysis
- B. Inadequate Disclosure of Liability

Handbook 4155.1, REV-4, CHG-1, section 2-3, states that major indications of derogatory credit problems require a sufficient written explanation from the borrower. The borrowers' credit reports in the file indicated many delinquencies. The borrowers explained that the debts were due to their unsuccessful business several years ago and that they, therefore, had difficulty paying them on time. The borrowers also stated they were currently paying all of their credit card bills on time. However, the credit report indicated that these payments were also untimely. These consistently delayed payments were also significant in amount and occurred within 2 months of closing. The borrowers' explanation of the current derogatory credit was inadequate.

HUD Handbook 4155.1, REV-4, CHG 1, section 2-11A, provides that in computing the debt to income ratios, the lender must include the monthly housing expense and all additional recurring charges. The co-borrower's bank statements listed significant monthly withdrawals before closing, and the account balance dropped from \$50,940 as of June 17, 2002, to \$12,405 as of December 15, 2002 (ending balance included the residual amount of a \$15,000 gift). This could indicate continuing borrower obligations (possibly from the failed business noted above) and that the cause of this drop in the bank balance should have been further reviewed.

- C. Verification of Deposits Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, states that if there is a large increase in a bank account amount, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The bank statements in the file showed many significant deposits without a written explanation from the borrowers as to the source of the funds. It is important to note that these deposits were needed for closing.

- D. Ineligible Commitment Fee

A commitment fee of \$395 was included on the HUD-1 Settlement Statement and paid by the borrower on February 04, 2003 (closing date). In the lock-in confirmation document on January 24, 2003, the borrower chose not to lock in. Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date.

E. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. The file contained one merged credit report and two supplemental credit reports. Each credit report was charged \$24. However, the borrowers were charged \$200, as opposed to the actual cost of \$72. Consequently, the \$128 is an unsupported fee.

First United's Comments

- A. First United disagreed that credit analysis and disclosure of liability were
- B. inadequate. First United stated that the borrowers explained that past derogatory credit was the result of a failed business, an event that was unlikely to recur, and that the borrowers were currently paying off their credit cards. First United stated that there was only one recent derogatory issue, which was minimal. First United further stated that since the borrowers were working to reduce their credit card balances, and there were sufficient funds to close, the decrease in borrowers' assets did not need to be questioned.
- C. First United stated that it would need to know the specific deposits that were the subject of inadequate verification in order to address it.
- D. First United agreed that the file did not contain documentation for a lock-in fee.
- E. First United agreed that the file did not contain documentation for credit report fees.

OIG's Evaluation of First United's Comments

- A. While the borrowers' credit explanation letter stated their credit card debt was being
- B. paid on time, the credit report disclosed recent delayed payments. We believe that this, at a minimum, should have been questioned. Similarly, we believe that the significant reduction in bank balances should have been questioned, as stated in HUD Handbook 4155.1 REV-4 CHG 1, section 2-11A. First United stated that since the borrowers were working to reduce their credit card balances, and there were sufficient funds to close, the decrease in borrowers' assets did not need to be questioned. We conclude that if the borrowers were paying off additional credit card balances, then these liabilities should have been documented and included in the borrower's debt to income ratios as required by HUD Handbook 4155.1 REV-4 CHG 1, section 2-11A.
- C. HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B requires that an explanation and source of funds be obtained for any large increase in a bank account. We noted the following deposits in the co-borrower's bank account: \$2,010.88 on 12/05/02, \$1,996.78 on 10/16/02, \$1,846.23 on 9/18/02, \$1,970.89 on 9/30/02, \$1,846.23 on 9/6/02, \$1,846.23 on 8/17/02, \$2,046.23 on 8/3/02, \$1,500 on 7/15/02, and \$1,916.53 on 7/1/02. We believe that the inconsistent amount and timing of these deposits required further questioning.

D. First Untied concurred.

E. First Untied concurred.

Case Number: 351-4271037
Loan Amount: \$134,893
Settlement Date: September 20, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

Handbook 4155.1, REV-4, CHG 1, paragraphs 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed debt to income ratios of 26.363 and 41.255 percent, respectively, without listing any compensating factors.

B. Inadequate Bank Account Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1F, provides that as an alternative to obtaining a verification of deposit, the mortgagee may choose to obtain the borrower's original bank statements for the most recent 3-month period. The borrower's bank statements obtained covered 1 month. In addition, the top of the statement indicated that it was for the period June 30 to July 31, 2002; however, the transactions listed on the statement were for the period July 29 to August 19, 2002. No explanation was documented for these discrepancies.

C. Verification of Deposits Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a bank statement from a credit union indicating a \$1,800 deposit on September 6, 2002, a \$1,480 deposit on August, 23, 2002, a \$1,220 deposit on August 9, 2002, and a \$960 deposit on July 26, 2002. No explanation was documented from the borrower for the source of these funds. In addition, these deposits were needed for closing.

D. Inadequate Funds To Close on HUD-1 Settlement Statement

Handbook 4155.1, REV-4, CHG-1, section 2-10K, provides that for assets such as individual retirement accounts and Keogh accounts, only the net amount, after subtracting Federal income tax and withdrawal penalties, may be considered as assets to close, and evidence of redemption is required. The file contained a letter from the borrower's pension service division indicating that the borrower could borrower half of the contributions in the pension plan. However, First United included 100 percent of the borrower's pension account balance as a liquid asset, without considering an already existing outstanding loan and the 50-percent borrowing cap. Moreover, there was no evidence of actual redemption from the pension plan. The mortgagee did not comply

with the regulation. It is also important to note that funds from the pension plan were needed to close.

E. Ineligible Commitment Fee

Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. The borrower paid a commitment fee of \$275 on September 02, 2002 (closing date). In the lock-in confirmation document, dated September 9, 2002, the borrower chose not to lock in. Therefore, the \$275 represents an ineligible fee.

F. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, paragraph 5-3, permits the lender to charge borrowers the actual costs of credit reports. The file contained a credit report at a cost of \$40; however, the borrower was charged \$50. Consequently, the \$10 is an unsupported fee.

First United's Comments

- A. First United disagreed that 41.255 percent ratios were excessive and needed compensating factors.
- B. First United agreed that there was inadequate bank account documentation because the loan lacked complete copies of bank statements.
- C. First United did not comment on the issue of inadequate verification of deposits.
- D. First United agreed that there was inadequate bank account documentation because the loan lacked complete copies of bank statements.
- E. First United agreed that the file lacked documentation to support the commitment fee.
- F. First United agreed that the file lacked documentation to support credit report fees.

OIG's Evaluation of First United's Comments

- A. HUD Handbook 4155.1, REV-4 CHG1, section 2-12 and 2-13 requires compensating factors for ratios that exceed HUD guidelines.
- B. First United concurred, and will need to obtain the documentation to respond to the issue.
- C. First United did not comment.
- D. First United concurred, and will need to obtain the documentation to respond to the issue.

E. First Untied concurred.

F. First United concurred.

Case Number: 352-4639998
Loan Amount: \$147,530
Settlement Date: July 19, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG-4, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors to justify exceeding these ratios. First United computed debt to income ratios of 38.36 percent and 44.04 percent, respectively, with no compensating factors.

B. Inaccurate Debt to Income Ratios

C. Inadequate Support for Income Calculation

The ratios completed by First United are incorrect. We could not determine how First United calculated the borrower's estimated base income of \$3,207 as required by Handbook 4155.1, REV-4, CHG-4, section 2-7, which provides that the income of each borrower must be analyzed to determine whether it can be reasonably expected to continue through at least the first 3 years of the mortgage loan. Based upon the borrower's pay stubs and employment verification letter, we calculated the borrower's monthly base income as \$2,948. After considering the above deficiency, we calculated the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio debt to income ratios to be 41.11 and 47.20 percent, respectively.

D. Verification of Cash Gift Not Obtained

Mortgagee Letter 00-28 provides that the donor must furnish conclusive evidence that the funds given to the borrower came from the donor's own funds. The mortgagee did not obtain conclusive evidence that the funds for two separate gifts given to the borrower came from the donor's own funds. The borrower received a \$12,500 gift on November 2, 2000, and a \$13,000 gift on June 18, 2002. To support the \$12,500 gift, the donor provided evidence of withdrawal from a bankbook and a corresponding bank check payable to a closing agent in connection with a prior non-executed purchase. However, 3 months before the gift withdrawal, this bank account had a balance of \$12,644 after a deposit of \$12,263. Accordingly, the source of the donor's funds for this gift is not clear. The \$13,000 gift was supported by a bank check from another financial institution and corresponding bank account activity up to June 17, 2002, 1 day before the gift withdrawal date. However, there was an unexplained \$3,200 deposit on June 7, 2002, 11 days before the gift. Accordingly, the source of the donor's funds for this gift is not clear.

E. Verification of Deposits Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. Our review of the file disclosed inadequate evidence for the source of funds. The borrower's bank statements contained a \$2,300 deposit on June 3, 2002, and a \$1,200 deposit on June 19, 2002. A borrower's explanation letter stated that \$2,000 of the \$2,300 deposit came from a closing attorney pertaining to a previous non-purchased residence. The source of the \$2,000 deposit provided by the borrower's attorney should have been obtained. However, the only documentation was a non-canceled \$2,000 check from a closing attorney, with no explanation from the attorney as to the source of the funds. The explanation letter also stated that the remaining \$300 was cash in possession of the borrower and that the \$1,200 was received from his mother and brother to ensure that there were enough funds for closing. Neither of these two amounts was adequately verified. First, verification for the \$300 should have been obtained in accordance with Handbook 4155.1 REV-4, CHG 1, section 2-10M, which states that borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the homebuyer's cash assets for closing, the money must be verified, and the asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. Second, the \$1,200 given by relatives should have been verified as a gift.

F. Verification of Paid Outside Closing Costs Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. The HUD-1 Settlement Statement in the file showed that the borrower paid a \$43 credit report cost

and a \$425 appraisal fee outside closing. The file had no evidence to support the payment of these paid outside closing costs.

G. Ineligible Commitment Fee

Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount fees for a period of not less than 15 days before the anticipated closing date. The borrower paid a commitment fee of \$275, included on the HUD-1 Settlement Statement, on July 19, 2002 (closing date). The borrower elected not to have an interest rate lock in the interest rate lock-in agreement, dated March 29, 2002. Because the borrower elected not to lock in the interest rate, the \$275 is an ineligible commitment fee.

H. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. The file contained two credit reports at a cost of \$20 for one and an unknown amount charged for another. The borrower was charged \$43 for credit reports on the HUD-1 Settlement Statement. Therefore, the \$23 is an unsupported fee.

First United's Comments

- A. First United disagrees that the loan was approved with excessive ratios and without compensating factors. First United states that 15 percent equity in a property is a sound compensating factor.
- B. First United disagrees that the ratios and the borrower's income were incorrectly
- C. calculated. First United states that the borrower's income was derived by averaging actual earnings for the full year 2001 with year to date earnings of 2002.
- D. First United disagrees that the underwriter did not obtain conclusive evidence that funds for two separate gifts came from the donor's own funds. First United states that one of the two donor accounts in question was a business account, into which large deposits would be likely. First United also states that it is not reasonable to expect, nor is it required, that the source of deposits into a donor account three months prior to the giving of a gift to the borrower, nor 2 weeks prior to giving the second gift, be questioned.
- E. First United disagrees that adequate verification of deposits was not obtained regarding \$300 cash provided by the borrower, noting that \$300 is not a large sum of money and it is more than reasonable that any borrower may have acquired this amount of cash. First United did agree that additional documentation should have been obtained for the \$2,000 provided by a prior attorney, as well as for \$1,200 by the borrower's relatives.

- F. First United states that they can pursue obtaining copies of cancelled checks for paid outside closing costs, however, they do not see that the total amount would have affected the borrower's ability to close.
- G. First United concurs with this issue.
- H. First United concurs with this issue.

OIG's Evaluation of First United's Comments

- A. HUD Handbook 4155.1, REV-4, CHG-4, section 2-12 and 2-13 requires that excessive ratios be justified with compensating factors. First United did not provide any compensating factors for ratios of 38.36 and 44.01 percent. In its response, First United cites a high property loan to value ratio as a compensating factor. However, this is not a compensating factor listed in HUD Handbook 4155.1, REV-4, CHG-4, section 2-13.
- B. We could not determine from the file how First United calculated the
- C. borrower's estimated base income of \$3,207 as required by Handbook 4155.1, REV-4, CHG-4, section 2-7. Based upon the borrower's pay stubs and employment verification letter, we calculated monthly base income of \$2,948. Based upon employment documentation in the file, overtime for this borrower would not be allowable per Handbook 4155.1, REV-4, CHG-4, section 2-7A. Moreover, we calculated borrower's monthly income of \$3,116.22 including overtime, as opposed to the \$3,207 calculated by First United.
- D. Mortgagee Letter 00-28 requires conclusive evidence that gift funds come from the donor's own funds. The loan file documented a gift donor withdrawal/deposit history statement that contained activity through June 17, 2002 (one day prior to the gift withdrawal). Therefore, although a \$13,000 check disbursement from the donor's account is documented on June 18, 2002, conclusive evidence that the gift amount came from the donor's funds is lacking.
- E. HUD Handbook 4155.1 REV-4, CHG 1, section 2-10As requires that large increases in a bank account should be explained and evidence of the source of funds obtained.
- F. Handbook 4155.1, REV-4, CHG 1, section 2-10 requires that paid outside closing costs be supported.
- G. First United concurred.
- H. First United concurred.

Case Number: 352-4592520
Loan Amount: \$109,112
Settlement Date: May 3, 2002
Status: Currently in Default

Pertinent Details

- A. Inaccurate Debt to Income Ratios
- B. Inadequate Disclosure of Liabilities
- C. Inadequate Compensating Factors

The total fixed payment to income ratio computed by First United is incorrect, and the compensating factors used to justify the ratio are inadequate. Handbook 4155.1, REV-4, CHG-4, section 2-11A, provides that the mortgagee must include the monthly housing expense and all other additional recurring charges, including child support, installment accounts, and revolving accounts, when computing debt to income ratios. A monthly liability of \$38 was not factored into the calculation of the ratio. Including this liability in the ratio would result in a total fixed payment to income ratio of 41.24 percent.

In addition, the compensating factor used to justify the ratio was inadequate. HUD Handbook 4155.1, REV-4, CHG-4, section 2-13, states that compensating factors may be used to justify approval of mortgage loans with ratios exceeding benchmark guidelines. The Mortgage Credit Analysis Worksheet listed “Existing lease on property supports \$1,275 per month ratios with rent roll supports 33%” and “borrower was qualified with gross market rents supported by appraisal” as compensating factors. However, the file disclosed that the lease, with a termination date of May 31, 2002 (one month after the closing date of May 3, 2002), provided for an annual amount of \$10,200, with monthly payments of \$850. This is \$425 lower than the \$1,275 security deposit amount applied by First United as a compensating factor. In addition, the continuance of a pending renewal lease with the same monthly rent is questionable because the appraisal report listed \$600 per month as the market rent.

- D. Inadequate Underwriting Requirements for Temporary Interest Rate Buydown

First United qualified the borrower for a temporary interest rate buydown without providing an explanation that the eventual increase in mortgage payments will not adversely affect the borrower and likely lead to default as stated in Handbook 4155.1, REV-4, CHG-4, section 2-14A, part 4. As a result, the borrower should have been underwritten without the temporary interest buydown, which would raise the debt to income ratios significantly.

- E. Inadequate Bank Account Documentation
- F. Verification of Deposits Not Obtained

HUD Handbook 4155.1, REV-4, CHG-4, section 3-1F, provides that as an alternative to obtaining a verification of deposit, the mortgagee may choose to obtain the borrower’s original bank statements for the most recent 3-month period. Our review of the file

disclosed incomplete bank statements for three borrower bank accounts and many unexplained deposits in two of these accounts. HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained incomplete bank statements for two accounts that showed deposits of \$2,100, composed of four \$500 deposits in one account and a \$100 deposit in the other account. No explanation from the borrower as to the source of funds was provided. In addition, one bank account included an ending balance of \$984, with no indication of the account's beginning balance. It is important to note that these deposits were needed for closing.

- G. Inadequate Funds To Close on HUD-1 Settlement Statement
- H. Verification of Paid Outside Closing Costs Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. The borrower did not appear to have sufficient funds to close. There was no documentation to show that paid outside closing items totaling \$400 had been paid before closing without reducing the funds available to close. Cash due from the borrower on the HUD-1 Settlement Statement was \$2,532. If the \$400 paid outside closing amount is added to the \$2,532 owed by the borrower and offset against the remaining \$2,757 assets, the borrower would have a \$175 deficit at closing.

- I. Ineligible Commitment Fee

Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount fees for a period of not less than 15 days before the anticipated closing date. A commitment fee of \$275 was included on the HUD-1 Settlement Statement and paid by the borrower on May 5, 2002 (closing date). The borrower elected not to have an interest rate lock-in in the agreement, dated January 28, 2002. Because the borrower elected not to lock in the interest rate on the loan, the \$275 represents an ineligible fee.

- J. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, section 5-3, permits the lender to charge the borrower the actual costs of credit reports. The file contained one credit report at a cost of \$16.50. However, the borrower was charged \$43 for credit reports, as opposed to the actual cost of \$16.50. Consequently, \$26.50 represents unsupported fees.

First United's Comments

- A. First United agrees that the total fixed payment to income ratio is inaccurate due to
- B. the failure to include a debt, but states that the corrected ratio would not be excessive.
- C. Further, First United believes that the compensating factor of proposed market rents from the appraisal qualified the borrower, and therefore consideration of the remaining lease term has no value.

- D. First United agrees that the underwriter should have justified the basis for approval of a loan with a temporary interest buydown, but disagrees that the ratio would have increased significantly because it is likely that the borrower's income would have increased in the future to offset the rise in the monthly mortgage payment.
- E. First United agrees that bank statements in the loan file were incomplete due to poor copying and will attempt to pursue to secure complete statements. First United disagrees that deposits of \$500 and \$100 are large and need to be specifically sourced.
- G. First United agrees that paid outside closing costs were not verified as paid, but H. maintains that the borrower would have had the funds to close because the amount (\$400) is nominal.
- I. First United agrees that documentation was lacking for a commitment fee.
- J. First United agrees that documentation was lacking for credit report fees.

OIG's Evaluation of First United's Comments

- A. First United concurs that the borrower's total fixed payment to income ratio was B. incorrect as per Handbook 4155.1, REV-4, CHG-4, section 2-11A due to omission of C. a debt. We concur with First United's response that rental income based upon an appraisal is an acceptable compensating factor as per HUD Handbook 4155.1, REV-4, CHG-4, section 2-12 and 2-13. We have eliminated this deficiency.
- D. First United qualified the borrower for a temporary interest rate buy down without justifying that a future increase in mortgage payments would not adversely affect the borrower and likely lead to default as directed in Handbook 4155.1, REV-4, CHG-4, section 2-14A, part 4. The borrower should have been underwritten without the temporary interest buydown, which we believe would have raised the debt to income ratios significantly.
- E. The file contained incomplete bank statements for two accounts that showed deposits F. of \$2,100, composed of four \$500 deposits in one account and a \$100 deposit in the other account. No explanation from the borrower as to the source of funds was provided as required by HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B. In addition, one bank account included an ending balance of \$984, with no indication of the account's beginning balance. It is important to note that these deposits were needed for closing.
- G. Handbook 4155.1, REV-4, CHG 1, section 2-10 requires that paid outside closing H. costs should be verified. Without verification, we calculated that the borrower would have a \$175 deficit at closing.
- I. First United concurred.

J. First United concurred.

Case Number: 351-4268219
Loan Amount: \$95,207
Settlement Date: August 27, 2002
Status: Currently in Default

Pertinent Details

A. Verification of Cash Gift Not Obtained

Mortgagee Letter 00-28 provides that the donor must be able to furnish conclusive evidence that the funds given to the borrower came from the donor's own funds and were not provided directly or indirectly by the seller, real estate agent, builder, or any other entity with an interest in the sales transaction. The borrower received a \$4,000 gift from the donor on August 24, 2002. The donor provided a \$3,000 canceled check but provided no disbursement support for the remaining \$1,000 gift.

B. Inadequate Support for Employment

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1, states that when standard documentation does not provide enough information, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or supplement the documentation submitted by the borrower. The file contained a verification of employment, dated July 17, 2002, and bank statements for the period May 20, 2002, to August 14, 2002, which listed five biweekly payroll direct deposits through July 17, 2002. However, there were no biweekly payroll direct deposits recorded for the periods ending July 31 and August 14, 2002 (the closing was on August 27, 2002). No explanation was obtained from the borrower as to why biweekly payroll direct deposits ceased on the borrower's bank statements.

C. Inadequate Earnest Money Deposit Documentation

HUD Handbook 4155.1, REV-4, CHG-4, section 2-10A, provides that if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive, based on the borrower's history of accumulating savings, the mortgagee must verify the amount of deposit and the source of funds. The Mortgage Credit Analysis Worksheet contained an earnest money deposit of \$1,400, composed of an unsupported \$1,000 down payment and a \$400 non-canceled check representing fees for a credit report and appraisal report. The borrower's savings history, as disclosed in the bank statements, included a negative beginning balance of \$139 as of May 21, 2002, and an ending balance of \$3,358 as of August 14, 2002 (the ending balance included a residual amount of a \$4,000 gift). Therefore, the lender should have verified the earnest money deposit based on the borrower's inability to accumulate savings.

D. Non-itemized Lender Credit

The HUD-1 Settlement Statement and Mortgage Credit Analysis Worksheet reported that the borrower received a non-itemized \$2,000 lender credit toward settlement costs. HUD

Handbook 4155.1, Rev-4, section 1-9A, part 1, states that closing costs and prepaid expenses paid on behalf of the borrower by the lender must be disclosed on the good faith estimate and the HUD-1 Settlement Statement. The good faith estimate and HUD-1 Settlement Statement must include an itemized statement indicating which items are being paid on the borrower's behalf; disclosing a lump sum is unacceptable.

E. Verification of Debt Payments Not Obtained.

The file contained evidence that the borrower paid debts of \$919, \$113, and \$328. However, these payments, which included a Western Union payment and two checks by phone, contained no support that the funds used to pay the debts originated from the borrower's bank account. According to HUD Handbook 4155.1, Rev-4, section 2-10C, when someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to purchase, and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage.

F. Verification of Deposits Not Obtained.

Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a bank statement indicating two \$1,000 deposits, one \$855 deposit, and one \$457 deposit without explanation from the borrower as to the source of funds. It is also important to note that these unexplained deposits were needed at the closing.

G. Inadequate Credit Analysis

The file contained copies of bank statements indicating that the borrower was charged many "non-sufficient fund" and overdraft fees. Handbook 4155.1, REV-4, CHG-1, section 2-3, provides that major indications of derogatory credit require a sufficient written explanation from the borrower. First United did not obtain the required explanation from the borrower.

H. Inadequate Disclosure of Liabilities

Handbook 4155.1, REV-4, CHG 1, section 2-11A, provides that borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. Documents containing partial copies of borrower bank checks in the file included many checks written to the same individual. These checks, which were written in individual amounts of \$75, \$100, \$125, and \$150, amounted to \$1,875 over a 5-month period. There was no explanation in the file of the purpose of these payments, which if deemed a liability, could increase the debt to income ratios significantly.

- I. Inadequate Funds To Close on HUD-1 Settlement Statement
- J. Verification of Paid Outside Closing Costs Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. The borrower did not appear to have sufficient funds to close. There was no documentation to show that paid outside closing items totaling \$1,392 had been paid before closing without reducing the funds available to close. Cash due from the borrower on the HUD-1 Settlement Statement was \$2,458. If the total \$1,392 paid outside closing amount is added to the \$2,458 owed by the borrower and then offset against the residual gift of \$3,357 with no remaining assets, the borrower would have had a \$494 deficit at closing.

- K. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports, ordered to monitor the performance of credit reporting agencies, may not be charged to the borrower. The file contained one credit report at no cost to the borrower. However, the borrower was charged \$50 for credit reports on the HUD-1 Settlement Statement. Consequently, the \$50 is an unsupported cost.

First United's Comments

- A. First United disagrees that \$1,000 of the \$4,000 gift was not documented. First United states that the \$1,000 earnest money deposit was the balance of the \$1,000 gift.
- B. First United disagrees that there was inadequate support for the borrower's employment. First United states that an underwriter determines the adequacy of employment and income documentation via copies of paystubs, verification of employment forms, W-2 forms, and tax returns, if necessary, and verifies that there are sufficient assets to close from bank statements and/or verifications of deposit. First United states that it is not likely that an underwriter would compare each of these documents to the other. In addition, First United stated that if the borrower chose to cease direct deposit to a certain bank account, it would not have affected the quality of the loan or the underwriting decision.
- C. First United disagrees that there was inadequate documentation for earnest money. First United states that \$1,000 earnest money was part of the \$4,000 gift.
- D. First United disagrees that the application of lender credit funds is not provided since the lender fees are broken out on the Good Faith Estimate and the HUD-1 Settlement Statement.
- E. First United agreed that additional documentation was needed to show that payment for one debt came from borrower's funds, but disagreed that documentation did not

exist for two other cited debt payments. For these two, First United states that the file documented two checks that utilized payment by phone.

- F. First United agreed that verification of large deposits was not obtained.
- G. First United agreed that an explanation was not obtained for derogatory credit.
- H. First United disagreed that there was inadequate disclosure of liabilities. First United states that a valid credit report was obtained, and that the various payments made to an individual over a period of time are likely for childcare, which are not required to be included in the monthly debt. First United did acknowledge, however, that the file may have been documented with an explanation for these payments.
- I. First United disagreed that the borrower did not have sufficient funds to close
- J. because it is not unreasonable that the borrower would have been able to accumulate the remaining \$400 earnest money deposit from regular earnings to the time of closing.
- K. First United agrees that documentation was lacking for credit report fees.

OIG's Evaluation of First United's Comments

- A. Neither the loan file nor First United's response provided adequate support for the \$1000 portion of a gift as required by Mortgagee Letter 00-28. In addition, the lender should have verified the earnest money deposit based on the borrower's inability to accumulate savings as required by HUD Handbook 4155.1, REV-4, CHG-4, section 2-10A.
- B. The verification of employment was dated July 17, 2002, which was also the last evidence of a biweekly direct pay deposit. There was no explanation obtained from the borrower as to why biweekly payroll direct deposits ceased on the borrower's bank statements as required by HUD Handbook 4155.1, REV-4, CHG 1, section 3-1.
- C. Because the \$1,000 gift was not adequately sourced as explained in part A, we were unable to determine that either of the two \$1,000 deposits listed in the bank statement on July 30, 2002 was a deposit of a gift by the donor. Therefore, as stated, the lender should have verified the earnest money deposit should have been verified based on the borrower's inability to accumulate savings as per HUD Handbook 4155.1, REV-4, CHG-4, section 2-10A.
- D. The loan file documented a lump sum lender credit on both the Good Faith Estimate and HUD-1 Settlement Statement in violation of HUD Handbook 4155.1, Rev-4, section 1-9A, part 1.
- E. First United concurred that the file did not contain payment evidence for a \$328 debt. First United, however, stated that borrower debts payments of \$113 and \$919.38 were adequately supported. Our review of these two payments revealed that they were

supported with two non-cashed checks, which is contrary to HUD Handbook 4155.1, Rev-4, section 2-10C.

- F. First United agrees with this issue.
- G. First United agrees with this issue.
- H. We concur with First United's statement that explanation for these payments should have been documented, and in fact, believe that Handbook 4155.1, REV-4, CHG 1, section 2-11A requires it.
- I. Handbook 4155.1, REV-4, CHG 1 requires that costs paid outside closing be verified
- J. prior to closing.
- K. First United concurred.

Case Number: 352-5002658
Loan Amount: \$123,373
Settlement Date: June 20, 2003
Status: Currently in Default

Pertinent Details

- A. Inadequate Credit Analysis
- B. Inadequate Bank Account Documentation
- C. Inadequate Compensating Factors

Handbook 4155.1, REV-4, CHG-4, section 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. First United computed debt to income ratios of 42.72 percent and 42.72 percent, respectively. The Mortgage Credit Analysis Worksheet noted compensating factors as "conservative use of credit" and "excellent savings pattern."

Handbook 4155.1, REV-4, CHG-4, section 2-3, provides that for those borrowers who do not use traditional credit, the lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider or may elect to use a nontraditional agency. The file contained a credit report for the co-borrower that listed no credit scores due to a lack of credit history. First United did not obtain an alternate credit history through a nontraditional agency.

Handbook 4155.1, REV-4, CHG-4, section 3-1F, provides that the file must include verification of deposit and most recent bank statements. The file included verification of deposit but no bank statements. It is also important to note that the verification of deposit was dated May 9, 2003, while the borrower's handwritten application was dated May 20, 2003 (11 days after the verification of deposit).

Handbook 4155.1, REV-4 CHG-4, section 2-13, states that compensating factors may be used in just approval of mortgage loans with ratios exceeding benchmark guidelines. As previously stated in sections B and C, the files included insufficient banking data and an inadequate credit history of the co-borrower. As a result, the compensating factors ("conservative use of credit" and "excellent savings pattern") applied by First United to provide justification for excessive debt to income ratios are inadequate.

- D. Inaccurate Debt to Income Ratios
- E. Inadequate Support for Income Calculation

The ratios completed by First United were incorrect by overstating the borrower's income as discussed in the following section.

Handbook 4155.1, REV-4, CHG-4, section 2-7, provides that the income of each borrower must be analyzed to determine whether it can be reasonably expected to

continue through at least the first 3 years of the mortgage loan. From the documents in the file, we could not determine how First United estimated the co-borrower's base pay of \$1,255 as stated on the Mortgage Credit Analysis Worksheet. Our estimation of the co-borrower's base income was \$1,225, a \$30 difference.

After considering the above deficiency, we calculated the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio debt to income ratios to be 43.18 percent, which would require justification by compensating factors.

F. Inadequate Disclosure of Liabilities

Handbook 4155.1, REV-4, CHG-4, section 2-3B, states that a satisfactory explanation must be provided by the borrower to account for the omission of any significant debt shown on the credit report but not listed on the loan application. The credit report in the file listed a debt with a balance of \$1,551 that was not listed on the borrower's application and not considered in the debt to income ratios.

G. Verification of Debt Payments Not Obtained

The file contained a payment by a realty company of the borrower's homeowners' insurance amounting to \$598. According to HUD Handbook 4155.1, Rev-4, section 2-10C, when someone other than a family member has paid off debts, the funds used to pay off the debt must be treated as an inducement to purchase, and the sales price must be reduced by a dollar-for-dollar amount in calculating the maximum insurable mortgage. We could not locate an explanation in the file by the lender for the payment of the borrower's homeowner's insurance by a real estate agency.

H. Inadequate Origination Analysis of Non-processed Borrower

The file included a mortgage that contained an additional borrower who was not included in the underwriting process. Handbook 4155, section 2-2A, refers to "cosigners" who do not take ownership interest, but they must execute the loan application and mortgage note (they become liable for the repayment of the obligation). The cosigner's income, assets, liabilities, and credit history are included in the determination of creditworthiness. First United should not have underwritten the loan with the non-processed borrower.

First United's Comments

- A. First United disagrees that the credit analysis of the co-borrower was inadequate. First United states that the file contains three trade lines for the borrower and co-borrower jointly.
- B. First United disagrees that the file included inadequate bank documentation, stating that the file included a Verification of Deposit form that documented average balances consistent with current balances.

- C. First United disagrees that compensating factors were inadequate. First United states that the compensating factors were adequate, and additionally, an 82 percent loan to value ratio, which is a compensating factor, was not listed on the Mortgage Credit Analysis Worksheet
- D. First United agrees that the debt to income ratio was inadequate, but states that the
- E. error would not have a significant impact on the resulting ratios or the underwriting decision.
- F. First United disagrees that there was inadequate disclosure of liabilities. First United states that the \$1,551 debt listed on the borrower's credit report was not listed on the borrower's application because the debt is a non-traditional credit item that was added to the credit report to establish credit history, and need not be considered.
- G. First United agrees that the file should have contained an explanation for payment of the homeowner's premium by a real estate agent. However, First United stated that the payment would not have affected the quality of the loan or the underwriting decision since the borrower demonstrated sufficient funds to close.
- H. First United disagrees that an unprocessed borrower should have been underwritten because the non-processed borrower is required by state law to sign the Mortgage but not the Note and is not obligated on the debt.

OIG's Evaluation of First United's Comments

- A. As stated in the finding, the file contained a co-borrower credit report ordered for the co-borrower only that listed no credit scores due to a lack of credit history. First United did not obtain an alternate credit history through a nontraditional agency as per handbook 4155.1, REV-4, CHG-4, section 2-3.
- B. Handbook 4155.1, REV-4, CHG 4 requires verification of deposit and obtaining bank statements.
- C. We believe that First United did not adequately justify the two compensating factors ("conservative use of credit" and "excellent savings pattern"). As previously stated in sections B and C, the file included insufficient banking data and an inadequate credit history of the co-borrower. In addition, HUD Handbook 4155.1, REV-4, CHG-4, section 2-13 does not list a property's loan to value ratio as an acceptable compensating factor.
- D. The ratios were incorrect by overstating the borrower's income. We estimated
- E. co-borrower's base income of \$1,225, a \$30 difference. After considering the above deficiency, we calculated the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio debt to income ratios to be 43.18 percent, which would require justification by compensating factors.
- F. We concur with First United's response and have eliminated this deficiency.

- G. The file did not document an explanation by the lender for the payment of the borrower's homeowner's insurance by a real estate agency as required by HUD Handbook 4155.1, Rev-4, section 2-10C.
- H. HUD Handbook 4155, REV-4, CHG-4, section 2-2A requires that loan be underwritten with the non-processed borrower as per HUD Handbook 4155, section 2-2A.

Case Number: 351-4255346
Loan Amount: \$88,152
Settlement Date: August 29, 2002
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

mortgage payment to effective income ratio and total fixed payment to income ratio should Handbook 4155.1, REV-4, CHG 1, section 2-12 and 2-13, state that the borrower's not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. First United computed ratios of 33.562 percent and 45.982 percent, and it did not identify any compensating factors.

B. Closing Not in Compliance with Loan Approval

The MCAW listed a total seller contribution of \$1,853, while the actual seller's contribution at closing on the HUD-1 Settlement Statement was \$3,000. Handbook 4155.1, REV-4, CHG 1, section 3-12, B, states that the loan must close in the same manner in which it was underwritten and approved.

C. Ineligible Commitment Fee

A commitment fee of \$275, included on the HUD-1 Settlement Statement, was paid by the borrower on August 29, 2002 (closing date). The mortgagor declined an interest rate lock-in in the lock-in confirmation document on July 15, 2002. Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. The \$275 commitment fee is ineligible because there was no documentation showing that the mortgagor agreed to a lock-in agreement.

D. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports ordered to monitor the performance of credit reporting agencies may not be charged to the borrower. The file contained one credit report at no cost to the borrower. However, the borrower was charged \$50 for a credit report on the HUD-1 Settlement Statement. Consequently, the \$50 is an unsupported fee.

First United's Comments

A. First United agrees that there were no compensating factors given for excessive debt to income ratios.

- B. First United agreed that the MCAW in its file incorrectly reported the seller contribution, but that the final 1003 reflected the correct amount as reported on the HUD-1 Settlement Statement.
- C. First United agrees that there was no documentation to support a lock-in fee.
- D. First United did not comment about the issue of an unsupported credit report fee.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. As noted by First United, the loan file MCAW was not updated to reflect what was on the HUD-1 Settlement Statement. OIG has determined that the HUD-1 Settlement Statement per the HUD file did reflect the correct seller contribution amount as reported on the HUD-1 Settlement Statement. Consequently, we eliminated the deficiency that closing was not in compliance with loan approval requirements.
- C. First United concurred.
- D. First United did not provide a comment.

Case Number: 352-4821402
Loan Amount: \$73,841
Settlement Date: August 10, 2003
Status: Currently in Default

Pertinent Details

- A. Inadequate Funds To Close on HUD-1 Settlement Statement
- B. Verification of Paid Outside Closing Cost Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. The borrower did not appear to have sufficient funds to close. There was no documentation to show that paid outside closing items totaling \$865 had been paid before closing. Adding these funds to the \$626 listed on the HUD-1 Settlement Statement as cash due from the borrower results in a total of \$1,491. The file disclosed that the borrower had total cash available of \$871, resulting in inadequate funds to close.

- C. Ineligible Commitment Fee

A commitment fee of \$395, included on the HUD-1 Settlement Statement, was paid by the borrower on August 19, 2003 (closing date). The mortgagor declined an interest rate lock-in in the lock-in confirmation document on May 29, 2003. Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. The borrower signed a June 6, 2002, Federal Housing Administration conditional commitment, which locked in an interest rate of 6.5 percent until August 27, 2003. The commitment did not list a commitment fee and stated that the current fees due were a 1-percent or \$727.50 origination fee. The commitment provided that if the loan was locked at zero points, the origination fee should be refunded to the borrower at closing upon receipt of the closing paper and funds from the borrower's attorney. The \$395 commitment fee is ineligible because there was no documentation showing that the mortgagor agreed to this fee. The \$727.50 origination fee should also be repaid to the borrower because the loan was locked at zero points and the file contained no documentation that this amount had been paid.

- D. Inadequate Verification of Previous Rental or Mortgage Payment History

Handbook 4155.1, REV-4, CHG-1, section 2-3, states that the payment history of the borrower's housing obligations is of significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, directly from the landlord or mortgage servicer, or through canceled checks covering the most recent 12-month period. The credit report verified the rental payment history for a Newark, NJ, residence while the applicant had resided in East Orange for the most recent 12 months. Therefore, there was no verification of the rental payment history for the most recent 12-month period.

E. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports ordered to monitor the performance of credit reporting agencies may not be charged to the borrower. The file contained one credit report at a cost of \$13.50. However, the borrower was charged \$75 for the credit report on the HUD-1 Settlement Statement, as opposed to the actual cost of \$13.50. Consequently, the \$61.50 is unsupported.

First United's Comments

- A. First United agrees that items paid outside closing were not verified, but asserts that
- B the borrower had adequate funds to close.
- C. First United stated that the loan file contains documentation that the loan was locked more than 15 days prior to closing. First United stated that additional research is necessary regarding the origination fee and the points associated with the loan.
- D. First United agrees that an updated rental verification should have been obtained.
- E. First United agrees that invoices for credit report fees were lacking, and that itemized bills will be maintained in the future.

OIG's Evaluation of First United's Comments

- A. Handbook 4155.1, REV-4, CHG 1, section 2-10, requires that all of the funds for the
- B borrower's investment must be verified and documented. First United did not do this, and consequently, after adding the paid outside closing amounts to the funds listed on the HUD-1 Settlement Statement as cash due from borrower, the borrower has insufficient funds to close. The mortgagor did not accept an interest rate lock-in, per the lock-in confirmation document on May 29, 2003 and should not have been charged the lock-in commitment fee. The \$727.50 origination fee should be repaid.
- C. First United concurred.
- D. First United concurred.
- E. First United concurred.

Case Number: 352-4187932
Loan Amount: \$74,600
Settlement Date: April 16, 2002
Status: Foreclosure Completed

Pertinent Details

A. Inadequate Bank Account Documentation

Handbook 4155.1, REV-4, CHG 1, section 3-1F, states that as an alternative to obtaining a verification of deposit, the mortgagee may choose to obtain the borrower's original bank statements for the most recent 3-month period. The file contained two statements from borrower's bank for the period February 8 to March 2, 2002, and an illegible date in March to March 26, 2002, respectively. Because the beginning balance of the second statement did not match with the ending balance of the first one, we concluded that these two bank statements were not consecutive. In addition, the account number on the first bank statement was covered up with dark ink. As a result, we cannot determine that the two bank statements came from the same bank account. The file also contained a co-borrower's bank statement covering the timeframe from January 11 to February 7, 2002 (less than 1 month). Therefore, the documentation for the borrowers' bank accounts was inadequate. It is important to note that the bank assets were needed for closing.

B. Verification of Paid Outside Closing Cost Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, states that all of the funds for the borrower's investment in the property must be verified and documented. There was no documentation to show that a paid outside closing item of \$594 as a 1-year flood insurance premium had been paid before closing, without reducing the funds available to close.

C. Case File Not Provided

Handbook 4155.1, REV-4, CHG-1, chapter 3, requires that all information required in processing and underwriting Federal Housing Administration-insured mortgages be verified and documented. First United was not able to locate a copy of the file for this case. Consequently, we had to use the Homeownership Center file as the resource for our review.

D. Ineligible Commitment Fee

A commitment fee of \$275, included on the HUD-1 Settlement Statement, was paid by the borrower on April 16, 2002 (closing date). In the lock-in confirmation document on January 20, 2002, the borrower chose not to lock in. Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Consequently, the \$275 commitment fee is ineligible.

E. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports ordered to monitor the performance of credit reporting agencies may not be charged to the borrower. The file contained two credit reports at a cost of \$25. However, the borrower was charged \$50 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$25. Consequently, the \$25 is an unsupported cost.

First United's Comments

- A. First United agreed that the file contained inadequate bank account documentation due to poor copying.
- B. First United disagreed that verification of costs paid outside closing was not obtained. First United stated that the borrower would have had enough funds to close, and could have earned the nominal \$594 from the time of the last verification of the account (March 26, 2002) to the date of closing, April 16, 2002.
- C. First United was unable to produce the loan file due to circumstances beyond its control, and noted that these circumstances will not recur.
- D. First United agreed that the loan file lacked documentation for the commitment fee.
- E. First United agreed that the loan file lacked documentation for the credit report fee.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. HUD Handbook 4155.1, REV-1 CHG 1, section 2-10 requires that all funds for the borrower's investment in the property must be verified and documented.
- C. This issue was not counted as a deficiency.
- D. First Untied concurred.
- E. First Untied concurred.

Case Number: 352-4840266
Loan Amount: \$156,300
Settlement Date: January 29, 2003
Status: Currently in Default

Pertinent Details

A. Excessive Debt to Income Ratios Without Compensating Factors

Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, state that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. First United computed debt to income ratios of 24.657 and 41.169 percent, respectively, without listing the required compensating factors. In addition, the ratios calculated by First United were incorrect, as discussed in the following sections.

B. Inaccurate Debt to Income Ratios

C. Inadequate Support for Income Calculation

The ratios calculated by First United were incorrect. We could not determine from the file how First United calculated the co-borrower's seasonal income of \$674, which was part of the estimated monthly income of \$1,506. Our calculation showed the average monthly seasonal income was \$602 for the past 3 years. As a result, we calculated debt to income ratios of 24.96 and 41.67 percent, respectively.

D. Verification of Deposits Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10B, provides that if there is a large increase in a bank account amount, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. We found three deposits that were not satisfactorily explained. The borrower's Astoria Federal Savings bank statement indicated a deposit of \$1,699 on September 23, 2002. A borrower's explanation letter stated that the deposit was 2 months' child support. We were not able to reconcile that amount to the child support payment as indicated in the file, which was \$699 biweekly. The borrower's First Union bank statement also contained a \$1,284 deposit and a \$1,515 deposit on December 6 and 17, 2002, respectively, that were not explained in the borrower's letter. It is important to note that these deposits were needed for closing.

E. Ineligible Commitment Fee

A commitment fee of \$275, included on the HUD-1 Settlement Statement, was paid by the borrower on January 29, 2003 (closing date). In the lock-in confirmation document on November 8, 2002, the borrower chose not to lock in. Mortgage Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the

anticipated closing date. First United charged a commitment fee ineligibly when the borrower did not select to lock in. Consequently, the \$275 commitment fee is ineligible,

F. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports ordered to monitor the performance of credit reporting agencies may not be charged to the borrower. The file contained two credit reports at a cost of \$33 each. However, the borrowers were charged \$86 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$66. Consequently, the \$20 is an unsupported cost.

First United's Comments

- A. First United disagreed that compensating factors were required because a 41.169 percent ratio is a fraction above the 41 percent guideline. In addition, First United states that income was conservatively calculated because social security income was not grossed up. This allowable action would have brought the ratio to below the 41% guideline.
- B. First United disagreed that there was inadequate support for the calculation of
- C. income. First United stated that it used a two-year average of seasonal income instead of the three-year average used by OIG.
- D. First United disagreed that the source of deposits were not verified. First United stated that the three deposits (\$1,699 on 9/23/02, \$1,284 on 12/6/02, and \$1,515 on 12/17/02) represented child support payments.
- E. First United agreed that the file lacks documentation to for the commitment fee.
- F. First United agreed that the file lacks documentation for credit report fees.

OIG's Evaluation of First United's Comments

- A. HUD Handbook 4155.1, REV-4 CHG1, section 2-12 and 2-13 requires compensating factors for ratios that exceed HUD guidelines. However, OIG recognizes that the income was conservatively calculated because social security income was not grossed up. Consequently, OIG eliminated the excessive ratio deficiency.
- B. We believe that First United's calculation is incorrect. Based upon a two-year
- C. average, we calculated monthly income of \$582.22, which is \$91.91 less than that calculated by First United. Further, use of the two-year average results in monthly income that is \$19.20 lower than our computation of a three-year average.
- D. We disagree that the three deposits were adequately sourced as child support payments. The file contained a borrower's explanation letter that the \$1,699 deposit

on 9/23/02 represented a two-month child support payment. However, this explanation does not reconcile with other supporting documents in the file that report child support as \$698.75 biweekly, which would be approximately \$1,400 per month. We believe that this discrepancy should have been questioned. Further, no explanation was documented in the file for the remaining two deposits as required by HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B.

- E. First United concurred.
- F. First United concurred.

Case Number: 352-4567838
Loan Amount: \$162,550
Settlement Date: April 30, 2002
Status: Currently in Default

Pertinent Details

- A. Inaccurate Debt to Income Ratios
- B. Inadequate Support for Income Calculation

Handbook 4155.1, REV 4, CHG 1, chapter 2, section 5, states that the lender is responsible for adequately analyzing the probability that the borrower will be able to repay the mortgage obligation in accordance with the terms of the loan. First Union computed front and back ratios of 37.108 percent. However, the ratio was computed incorrectly because income was overstated. Handbook 4155.1, REV-4, CHG-1, section 2-7, provides that overtime and bonus income may be used to qualify if the borrower has received such income for approximately 2 years and there are reasonable prospects for continuance. If bonus income varies significantly from year to year, a period of more than 2 years must be used to calculate average income. The borrower received overtime for over 3 years, and there were significant variations in the amount earned over the 3 years. We could not determine from the file how the borrower's employment income was calculated. We calculated monthly income of \$369 less, which increases the ratios to 39.974.

- C. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge the actual costs of the credit reports to the borrower. Charges for backup credit reports ordered to monitor the performance of credit reporting agencies may not be charged to the borrower. The file contained one credit report at a cost of \$36.50. However, the borrower was charged \$50 for credit reports on the HUD-1 Settlement Statement, as opposed to the actual cost of \$36.50. Consequently, \$13.50 is unsupported.

First United's Comments

- A. First United disagrees that the income calculation was incorrect, noting that the
- B. income calculation included an average of bonus income for 2001 and year-to-date 2002. First United further states that, even if OIG's income calculation were used, the front and back ratios would be 39.974, which are within prescribed guidelines.
- C. First United stated that actual invoicing for credit reports will occur in future files.

OIG's Evaluation of First United's Comments

- A. The calculation of bonus income was incorrect. Handbook 4155.1 REV-4 CHG-1,
- B. Paragraph 2-7 provides that overtime and bonus income may be used to qualify if the borrower has received such income for approximately two years and there are reasonable prospects for continuance. If bonus income varies significantly from year

to year a period of more than two years must be used to calculate average income. Since overtime income varied significantly over three years (\$8,000 in 1999, \$1,000 in 2000, and \$13,500 in 2001), we believe that it should have been averaged over the three years. Additionally, Handbook 4155.1, REV-4, CHG 1 states that the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent, respectively, unless compensating factors are identified.

C. First United concurred.

Case Number: 352-4903996
Loan Amount: \$132,762
Settlement Date: February 2, 2003
Status: Paid in Full

Pertinent Details

A. Ineligible Commitment Fee

A commitment fee of \$225, included on the HUD-1 Settlement Statement, was paid by the borrower on February 21, 2003 (closing date). The borrower elected not to have an interest rate lock in the interest rate lock-in agreement, dated February 4, 2003. Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount fees for a period of not less than 15 days before the anticipated closing date. Because the borrower elected not to lock in the interest rate on the loan, the \$225 commitment fee is ineligible.

First United's Comments

A. First United agrees that support was lacking for the commitment fee.

OIG Evaluation of First United's Comments

A. First United concurred.

Case Number: 352-4787988
Loan Amount: \$137,583
Settlement Date: November 7, 2002
Status: Currently in Default

Pertinent Details

A. Non-itemized Lender Credit

HUD Handbook 4155.1, REV-4, CHG-1, section 1-9A, provides that “lenders may pay the borrower’s closing costs and/or prepaid items by ‘premium pricing.’ The funds derived from a premium priced mortgage may never be used to pay any portion of the borrower’s down payment and must be disclosed on the good faith estimate and the HUD-1 Settlement Statement. The good faith estimate and HUD-1 Settlement Statement must provide an itemized statement indicating which items are being paid on the borrower’s behalf; disclosing only a lump sum is not acceptable. Also, the amount paid on the borrower’s behalf for each item may not exceed the allowable fees recognized by the Federal Housing Administration office having jurisdiction where the property is located. If the premium pricing agreement establishes a specific dollar amount for closing costs and prepaid expenses with any remaining funds reverting to the borrower, the excess funds must be used to reduce the principal balance. Closing costs paid in this manner may not be included in the acquisition cost of the property and, thus, the mortgage amount. If the lender through the premium rate pays all closing costs and prepaid expenses, the mortgage amount will typically be based on the loan-to-value limit applied solely to the lesser of the sales price or appraised value.”

The HUD-1 Settlement Statement indicated that a lender assist of \$1,434 was paid on November 7, 2002 (date of closing). The lender assist was not itemized on the good faith estimate or the HUD-1 Settlement Statement.

B. Ineligible Commitment Fee

A commitment fee of \$225, included on the HUD-1 Settlement Statement, was paid by the borrowers on November 7, 2002 (closing date). Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. The \$225 commitment fee is ineligible because there was no documentation to show the mortgagor agreed to a lock-in agreement.

First United’s Comments

- A. First United disagrees, and states that in the event the HUD instructs that specific application of funds breakout is required, it will appear in future files.
- B. First United agreed that the loan file lacked documentation to support a commitment fee.

OIG's Evaluation of First United's Comments

- A. The HUD-1 indicated that a lender assist of \$1,433.57 was paid on November 7, 2002, the date of closing. Neither the GFE nor the HUD-1 itemized the lender assist.
- B. First United concurred.

Case Number: 352-4635690
Loan Amount: \$133,168
Settlement Date: July 26, 2002
Status: Currently in Default

Pertinent Details

A. Non-itemized Lender Credit

The HUD-1 Settlement Statement and Mortgage Credit Analysis Worksheet listed a lump-sum, non-itemized lender credit of \$591, received by the borrower. HUD Handbook 4155.1, Rev-4, section 1-9A, part 1, states that closing costs and prepaid expenses paid on behalf of the borrower by the lender must be disclosed and itemized on the good faith estimate and the HUD-1 Settlement Statement.

B. Ineligible Commitment Fee

A commitment fee of \$225, included on the HUD-1 Settlement Statement, was paid by the borrower on July 02, 2002 (closing date). The borrower elected not to have an interest rate lock in the interest rate lock-in agreement, dated July 26, 2002. Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount fees for a period of not less than 15 days before the anticipated closing date. Because the borrower elected not to lock in the interest rate, the \$225 represents an ineligible fee.

First United's Comments

- A. First United disagreed that the lender credit was not itemized, and noted that if HUD instructs that breakout of specific application of funds is required, it will be done in the future.
- B. First United agreed that the loan file lacked documentation for a commitment fee.

OIG's Evaluation of First United's Comments

- A. Handbook 4155.1, REV-4 CHG 1, section 1-9A requires that a lender credit be itemized on the HUD-1 Settlement Statement. The HUD-1 in the file lacked any itemization.
- B. First United concurred.

Case Number: 351-4317276
Loan Amount: \$47,958
Settlement Date: November 22, 2002
Status: Currently in Default

Pertinent Details

A. Ineligible Commitment Fee

The borrower paid a \$275 commitment fee, listed on the HUD-1, Settlement Statement, on November 22, 2002, the closing date. The borrower elected not to have an interest rate lock-in in the agreement, dated November 13, 2002. Mortgagee Letter 94-7, section IV, provides that commitment or lock-in fees must be in writing and must guarantee the interest rate and/or discount fees for a period of not less than 15 days before the anticipated closing date. Because the borrower elected not to lock in the interest rate, the \$275 commitment fee is an ineligible fee.

B. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, section 5-3, states that the lender is permitted to charge a borrower the actual costs of credit reports. The borrower was charged \$10 for credit reports on the HUD-1 Settlement Statement; however, we could not locate a credit report in the file. Consequently, the \$10 is an unsupported cost.

First United's Comments

- A. First United agreed that the loan file lacked support for a commitment fee.
- B. First United agreed that the loan file lacked documentation for credit report fees.

OIG's Evaluation of First United's Comments

- A. First United concurred.
- B. First United concurred.

Case Number: 352-4660882
Loan Amount: \$139,461
Settlement Date: May 24, 2002
Status: Paid in Full

Pertinent Details

A. Ineligible Shipping Fee

The borrower was charged an overnight fee of \$50. Such a fee is not listed on the approved listing of closing costs and other fees as stated in HUD Handbook 4000.2, REV-2, section 5-3. Consequently, the \$50 is an ineligible cost.

First United's Comments

- A. First United disagrees that it charged the shipping fee, and stated that the closing attorney charged the fee despite written instruction that such fee was unallowable. First United advised that it will request that the fee be refunded.

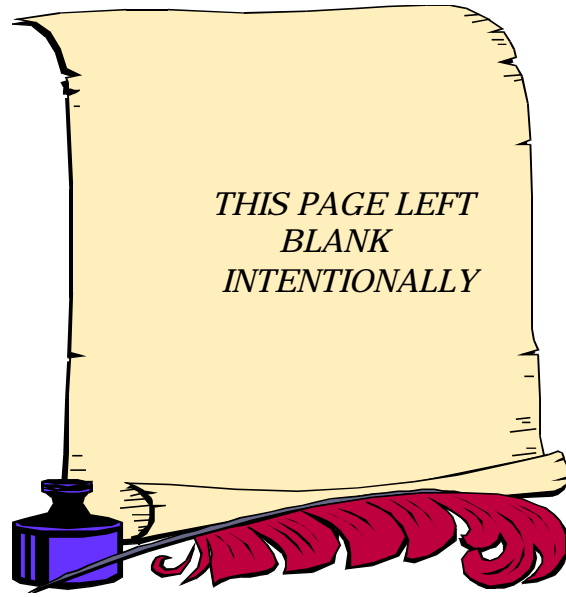
OIG's Evaluation of First United's Comments

- A. The \$50 shipping fee is an ineligible fee that should be refunded to the borrower.

Schedule of Questioned Costs and Funds To Be Put to Better Use

<u>Finding Number</u>	<u>Type of Questioned Costs</u>		<u>Funds To Be Put to Better Use 3/</u>
	<u>Ineligible Costs 1/</u>	<u>Unsupported Costs 2/</u>	
1A	3,773	\$ 571	
1B		1,933	
1C			\$2,482,438
Total	<u>\$3,773</u>	<u>\$2,504</u>	<u>\$2,482,438</u>

- 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 costs whose eligibility cannot be clearly determined during the audit since such costs were not supported by adequate documentation. A legal opinion or administrative determination may be needed on these costs.
- 3/ “Funds to be put to better use” are costs that will not be expended in the future if our recommendations are implemented; for example, costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.



First United's Comments



November 29, 2004

Alexander C. Malloy
Regional Inspector General for Audit
New York/New Jersey
U. S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, New York 10278-0068

Re: Draft Audit Report – October, 2004
First United Mortgage Company, Inc.
Lender ID No.: 766870008

Dear Mr. Malloy:

In reference to the above and in accordance with instruction during our exit conference of November 16, 2004, you requested that we provide written, general feedback to the findings of the report, with more detailed, specific "loan-by-loan" responses to be sent directly to Julie Shaffer of the Philadelphia Homeownership Center at a later date.

Despite the extremely limited timeframe, we did not wish to convey any lack of effort, or risk that a detailed response might actually be expected at this time. In light of the seriousness of the allegations contained within the report, we are providing specific responses at this time. Please note that this draft response will likely be supplemented and may be so directly by our counsel if deemed necessary.

As we relayed during our exit conference, we take our relationship with HUD very seriously and pride ourselves on having been a DE Lender for over ten (10) years. During that time we have worked with HUD wherever possible to improve our performance as a lender. The subject audit is stated to be the result of an unusually high default rate of 8.43 percent as of January 31, 2004 while the statewide rate was 3.49 percent for the same period. There are specific circumstances which clearly tie to the steep increase of the default rate within a set period of time, the details of which are highly confidential and the subject of ongoing litigation. Although we feel it critical to advise of these circumstances at some point for a variety of reasons, written disclosure

within a public forum would be neither wise nor appropriate. The details of this situation will be given in full at a later date to the Homeownership Center.

In the Draft Report, you recommended that FUMC indemnify HUD against future losses on 20 of the 25 loans reviewed which were identified in Appendix A of the Draft Report. You further recommended that FUMC reimburse borrowers for ineligible and unsupported fees. Lastly, you recommended that First United provide the Homeownership Center with a corrective action plan containing assurances that all guidelines pertaining to underwriting FHA insured loans be followed by its underwriting staff and that First United take specific steps to implement its Quality Control Plan in accordance with HUD requirements. You do note that significant action to alleviate the deficiencies has already taken place with the closure of two (2) branches that originated eleven (11) of the delinquent loans.

FUMC agrees that improvement is needed in the documentation of our loan files pertaining to lock dates and acknowledgement of commitment fees by the borrower prior to charging them. In addition, almost every loan is cited for a failure to document actual credit report fees. The discrepancies occurred as a result of supplements and credit update fees incurred without invoices contained within the individual loan files. FUMC will be immediately discussing new procedures to enable the insertion of each credit report cost, including supplements and updates on an itemized basis, within the actual loan files to support the amounts charged.

FUMC does not agree with the assertion that we failed to adhere to prudent lending practices or that we did not process the loans in accordance with applicable HUD requirements for the majority of the loans reviewed as stated in Finding 1. We believe that the draft report includes errors and oversights and that in many instances where some discrepancy was found, that this discrepancy did not affect the overall underwriting decision or the basis of prudent lending. Appendix A contains a detailed discussion of our findings following a review of the loans in conjunction with the draft report. Based on our response, we trust that you will be in a position to rescind your recommendation for indemnification on the part of First United Mortgage for all loans initially noted with the exception of Case No. 351-4271956 (David L. Boston) which we agree displays a lack of prudent underwriting.

As noted in your report, we will continue to work to improve our quality control practices, reporting and documented managerial responses.

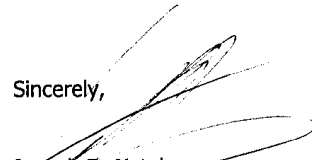
In closing, it was relayed that this audit was the result of an unusually high default percentage for our company at a specified time. As mentioned briefly, a series of events led us to this place, events which will not recur. We present to you that our default ratio has decreased from 8.43 to 6.87 as of 09/30/04 which covers the period of 10/01/02 through 09/30/02. Having replaced the former DE Underwriter in December of 2002, we would present to you that our total loans originated from 12/31/02 through 10/31/04 were 422 with only 12 of these loans having defaulted to date. This equates to a default percentage of 2.843 as compared to the statewide percentage of 3.34% for this same period. In addition, it should be noted that of the 12 defaulted loans, 3 have been paid in full leaving a net number of defaulted loans at 9 of 422 or 2.13%.

We believe that the numbers above lend credibility to our statement that the high delinquency numbers at a given point were due to an extreme set of circumstances. We are more than confident that our numbers will continue to decrease in terms of early defaults.

Having said this, we are also compelled to advise that while First United has prided itself on the fact that we have placed literally thousands of surrounding community members into homes over the past 10 years through the hard work and efforts of making FHA insured loans, it has come to the point, in light of audits such as these, that we are forced to revisit the wisdom of remaining as significant of an FHA lender as we have been in the past. Conventional lending has evolved to the point that it now allows significantly lower downpayment amounts; more outlets for previously unacceptable credit; permits the charging of additional fees that are restricted by HUD; and has become far more ratio tolerant, especially with the use of automated underwriting systems. With this evolution, the business of government loan lending is swiftly losing many of its prior advantages and certainly its appeal as a lender, from a business and liability standpoint.

While we do intend to continue to actively service the members of our surrounding communities for hopefully many years to come, we are compelled to evaluate at what cost our product menu and core programs should continue to include FHA loans. We would humbly suggest that it might behoove the government to rethink the practice of imposing blanket indemnification requests for millions of dollars that will hang over a lender's head as a contingent liability, literally for years to come, unless one of the objectives of audits such as this one is to discourage lenders from making these loan types and to make a move away from FHA lending altogether.

At this point, we sincerely hope that our comments will be found to be satisfactory and acceptable and will alleviate the requests for blanket indemnification. We thank you for the opportunity to respond to the draft report and for your consideration of these matters. If you have questions or are in need of further information, please feel free to contact the undersigned at (908)272-4100.

Sincerely,

Joseph D. Natale
President

Encls.

/pac

APPENDIX A**351-4271956: Boston**

The draft report states that FUMC overstated income by \$991 based upon use of overtime income. The report quotes HUD Handbook 4155.1, REV-4, CHG 1, section 207A as stating that "overtime may be used as qualifying income if the borrower has received such income for approximately the past 2 years and there are reasonable prospects of its continuance. The lender must develop an average of overtime income for the past 2 years, and the employment verification must not state categorically that such income is not likely to continue." The verifications of employment for both borrowers indicated that overtime was "not guaranteed". We do not agree that this is a categorical statement that it will not continue. A history was established and therefore use of the averaged overtime was permissible. A statement that OT is not guaranteed is protective for the employer. The established history of earning such overtime lends more weight to the fact that it will continue. We do agree that the underwriter should have specified her reasoning for use of the overtime as well as documenting her calculation of income. Our current underwriter will be so instructed to clearly document each file with the calculation of income.

FUMC does agree that debt was incorrectly excluded by the underwriter and that the existence of the state tax lien and its prior disposition were not properly documented. We do also agree that a credit explanation is not contained within the loan file and should have been. Further, we do agree with the draft report findings relative to funds to close and the lack of complete employment documentation.

The additional \$10.00 in credit report fees charged to the borrower resulted from two (2) supplements at a cost of \$5.00 each. Procedure will be changed to include exact itemized cost listings within each loan file in the future.

352-4245405: Ellerbe

- A) The draft report states that income was incorrectly calculated as the bonus income should have been averaged over three (3) years resulting in monthly income of \$4,123. rather than the income used of \$4,231. The figure used was the average of bonus income for the previous two (2) years. The borrower had a base salary of \$3,502. Had the underwriter averaged bonus for the previous 2 years plus year-to-date, the resulting figure would have been \$745 per month for total income of \$4,247 which is higher than the income actually used. We disagree that the income calculation was incorrect.
- B) A credit explanation is contained within the loan file and therefore we disagree with the draft report statement that one was not provided. In regard to the \$284. balance in collection, the file does contain a reference number for payment. It appears that the credit supplement was not copied into the loan file. We will pursue obtaining the supplement and forward it on to the Homeownership Center.

- C) The draft report indicates that the loan did not close in compliance with the loan approval. The MCAW contained a typographical error and did not reflect the correct seller contribution amount; however, the final 1003 properly reflects the \$2,000. seller contribution as well as demonstrating sufficient funds to close. The loan was closed properly.
- D) Variant house numbers for the address of property on Robinson Avenue are typographical only. We do agree that they should have been corrected or addressed via an explanation within the loan file.
- E) Additional \$10.00 in credit report charges resulted from credit supplements. As noted earlier, actual invoicing within the loan file will occur on future files.

352-4737106: Naibee

- A) The loan to value of 93% versus total acquisition gave strength to the loan in terms of justifying ratios outside of guideline. We do agree that underwriter comments should have been in the loan file to address the higher ratios and will implement this as a standard procedure in the future.
- B) The previous MCAW by another underwriter should not have remained in the loan file. Actions such as these are part of ongoing litigation and cannot be discussed in-depth at this time or in this forum.
- C) The draft report indicates that the borrower was to receive a total gift of \$26,900. The file contains supporting documentation for \$18,000. of the \$26,900. The report states that the remaining \$8,900 was supported by a check made by the donor to an unrecognized third party. The unrecognized third party was the attorney for the transaction. The \$8,900 downpayment amount is reflected on the HUD.
- D) The report indicates that earnest money was not properly documented. As noted above, the initial portion of the gift in the amount of \$8,900 was held by the seller's attorney. The escrow letter from this individual indicates that he was holding \$9,900. which included \$1,000 paid at time of contract signing. The balance of the gift in the amount of \$18,000. was properly documented and therefore we disagree that earnest money documentation was inadequate.
- E) The report indicates inadequate funds to close on the MCAW in the amount of \$29,053. This amount is correct. The borrower received an additional gift of \$2,500 the transfer of which is documented in the loan file; however, the file does not contain a copy of the additional gift letter. We will attempt to obtain this from the investor. The borrower did have sufficient funds to close and we therefore disagree with this finding.
- F) The report indicates that the "closing attorney's records did not reconcile with the HUD-1 Settlement Statement, which reported more costs that documentation

disclosed was actually paid. Further, there were surplus funds in the attorney's trust fund, which were not returned to the borrower."

In this regard, we are not privy to the closing agent's records and therefore cannot respond to the statements made without first establishing contact with the attorney, requesting access to his records and attempting to ascertain the validity of the statements made in the report. We will be pursuing this avenue of action.

- G) The report indicates that the credit report showed variant sources of employment over the past five years while the borrower indicated he was self-employed for that period of time. We do not, nor are we permitted to, utilize the credit report as confirmation of employment history as it is raw, unconfirmed data that may be reported by a variety of non-reliant sources. The file did contain complete documentation to support self employment of the borrower including 2 years tax returns and year to date profit and loss. The self employed status was clearly documented as were the earnings. The report indicates that a balance sheet was not provided which is true; however, its contents would not have effected the calculation of income and would not have altered the underwriting decision. We contend that the self employed status and income were completely and correctly documented.
- H) We do agree that the commitment fee should not have been charged as the file does not contain documentation to support that the loan was locked at least 15 days prior to closing.
- I) The report speaks to an ineligible UPS shipping fee charged to the borrower. The fee was not charged by FUMC but rather by the closing agent despite specific, written instruction that this was not an allowable fee and could not be collected.
- J) As discussed in previous cases, supplement fees for credit reports will be documented in the future.
- K) The report indicates that the sales contract within the loan file is unsigned. The loan file did contain a fully executed signature page which was inadvertently not copied. We will attempt to secure a copy from our investor or the closing agent.

352-4446481: Perez

- A) The draft report indicates that support for employment was inadequate due to the fact that pay stub summaries were generated by the same employer and covered an identical 4 weeks of employment for each borrower, contained mathematical errors and were not in sequence by check order. The borrowers worked at the same place and the summaries provided were for the most recent, four consecutive weeks which was the month of January, 2002 for both. We do not know how many employees work at this place of employment or whose check is cut in what order and therefore we do not see the relevance of

sequential order of checks. Checks were copied by the borrowers prior to cashing as they knew they would soon be applying for a loan. We do not see that we could or should have gone any further regarding the borrowers' time of cashing and/or depositing of their paychecks. An argument can be made that the mathematical error regarding the total of deductions and the net pay amount on the one paystub should have been questioned by the underwriter; however, we disagree with the other statements that the employment was not adequately documented.

- B) The draft report indicates that verification of cash gift was not obtained due to the fact that gift funds of \$3,200 were deposited in December, 2001, six weeks prior to the date on the gift letter which was February 20, 2002. This is simply the date the letter was actually signed and does not negate the source of the gift funds. We are required to document that the gift comes from the donor's own monies. The file does contain a copy of the gift check from the donor's account. If he transferred money from another account to this one in order to write the gift check, it is both impractical and an undue burden to request that the donor source his funds. We are required to see donor ability and transfer of funds, both of which are contained within the loan file.
- C) The draft report indicates that the co-borrower's bank statement contained an unexplained deposit of \$900 on March 14, 2002. We do not agree that this is an excessive deposit amount that would need to be sourced. Regarding the \$3,200 deposit on December 5, 2001, this is the deposit of gift funds discussed in "B" above wherein one of the inaccuracies of the draft report was the statement that the file did not contain documentation to show borrowers' receipt of gift funds. This "unexplained" deposit completes the gift trail.
- D) The draft report speaks to a \$310 auto payment to Honda for the co-borrower, NSF charges and remittance of \$623 from the bank statement which would increase the debt ratio. The co-borrower simply remitted two months payments during the timeframe covered by the bank statement, which corresponds to the required amount of \$310 per month. We do not understand the statement that there is no evidence to show the co-borrower was making the car payments as the preceding sentences clearly address the remittance of the most recent two payments. In addition, the credit report on file shows the loan as current. Seeing the payments leaving the co-borrower's account simply confirms what would ordinarily be assumed, that the payments were being remitted. We disagree that credit was not properly evaluated.
- E) The draft report indicates that the loan was not closed in compliance with the Loan Approval as FUMC estimated two months hazard and real estate taxes for escrow at closing yet only collected one month of taxes at close. The loan closed in March. Taxes would have been paid through the second quarter at close meaning that the next due would be in August. With closing in March, first payment would be May with both June and July payments made prior to the 3rd Quarter due date of August. Months held in escrow depend upon actual close dates. We disagree that the loan was not closed properly.

- F) In conjunction with "E" above, escrow amounts on the Good Faith which carry over as closing costs on the final 1003 and MCAW would have been slightly overstated. A thorough review of actual and estimated costs needs to be completed in order to properly address this item as well as those in items "G" and "H" regarding inadequate funds to close on the HUD-1.
- I) The draft report indicates the existence of a "non-processed borrower" who should have been included on the loan with full processing as a co-signed. The individual in question is the spouse of one of the borrowers who was not on the loan. By law, she is required to sign the Mortgage and TIL but did not sign the Note as she is not obligated on the loan. We disagree with this finding.
- J) Additional credit charges due to supplements and updates will be individually invoiced and contained within the loan files in the future.
- K) We do agree that the loan file did not properly document a lock in date fifteen days prior to close and must contain same in the future.

351-4166768: Jackson

We do agree that the underwriter should have listed compensating factors for the 33% front ratio; however as noted, the total DTI was also 33%, well below the guideline. Compensating factors will be specifically noted in the future.

Our copy of the loan file does not contain the credit report which we will attempt to secure from our investor. We need to see the balance for the \$209 monthly payment to ascertain if it had less than 10 months remaining which would explain exclusion from debt. We will pursue this matter.

We disagree that deposits into the bank account as noted were large or unexplained based on the following:

Commit Fee Pd	2/5/02	Paid	\$ 250	Via Money Order
Account Opened	2/8/02	Deposit	\$1,797	From paychecks
	2/22/02	Deposit	\$ 700	
	2/26/02	Deposit	\$2,200	From 401k

The amount of \$250 is nowhere near excessive or needing to be sourced. The borrower then opened a checking account in preparation of closing the loan. Rather than cash on hand as was prior experience, paychecks were deposited with additional paycheck deposit two weeks later. We do not agree that these are large amounts that needed to be further sourced.

Further, the borrower's ending balance before close was \$1,639 while she needed \$1,861 to close. It is both logical and conceivable that an additional paycheck would have covered the amount to close. It is not reasonable or possible to verify funds to close in an account up to the day prior to closing.

We do agree that the MCAW contained an error in terms of seller contribution; however, the final 1003 and HUD contained the correct amounts which negates the statement that the loan did not close in compliance with loan approval. The underwriter should have revised the MCAW.

We do agree that the file lacks documentation to support a lock in at least 15 days prior to close as well as documentation of itemized credit report fees.

352-4624970: Singh

We do agree that compensating factors should have been specifically listed. Despite this, the underwriting decision was justified based on the following:

Previous credit problems resulted from the fact that the borrower was a student completing his education while the co-borrower was on disability for a time. Neither explanation displays a wanton disregard for credit obligations nor are they likely to recur. At the time of loan approval, both borrowers were gainfully employed within skilled trades with a likelihood of advancement and increased earnings in the future which would have logically indicated decreasing ratios in the future.

In regard to two year history for overtime and bonus, as noted above, the borrower had previously been in school but was in a skilled trade with both opportunity and likelihood of advancement.

We do agree that documentation of gift transfer and sufficient funds to close is incomplete for this transaction.

We disagree with the statements in the draft report that employment was not adequately supported. Although the loan file does not contain verbal verification of employment to accompany the paystubs, it does contain a letter from the employer confirming a raise effective December 31, 2001. The file also contains consecutive paystubs for the periods of 1/15/02 and 1/31/02 which reflect the raise. There is also an updated paystub within 30 days of closing dated 4/15/02.

The file did contain the previous VOE; however, inadequate copying is proven when looking at the top of the current VOE. We will attempt to obtain a copy from our investor. The file also contained the 2000 Federal Tax Return as the borrower was unable to locate his W-2 form for this year, along with the 2001 W-2 form. Both employment and income were completely documented for this file.

As noted previously, itemized credit report billings will appear in individual loan files in the future.

352-4713314: Miqueis

Although spousal earnings are not listed as a compensating factor in the handbook, contributing income of an occupying spouse, even though not obligated on the loan, is a practical and logical compensating factor.

The draft report indicates that income was overstated because FUMC used unemployment income with an explanation from the borrower that receipt of same was due to illness. In fact, the borrower is a union worker, a profession that oftentimes results in recurrent unemployment. A history of receipt of unemployment income is documented within the loan file with no reason to think it will not continue. The borrower's explanation was not relative to the unemployment income used as illness would result in disability income rather than unemployment compensation.

The report further alleges inadequate support for employment. We do not agree. The borrower lists himself as self-employed receiving wages from more than one employer. The file contained 2 years W-2 forms and 1040's along with a letter from his accountant detailing his income tax filing. The borrower was treated as a self-employed individual which calls for more conservative underwriting as we deal in net rather than gross income. The file was actually underwritten more conservatively than it needed to be, an additional compensating factor to offset the higher than guideline ratios.

We disagree with the contention that the file did not contain adequate earnest money documentation. The report indicates that the borrower's spouse who was not a co-borrower, borrowed \$2,700 from her 401k and gave it to the borrower to deposit into his account. In fact, the borrower's wife liquidated a life insurance policy and deposited the funds along with provision of a letter indicating that the borrower had full access to the funds in the subject account. Supporting documentation is contained within the loan file.

We do agree that the file lacks documentation to support a lock in 15 days prior to closing in support of charging a commitment fee.

Future files will contain itemized credit report billings within.

351-4258438: Awujoola

The report indicates that income and ratios were incorrectly calculated. The auditors calculated income to be \$4,434 per month rather than \$4,526, a difference of \$92 per month. Even if this file contains a mathematical error, ratios are still within guideline and this difference does not affect the quality of the underwriting decision.

The report indicates that the borrower had inadequate funds to close based on the fact that the MCAW erroneously counts a \$2,500. gift twice and does not include \$2,361 in discount points thus resulting in cash reserves of negative \$669. While we do agree the MCAW contains an error in counting the \$2,500. twice, the \$2,361 in discount points were paid by the seller and therefore there was not a shortage of funds or reserves.

The report states that Verification of Deposits were not obtained and cites specific deposits as follows:

Account opened 09/15/02		
09/16/02	\$200.	"Unexplained deposit"
09/23/02	\$1,000.	Deposit

Other bank statement:

07/19/02	\$1,000	Deposit
08/02/02	\$1,000	Deposit
08/23/02	\$1,049	Deposit

If arranged chronologically, these deposits appear to establish a pattern of deposit of earnings quite consistently, without any excessive amounts in a lump sum that would require explanation. We disagree with the finding that FUMC failed to source deposits as they were both consistent and of reasonable amounts. The draft report also cites that the borrower paid his \$1,000 deposit with a money order on July 12, 2002 while his ending bank account balance on July 19, 2002 was \$9.00. The report states that he may not have had enough funds to purchase the money order? The borrower obviously had the funds to purchase the money order from earnings that had not been being consistently deposited, rather cashed. He begins to demonstrate a consistent deposit pattern from earnings on July 19, 2002 which continues throughout September. We disagree that his ability to purchase a money order should be an item of discussion at all. We assert that the deposits were reasonable and consistent.

The report indicates that the loan was not closed in compliance with the Loan Approval due to a typographical error on the MCAW which reflects a seller concession of \$2,361. while the actual concession on the HUD-1 was \$3,000. The final 1003 does reflect the correct concession amount in conjunction with the HUD and we therefore assert that the loan was closed properly.

The draft report indicates asserts an inadequate credit analysis due to the fact that two accounts, one with Provident and one with Universal Citi, were not specifically addressed. We do agree that the borrower's explanation failed to include these two accounts; however, this oversight in the explanation would not have effected the credit decision. We disagree that the analysis was inadequate.

We do agree that the loan file did not contain documentation to support a lock in 15 days prior to closing.

352-4705394: Burton

It is true that we do not have a file copy for this loan due to circumstances beyond our control. The auditors were able to review the original file obtained directly from the HOC. Please note that it is difficult to refute the findings of the auditors without a file; however, the only underwriting issue cited is a lack of compensating factors for high ratios. The MCAW did cite the 85% LTV as a compensating factor which the report

indicates is not a valid compensating factor per the handbook. We disagree. Equity of 15% as opposed to the required 2% is a strong motivator for working to keep a property. Current status of this loan confirms this as it initially went into default after 9 months of payments in October, 2003. The history reports partial reinstatement in November, 2003 with repayment in January and March of 2004. Current status shows the loan reinstated as of June, 2004. We disagree that sound equity is not a valid compensating factor.

We do agree that the file lacked an itemized credit charge billing which will be corrected in the future.

351-4248193: Porrino

Although this loan is paid in full and not a subject of indemnification, we do not agree with the statements made in the draft report and wish to address them as follows.

The report indicates inadequate credit analysis and inadequate disclosure of liability. We disagree with these findings as the borrowers explained past credit derogatories as the result of a failed business which was not likely to recur. They also indicated that they were paying off their credit cards. The borrowers were working to get back on their feet and were showing commitment to repairing credit damage. The report indicates that recent accounts were being paid untimely and that they were significant in amounts. There was only one recent derogatory of a minimal amount with Capital One. We disagree with the finding in both respects.

The report continues with a discussion of the decrease in the borrowers' assets from \$50,000 in June to approximately \$12,000 in December, including residual amount of a \$15,000 gift. As noted above, the borrowers were working to decrease their credit card balances. In addition, the balance in December was sufficient for funds to close this transaction and we therefore would not be questioning any further as to how these borrowers chose to spend their own money.

The report indicates many significant deposits into the bank statements on file; however, it does not break out when or how much these deposits were as it did with other cases reviewed. We would need to know which deposits were the subject of this inadequacy in order to address it in conjunction with earnings and savings pattern.

We do agree that the file did not contain documentation of a lock in 15 days prior to closing nor did it contain an itemized billing of the several credit supplements and updates occurring as a result of the ongoing pay down of debt. Future files will contain this itemization.

351-4271037: Reed

The draft report cites excessive debt to income ratios without compensating factors. The ratios are 26.363 and 41.255. We disagree with this finding. .255 hardly equates to excessive. In addition, the 29/41 guideline is just that, a guideline. We contend that a ratio of 41.255 is acceptable without a compensating factor.

The remainder of the draft report cites inadequate bank account documentation and funds to close. We do agree that the loan file does not include complete bank statement copies and will need to attempt to secure these from our investor before we are able to competently address the issues cited for this loan.

We do agree that the file lacks documentation to reflect a rate lock 15 days prior to closing and also that it lacks an itemized credit charge billing which will be contained in future files.

352-4639998: Murillo

The draft report cites excessive ratios without compensating factors. Again, the LTV for this transaction was 85%. We would argue that 15% equity in a property is a sound compensating factor.

The report indicates that ratios were incorrectly calculated as was the income. We disagree with this finding. Income was derived by averaging actual earnings of the borrower for the full year 2001 with year to date 2002. A review of the borrower's earnings disclosed that income was increasing each year and overtime did apply. We contend that income was properly calculated.

The report contains a discussion of inadequate verification of gift funds from the donor speaking primarily to deposits into the donor's account three months prior to the gift withdrawal. The gift funds came from two different accounts of the donor. The report indicates a failure to obtain an explanation for a deposit into one of the donor's accounts three months prior to giving one of the gifts as well as a \$3,200 deposit into the donor's account 11 days prior to his giving of the second gift. One of the donor's accounts in question was a business account. Large deposits into such an account type would be likely as would withdrawals. It is not reasonable to expect nor is it required, that we would question a donor as to the source of deposits into his account three months prior to his giving a gift to our borrower, nor 2 weeks prior to giving the second gift. We are required to see that gift funds come from the donor's own funds. This was demonstrated with the withdrawal from the donor's account and the copies of the checks. No further action in this regard is required or should be expected.

Section E of the report indicates that adequate verification of deposits was not obtained. It does indicate that we should have sourced \$300 that the borrower indicated was cash on hand. We do not agree with this finding. This is not a large sum of money and it is more than reasonable that any borrower may have acquired this amount of cash. Larger sums were explained and documented. We do agree that we could have gone further in obtaining more complete documentation from the attorney for the funds deposited on a prior transaction, and will pursue this matter if requested. We do agree that the \$1,200 given by relatives should have been verified as a gift.

The draft report indicates that borrower funds POC were not verified. The total amount in question is a \$43 credit report fee and \$425 appraisal fee. We can pursue obtaining

copies of the cancelled checks for these services if so directed; however, we do not see that the total of these 2 amounts would have affected the borrower's ability to close.

We do agree that the file does not contain documentation to support a lock in 15 days prior to closing nor does it contain an itemized breakout of credit report charges which will be contained in future loan files.

352-4592520: Ovinlola

The initial finding for this loan indicates excessive ratios and discusses a failure to include a \$38 debt. The inclusion of this debt results in a back ratio of 41.24% which, again, is hardly excessive and considered to be acceptable in light of guideline ratio of 41%. In addition, the monthly homeowner's was estimated at \$60. per month and was only actually \$42. per month which would further lower the 41.24% back ratio.

The second paragraph speaks to the compensating factor utilized to offset the already acceptable back ratio as a comparison of the actual rent received versus that shown as market rent on the appraisal. The report indicates that the compensating factor is negated due to the fact that the actual higher lease only had one month remaining to its term. The borrower was qualified with the proposed market rents from the appraisal and therefore the discussion regarding the remaining lease term is of no value.

The draft report then discusses the fact that the borrower was qualified at a bought down rate without documentation from the underwriter as to how the borrower would handle the rate increases. We do not agree that the ratios would have increased significantly in that the ratio of 41.24 was not excessive to begin with. In addition, it is likely that the borrower's income would have increased in the future to offset the rise in the payment. In the future, the underwriter will document the file in writing as to justification for approval of a loan at a bought down rate with a basis for the borrower's ability to handle rate increases in the second and third years of the loan term.

In regard to inadequate verifications of deposit, we do agree that the bank statements in the loan file are incomplete due to poor copying and will attempt to secure complete statement copies from our investor. We do not agree that deposits of \$500 or \$100 are large and need to be specifically sourced. We feel these amounts are minimal and that it is more than reasonable that a borrower would make such a deposit amount from earnings or other various sources.

The draft report indicates that the items paid outside of closing were not documented as having cleared the borrower's account which would have resulted in a \$175. deficit at closing. While we could pursue obtaining documentation to show that the \$400 POC item was cleared prior to the last bank statement on file, it is not deemed necessary as the amount of \$175. is nominal enough that it is more than reasonable that the borrower would have had this amount of money to close, from regular earnings.

We do agree that the loan file lacks documentation to support a lock in 15 days prior to closing and also that it does not contain an itemized credit charge billing. Future loan files will contain this documentation.

351-4268219: Giordano

The draft report finding for this loan begins with the assertion that verification of cash gift was not obtained. The report indicates that documentation is contained to show transfer of \$3,000 of the total \$4,000 gift; however, the donor "provided no disbursement support for the remaining \$1,000 gift". Further down in item "c", the report speaks to inadequate earnest money documentation stating that the borrower paid \$1,000 which was un sourced. This is the balance of the \$4,000 gift which is also referenced in this paragraph as having been verified. We disagree with both findings here as the full \$4,000 gift was sourced as was the earnest money deposit of \$1,000 which was the balance of the gift.

The report also speaks to the fact that \$400 credit report and appraisal fees were not verified as having cleared the borrower's account prior to the last bank statement. Again, we could pursue obtaining copies of the cancelled checks to show these items as cleared; however, it is not unreasonable that the borrower would have been able to accumulate this amount of money from regular earnings from the time of the last bank statement verified to the time of closing.

The report also cites Inadequate Support for Employment indicating that direct deposit of earnings into the bank statements was not seen for the periods ending July 31 and August 14 although there had been biweekly direct deposits before that time. In all fairness, an underwriter reviews and determines the adequacy of employment and income documentation via copies of paystubs, Verification of Employment form, W-2 forms and tax returns if necessary. The underwriter verifies sufficient assets to close from an acceptable source via bank statements and/or verifications of deposit. It is not likely that an underwriter would be comparing each of these documents to the other as a source of additional verification.

The employment and income were fully and properly documented for this loan file. If the borrower chose to cease direct deposit to a certain bank account, it could have been for a number of reasons, none of which would have affected the quality of the loan or the underwriting decision.

The draft report cites Non-Itemized Lender Credit as a violation as a \$2,000. lender credit appeared on the HUD-1 without specific breakout of its application. We disagree that application of the funds is not provided anywhere as the lender fees are broken out on the Good Faith Estimate as well as on the HUD-1. The report indicates that a lender credit cannot be reflected as a lump sum on the HUD or elsewhere throughout the file. If so directed by the Homeownership Center, future loans with lender assist will contain a written breakdown of application of funds, in addition to the initial and final Good Faith Estimates and the HUD-1, on a separate form within the loan file.

We disagree with the finding that the loan file does not contain any documentation to show payment of debts by phone from the borrower's own funds. The loan file does contain copies of two personal checks that were utilized for the two pay by phone accounts. The third account was paid by Western Union. We do agree that additional

documentation to show this amount paid from the borrower's funds should have been obtained.

We do agree with the finding that this loan file contained several large deposits that should have been sourced and also with the finding that the file does not contain a written credit explanation from the borrower.

We disagree with the finding relating to Inadequate Disclosure of Liabilities which speaks to various payments made to an individual over a period of time with the assertion that this could have been an additional liability. It is likely that these payments are for child care which would not be included in the monthly debt. The file did contain a valid credit report with use of all liabilities stated thereon. A borrower's personal check payments to an individual are not required to be sourced or utilized in a debt ratio. We do agree that the question may have been asked and the file documented by a memorandum as to what the payments were for; however, such action is not required.

We disagree with the statement that the borrower did not have sufficient funds to close which is again based upon the fact that the file does not contain documentation that items paid outside of closing cleared prior to verified assets. We can pursue attempting to obtain cancelled checks for these items if so directed by HOC; however, even using the auditor's calculation we are talking about a shortage of \$494 if the POC items had not cleared, again, an amount that is nominal enough that it is likely the borrower would have had these funds on hand from earnings obtained after verification of the last bank statement up to the time of closing.

We do agree that an itemized credit charge invoice is not contained within the loan file and will be in future files.

352-5002658: Philippe

The finding for this loan begins with a discussion of inadequate compensating factors which were listed as conservative use of credit and excellent savings pattern. This is further supported by an LTV of 82% although this was not listed as a compensating factor. We disagree that the compensating factors were inadequate to offset the out of guideline ratios.

The report then discusses an inadequate credit analysis citing a lack of credit history, primarily related to the fact that the co-borrower's credit report did not contain any account history. The file does contain three tradelines for the borrower and co-borrower jointly. We disagree that the credit analysis was inadequate.

The report indicates inadequate bank account documentation due to the lack of bank statements within the file. We disagree with this finding as the loan file contains a fully completed Verification of Deposit form with average balances that are in line with the current balance. No further documentation would have been necessary. The report also speaks to the fact that the VOD is dated before the application date; however, the initial application package had expired and was fully updated on May 20, 2003 while the

VOD was sent out and requested at the same time the new application package was requested. In light of this information, the following paragraph of the report is negated.

The report indicates overstatement of income due to the fact that the loan file contains a monthly income figure of \$1,255 while the auditor's arrived at a figure of \$1,225., a \$30 difference. It appears that this is a data input error in our loan file; however, it would not have a significant impact on the resulting ratios or the underwriting decision. Even using the lower monthly payment, the resulting ratio from the auditors would be 43.18% which is considered acceptable in light of the compensating factors provided and the 82% LTV.

The report cites inadequate disclosure of liabilities citing an account on the credit report with a balance of \$1,551 and no payment included in the debt ratio. This account is a non-traditional credit item that was added to the report to establish credit history as discussed above; however, it is not a debt that would be included in ratios for any borrower. We therefore disagree with this finding.

We do agree that the file should have contained an explanation for payment of the homeowners' premium by the real estate agent which was action taken in order to meet timeframes for the closing of the loan. Despite this, the amount of \$598. paid by the outside party would not have affected the quality of the loan or the underwriting decision as the borrower did demonstrate sufficient funds to close.

We disagree with the finding cited under the heading "Inadequate Origination Analysis of Non-Processed Borrower". The third signature appearing on the mortgage is that of a spouse which is required by law although the individual did not sign the Note and is not obligated on the debt. This was not a "non-processed borrower".

351-4255346: Storey

We do agree with the initial finding that the file does not contain any compensating factors for ratios outside of guidelines.

We do not agree with the statement that the loan did not close in compliance with the loan approval as the MCAW incorrectly listed the seller contribution of \$1,853 while it was actually \$3,000. The final 1003 reflected the correct figures that matched with the HUD-1 Settlement Statement. The underwriter did not correct her MCAW. It is to be noted that this error, which has appeared on several loans, has been corrected with the replacement of the underwriter; however, the loan did close properly.

We do agree that the file does not contain documentation to support a lock in 15 days prior to closing or an itemized credit charge invoice which will be contained in future files.

352-4821402: Lightford

The finding for this loan again relates to insufficient funds to close in light of POC items not reflected as cleared prior to closing. We can pursue obtaining these cancelled

checks if so directed by HOC; however, the HUD-1 shows the amount due at closing was \$626. and the borrower had verified funds of cash available in the amount of \$871. The borrower demonstrated sufficient funds to close with actual fees from the HUD-1. We disagree that any further action was necessary.

We disagree with the finding that we charged an ineligible commitment fee. The file contains documentation which clearly shows that the loan was locked more than 15 days prior to closing and the \$395. commitment fee was disclosed on the Good Faith Estimate.

In regard to a refund of the \$727.50 origination fee paid by the borrower, additional research is necessary as to the actual amount of points associated with the lock. This finding will be supplemented.

We do agree that updated rental verification should have been obtained at the time the entire loan was updated. The loan file does contain a previous 12 month rental history which did satisfy guidelines at the time the loan was approved. The file was updated without request for additional, updated housing history which should have been obtained.

We do agree that the loan file lacks invoices for the several credit updates required for the length of time the loan was in process. Future files will contain itemized billings.

352-4187932: Pollard

The initial finding for this loan cites inadequate bank account documentation which was the result of poor copying. We will attempt to obtain complete bank statements from our investor and supplement this response.

The second finding again speaks to funds paid outside of closing not having been verified as clearing the borrower's account prior to closing. The issue at hand is payment of \$594 for a flood insurance premium. We disagree with the finding here as the borrower still would have had sufficient funds to close and could have earned this nominal amount from the time of the last verification of account on file (March 26, 2002) to the date of closing, April 16, 2002.

We have previously mentioned that our inability to produce the loan file was beyond our control. In addition, the series of events which produced this circumstance cannot recur as all loan files are now maintained at the corporate site.

We do agree that the loan file lacks documentation to reflect a lock in 15 days prior to closing and an itemized credit charge billing which will appear in future loan files.

352-4840266: Ocasio

The initial finding for this loan is for excessive ratios. The ratio is 41.169%. We disagree that .169% is excessive for the 41% *guideline*. In addition, income was conservatively stated in that social security income was not grossed up. This allowable action would have brought the ratio to below the 41% guideline.

The draft report indicates that income was incorrectly calculated as the auditor averaged seasonal income for the past 3 years. The underwriter averaged the seasonal income for the past 2 years which is acceptable. The difference in the income amounts is approximately \$70 per month which would increase the back ratio to 41.67 which is still an acceptable amount. We disagree with the calculation of income and the statement that the ratio is excessive.

The draft report indicates that verification of deposits were not obtained in light of three deposits of \$1,699 on 9/23/02; \$1,284 on 12/6/02; and \$1,515 on 12/17/02. The explanation on file is that the source of these deposits were child support payments. The borrower received \$699 biweekly in support, the payment of which was documented via history supplied by child support services. The borrower advised that the \$1,699 deposit came from 2 months support payments. Deposits on 12/6 and 12/17 also resulted from payments of the child support. At the rate of \$1400 per month in support payments and the timing of these deposits, it is logical that the source of funds was adequately explained.

We do agree that the file lacks documentation to show a lock in 15 days prior to closing as well as an itemization of credit charges which will appear in future loan files.

352-4567838: Ruiz

We disagree with the finding that income and ratios were inadequately calculated. The underwriter averaged earnings for the full year 2001 and year-to-date 2002 based upon a fully completed Verification of Employment which indicated that overtime was expected to continue. The auditors calculated income by averaging over a 3 year period. Despite the fact that we feel the calculation of income by our underwriter was acceptable, the ratio would increase to 39.974 with the auditors' calculation which is still within the guideline.

We do agree that the file lacked an itemization of credit charges which will be contained in future files.

352-4903996: Leggett

Although this loan is paid in full and indemnification is therefore not recommended, we do agree that the file did not contain documentation to support a lock in 15 days prior to closing.

352-4787988: Morales
352-4635690: Fayton

The draft report cites "Non-Itemized Lender Credit" as a violation. As discussed previously, lender fees are broken out on the initial and final Good Faith Estimates as well as the HUD-1 Settlement Statement. In the event the HOC instructs that specific application of funds breakout is required, it will appear in future files.

We do agree that the loan file lacks documentation to support a lock in 15 days prior to closing.

351-4317276: Lippincott

We do agree that the loan file lacks documentation to support a lock in 15 days prior to closing as well as an itemization of credit charges which will appear in future loan files.

352-4660882: Paredes

We disagree with the finding that we charged an ineligible shipping fee. The fee was not charged by or paid to FUMC; but rather, by the closing attorney despite specific, written instruction that this was not an allowable fee and not to be charged, in the closing instructions issued by FUMC. We will issue correspondence to the closing agent to request his refund of these monies.