AUDIT REPORT

SECURITY ATLANTIC MORTGAGE COMPANY, INC.
NONSUPERVISED MORTGAGEE
EDISON, NEW JERSEY

2005-NY-1007

September 16, 2005

OFFICE OF AUDIT
New York/New Jersey Region

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

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

Edgar Moore

FROM: Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: Security Atlantic Mortgage Company, Inc., Did Not Always Comply with HUD/Federal Housing Administration Loan Origination Requirements

HIGHLIGHTS

What We Audited and Why

We audited Security Atlantic Mortgage Company, Inc. (Security Atlantic), a nonsupervised direct endorsement lender located in Edison, New Jersey, because its 7.02 percent default rate for loans with a beginning amortization date between October 1, 2002, and September 30, 2004, was more than twice the average default rate for the State of New Jersey, which was 3.34 percent.

Our audit objectives were to determine whether Security Atlantic (1) approved insured loans in accordance with the requirements of the U.S. Department of Housing and Urban Development (HUD)/Federal Housing Administration, which include following prudent lending practices, and (2) developed and implemented a quality control plan that complied with HUD requirements.

What We Found

HUD assumed an unnecessary insurance risk for 16 loans valued at $3,208,308 that Security Atlantic approved with material underwriting deficiencies. In addition, borrowers were charged $11,249 for ineligible and/or unsupported fees. Further, Security Atlantic could not document that it complied with HUD regulations that prohibit charging a commitment fee unless borrowers agree to lock in a mortgage rate.

Security Atlantic did not comply with HUD tier pricing regulations in the origination of 38 loans, resulting in $60,546 in inappropriate charges. These loans, which had the same interest rate and lock-in date and were within the same metropolitan statistical area, had a variation of more than two discount points.

Security Atlantic did not ensure that its quality control plan was implemented in accordance with both HUD's and its own requirements. Security Atlantic did not ensure that (1) loans that defaulted within six months were analyzed, (2) management responses to quality control findings were timely, and (3) compliance with the HUD tier-pricing rule was monitored.

What We Recommend

We recommend that the assistant secretary for housing - federal housing commissioner require Security Atlantic to: (1) indemnify HUD for potential losses on 15 loans with significant underwriting deficiencies valued at $3,048,552, (2) reimburse HUD $171,053 for the amount paid in claims and fees on one loan with significant underwriting deficiencies, and (3) reimburse borrowers for $11,249 in ineligible and/or unsupported fees found in 26 loans. In addition, we recommend that the assistant secretary for housing - federal housing commissioner determine the extent to which Security Atlantic violated HUD regulations regarding lock-in fees, take appropriate administrative action, and seek reimbursement to any borrowers erroneously charged fees. We further recommend that Security Atlantic reimburse borrowers for $60,546 in overcharges that were levied in violation of HUD's tier pricing regulations and implement a quality control process in accordance with HUD requirements.

Auditee's Response

Officials of Security Atlantic disagreed with the tone of the report and the recommendations made. Specifically, Security Atlantic officials did not agree with our conclusion that it approved loans that increased risk to the Federal Housing Administration insurance fund. Overall, Security Atlantic officials agreed with many of the underwriting deficiencies we noted, but did not believe that these deficiencies were a contributing factor to the mortgagor's default. Security Atlantic disagreed that it violated HUD's tier pricing rule based on the belief that sponsors cannot be held accountable for monitoring tier-pricing rules for loan correspondents. Security Atlantic generally agreed that it had inadequately implemented its quality control plan during our audit period, but noted that it has made improvements.

We discussed the contents of the report with Security Atlantic officials during the audit and at an exit conference on July 28, 2005, and they provided their written comments on August 15, 2005. Appendix B of this report contains the complete text of Security Atlantic's comments, along with our evaluation of the comments.

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BACKGROUND AND OBJECTIVES

Security Atlantic Mortgage Company, Inc. (Security Atlantic), became an approved U. S. Department of Housing and Urban Development (HUD)/Federal Housing Administration lender in 1993. The company originates loans, which it then sells to investors, banks, and other mortgage bankers. The main office of Security Atlantic is located in Edison, New Jersey, and at the beginning of our audit, there were separate branch offices located in Staten Island, New York, Malvern, Pennsylvania, and Boca Raton, Florida. In addition to being an authorized agent for three principals, Security Atlantic has 166 loan correspondents. Security Atlantic terminated the contract with its quality control contractor in December 2004 and began conducting its own quality control function.

Between October 1, 2002, and September 30, 2004, Security Atlantic originated 342 and 5,106 Federal Housing Administration-insured mortgages for its retail and wholesale division, respectively.[1] We selected Security Atlantic for audit because its 7.02 percent default rate for loans with a beginning amortization date between October 1, 2002, and September 30, 2004, was more than twice the average default rate for the State of New Jersey, which was 3.34 percent.

The objectives of this audit were to determine whether Security Atlantic (1) approved insured loans in accordance with HUD requirements, which include following prudent lending practices, and (2) developed and implemented a quality control plan that complied with HUD requirements.

[1] Retail loans are originated by Security Atlantic staff. Wholesale loans are originated by licensed mortgage brokers, also referred to as third party originators.

RESULTS OF AUDIT

Finding 1: Security Atlantic Approved Loans That Caused An Unnecessary Risk to the HUD/Federal Housing Administration Insurance Fund

Security Atlantic did not follow prudent lending practices and regulations prescribed by HUD in its loan origination and underwriting in 20 of 31 loans we reviewed   As a result, loans were approved for potentially ineligible borrowers. Fifteen of these loans valued at $3,048,552 are currently insured, while $171,053 in claims and fees were paid on one remaining loan. The remaining four loans were paid in full during the course of our audit, and thus no longer represent a risk to the HUD/Federal Housing Administration insurance fund.   In addition, borrowers were charged $11,249 for ineligible and/or unsupported fees. These deficiencies occurred because Security Atlantic did not have adequate controls to ensure that loans were processed in accordance with HUD requirements.

Origination and Underwriting Deficiencies

We found material origination and underwriting deficiencies in 20 of 31 loans we reviewed with beginning amortization dates between October 1, 2002, and September 30, 2004. These deficiencies occurred because Security Atlantic did not adequately (1) verify of borrowers' income, employment, and/or source of funds for down payment and closing costs, and (2) analyze borrowers' liabilities, credit history, and/or ability to pay.

HUD Handbook 4155.1, REV-4, entitled "Mortgage Credit Analysis for Mortgage Insurance," prescribes basic underwriting requirements for HUD-insured single-family mortgage loans. Lenders must ensure that borrowers have 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: (1) qualifying ratios and compensating factors, (2) stability and adequacy of income, (3) funds to close, and (4) credit history. This assessment must be based on sound underwriting principles in accordance with the guidelines described in Handbook 4155.1 and be supported by sufficient documentation. In addition, section 3-1 of this handbook requires that the application package contain sufficient documentation to support a lender's decision to approve a mortgage. While this decision will involve some subjectivity, Security Atlantic did not always follow the above requirements in its loan origination and underwriting.

As shown in the chart below and in appendix C, we found a variety of significant underwriting deficiencies in 16 loans. The deficiencies noted are not independent of one another, as many of the loan files contained more than one deficiency.

Areas of deficiency	Number of loans
Nonqualifying ratios and/or inadequate compensating factors	13 of 16 loans
Inadequate verification of funds to close	14 of 16 loans
Inadequate verification of income/employment	6 of 16 loans
Inadequate credit analysis	3 of 16 loans
Other processing procedures	4 of 16 loans

Specific examples of Security Atlantic's inadequate underwriting are as follows:

- Case 352-5094184 was approved with a mortgage payment expense to effective income ratio and a total fixed payment to effective income ratio of 37.97 and 50.83 percent, respectively. HUD Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, provide 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 lender identifies compensating factors that could justify exceeding these ratios. "Excellent credit, very good job stability, 203k with repairs, and a reserved savings pattern" were listed as compensating factors. However, except for "a reserved savings pattern," the factors cited are not allowable compensating factors as defined in section 2-13. Further, the reserved savings pattern was inadequate because the borrower had significant credit card debts and numerous deposits were unexplained. The loan defaulted after five payments, and the reported cause was excessive obligations.

- In case number 352-5033337, Security Atlantic inadequately evaluated the borrowers' ability to repay the mortgage. The verification of current employment lacked an address, telephone number, and the starting date of employment; and the verification of prior employment was provided by the current employer. In addition, (1) borrowers' income was not accurately calculated, (2) the credit analysis was inadequate, (3) liabilities were not adequately disclosed, (4) one of the borrowers had discrepant birth date information, and (5) the closing did not comply with the loan approval. The loan defaulted after one payment with no specific reason cited.

- Case number 352-4927551 lacked adequate verification of funds to close because the file did not contain adequate verification of deposits. There was no documentation for $6,100 in personal funds listed on the borrower's application. Without these funds, the borrower would have had a negative $3,864 cash reserve at closing. Further, verification of $7,468 in non-payroll deposits, a debt payment of $2,010, and a $500 earnest money deposit was inadequate. The loan defaulted after six payments, and the reason reported was curtailment of income.

- Case number 352-4957069 was approved with a mortgage payment expense to effective income ratio and a total fixed payment to effective income ratio of 30.90 and 48.04 percent, respectively, without adequate compensating factors. After taking into consideration overstated overtime income, the ratios would be 32.24 and 50.11 percent. In addition, (1) the borrower did not have sufficient funds to close with a negative cash reserve of $1,830 at closing, and (2) the closing was not in compliance with loan approval because there were differences between the HUD-1 settlement statement and the mortgage credit analysis worksheet for a seller concession, gift, and earnest money deposit. The loan defaulted before any payments were made, and the reason reported was curtailment of income.

As of June 1, 2005, eight of the 16 loans were in default, seven were current, and claims had been paid on one. We are requesting indemnification for 15 of the 16 loans with significant underwriting deficiencies. These loans are insured for $3,048,552. Indemnification of these loans would preclude a potential future claim against the HUD/Federal Housing Administration insurance fund, resulting in funds to be put to better use. We are also requesting repayment of the claims and fees paid of $171,053 on one loan with significant underwriting deficiencies. Four additional loans with significant underwriting deficiencies were paid in full during the course of our audit; therefore, they no longer represent a risk to the HUD/ Federal Housing Administration insurance fund.

Appendix C to this report provides a summary of the significant underwriting deficiencies noted in the 15 cases still actively insured, and in the one case for which a claim has been paid, while appendix D provides a more detailed description of the deficiencies. The deficiencies occurred because Security Atlantic did not have adequate controls to ensure that loans were processed in accordance with applicable HUD requirements. The deficiencies resulted in the approval of mortgages for potentially ineligible borrowers, which caused HUD to assume an unnecessary insurance risk.

Ineligible/Unsupported Fees Charged Borrowers

Security Atlantic charged ineligible and/or unsupported fees in 26 of the 31 loans reviewed. Mortgagee 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. HUD Handbook 4000.2, REV-2, section 5-3, identifies the types of costs, such as obtaining credit report fees, that a lender is allowed to charge a borrower and limits the charge to 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	9 loans	$4,255
Ineligible shipping fee	2 loans	$ 120
Total ineligible fees		$4,375
Unsupported commitment fee	16 loans	$6,720
Unsupported credit report fee	5 loans	$ 154
Total unsupported fees		$6,874
Total ineligible/unsupported fees		$11,249

HUD Handbook 4000.2, REV-3, section 1-9A, provides that lenders are permitted to charge a commitment fee to guarantee, in writing, the interest rate and discount points for a specific period or to limit the extent to which they may change. The minimum time for lock-ins is 15 days. The loan may close in less than 15 days at the convenience of the borrower, and the lock-in fees may still be earned. Lenders are expected to honor all such commitments.

Of the 25 loans charged a commitment fee, 16 lacked documentation to substantiate that the borrowers agreed to lock in their loans, and the remaining nine loans contained lock-in agreements signed by the borrowers; however, the agreement stated that the borrower did not want an interest rate commitment. Monthly quality control reports provided by Security Atlantic also reported deficiencies regarding commitment fees. These reports noted that borrowers were charged commitment fees with written commitments that were incomplete or missing or when a lock-in was declined. Other ineligible and unsupported fees charged included shipping fees and credit report fees.

During our audit period, October 1, 2002, through September 30, 2004, Security Atlantic underwrote 5,106 loans in its wholesale division. Given the incidence of ineligible or unsupported fees disclosed in our sample (25 of 31, or 80.6 percent), as well as by Security Atlantic's quality control reviews, and the large number of loans underwritten, there is the potential that significant numbers of borrowers have been erroneously charged a commitment fee.

Appendix F lists the ineligible and unsupported costs by loan.

Recommendations

We recommend that the assistant secretary for housing - federal housing commissioner require Security Atlantic to:

1A. Indemnify HUD against potential future losses on 15 loans totaling $3,048,552, which are considered as funds to be put to better use since indemnification prevents future claims against the Federal Housing Administration insurance fund.

1B. Reimburse HUD the $171,053 on the one loan for which claims and fees have been paid that contained serious underwriting deficiencies.

1C. Reimburse borrowers for the $4,375 in ineligible fees.

1D. Work with the Homeownership Center to determine the eligibility of the $6,874 in unsupported fees charged borrowers. If the fees are determined to be ineligible, Security Atlantic should be required to reimburse the borrowers accordingly.

1E. 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.

1F. Work with the Home Ownership Center to review the 5,106 loans with beginning amortization dates between October 1, 2002, and September 30, 2004, for ineligible commitment fees. If it is determined that borrowers were charged ineligible commitment fees, Security Atlantic should be required to reimburse borrowers or HUD, as applicable, for these fees.

Finding 2: Security Atlantic Violated the HUD Tier Pricing Rule

Our review found that Security Atlantic originated 38 loans that did not comply with HUD tier pricing regulations resulting in $60,546 in inappropriate charges. Security Atlantic charged certain borrowers discount points although other borrowers with the same mortgage interest rate and lock-in date and who were in the same metropolitan statistical area were not charged discount points. These deficiencies occurred because Security Atlantic did not have adequate controls to ensure that loans complied with tier pricing guidelines. Consequently, Security Atlantic's lending practices may have unfairly imposed greater costs on some borrowers.

Violations of HUD Tier Pricing Regulations

HUD's tier pricing rule (24 CFR [*Code of Federal Regulations*] 202.12) limits variation in mortgage charge rates to no more than two percentage points when borrowers lock in the interest rate on or around the same day, using the same mortgage type, and the properties financed are located in the same geographical area. Mortgagee Letter 94-43 provides that Federal Housing Administration-approved lenders should determine that any permitted overage does not violate the tiered pricing rule and include in their quality control program a system to monitor and supervise their overage activities to prevent violations of tiered pricing prohibitions.

We obtained and analyzed a tier-pricing database from Security Atlantic that contained 5,106 wholesale loans closed between October 1, 2002, and September 30, 2004, and we identified 38 loans that had a variation greater than two discount points with the same interest rate, lock-in date, and metropolitan statistical area. For instance, two loans with the same interest rate were locked in on May 12, 2004, for properties within the same metropolitan statistical area. One loan was charged four discount points, while the other loan was not charged discount points, resulting in a $3,940 overcharge to the borrower who paid the points. Security Atlantic officials did not have an adequate system to monitor for violations of tier pricing regulations. As a result, we found that 38 borrowers were inappropriately charged $60,546 due to violations of HUD's tier pricing regulations. See appendix E for a detailed list of the loans.

Recommendations

We recommend that the assistant secretary for housing - federal housing commissioner require Security Atlantic to:

2A. Reimburse the borrower the $60,546 in overcharges that were levied in violation of HUD's tier pricing rule.

2B. Submit a corrective action plan for HUD’s review to ensure that Security Atlantic is adequately documenting its monitoring for compliance with HUD’s and its own tier pricing rules and regulations.

Finding 3: Security Atlantic Inadequately Implemented Its Quality Control Plan

Security Atlantic did not ensure that its quality control plan was implemented in accordance with both HUD's and its own requirements. It did not ensure that (1) loans that defaulted within six months were analyzed and (2) management responded in a timely manner to quality control findings. Additionally, Security Atlantic did not monitor its loans to ensure compliance with the HUD tier-pricing rule as required by its quality control plan. These weaknesses occurred because Security Atlantic did not establish procedures to ensure that its quality control plan was properly implemented. Consequently, the effectiveness of Security Atlantic's quality control plan was lessened, with the result that Security Atlantic is unable to ensure the accuracy, validity, and completeness of its loan origination process.

Loans Defaulting within Six Months Not Selected for Review

Loans defaulting within six months were not adequately reviewed as required by HUD Handbook 4060.1, REV-1, paragraph 6-6D, and as intended by Security Atlantic's quality control plan, sections 7.19 and 7.23. While Security Atlantic selected 2 of the 17 loans in our sample of 31 that had defaulted within six months for quality control review, the remaining 15 were not reviewed. Further, the two loans reviewed were apparently randomly selected, as opposed to being selected because they defaulted within six months. This occurred because Security Atlantic did not have adequate controls over its quality control functions. Quality control reviews of these early defaulted loans can provide valuable information about the causes of default that may indicate inadequate underwriting. Security Atlantic officials acknowledged this weakness and advised that review of these defaulted loans will be routine.

Inadequate Management Response

Management response to quality control reports was not always adequate. Of 24 monthly quality control reports we reviewed, we found that Security Atlantic had not prepared management responses for 18 of the reports. HUD Handbook 4060.1, REV-1, CHG-1, section 6-3I, requires that management take prompt action to deal appropriately with any material findings and that the final report or an addendum identify actions taken, the timetable for their completion, and any planned follow-up activities.

In an effort to better use the results of monthly quality control reports, in October 2003, Security Atlantic officials hired a liaison to work with them and their quality control contractor. In December 2004, Security Atlantic terminated its quality control contractor and hired the liaison to supervise a quality control department to improve the effectiveness of its quality control function.

Nevertheless, Security Atlantic must address the quality control deficiencies noted in this report to ensure that HUD does not continue to assume an unnecessary insurance risk.

Our review also disclosed that Security Atlantic could not provide evidence to support management's monitoring of its tier pricing practices. As stated in Security Atlantic's quality control plan, section 3.3, Security Atlantic shall extend strong oversight to monitor overages and tier pricing by its loans officers. However, Security Atlantic lacks assurance that its lending practices do not impose greater costs on some borrowers.

Recommendations

We recommend that the assistant secretary for housing - federal housing commissioner require Security Atlantic to:

3A. Develop procedures to implement an adequate quality control process to ensure that (1) all loans that default within the first six payments are properly reviewed, (2) quality control reviews and appropriate management responses are completed in a timely manner, and (3) proper review for compliance with tier pricing regulations is performed and documented.

SCOPE AND METHODOLOGY

We sampled 31 defaulted loans that were originated by Security Atlantic with a beginning amortization date between October 1, 2002, and September 30, 2004. Thirty loans were selected from Neighborhood Watch, and one was referred by the Philadelphia Homeownership Center. Sample selections included loans underwritten for Security Atlantic's wholesale and retail divisions. Loan selection criteria included factors such as loans that 1) defaulted within 12 payments, 2) had a high-back ratio, 3) involved a gift of $25,000 or more, and 4) were not reviewed or indemnified by HUD.

To achieve our audit objectives, we reviewed documentation from the Homeownership Center loan endorsement files, as well as electronic case files provided by the auditee. We also reviewed Security Atlantic's quality control procedures to assess whether they were adequate and properly implemented in accordance with HUD requirements. Lastly, we obtained pertinent database files from the auditee to determine whether tier-pricing practices conducted by Security Atlantic complied with HUD's tier pricing rule.

We interviewed Security Atlantic's management and quality control staff to obtain an understanding of the policies and procedures related to the auditee's management controls. We also analyzed the auditee's post-endorsement technical reviews, quality assurance reports, and independent audit reports.

We performed audit fieldwork from December 2004 through June 2005. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

We determined that the following internal 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 the relevant controls identified above.

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

Significant Weaknesses

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

- Security Atlantic did not ensure that certain loans were processed in accordance with all applicable HUD requirements (see Finding 1).

- Security Atlantic did not ensure that it complied with HUD's tier pricing rule (see Finding 2).

- Security Atlantic did not ensure that it complied with HUD regulations regarding lock-in fees (see Finding 1).

- Security Atlantic did not adequately implement its quality control plan to ensure compliance with HUD requirements (see Finding 3).

APPENDIXES

Appendix A

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

Type of questioned costs

Finding number	Ineligible costs **1/**	Unsupported costs **2/**	Funds to be put to better use **3/**
1	$ 175,428[2]	$ 6,874	$ 3,048,552
2	$ 60,546		
3			
Total	$ 235,974	$ 6,874	$ 3,048,552

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

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity whose eligibility could not be determined at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

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

[2] Represents $4,375 of ineligible fees charged borrowers and $171,053 in claims paid by HUD.

Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation | **Auditee Comments**

SECURITY ATLANTIC
WHOLESALE LENDING GROUP

August 10, 2005

Edgar Moore
Regional Inspector General for Audit, 2AGA
U.S. Department of Housing and Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY

Re: Draft Audit Report – Security Atlantic Mortgage Co., Inc.

Dear Mr. Moore:

Thank you for allowing us to review and provide comments/replies to the subject document.

We believe that Security Atlantic Mortgage Co., Inc. has, since 1993, been a good partner with HUD and made efforts to assure its conformity with HUD regulations and requirements. During this time, we have noted a rapidly decreasing HUD mortgage loan activity and a simultaneous increase of the conventional, sub-prime, and Alt A products. Within this document we have noted some of the reasons we think contributed to this change of products and which has caused many lenders to reconsider their desire to participate in the HUD programs.

While we appreciate the courtesy extended by Messrs. Harrison and Zaccaria and their staffs, it is our opinion that the draft audit report can easily be misread as though our company has egregiously violated HUD regulations and requirements, and that Security needs to be assessed penalties for these alleged violations. This is clearly pointed out on page 2 of the audit wherein the auditors have recommended that Security be required to indemnify HUD for 18 loan files, reimburse HUD $346,181 for two other files, reimburse borrowers $11,256 for ineligible/unsupported fees, and reimburse borrowers $60,547 for alleged tier pricing overcharges and on page 9 of the audit report, item 1F wherein the auditors recommend that Security work with the HOC to review 5,106 closed loans.

Comment 1

We completely disagree with the overview/tone of the audit as well as the recommendations, not only for the reasons cited within our replies, but more so the simple principle of companies doing good business with each other. That is, when alleged deficiencies are found, then both companies can benefit if the deficiencies are discussed and plans implemented that will help reduce or eliminate those deficiencies. However, when one of the companies is placed in a position of having to monetarily compensate for the deficiencies, then there has not been a mutual effort, but instead, the appearance of a unilateral effort to drive the other company out of business.

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation **Auditee Comments**

SECURITY ATLANTIC
WHOLESALE LENDING GROUP

We no longer consider HUD audits to be helpful to us, but rather merely as HUD's efforts to collect monies and reduce its costs. The previous good experiences we had in collaboration and partnership with HUD have concurrently seemed to slowly evaporate. Overall, we are disappointed about the direction in which HUD seems to be heading, but sincerely hope this is more perception than reality.

Please review our comments and replies and let us know if we can provide you or your staff with any further information or documentation.

Respectfully,

Werner Jasinski
QC Manager

cc: Mr. Samuel Lamparello, President
Security Atlantic Mortgage Co., Inc

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation | **Auditee Comments**

Security Atlantic Mortgage Co., Inc's Response Regarding HIGHLIGHTS

We will separately address the issues noted in the HUD OIG report. However, we wish to provide you with a general overview of the topics noted in the "Highlights" section of the report.

DEFAULT AND COMPARE RATIOS

Comment 2

Security Atlantic Mortgage Company prides itself on being the largest underwriter of Direct Endorsement loans in the State of New Jersey. (4,011 loans as of 6/30/2005 with a 124% Compare Ratio). As for our retail-originated mortgages, the FHA Connection data discloses that we in fact had a 7.02% default rate and a 210% Compare Ratio as of 9/30/04; however, we believe that progress has been made inasmuch as the 6/30/2005 statistics reveal a 6.39% default rate and a 142% Compare Ratio (NJ average default rate was 4.49%).

QUALITY CONTROL

Comment 3

We pride ourselves on maintaining a sound and prudent Quality Control program, and our continuous efforts to improve. However, were a lay person to read this OIG Report, he/she would mistakenly assume that Security Atlantic's Quality Control program is fraught with errors and non-vigilance. While we recognize the need for continued improvement, we believe that the report inaccurately and unfairly paints Security as being non-compliant with HUD requirements.

TIERED PRICING

Comment 4

It has been our position that Sponsors cannot and do not have the ability to monitor and supervise their Loan Correspondents, and that HUD is in a far better position to call attention to potential tiered pricing violations by dealing directly with the Loan Correspondents rather than the Sponsors.

INDEMNIFICATION

Comment 5

We fully understand that under the 24CFR, HUD may review a file after closing. However we object to the broad-brush approach in the report recommending that Security be held liable for indemnification on the 20 loans noted within the report. In that regard, we have addressed the miscellaneous issues noted for each loan.

During our Exit Conference, we conveyed to the auditors our thoughts regarding the HUD indemnification process and wish to make our comments a matter of public record. Specifically:

1. *The HUD percentage of mortgage loans has dramatically declined in the past 10 years. There are many reasons for this, but chief among them are:*
    a. *Conventional, Sub-Prime, and Alt A Programs which provide 100% financing;*
    b. *When using any of the aforementioned programs, lenders are not subjected to audits one, two or three years after closing.*
    c. *Unlike HUD, conventional, Alt A, and Sub-Prime programs do not include indemnification recourse.*
    d. *Less paperwork required for the aforementioned programs.*
    e. *Minimal computer data entry for the aforementioned programs.*
    f. *The ability to obtain information and answers from the lenders that underwrite the aforementioned programs. (That is, it is easier to call or write to these companies than it is to get answers from HUD staff).*
    g. *Far less handbooks than HUD uses or references (HUD requires lenders to be familiar with: 4000.2, 4000.4, 4060.1, 4060.2, 4070.1, 4115.3, 4135.1, 4145.1, 4150.1, 4150.2, 4155.1, 4165.1, 4235.1, 4240.1, 4240.2, 4240.4, 4265.1, 4905.1, 4910.1, 2000.4, Mortgagee Letters, and 24CFR. (This list does not include the outdated handbooks that are still listed on HUD's website nor does it include the miscellaneous HUD websites [e.g., FHA Reference Guide] which may contain information contradictory to the handbooks and mortgagee letters).*
    h. *And last, but not least, a prevailing "unfriendly" and/or cavalier attitude among many HUD employees.*
2. *HUD audits files several years after the closings. This process places an undue burden on lenders because HUD has the benefit of being a "Monday morning quarterback". It is our belief that HUD would do far better by auditing files within six months after closing because at that point in time, HUD does not have the advantage of arbitrarily "selecting" defaulted loan files. In other words, the auditors would have*

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation	Auditee Comments

to place themselves in the same position as the underwriter and lender and assess the worth/value/documentation of the file without knowing whether the mortgagor is in default.

3. When HUD audits defaulted files, it does not do so for the purpose of assessing what caused the mortgagor to default, but rather on documents or procedures it believes were not in accordance with HUD requirements at or before loan closing. In virtually every instance, these issues were not a contributing factor to the mortgagor's default. We commend HUD for attempting to provide greater loss mitigation processes, but we also believe that HUD's focus on documentation issues after-the-fact is not in the best interests of HUD, lenders, and most importantly, the mortgagors.

CONSIDERATION

We understand that an OIG audit is not the forum for which to note such matters and we further understand that the HUD OIG staff is not in a position to cause changes to the HUD programs and overall HUD demeanor. We do request, however, that our general comments above be brought to the attention of the Mr. Brian Montgomery, FHA Commissioner and Mr. Kenneth Donohue, Director, OIG.

FINDING 1

Security Atlantic Approved Loans That Caused An Unnecessary Risk to the HUD/Federal Housing Administration Insurance Fund

The Report alleges that Security did not follow prudent lending practices and HUD regulations, did not observe due diligence in the underwriting and closing of loans, and as such, recommends that HUD demand Security's indemnification of eighteen loans, and recommends that Security repay HUD $346,181 on two loans. We disagree with this conclusion and recommendation based on our responses to the individual loan file reports included herein. Moreover, the $346,181 was the claim amount paid by HUD to the servicers of record, but does not take into account the fact that HUD's Marketing and Management Contractors are charged with the responsibility of selling these homes. If properly marketed and sold, HUD will not suffer any losses for these properties.

The Report also notes that there were numerous ineligible or unsupported fees, chief among these being the commitment fees. Although we will make every effort to procure the Loan Correspondent's written commitment or refund of the commitment fees, we have noted to the auditors that the commitment fee was not charged by Security, but rather the Loan Correspondent, and therefore, requiring Security to obtain these commitments or refunds is an inappropriate way of handling this. As for the unsupported fees, we believe that the Loan Correspondents are also responsible for assuring that they have the proper documents which support the charges (e.g., copy of credit report bill, copy of appraisal bill, etc.). Sponsors generally do not request nor require such documents when they underwrite or close these files.

As for the recommendations made by the auditing staff, we have noted our thoughts about each item:

1A. Indemnify HUD against potential future losses on 18 loans totaling $3,598,783, which are considered as funds to be put to better use since indemnification prevents future claims against the Federal Housing Administration insurance fund.

Comment 5

REPLY: We completely disagree based on the responses made to the file findings, but more importantly based on general principle. The reviews and findings are performed more than a year after loan closing, and therefore in somewhat of a "Monday Morning Quarterback" style. If the reviews were performed within the six month period following closing, it would be unlikely that an audit would require indemnification, but rather, guidance/assistance to the lender.

1B. Reimburse HUD the $346,181 on the two loans for which claims and fees have been paid that contained serious underwriting deficiencies.

Comment 6

REPLY: As noted earlier, the $346,181 was the amount that HUD paid as claims to the lender. The process of selling the homes has not yet occurred and therefore, HUD cannot ascertain

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whether it will suffer a loss on the properties. Without regard to the potential amount, based on our replies to the individual loan findings, we disagree that we should be held liable

Comment 7

1C. Reimburse borrowers for the $4,375 in ineligible fees.
REPLY: We disagree. These charges were fees collected by the loan correspondents and the absence of bills, etc. does not mean these are ineligible fees. We recommend that HUD contact the loan correspondents to request copies of the checks, etc. used to pay the appraisal and credit report bills.

Comment 8

1D. Work with the Homeownership Center to determine the eligibility of the $6,881 in unsupported fees charged borrowers. If the fees are determined to be ineligible, Security Atlantic should be required to reimburse the borrowers accordingly.
REPLY: As noted earlier, we believe that Security should not be held liable for commitment fees since Security did not charge these nor receive monies from the mortgagors. Instead, these were fees charged by the Loan Correspondents. We will attempt to contact and request from the Loan Correspondents the evidence of the written commitments or refunds of the fees, but cannot guarantee that we will be fully successful.

Comment 9

1E. 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.
REPLY: We do not believe a "correction action plan" is necessary. Security has continued to increase its market share of business and has closed more than 5,000 mortgage loans. During this time, we have continuously sought to review our procedures and make improvements as necessary. The fact that we have decided to have our QC performed internally is one of the major reasons we believe that we meet HUD (and all investor and State) guidelines, in addition to the fact that Mr. Jasinski has more than thirty years FHA and VA experience which he is now passing on to all Security staff via monthly meetings with the individual departments.

Comment 10

1F. Work with the Home Ownership Center to review the 5,106 loans with beginning amortization dates between October 1, 2002, and September 30, 2004, for ineligible commitment fees. If it is determined that borrowers were charged ineligible commitment fees, Security Atlantic should be required to reimburse borrowers or HUD, as applicable, for these fees.
REPLY: This would be a time-consuming and prohibitively expensive undertaking. Rather than holding the Sponsors responsible for these fees, we recommend that HUD consider monitoring and holding accountable the Loan Correspondents.

FINDING 2
Security Atlantic Violated he HUD Tier Pricing Rule

Comment 4

We disagree. Mortgagee Letter 94-16 notes that sponsors should be aware of their correspondents lending practices, and while Security attempts to do that, we cannot nor are we able to monitor our Loan Correspondents' pricing so as to preclude tiered pricing violations. We can, however, monitor and control pricing in our Retail Division since the pricing therein is within our control.

We believe that sponsors cannot be held accountable for monitoring/enforcing tiered pricing rules for their Loan Correspondents, but rather that HUD QC and/or OIG staff are in a position to better analyze that data directly from the Loan Correspondents.

This is a complex issue which is virtually impossible to monitor. Even if we were able to compare the pricing on one specific loan file submitted by a Loan Correspondent with a file we receive from another Loan Correspondent on the same day, we still would not be able to dictate to the first Correspondent (with a perceived higher priced loan) that he/she would have to reduce the fees or rate in order to meet Tiered Pricing rules. The Loan Correspondent would simply decide to retract the lock-in from Security and attempt to lock in that file with another of its sponsors. And, it could well be that the other Sponsor may not have received that day a file involving a property within the same MSA and therefore, not consider the lock-in to be a violation of tiered pricing.

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Based on the above, we completely disagree that Security should be held responsible for the alleged $60,547 overcharges, not only for the reasons cited herein, but also because we never received those funds.

If HUD could provide Sponsors with a suitable program that would help in this regard and one which would not require an inordinate amount of time to monitor, Sponsors would consider implementing that program. Meanwhile, rather than holding the Sponsors accountable for possible tiered pricing violations of Loan Correspondents, we recommend that HUD staff and auditors contact the respective Loan Correspondents and perform a tiered pricing test of their originated files in order to ascertain whether the alleged overcharges were indeed overcharges or that the Loan Correspondents fully complied with Mortgagee Letters 94-43 and 94-23.

FINDING 3
Security Atlantic Inadequately Implemented Its Quality Control Plan

As noted in the preamble to this reply, we pride ourselves on our Quality Control program, but recognize that we must always strive for improvement. We advised Mr. Zaccaria that we did not always review first payment defaulted loans because our investors do not provide us with such details, and therefore, our only recourse is to check the FHA Connection Neighborhood Watch. Unfortunately, we have not been as attentive to this part of the Quality Control plan, but did note that we were in the process of making this a routine part of our QC functions.

One interesting aspect of Finding 3 is that your report notes: "Quality control reviews of these early defaulted loans can provide valuable information about the causes of default that may indicate inadequate underwriting". As noted earlier, it does not appear to us that HUD is interested in checking the causes of default, but rather, focusing on the absence or incorrectness of certain documents.

Comment 3

We partially agree with your statement that "Management response to quality control reports was not always adequate". Earlier on in the QC process, management's method of correcting any deficiencies cited on QC reports was to meet with staff, issue internal advice memorandum, or provide staff with copies of procedures/documents that would have alleviated the deficiencies. A more pronounced and detailed management response procedure was initiated in 2004 and is now a standard requirement for all QC reports. Moreover, our QC Manager has been holding monthly meetings with all department staff, managers, and senior management for the purpose of reviewing deficiencies found during audits, reinforce existing policies and training, and provide detailed information for any new policies or procedures required by FHA or other insurers/investors.

As was noted by Mr. Zaccaria, it is our belief that because the QC program is now performed internally, future QC monitoring will meet FHA, VA, FNMC, and FHLMC requirements. We have had 9 formalized senior management responses out of the past 12 months, plus individual memos and instructions that were issued by senior management when significant issues were noted in the QC reports. Although these could possibly be considered inadequate, we believe that we have met spirit of HUD's (and other investors') QC requirements, and where we have found deficiencies, we have made every effort to correct the deficiencies.

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Appendix D

Case number: 351-4404800
Status: Reinstated by borrower who retains ownership

A. Inaccurate Debt to Income Ratios
B. Inadequate Disclosure of Liabilities
Response to A and B:
We agree that the $60 monthly recurring debt to CBUSA was not included, but disagree that the $388 monthly auto loan debt to Primus Financial should have been included. This auto loan was originated May 2001 and the mortgagor co-signed on behalf of his sister-in-law. HUD Handbook 4155.1, paragraph 2-11B2 permits lenders to disregard co-signed obligations if the lender can demonstrate a 12 month payment history having been made by the primary obligor and that there is no history of delinquency. Because Ms. Cynthia Sloan-Miller provided satisfactory evidence of having paid the previous 12 months, the underwriter did not include the debt.

Comment 11

By including the $60 recurring debt, the ratio is increased from 41.596% to 42.45%. Although the ratio exceeds HUD guidelines, we believe that this is a minimal increase which does not dramatically impact the overall approvability of the application.

C. Verification of Paid-Outside-Closing Cost Not Obtained
Response to C:
The HUD-1 form denoted that the applicants had paid the $74 pest inspection fee outside of closing, but Security did not require evidence of that payment. We recommend that HUD contact the Loan Correspondent to obtain a copy of that receipt. Additionally, because this was an FHA No Cash Out refinance transaction, the mortgagor was permitted to include closing costs (of which a pest inspection is part) in the mortgage amount – therefore, we did not have to verify that the applicant had the funds with which to pay this charge, but at worst, the Loan Correspondent would have to provide your office with a copy of the receipt.

D. Ineligible/Unsupported Commitment Fee
Response to D:
We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $495.

[redacted]

Case number: 352-4762508
Status: First legal action to commence foreclosure

A. Excessive Debt to Income Ratios without Compensating Factors
Response to A:
We agree that the underwriter failed to list compensating factors for these high ratios, but make note of the fact that since that time, HUD modified its allowable ratio guidelines to 31% and 43% respectively.

Comment 12

B. Inadequate Credit Analysis
Response to B:
We agree that there was no explanation regarding the Nelnet educational loan account, but in the overall, the absence of this explanation does not necessarily jeopardize the approval.

C. Inadequate Bank Account Documentation
Response to C:
We disagree. The file also contained a copy of Ms. Byrd's 6/14/02 to 7/16/02 statement (for account 94488888010) reflecting an opening balance of $173.15, deposits/credits of $3,633.38, withdrawals/debits of $2,418.49 and an ending balance of $1,287.04.

D. Inadequate Underwriting Documentation

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Response to D:
We agree. Additional clarifications should have been obtained regarding the marital status of Ms. Jones.

E. Verification of Paid-Outside-Closing Cost Not Obtained
Response to E:
When the file was underwritten, the borrowers' estimated closing costs were $385 due to the seller's payment of the borrowers' closing costs and prepaids. Therefore, there was no reason to verify that the buyers had paid the appraisal fee.

F. Ineligible/Unsupported Commitment Fee
Response to F:
We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

[redacted]

Case number: 352-4927551
Status: Reinstated by Borrower who retains ownership

A. Inadequate Compensating Factors
B. Inaccurate Debt to Income Ratios
C. Inadequate Disclosure of Liabilities
Response to A, B and C:
A. We agree that job stability and low mortgage payment to income ratio are not allowable factors. We further agree that the file did not contain documentation supporting the savings ability/history. We do note however, that the applicant's housing expense would increase from $700 monthly to $858 monthly, representing a very low 22% housing expense increase.
B. The inaccurate debt-to-income ratios was caused by not having included the $14 monthly Macy's payment. While we agree that this could be considered "inaccurate", the impact to the overall ratios was .01% and .41% respectively.
C. We agree that the Macy's debt was not included as a recurring liability.

D. Inadequate Support for Employment
Response to D:
Mr. Camacho was self-employed. The IRS tax return verification disclosed that he earned $46,538 wages and <$4,612> self-employment income in 2001, $68,361 (net) self-employed income in 2002, and $10,541 (net) self-employed earnings through April 14, 2003. We agree that the balance sheet was not included in the file, but believe that the 2002 reported IRS earnings combined with the P&L earnings through 2003

E. Inadequate Bank Account Documentation
Response to E:
We agree that our file did not contain the complete bank account documentation.

F. Verification of Deposit Not Obtained
Response to F:
Although the application denoted $5,300 with Sovereign Bank, we agree that the bank statements were not clear enough.

G. Inadequate Earnest Money Deposit
Response to G:
We agree.

Comment 13

H. Inadequate Funds To Close on Mortgage Credit Analysis Worksheet
Response to H:
We disagree. The MCAW did not include the prepaids because these were being paid by the seller.

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

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J. Verification of Paid-Outside-Closing Costs Not Obtained
Response to I and J:
The HUD-1 form denoted that the applicant had paid the $450 appraisal fee outside of closing, but Security did not require evidence of that payment. We recommend that HUD contact the Loan Correspondent to obtain a copy of that receipt. We agree that we did not verify the earnest money deposit, but disagree that this amount and the $450 appraisal fee should be added to the amount denoted on line 303 of the HUD-1.

K. Inadequate Origination Analysis of Nonprocessed Borrower
Response to K:

Comment 14

New Jersey law requires that a non-purchasing spouse execute the Mortgage in order to assure various rights for the lender and mortgagor. In this case, Mr. Camacho's application denoted that he was married, but that he would take title as a single man (this was the incorrect phrase). Therefore, Mrs. Camacho was not required to complete an application nor to execute the Note or be noted as a party to the Deed.

L. Verification of Debt Payments Not Obtained.
Response to L:
We agree.

M. Unsupported Credit Report Fee
Response to M:
We apparently do not have a complete set of copies for the credit reports. It appears that there were at least two report – one for $32 and another for $7.50.

N. Ineligible/Unsupported Commitment Fee
Response to N:
We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

[redacted]

Case number: 351-4420218)
Status: First legal action to commence foreclosure

A. Inadequate Compensating Factors
Response to A:

Comment 15

Mr. Smith and Ms. Harris were paying $1,325 rent. Their PITI for this subject home was $1,407. Although a recalculation shows the increase to be approximately 6.2%, we definitely agree with the underwriter that the 6.2% constituted a minimal housing increase. As for the ARM, HUD requires that lenders underwrite ARM files based on 1% above the stated interest rate unless the applicants have made a downpayment of 5% or more. Therefore, the underwriter was correct in using the Note rate to calculate the ratios. With regard to the downpayment, we concur that the 4155.1 handbook cites a 10% downpayment as being considered a compensating factor. Finally, we noted that the underwriter did not list the fact that the mortgagors had completed a homeownership course.

B. Inaccurate Debt to Income Ratios
C. Inadequate Support for Income Calculation
Response to B and C
Mr. Smith's overtime and bonus for 2001 and 2002 amounted to $30,439 which would produce a $1,268 monthly average. For the 2003 year-to-date, he averaged $1,567 overtime. Although it would be feasible to have used the $1,567 year-to-date overtime, the more prudent method of calculating this amount would be to average it for 2001, 2002 and 2003 year-to-date which produces $1,305. This average is lower than the $1,375 used by the underwriter and we can only conclude that the underwriter made a mathematical miscalculation.

D. Inadequate Credit Analysis
Response to D

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Mr. Smith used the term "ex-wife" to refer to his wife during the time they were married and had incurred these late payments. In other words, his wife was evidently the person they had agreed would pay the bills, but according to Mr. Smith, his wife failed to timely pay the debts. Although the divorce decree was undated, we concluded that it occurred sometime in early 2002 inasmuch as the file also contained copies of child support/custody documents dated December 2002. You are correct that the majority of the debts were in Mr. Smith's name, but with the exception of the FMCC loan, the delinquencies occurred during the time of his marriage.

E. Verification of Deposits Not Obtained

Response to E

We obtained a copy of the Wachovia statement from 5-6-03 to 5-21-03 which reflected a balance of $10,223.38

F. Verification of Gift Not Obtained

Response to F

There was no gift involved in this transaction. The applicants had withdrawn $6,324 from Mr. Smith's ADP 401K plan, deposited that into Ms. Harris's account, and then Ms. Harris wrote a check payable to herself for the $11,500. The funds were in her account.

[redacted]

Case number: 351-4475365([illegible])
Status: First legal action to commence foreclosure

A. Excessive Debt to Income Ratios without Compensating Factors

Response to A:

The application was approved under the FHLMC Loan Prospector automated underwriting system. Therefore, no compensating factors were required.

B. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet

Response to B:

Mr. Talas had an account with the Wentworth Group which denoted equity of $8,967 as of July 25, 2003. Additionally, his First Union checking account statement for June 17, 2003 reflected a balance of $873.44. We agree that there may have been a double crediting of assets.

Comment 16

C. Verification of Gift Not Obtained

Response to C:

Mr. Talas had planned to obtain a gift, but then changed his mind and instead, cashed in certain stocks/bonds from his Ameritrade account.

D. Closing Not in Compliance with Loan Approval

Response to D:

We agree the HUD-1 listed $2,100 as the earnest money rather than the $2,000 that was listed on the MCAW. The file contained a letter signed by RE/MAX Realty agency which denoted $2,100 as the earnest money, and our underwriter should have specified this amount rather than the $2,000. As for the reduced discount points, it appears that this was our error because the original MCAW submitted by the Loan Correspondent denoted $1,349.95 as the estimated discount points.

E. Verification of Paid-Outside-Closing Costs Not Obtained

Response to E:

As noted in other file responses, Security does not request evidence of the POC items.

F. Ineligible/Unsupported Commitment Fee

Response to F:

We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

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[redacted]

Case number: 352-4877503
Status: Reinstated by borrower who retains ownership

A. Inadequate Compensating Factors
Response to A:
Although we agree that the 10% housing expense increase was incorrect, the actual increase of 25% is still considered "minimal". HUD Handbook 4155.1 does not provide any guidelines as to what should be considered "minimal", but rather, leaves this to the discretion of the underwriter. We agree that the 5% downpayment was not a compensating factor.

B. Inadequate Support for Employment
Response to B:
We had previously addressed these issues to the Philadelphia HOC. For your clarification, we did contact the new employer and confirmed that Ms. Williams did in fact begin work with the U.S. Attorney's Office, but has since left.

Comment 17

The late credit card payments occurred in September 2002. The mortgagor had worked at Mintz, Levin, Cohn Ferris, Clovsky from 9/1/00 to 7/31/2002 and then worked at Boston University from 9/1/2002 till shortly before the application when she was offered the position with the US Attorney's office. The time period in question was August 2002 when she was "between jobs".

C. Inadequate Credit Analysis
Response to C:
Ms. Williams had been a co-mortgagor for her mother. That mortgage was originated November 1998 and during the 48 month period of review, there had been 4-30 day lates, 3-60 day lates, and 2-90 day lates all of which occurred between July and November 2000. Ms. Williams explained that these were the result of difficult financial stress that her mother had encountered, and the underwriter believed this was a valid explanation. Ultimately, this loan was paid in full prior to Ms. Williams having closed on her new FHA mortgage.

D. Inadequate Bank Account Documentation
Response to D:
We agree that there were some missing pages of Ms. Williams' Fleet Bank Account. However, the online printout as of 12/19/2002 did reflect the $10,000 deposit she'd made to her account from the proceeds of the sale of her mother's home.

E. Nonitemized Lender Credit
Response to E:
We agree that the HUD-1 and the GFE should have broken down the allocation of the $700 lender credit. However, absent the $700 credit, Ms. Williams still had sufficient fund with which to close the loan.

[redacted]

Case number: 352-5089740
Status: Property conveyed to insurer

Comment 18

A. Inaccurate Debt to Income Ratios
B. Inadequate Disclosure of Liabilities
C. Inadequate Support for Income Calculation
Response to A, B and C:
We agree that the overtime and bonus was miscalculated, and that one debt was not included. However, the 7-25-03 year-to-date paystub reflected $27,968 as the earnings thus far which would have produced a monthly income averaged at $4,302. Thus, the income was not

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overstated by $532 as you noted on your report, but rather $354 (an overstatement nevertheless)

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

Response to D:

Ms. Monroe's Fleet account reflected a $5,174.36 balance which was based on the $3,274.36 she had in the account plus the $2,000 gift funds that had not been confirmed as of August 19th.

E. Ineligible/Unsupported Commitment Fee

Response to F:

We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

[redacted]

Case number 352-4894655 (I)

Status: Reinstated by borrower who retains ownership

A. Excessive Debt to Income Ratio with Inadequate Compensating Factors

Response to A:

We agree that the ratios were high and that there were no strong compensating factors to offset these. However, it is important to note that the borrower had two jobs for more than 3 ½ years. Her daughter "helped" her mother by giving the borrower the monthly $583 social security check the daughter received for her son, Leonard. As for the credit scores, it has been HUD's requirement that credit scores not be considered in underwriting analysis, but rather that the underwriter look at the whole credit picture including explanations provided by the borrower.

Comment 19

B. Verification of Gift Not Obtained

Response to B:

We agree

C. Verification of Paid-Outside-Closing Cost Not Obtained

Response to C:

As note in other replies, we do not verify these payments.

D. Unsupported Credit Report Fee

Response to D:

As note in other replies, we do not verify these payments.

E. Ineligible/Unsupported Commitment Fee

Response to E:

We will attempt to contact the mortgage broker to request a copy of the commitment or evidence of refund.

[redacted]

Case number: 352-5069903

Status: First legal action to commence foreclosure

A. Excessive Debt to Income Ratios with Inadequate Compensating Factors

Response to A:

The essence of the underwriter's compensating factors was that Mr. Hamue had virtually depleted his savings in order to help his mother rebuild her home after his father had died. Since Mr. Hamue had an interest in the property (albeit through his mother), the underwriter believed that with his purchase of the home, Mr. Hamue would be an even stronger mortgagor.

Comment 20

B. Inadequate Funds to Close on HUD-1 Settlement Statement

Response to B:

We agree that the HUD-1 did not properly identify the seller's gift of equity. However, our file documents did denote that Mr. Hamue's mother (the seller) would provide him with whatever amount was necessary in order to consummate the transaction.

C. Verification of Paid-Outside-Closing Cost Not Obtained

Response to C:

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As noted within other responses, it has been Security's policy to require loan officers to have collected the appraisal and credit report fees prior to accepting an application.

D. Closing Not in Compliance with Loan Approval

Response to D:

We agree that the HUD-1 was improperly prepared inasmuch as it did not disclose the concession nor the gift of equity.

E. Unsupported Credit Report Fee

Response to E:

The HUD-1 reflected the buyer having been charged $58 for the credit report ($53 POC and $5 at closing), but the file did not contain a copy of the bills. We can conclude that these were legitimate charges, but agree that our file does not contain a copy of the bills.

F. Ineligible/Unsupported Commitment Fee

Response to F:

We agree. Since the mortgagor is presently in foreclosure, please advise if Security should issue its check (reimbursement for the $495 commitment fee) payable to the servicer or HUD.

[redacted]

Case number: 352-5083379

Status: Foreclosure completed

A. Inaccurate Debt to Income Ratios

B. Inadequate Support for Income Calculation

Response to A and B:

Comment 21 *We agree that the underwriter didn't properly calculate the foster care income, but disagree that there was an adverse impact on the housing ratios.*

C. Inadequate Support for Employment

Response to C:

Foster care income is non-reportable and therefore not taxed. The underwriter relied on the confirmation letter from Tri-City People's Corporation plus the copies of the "paystubs" that Ms. Files had provided as evidence of receipt of the foster care income.

D. Closing Not in Compliance with Loan Approval

Response to D:

We agree that the seller's concession on the HUD-1 was slightly higher than the amount noted on the MCAW, and that the mortgage amount was lower than that noted on the MCAW.

E. Inadequate Documentation of Earnest Money Deposit

Response to E:

As noted in other deficiency replies concerning this issue, it has been and continues to be Security's requirement that loan officers collect the appropriate appraisal and credit report fees prior to accepting mortgage applications.

F. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet

Response to F:

The prepaids and discounts were not shown because the underwriter considered those to be part of the seller's concession. (We have since advised our underwriters of the correct procedure). As for the $433, please see our reply to E above)

G. Inadequate Funds to Close on HUD-1 Settlement Statement

H. Verification of Paid-Outside-Closing Costs Not Obtained

Response to G and H:

Apart from your logic regarding the $433, we agree that the file did not contain sufficient asset verifications.

Comment 22

I. Inadequate Credit Analysis

Response to I:

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Ms. Files provided us with her August 4, 2003 credit explanation letter. A copy is being separately faxed to your office.

J. Inadequate Bank Account Documentation

K. Verification of Deposits Not Obtained

Response to J & K:

Ms. Files explained that the deposits were sourced from the foster children checks plus money she'd earned from babysitting for two children in the neighborhood. We agree that this should have been verified.

L. Ineligible/Unsupported Commitment Fee

Response to L:

We agree. Since the foreclosure has been completed on this mortgagor, please advise to whom Security should make the commitment refund check payable.

[redacted]

Case number: 352-5094184

Status: First legal action to commence foreclosure

A. Inadequate Compensating Factors

Response to A:

We disagree. Ms. Cruz appeared to be a determined saver as was reflected on her bank statements and her Investco 401K plan account.

B. Inadequate Reserves after Closing

Response to D:

Ms. Cruz 's Fleet account reflected a $13,184.82 balance as of October 10, 2003. The HUD-1 disclosed that she needed $10,515 at closing which therefore would have left her with approximately $2,800 reserves. The MCAW denoted Ms. Cruz to have $17,827 which consisted of her funds at Fleet Bank and her 401K plans with Investco, and therefore, Ms. Cruz's reserves met HUD requirements.

C. Closing Not in Compliance with Loan Approval

Response to C:

The underwriter credited Ms. Cruz with $503 for the appraisal and credit report, but did not credit her with the $1,000 earnest money deposit. Instead, the underwriter calculated the total money needed by Ms. Cruz to be approximately $9,767 which was offset by $17,827 assets.

Comment 23

D. Inadequate Credit Analysis

Response to D:

The underwriter concluded that Ms. Cruz's explanation made sense given the fact that the account in question had been reviewed more than 25 months, which when combined with her other credit history, showed that the late payments were the exception rather than the rule.

E. Verification of Deposits Not Obtained

Response to E:

We agree that there were numerous non-payroll deposits and that we did not obtain confirmation/verification of the source of these. The underwriter is no longer with Security, but it appears that she did not require the verification of these because the majority were under $900 combined with the fact that the credit report did not disclose any new loans.

F. Verification of Paid Outside Closing Costs Not Obtained

Response to F:

Our file contained a copy of the $503 check Ms. Cruz paid for the appraisal and credit report. A copy has been separately faxed to you.

G. Ineligible Shipping Fee

Response to G:

We agree and will arrange to have our check for $50 sent to the servicer and applied to the principal balance.

H. Unsupported Credit Report Fee

Response to H:

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation | **Auditee Comments**

The total credit report fee included the cost of the LP credit report.

[redacted]

Case Number: 352-5097014
Status: Forbearance

A. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet
Response to A:
The $433 was for the appraisal and credit report.

B. Inadequate Funds to Close on HUD-1 Settlement Statement
Response to B:

Comment 24

The HUD-1 reflected the $6,581 due at closing. You are correct that the file documents only verified $5,874 which therefore made the mortgagors short $707 at closing, and while we would agree that this may have been a cause for concern, we do note that the mortgagors combined monthly income of $6,036 would easily permit them to save this $707 from one or two of their paychecks.

C. Verification of Paid-Outside-Closing Cost Not Obtained
Response to C:
We do not have available the copies of the respective appraisal and credit report bills. However, please be assured that it has been and continues to be Security's policy that loan officers may not take an application unless the loan officer has received the appraisal and credit report fees.

D. Ineligible/Unsupported Commitment Fee
Response to D:
We agree that the commitment fee was ineligible. Please advise whether we should issue a refund check to the mortgagors or have this money applied to the principal balance.

[redacted]

Case number 352-4957069
Status: First legal action to commence foreclosure

Comment 25

A. Excessive Debt to Income Ratios without Compensating Factors
B. Inaccurate Debt to Income Ratios
C. Inadequate Support for Income Calculation
D. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet
E. Closing Not in Compliance with Loan Approval
F. Ineligible/Unsupported Commitment Fee

Response to all issues:
We have been unable to locate our copy package of this file and therefore request that you send us a copy. We apologize and trust you will understand that mistakes do happen

[redacted]

Case number: 352-5090016
Status: Reinstated by borrower who retains ownership

A. Inadequate Earnest Money Deposit Documentation
Response to A:

Comment 26

We agree. The file documents reflect that the borrowers were to receive a gift, but we are unable to locate the documents which would support this.

B. Verification of Deposits Not Obtained
Response to B:

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation | **Auditee Comments**

As noted in A, we agree.

C. Verification of Paid-Outside-Closing Cost Not Obtained

Response to C:

As noted in other file replies, we do not require verification of these funds.

D. Ineligible/Unsupported Commitment Fee

Response to D:

We will contact the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

[redacted]

Case number: 352-4835578 ( )
Status: Reinstated by borrower who retains ownership

A. Inaccurate Debt to Income Ratios

B. Inadequate Compensating Factors

Response to A and B:

Comment 27

Mr. Batista worked for Wakefern Food Corp. and was verified to receive $11.00 hourly. His year-to-date pay as of January 17, 2003 was $1,067 base plus $891 overtime and $176 "other". It was unfair of the auditors to average Mr. Batista's income during the previous years because those earlier amounts were most likely based on a lower hourly rate. Therefore, we believe the underwriter was correct in how she calculated Mr. Batista's base income. As for the overtime, "other" and bonus incomes, averaging these over the periods noted on the verification of employment would have been the sound method since the employment verification did not provide details about the continuity of either/both these amounts. This would produce a two year history of $6,923 for the two years averaged to $290 monthly. Interestingly, Mr. Batista's January 17th total of these amounts was $1,067 which if averaged on a full year's basis would have produced $12,804. However, because we did not fully develop this information, it is our belief that in a worst case scenario (using $1,906 base and $290 overtime/other/bonus), the total gross monthly income would have been $4,330 rather than the $4,359 denoted on the MCAW. This in turn would have produced ratios of 35.98% and 42%. We agree that the "borrowers have excellent credit" is not a valid compensating factor.

C. Ineligible/Unsupported Commitment Fee

Response to C:

We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

[redacted]

Case number: 352-4919530 (
Status: Case no longer active – claim without conveyance of title

A. Excessive Debt to Income Ratios without Compensating Factors

Response to A:

We agree that the underwriter failed to include compensating factors.

Comment 28

B. Inadequate Verification of Sales Proceeds for Present Property

Response to B:

We agree. However, we did follow up and were able to obtain a copy of the HUD-1 for this sale.

C. Verification of Deposits Not Obtained

Response to C:

Although we agree that lenders are usually required to obtain an explanation as to the source of any large increases in an applicant's bank account, the underwriter elected not to pursue this due to the applicant's sale of their previous home with a net proceeds of more than $10,000.

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation	Auditee Comments

[redacted]

Case number: 352-4961335
Status: Delinquent

A. Inadequate Earnest Money Deposit Documentation
Response to A:
The source of the earnest money deposit was a refund of monies that the applicants had given on another property on which they did not consummate the transaction. We agree that we should have further checked this, but here was already a gap of about 4 months, and therefore, the underwriter did not believe any further details should be obtained since there were no new loans reported on the credit report. As to the difference noted on the HUD-1 versus the letter we received from the seller's attorney, we can only believe that the additional $500 was money held in the real estate broker's trust account, but again agree that we should have verified this.

Comment 29

B. Ineligible/Unsupported Commitment Fee
Response to B:
We have sent a fax to the Loan Correspondent to request that they provide us with either a copy of the firm written commitment or evidence of the refund of the $395.

C. Inadequate Underwriting Documentation
Response to C:
Mr. Luciano worked for Dru Whitacre Media Services from January 28, 2003 until the VOE date of 6/20/03. Prior to that, he work for Glenn Wood Mgt. Corp from 6/4/02 to 12/16/02, Hands On Production from 4-24-02 to 9-3-02, and Staging Techniques from 2-8-00 to 10-26-02. The 2002 W-2 forms in the file from 80th Realty LLC, Arwin 74th St., LLC, Showorkz Enterprise, Ltd, York Avenue Corp, Hamilton Realty, LLC, Columbus 80th Realty, LLC, and Matthew David Events, Ltd., suggest that Mr. Luciano may have truly been "self-employed" rather than payroll-employed, and the underwriter should have followed up on these discrepancies.

[redacted]

Case number: 352-5010076
Status: Delinquent

A. Verification of Gift Not Obtained
Response to A:
Reply: We do not disagree that there was no gift letter. However, in "gift of equity" transactions between family members, this "gift" is generally noted on the contract of sale. In this case, the contract contained the initials "GOE" and based on that and the fact that the parties were mother and son, we believe that there was no need to obtain a formal gift letter.

Comment 30

B. Verification of Paid-Outside-Closing Cost Not Obtained
Response to B:
Reply: As noted in replies to this issue for other files, we have not requested evidence of the appraisal and/or credit report fees having been paid since the underwriter did not credit these amounts on the MCAW.

C. Ineligible/Unsupported Commitment Fee
Response to C:
Reply: We will contact the mortgage broker to request a copy of the commitment letter or refund.

[redacted]

Case number: 352-5052966
Status: Repayment

A. Verification of Deposits Not Obtained
Response to A:

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Appendix B

Auditee Comments and OIG Evaluation

Ref to OIG Evaluation	Auditee Comments
	We agree that the underwriter should have obtained clarification/verification of the source of the additional deposits.
Comment 31	B. Inadequate Evaluation of Savings Pattern *Response to B:* *We agree.* C. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet *Response to C:* *We agree.* D. Inadequate Funds to Close on HUD-1 Settlement Statement *Response to D:* *We agree.*
	[redacted] Case number: 352-5033337 Status: Foreclosure completed
Comment 32	A. Inaccurate Debt to Income Ratios B. Inadequate Support for Income Calculation C. Inadequate Support for Employment D. Closing Not in Compliance with Loan Approval E. Verification of Paid-Outside-Closing Costs Not Obtained F. Inadequate Credit Analysis G. Inadequate Disclosure of Liabilities H. Inadequate Verification of Power of Attorney I. Nonitemized Lender Credit J. Inadequate Underwriting Documentation *Response to All items:* Security has already agreed to indemnify HUD (via the Philadelphia HUD HOC)
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Appendix B

Auditee Comments and OIG Evaluation

Comment 1 Our report responds to the audit objectives to determine whether Security Atlantic approved insured loans and implemented a quality control plan in accordance with HUD requirements for the tested loans during the review period. As such, the conclusions address deficiencies and weaknesses in Security Atlantic's underwriting and quality control processes as measured against HUD requirements. When appropriate, we have recognized improvements made by Security Atlantic, and recommended additional measures to ensure that Security Atlantic complies with these requirements. As such, our objective is not to drive a company out of business, but to help eliminate future underwriting deficiencies so that a business may continue to function efficiently as a Federal Housing Administration approved lender.

Comment 2 Our report cites the default rate for loans originated during our audit period, October 1, 2002 through September 30, 2004, in order to provide the reason that Security Atlantic was selected for audit. This rate will fluctuate over time in response to the both the number of loans originated and the default history.

Comment 3 During the review period, Security Atlantic did not implement its quality control plan in accordance with HUD regulations that require loans that default within six months to be reviewed, and management responses to quality control findings to be timely. However, our report points out the actions and improvements that Security Atlantic has taken to improve its quality control process. As such, our report is not inaccurate and unfair.

Comment 4 Security Atlantic maintains that it cannot be held responsible for monitoring/enforcing tiered pricing rules for its loan correspondents, and should not be responsible for the alleged $60,547 overcharges because it never received those funds. However, HUD Handbook 4060.1 REV-1, section 3-4A(1) holds the sponsor responsible for the actions of its loan correspondents in originating insured mortgages. A sponsor is required to supervise and perform quality control reviews of its loan correspondents to assure that they comply with the HUD loan origination requirements. Mortgagee Letter 94-43 states that lenders should determine that any permitted overage does not violate the tier-pricing rule, and include in their quality control program a system to monitor and supervise overage activities to prevent violations. Further, Security Atlantic's quality control plan states that it will exercise strong oversight to monitor overages and tier pricing by its loan officers.

Comment 5 We recommended indemnification for cases in which we believe the significance of the underwriting deficiencies adversely affected the risk assumed by the Federal Housing Administration insurance fund. This decision was based upon criteria in HUD regulations and additional guidance promulgated by HUD. In its response to each case noted in Appendix D, Security Atlantic provided additional documents and information that was not previously available. As a result of this information, we deleted indemnification requests for three loans.

Comment 6 Security Atlantic provided a HUD-1 that evidences sale of the borrower's previously owned property; consequently, we have deleted a request for payment of a claim on this case. Reimbursement to HUD for the other claim paid and any associated fees should be made as per HUD regulations.

Comment 7 The $4,375 represents commitment and shipping fees charged which are not allowable charges as per HUD regulations. These fees should be refunded to the borrowers regardless of whether Security Atlantic or its loan correspondents charged the borrowers.

Comment 8 The $6,874 represents commitment and credit report fees for which there was no support in the file. Security Atlantic believes that it should not be liable for commitment fees charged by its loan correspondents. However, three of the 16 cases with unsupported commitment fees were originated by Security Atlantic, as were three of the five loans with unsupported credit report fees. Regardless of who originated the loans, if these are unsupported fees, the borrowers should be reimbursed.

Comment 9 While we recognize, and acknowledge in the report, that Security Atlantic has taken action to improve its quality control process, we believe that Security Atlantic needs to specifically detail how it has, or plans to, ensure that the underwriting deficiencies found in the cases reviewed will be addressed.

Comment 10 Given the high incidence (80.6 percent) of ineligible and/or unsupported commitment fees that we found in the 31 cases reviewed, we believe that Security Atlantic and the HOC need to further determine the extent to which borrowers may have been charged ineligible and unsupported fees.

Comment 11 Regarding issues A and B, Security Atlantic agreed that a $60 recurring debt was excluded, but did not believe the $388 debt should be included because there was evidence of satisfactory payment during the previous 12 months. However, the satisfactory payment refers to another loan on which the borrower was a co-signor, and was properly excluded. The $388 debt evidenced two delinquencies within the past 12 months, and therefore should have been included. We deleted reference to the verification of paid-outside closing costs in issue C.

Comment 12 The borrower had two bank accounts at Fleet Bank, for which there were two statements as noted by Security Atlantic, but only one statement for the other account, which was not addressed by Security Atlantic in issue C. Concerning issue E, the HUD-1 noted that the borrower paid a $379 appraisal fee outside closing that was not verified.

Auditee Comments and OIG Evaluation

Comment 13 The $1,002 prepaid items noted in issue H were accounted for as a seller concession, after which we calculated that the borrower had inadequate funds to close.

Comment 14 Reference to inadequate origination of a nonprocessed borrower was deleted because of the New Jersey State law governing non-purchasing spouses.

Comment 15 HUD regulations do not specifically cite taking a homeownership course as a compensating factor as noted by Security Atlantic to issue A. Concerning the calculation of overtime in issues B and C, we computed an average ($1,227) for a two-year period, and can not determine how Security Atlantic computed $1,305. With regard to inadequate credit analysis in issue D, the late payments occurred after the separation agreement, and some even after the presumed divorce decree in early 2002. Concerning issue F, if the $11,500 were not a gift as Security Atlantic states, then the borrower would not have had sufficient funds to close. With the $7,633 bank asset that already included the fund from the borrower's 401k plan, the borrowers could not afford $13,137 cash due on HUD-1. In addition, there is no support for the check the co-borrower made to herself as mentioned in item F.

Comment 16 Regarding issue A, although Loan Prospector was used to process the loan, which would not require compensating factors, proper application of Loan Prospector requires data integrity. The file contained a Loan Prospector Feedback Certificate that listed a different property address and different mortgage amount from that for which the loan was processed. Further, the closing occurred more than six months after the processing through Loan Prospector in violation of HUD Handbook 4155.1, REV-4, CHG 1, section 3-1. Regarding issue C, if the $10,000 was not a gift, but derived from the proceeds of stock sales, these proceeds were not properly sourced and verified.

Comment 17 Based upon additional information provided by Security Atlantic, we deleted the inadequate support for employment deficiency. Concerning inadequate credit analysis, we do not believe that an adequate explanation was obtained as to why the borrower, as co-mortgagor on another mortgage, had not made the payments. Nevertheless, we have deleted reference to this deficiency since the mortgage had been paid in full prior to the closing of the current loan.

Comment 18 Concerning issues A, B and C, Security Atlantic erroneously calculated overtime/bonus income based upon a year-to-date statement; HUD regulations require that a 2-year average be used. Based upon the information provided by Security Atlantic, we deleted the inadequate funds to close deficiency.

Comment 19 Auditee concurs.

Auditee Comments and OIG Evaluation

Comment 20 There were inadequate compensating factors to justify a back ratio of 55.9 percent.

Comment 21 HUD Handbook 4155.1, REV-4, CHG 1, section 2-7 requires that if income is used to qualify as other than a compensating factor, a determination must be made as to the likelihood that it will continue; as Security Atlantic agreed, this was not done.

Comment 22 Security Atlantic subsequently provided the borrower's credit explanation letter; consequently, we deleted this deficiency.

Comment 23 Regarding compensating factors, the late credit card payments and unexplained deposits contradict the assertion that there was sufficient evidence of a determined saver to compensate for a back ratio of 50.83 percent. Since the borrower's 401k plan would be allowable as reserves after closing, we have deleted the inadequate reserves after closing deficiency. While the late payments noted in the inadequate credit analysis deficiency were within two years of closing, we have eliminated this deficiency based upon the borrower's explanation. We also eliminated the verification of paid outside closing deficiency after Security Atlantic provided a copy of the check used to pay the paid-outside-closing items.

Comment 24 Although Security Atlantic could not produce evidence that the paid-outside closing costs were paid or that the borrower had the $707 needed to close, we have deleted the case because of the minimal amounts involved.

Comment 25 Auditee unable to locate case file, therefore no comments were provided.

Comment 26 Auditee concurs.

Comment 27 Security Atlantic provided documentation to support most of the calculation of the borrowers' income. The unexplained difference had a minimal impact upon the qualifying ratios. Although Security Atlantic admitted that the compensating factor was inadequate, we deleted this case because the back ratio would be 42 percent, which although in excess of the HUD guidelines in effect at the time, is below the current threshold for which a compensating factor is required.

Comment 28 Security Atlantic advised that it has obtained a copy of the HUD-1 for the sale of the borrowers' prior property; accordingly, we have deleted this case pending receipt of the HUD-1.

Comment 29 Auditee concurs.

Comment 30 We deleted this case because, although there was no gift letter, the contract of sale recorded the gift of equity.

Auditee Comments and OIG Evaluation

Comment 31 Auditee concurs.

Comment 32 Auditee concurs

SUMMARY OF LOANS WITH SIGNIFICANT DEFICIENCIES

FHA Case #	351-4404800	352-4762508	352-4927551	351-4420218	351-4475365	352-4877503	352-5089740	352-4894655	352-5069903	352-5083379	352-5094184	352-4957069	352-5090016	352-4961335	352-5052966	352-5033337	Total Loans
Mortgage Amount ($)	128,981	141,175	100,424	214,801	120,531	164,112	159,756	188,680	422,890	157,426	238,500	253,953	275,674	211,678	263,088	166,639	$3,208,308
Payments Before First Default	n/a	8	6	6	0	2	8	n/a	4	1	5	n/a	1	7	8	1	
Areas of Deficiencies:																	
Qualifying Ratios and Compensating Factors																	
Excessive Debt To Income Ratios Without Compensating Factors		x			x			x	x			x					
Inaccurate Debt To Income Ratios	x		x	x			x			x		x				x	
Inadequate Compensating Factors			x	x		x					x						
Inadequate Disclosure Of Liabilities	x		x				x									x	13 Loans
Inadequate Verification of Funds To Close																	
Verification Of Gift Not Obtained				x	x			x									
Verification Of Debt Payments Not Obtained			x														
Verification Of Deposit Not Obtained			x	x						x	x		x		x		
Verification Of POC Cost Not Obtained		x	x		x			x	x	x			x			x	
Inadequate Bank Account Documentation		x	x			x				x							
Inadequate Earnest Money Deposit Documentation			x							x			x	x			
Inadequate Funds To Close On MCAW			x		x					x		x			x		
Inadequate Funds To Close On HUD-1			x						x	x					x		
Inadequate Evaluation of Savings Pattern															x		
Inadequate Verification of Sales Proceeds for Present Property																	
Closing Not In Compliance With Loan Approval					x				x	x	x	x				x	14 Loans

SUMMARY OF LOANS WITH SIGNIFICANT DEFICIENCIES

FHA Case #	351-4404800	352-4762508	352-4927551	351-4420218	351-4475365	352-4877503	352-5089740	352-4894655	352-5069903	352-5083379	352-5094184	352-4957069	352-5090016	352-4961335	352-5052966	352-5033337	Total Loans
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Payments Before First Default	n/a	8	6	6	0	2	8	n/a	4	1	5	n/a	1	7	8	1	
Areas of Deficiencies:																	
Inadequate Verification of Income/Employment																	
Inadequate Support For Income Calculation				X			X			X		X				X	
Inadequate Support For Employment			X							X						X	6 Loans
Credit History																	
Inadequate Credit Analysis		X		X												X	
Inadequate Verification of Rent																	3 Loans
Other Processing Procedures																	
Inadequate Origination Analysis Of Non-Processed Borrower																	
Inadequate Underwriting Documentation		X												X		X	
Inadequate Verification of Power of Attorney																X	
Missing Real Estate Certification																	
Non-Itemized Lender						X										X	4 Loans
Indemnification Recommended	Yes	Yes	Yes	Yes	Yes	Yes	1/	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	$3,048,552

Note: 1/ A claim of $171,053 (mortgage amount of $159,756 plus associated fees) was paid, for which reimbursement is recommended.

Appendix D

NARRATIVE CASE PRESENTATIONS

Case number:	351-4404800
Loan amount:	$128,981
Settlement date:	April 23, 2003
Status:	Reinstated by borrower who retains ownership

Pertinent Details

A. Inaccurate Debt to Income Ratios
B. Inadequate Disclosure of Liabilities

The ratios calculated by Security Atlantic were incorrect because two debts were omitted, which caused a $448 understatement of liabilities. After considering this deficiency, we calculated the debt to income ratios to be 16.36 and 48.03 percent, respectively. The borrower cosigned for a loan of $15,698, giving the borrower liability exposure of $388 per month. In addition, the underwriter did not include a recurring liability of $60 per month on a balance of $2,463 owed by the borrower. HUD Handbook 4155.1, REV-4, CHG-1, section 2-11A, provides that the lender 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.

C. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. However, the case file did not contain a lock-in agreement for the $495 paid by the borrower on April 23, 2003 (closing date).

Case number: 352-4762508
Loan amount: $141,175
Settlement date: November 8, 2002
Status: First legal action to commence foreclosure

Pertinent Details

A. Excessive Debt to Income Ratios without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, provide 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 lender identifies compensating factors to justify exceeding these ratios. Security Atlantic computed debt to income ratios of 30.53 and 42.70 percent, respectively, without listing compensating factors.

B. Inadequate Credit Analysis

HUD 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. Security Atlantic did not obtain an explanation for three delayed payments in the borrower's Nelnet account.

C. Inadequate Bank Account Documentation

Handbook 4155.1, REV-4, CHG 1, section 3-1 F, provides that as an alternative to obtaining a verification of deposit, the lender may choose to obtain original bank statements for the most recent three-month period. Security Atlantic chose the alternative methodology, and while there were bank statements for the borrower for a three-month period, there was one statement for the coborrower covering the period July 17 to August 15, 2002.

D. Inadequate Underwriting Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1, provides that when standard documentation does not provide enough information to support a decision, the lender must provide additional explanatory statements, consistent with information in the application, to clarify or supplement the documentation submitted by the borrower. Security Atlantic should have clarified questions about the marital status of the borrower. While the file contained an application indicating that the borrower was married, the mortgage note indicated that the borrower was unmarried. In addition, the file contained a gift letter from the borrower's husband.

E. 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 a $379 appraisal fee outside of closing. However, there was no documentation to show that this had been paid before closing without reducing the funds available to close.

F. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $395, included on the HUD-1 settlement statement, was paid by the borrower to Sunset Mortgage on November 8, 2002 (closing date). However, the lock-in agreement, dated July 25, 2002, disclosed that the borrower did not choose to lock-in the interest rate or discount points. Consequently, the $395 is an ineligible fee.

Case number:	352-4927551
Loan amount:	$100,424
Settlement date:	May 13, 2003
Status:	Reinstated by Borrower who retains ownership

Pertinent Details

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

HUD Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, provide 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 lender identifies compensating factors that could justify exceeding these ratios. Security Atlantic computed ratios of 25.14 and 46.13 percent, respectively. "Job stability, low mortgage payment to income ratio, and saving ability" were listed as compensating factors. However, job stability and low mortgage to income ratio are not allowable compensating factors as defined in section 2-13. In addition, the file did not contain appropriate documentation supporting the borrower's saving ability or history. Further, the ratios calculated by Security Atlantic were incorrect because a monthly liability of $14 was not factored into the calculation of the ratios. Including this liability in the ratio calculation would increase the debt to income ratios to 25.15 and 46.54 percent, respectively.

D. Inadequate Support for Employment

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 the file contained a profit-and-loss statement, a balance sheet was not included.

E. Inadequate Bank Account Documentation
F. Verification of Deposit Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 3-1F, provides that the file must include verification of deposit and most recent three-month bank statements. The file did not contain bank statements to document the $6,100 personal funds listed on the borrower's application form, which were needed for closing. Section 2-10B provides that if there is a large increase in a bank account or the bank account was opened recently, the lender must obtain an explanation and evidence of the source of funds from the borrower. The file contained a bank statement from the borrower's business account, which was opened on March 19, 2003, two months before the closing date. However, no verification was obtained for four large deposits ($1,508 on March 19, 2003, $1,880 on April 3, 2003, $1,300 on April 11, 2003, and $2,780 on April 23, 2003). The available balance of $1,514 in this business account on April 28, 2003, was needed for closing.

G. Inadequate Earnest Money Deposit

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 lender must verify the amount of deposit and the source of funds. The mortgage credit analysis worksheet contained an earnest money deposit of $500. Since the file did not contain adequate bank documentation as stated in section E, we conclude that there was insufficient documentation to support the borrower's history of accumulating savings. As a result, the $500 earnest money needs to be explained.

H. 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 a property equals 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, section 2-10 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 prepaid expenses of $1,002 as stated on the good faith estimate. After offsetting against the seller concession, which was the only funds available to the borrower due to the unverified personal bank assets (refer to section E), the borrower would have a negative cash reserve of $2,012.

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

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, provides 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. The file did not contain documentation to show that a paid-outside-closing appraisal fee of $450 had been paid without reducing the funds available to close. Cash due from the borrower on the HUD-1 settlement statement was $2,913. If the total $450 paid outside of closing and $500 unverified earnest deposit (see section G) are added to the $2,913 owed by the borrower, the borrower has a $3,864 deficit at closing without appropriate verification of the $6,100 personal funds in the bank (see section E).

K. Verification of Debt Payments Not Obtained.

HUD Handbook 4155.1, REV-4, section 1-7B requires that certain other expenses paid on behalf of the borrower and other inducements to purchase result in a dollar-for-dollar reduction to the sales price before applying the appropriate LTV ratio. The HUD-1 settlement statement listed that the borrower satisfied a $2,010 debt to New Jersey Family Support Center on the date of closing. However, the file contained no support that the funds used to pay the debts originated from the borrower's bank account. The borrower did not have enough funds to close as mentioned in section I.

L. 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 that cost $39. However, the borrower was charged $60 for the credit report on the HUD-1 settlement statement. Thus, the $21 is an unsupported fee.

M. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $395, paid by the borrower on May 13, 2003 (closing date), was included on the HUD-1 settlement statement. However, the lock-in document, dated February 26, 2003, indicated that the borrower did not choose a lock-in. Therefore, the $395 is an ineligible fee.

Case number: 351-4420218
Loan amount: $214,801
Settlement date: May 29, 2003
Status: First legal action to commence foreclosure

Pertinent Details

A. Inadequate Compensating Factors

HUD 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 lender identifies compensating factors that could justify exceeding these ratios. Security Atlantic computed ratios of 13.8 and 42.52 percent. Compensating factors listed were a 5 percent increase on housing payment and 5 percent downpayment. HUD Handbook 4155.1, REV-5, section 2-13 F, provides that only a minimal increase in the borrower's housing expense is justified as a compensating factor. We do not consider five percent a minimal increase. HUD Handbook 4155.1, REV-5, section 2-13 B, provides that a large downpayment is a compensating factor, however, we do not regard a five percent downpayment as large. In addition, we noted that the borrowers received a 4 percent adjustable interest rate for the first year, and the rate may change on the first day of October 2004 and on that day of each succeeding year. Since the borrowers were highly leveraged, a small interest rate increase may cause financial distress to the borrowers.

B. Inaccurate Debt to Income Ratios
C. Inadequate Support for Income Calculation

The ratios calculated by Security Atlantic were incorrect because income was overstated by $148. HUD Handbook 4155.1, REV-4, CHG 1, section 2-7A, provides that overtime may be used as qualifying income if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. We calculated the two-year monthly average overtime income and bonus as $1,227 based on the employment verification information, which would increase the debt to income ratios to 14.01 and 43.16 percent, respectively. We cannot determine the basis for Security Atlantic's computation of bonus and overtime income of $1,375.

D. Inadequate Credit Analysis

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. The borrower noted that he could not explain the reason for late credit card payments because his ex-wife incurred the delinquencies. However, we noted that 29 of these late payments were for credit cards under the borrower's name only and occurred after the date of separation as stated in the divorce decree.

E. 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 lender must obtain an explanation and evidence of the source of funds from the borrower. Security Atlantic did not obtain explanation from the borrower regarding six deposits totaling $13,425. After deducting $6,324 we identified as a withdrawal from the borrower's 401k plan, total nonsourced deposits would be $7,101.

F. Verification of Gift Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10C, requires that the lender obtain a copy of the 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 the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. Mortgagee Letter 00-28 also requires that the donor furnish conclusive evidence that the funds given to the homebuyer came from the donor's own funds. We noted that the donor deposited $11,700 to her bank account the same day she withdrew $11,500 as a gift. The ending balance after these transactions became $583. Therefore, we could not determine the source of the gift. The file contained a gift letter for $11,500, and a noncanceled check of $11,500 made by the donor "payable to cash." Since there was no other supporting documentation for this gift transaction, we cannot verify whether the borrower or the closing agent received the funds.

Case number: 351-4475365
Loan amount: $120,531
Settlement date: September 15, 2003
Status: First legal action to commence foreclosure

Pertinent Details

A. Excessive Debt to Income Ratios without Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, provide 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 lender identifies compensating factors to justify exceeding these ratios. Security Atlantic computed debt to income ratios of 32.89 and 48.08 percent, respectively, without listing compensating factors. While LoanProspector was used to underwrite this loan, there are questions about the integrity of the data used in the risk assessment. The LoanProspector Feedback Certificate listed a different property address than the property for which the loan was approved, and the LoanProspector evaluation was completed over six months before the closing date, which exceeds the 120 day timeframe required by HUD Handbook 4155.1, REV-4, CHG 1, section 3-1. Accordingly, compensating factors would be required.

B. 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 estimate the settlement requirements to determine the cash required to close. The mortgage credit analysis worksheet listed a $10,000 gift and $10,507 in available bank assets. However, we noted that the borrower's bank assets of $10,507 already included the $10,000 gift. Since the gift was double counted, the borrower's cash reserve would be negative $1,132.

C. Verification of Gift Not Obtained

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10C, requires that the lender document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift; provides that no repayment is required; shows the donor's name, address, and telephone number; and provides the nature of the donor's relationship to the borrower. The file contained a gift letter that lacked the donor's address and was not signed and dated by the borrower.

D. <u>Closing Not in Compliance with Loan Approval</u>

Handbook 4155.1 REV-4, CHG 1, section 3-12B, provides that the loan must close in the same manner in which it was underwritten and approved. The mortgage credit analysis worksheet listed discount points of $2,411, which was reduced to $1,205 on the HUD-1 settlement statement. In addition, earnest money was $2,000 on the mortgage credit analysis worksheet but $2,100 on the HUD-1 settlement statement.

E. <u>Verification of Paid-Outside-Closing Costs Not Obtained</u>

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, provides that all of the funds for the borrower’s investment in the property must be verified. The file did not contain documentation to show that a $375 paid-outside-closing appraisal fee had been paid before closing.

F. <u>Ineligible/Unsupported Commitment Fee</u>

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $395 was included on the HUD-1 settlement statement, which was paid by the borrower on September 15, 2003 (closing date). However, the file did not contain the lock-in confirmation document. Therefore, the $395 is an unsupported fee.

Case number:	352-4877503
Loan amount:	$164,112
Settlement date:	February 14, 2003
Status:	Reinstated by borrower who retains ownership

Pertinent Details

A. Inadequate Compensating Factors

HUD Handbook 4155.1, REV-4, CHG 1, sections 2-12 and 2-13, provide 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 lender identifies compensating factors that could justify exceeding these ratios. Security Atlantic computed ratios of 27.5 and 45.88 percent, respectively. The compensating factors were listed as (1) less than 10 percent increase in housing payments, (2) ability to save, and (3) 5 percent down payment. HUD Handbook 4155.1, REV-5, section 2-13 F, provides that only a minimal increase in the borrower's housing expense is justified as a compensating factor. We do not consider 10 percent a minimal increase. Prior rental expense was $1,200 per month, while the projected housing expense was $1,500 per month, or more than a 25 percent increase. HUD Handbook 4155.1, REV-5, section 2-13 B, provides that large down payment is a compensating factor. As a result, a five percent down payment was not an adequate compensating factor.

B. Inadequate Bank Account Documentation

Handbook 4155.1, REV-4, CHG 1, section 3-1F, provides that as an alternative to obtaining a verification of deposit, the lender may choose to obtain the borrower's original bank statements for the most recent three-month period. The bank statements in the file for the period April 26 to November 26, 2002, were missing pages. As a result, we could not document a full three-month period. In addition, we noted that the ending balance of the bank statement was illegible.

C. Nonitemized Lender Credit

The HUD-1 settlement statement reported a $700 nonitemized lender credit. HUD Handbook 4155.1, REV-4, section 1-9A, part 1, provides 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.

Case number: 352-5089740
Loan amount: $159,756
Settlement date: August 27, 2003
Status: Property conveyed to insurer

Pertinent Details

A. Inaccurate Debt to Income Ratios
B. Inadequate Disclosure of Liabilities
C. Inadequate Support for Income Calculation

Security Atlantic computed debt to income ratios of 31.20 and 42.99 percent, respectively. However, this calculation omitted a debt and overstated bonus income. After considering these deficiencies, we calculated debt to income ratios of 35.23 and 50.38 percent, respectively. HUD Handbook 4155.1, REV-4, CHG-1, section 2-11A, provides that the lender 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. A debt balance of $6,017 was omitted, causing a $76 understatement of monthly liabilities. HUD Handbook 4155.1, REV-4, CHG-1, section 2-7A, requires the lender to develop an average of bonus or overtime income for the past two years and verify that such income is likely to continue. We could not determine how the lender calculated the monthly bonus income amount of $756. We calculated the amount at $225 (by dividing the total annual bonus amounts listed on the verification of employment by the total number of months covered), resulting in an overstatement of $531.

D. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. However, the case file did not contain a lock-in sheet or other document explaining the $495 commitment fee charge, which was paid by the borrower on August 27, 2003 (closing date). Therefore, the $495 is an unsupported fee.

Case number	352-4894655
Loan amount:	$188,680
Settlement date:	April 15, 2003
Status:	Reinstated by borrower who retains ownership

Pertinent Details

A. Excessive Debt to Income Ratio with Inadequate Compensating Factors

HUD 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 lender identifies compensating factors to justify exceeding these ratios. Security Atlantic computed debt to income ratios of 42.90 and 55.58 percent, respectively. The compensating factors listed on the mortgage credit analysis worksheet were credit explanation for derogatoriness, good credit scores, income stability, savings pattern, and daughter lives with her (borrower) and helps with payments. However, the compensating factors listed were either not valid or inadequate. The first and second factors were inadequate because the borrower's credit scores were marginal and explanations for credit problems were inadequate. The third and fifth factors are not valid factors. The fourth factor was inadequate because the bank statement did not demonstrate accumulative savings pattern. Moreover, the borrower's daughter had specified in writing that she was an unemployed mother, and the extent of help with payments was undocumented.

B. Verification of Gift Not Obtained

HUD Handbook 4155.1, REV 4, CHG 1, provides that a lender must document the transfer of the funds from the donor to the borrower. While the file contained a gift check for $8,700, there was inadequate documentation that the funds came from the donor because the donor's bank statement had pages missing. The donor's bank statement disclosed an available balance of $437.64; however, we could not determine whether the $8,700 was recently deposited or whether the donor had the funds available prior to the gift.

C. 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 reported that the borrower paid $400 as an appraisal fee and a $58 credit report fee. Although, the file contains an appraisal report, it does not contain documentation for the cost of the appraisal or whether the fee was paid. Similarly, there was inadequate documentation to indicate that the credit report fee was paid. 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.

D. Unsupported Credit Report Fee

Handbook 4000.2, REV-2, paragraph 5-3, provides that the lender is permitted to charge the actual costs of credit reports. The file contained one credit report at a cost of $14. However, the borrower was charged $58 for credit reports on the HUD-1 settlement statement as opposed to the actual cost of $14. Consequently, the $44 is regarded as unsupported fees.

E. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $495 was included on the HUD-1 settlement statement, which was paid by the borrower on August 15, 2003 (closing date). However, the lock-in agreement document, dated December 18, 2002, indicated that the borrower did not choose a lock-in. Therefore, the $495 is an ineligible fee.

Case number:	352-5069903
Loan amount:	$422,890
Settlement date:	August 25, 2003
Status:	First legal action to commence foreclosure

Pertinent Details

A. Excessive Debt to Income Ratios with Inadequate Compensating Factors

HUD 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 lender identifies compensating factors to justify exceeding these ratios. Security Atlantic computed debt to income ratios of 44.53 and 55.90 percent, respectively. The compensating factors listed on the mortgage credit analysis worksheet were "credit explanation for derogatoriness, borrower has been paying mom's bills, he will be occupying property, wife's income is comp factor, income, job stability, and savings reserves, and property self-sufficient." The first and sixth compensating factors are not valid because they are loan requirements. The second and third factors are not valid factors according to HUD Handbook 4155.1, REV-4, CHG 1, section 2-13. Concerning the eighth factor, it is questionable whether the property is self-sufficient since it suffered a devastating fire and the file did not indicate whether or when the units would be rentable. The file includes a document from the contractor in charge of 203k repairs of the property in which he estimates the total repair costs at $176,659. The fact that the property needed extensive repairs during the time of closing may indicate that the property's ability to generate rental income was impaired. The seventh factor is not adequate because the borrower did not have enough funds to close (See section B). The fourth factor is valid; however, given the condition of the property, we question whether these were adequate compensating factors to justify ratios of 44.53 and 55.90 percent.

B. Inadequate Funds to Close on HUD-1 Settlement Statement

Handbook 4155.1, REV-4, CHG 1, section 2-10, provides that all of the funds for the borrower's investment in the property must be verified and documented. Based on the HUD-1 settlement statement, the borrower was required to have funds amounting to $64,675 to close (cash due from borrower $64,172 plus paid-outside-closing costs of $503). However, the borrower did not appear to have sufficient funds to close. First, there was no documentation to show that paid-outside-closing items were paid before closing without reducing the funds available to close. Second, bank documents disclosed that the borrower had assets available of $12,688, and other documents supported a $49,219 gift of equity (which was not recorded on the HUD-1 settlement statement). Consequently, the borrower would have had a $2,768 deficit at closing. Further, there was a letter from the borrower explaining that savings were reduced from $35,000 to $4,000. If this pertains to the bank balance after the documented $12,688 balance, then a larger deficit would result at closing. The borrower defaulted after four payments.

C. 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 $450 for an appraisal fee and a credit report fee of $53. Although, the file contains an appraisal report showing that an appraisal was performed, it does not contain documentation showing the cost of the appraisal or whether the appraisal or credit report fees were paid. 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.

D. Closing Not in Compliance with Loan Approval

Handbook 4155.1, REV-4, CHG 1, section 3-12B, provides that the loan must close in the same manner in which it was underwritten and approved. The HUD-1 settlement statement did not disclose a $49,219 gift of equity that the seller of the property gave to the borrower. In addition, a $15,000 seller concession listed on the mortgage credit analysis worksheet was not listed on the HUD 1 settlement statement. The undisclosed gift of equity and seller concession was needed for closing.

E. Unsupported Credit Report Fee

HUD Handbook 4000.2, REV-2, paragraph 5-3, permits the lender to charge the actual costs of credit reports. The file contained a credit report at a cost of $24; however, the borrower was charged $53. Consequently, the $29 is an unsupported fee.

F. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $495 was included on the HUD-1 settlement statement, which was paid by the borrower on August 25, 2003 (closing date). However, the lock-in agreement, dated July 1, 2003, indicated that the borrower did not choose a lock-in. Therefore, the $495 is an ineligible fee.

Case number: 352-5083379
Loan amount: $157,426
Settlement date: August 28, 2003
Status: Foreclosure completed

Pertinent Details

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

The ratios calculated by Security Atlantic are incorrect due to an overstatement of income by $1,025. Security Atlantic calculated the borrower's estimated monthly income of $5,062 based on foster care payments for the period from July 1-31, 2003. The file did not contain a document supporting the continuance of this income. We calculated monthly income of $4,037, based on the contractual income indicated in the letter provided by the borrower's contracting house, which resulted in debt to income ratios of 36.89 and 38.27 percent, respectively, instead of 29.42 and 30.52 percent calculated by Security Atlantic.

C. 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 two 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. Mortgagee Letter 97-26 provides that the lender may perform telephone verification of current employment when the alternate procedure is used. HUD Handbook 4155.1, REV-4, CHG 1, section 2-7, provides that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. The file contained a letter from a care service indicating the borrower had a contractual relationship with it for the past three years and provided the income earned for the last two years. However, there was no document to support the reasonable continuance of the borrower's income for the next three years.

D. Closing Not in Compliance with Loan Approval

Handbook 4155.1, REV-4, CHG 1, section 3-12B, provides 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 $8,000, which was $233 higher than the amount of $7,767 indicated on the mortgage credit analysis worksheet, and the principal mortgage amount was $155,100 on the HUD-1 settlement statement, while it was $157,426 on the mortgage credit analysis worksheet, mortgage, and note.

E. Inadequate Documentation of Earnest Money Deposit

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 listed the earnest money as $5,676, which was more than 2 percent of the sales price ($159,900 x 2 percent = $3,198). While the file contained supporting documents for $5,243, we were unable to locate support for the remaining $433.

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 prepaid expenses of $1,887 and discount points of $2,069 as stated on the good faith estimate. In addition, the mortgage credit analysis worksheet listed an overstated earnest money amount of $433 as stated in section E. After offsetting against the borrower's assets and seller's concession, the borrower would have a negative cash reserve of $323.

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, provides 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 $433 had been paid before closing without reducing the funds available to close. Cash due from the borrower on the HUD-1 settlement statement was $2,724. If the $433 paid-outside-closing amount were added to the $2,724 owed by the borrower and offset against $617 in available assets, the borrower would have a $2,540 deficit at closing.

I. Inadequate Bank Account Documentation
J. Verification of Deposits Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 3-1F, provides that as an alternative to obtaining a verification of deposit, the lender may choose to obtain the borrower's original bank statements for the most recent three-month period. The bank statements in the file only covered one month. The borrower also deposited $1,143 in cash to the bank account on July 31, 2003, without explanation. This amount was needed for closing.

K. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $495 was included on the HUD-1 settlement statement, which was paid by the borrower on August 28, 2003 (closing date). However, the lock-in agreement, dated July 13, 2003, indicated that the borrower did not choose a lock-in. Therefore, the $495 is an ineligible fee.

Case number: 352-5094184
Loan amount: $238,500
Settlement date: October 14, 2003
Status: First legal action to commence foreclosure

Pertinent details

A. Inadequate Compensating Factors

HUD 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 lender identifies compensating factors that could justify exceeding these ratios. Security Atlantic computed ratios of 37.97 and 50.83 percent. "Excellent credit, very good job stability, reserved savings pattern, and 203k with repairs" were listed as compensating factors. However, except for "reserved savings pattern," the factors cited are not allowable compensating factors as defined in section 2-13. Section 2-13 provides that if the borrower has demonstrated an ability to accumulate savings and has a conservative attitude toward the use of credit, it may be considered as an allowable compensating factor. The bank statements in the file indicated the borrower had numerous unexplained nonpayroll deposits as mentioned in section C. As a result, the borrower has not demonstrated a reserved savings ability.

B. Closing Not in Compliance with Loan Approval

Handbook 4155.1, REV-4, CHG 1, section 3-12B, provides 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 $4,772, which was $495 lower than the amount of $5,267 indicated on the mortgage credit analysis worksheet. The earnest deposit was $1,000 on HUD-1 settlement statement, while it was $503 as listed on mortgage credit analysis worksheet.

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 lender must obtain an explanation and evidence of the source of funds from the borrower. During the period August 18-October 7, 2003, the borrower made numerous nonpayroll deposits totaling $12,874. Security Atlantic did not obtain an explanation from the borrower. It is important to note that this amount was needed for closing.

D. Ineligible Shipping Fee

The borrower was charged $50 for a Federal 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.

E. 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 $14. However, the borrowers were charged $58 for credit reports on the HUD-1 settlement statement. Consequently, the $44 is an unsupported fee.

Case number 352-4957069
Loan amount: $253,953
Settlement date: July 31, 2003
Status: First legal action to commence foreclosure

Pertinent Details

A. Excessive Debt to Income Ratios without Compensating Factors

HUD 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 lender identifies compensating factors to justify exceeding these ratios. Security Atlantic computed debt to income ratios of 30.90 and 48.04 percent, respectively, without listing compensating factors. While LoanProspector was used to underwrite this loan, there are questions about the integrity of the data used in the risk assessment. First, there was no amount provided for reserves on the LoanProspector sheet when we calculated a negative reserve as noted in D below. Second, as noted in C below, Security Atlantic appears to have underestimated the borrower's income. Accordingly, compensating factors would be required.

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 overtime may be used as qualifying income if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. The lender must develop an average of overtime income for the past two years. The ratios calculated by Security Atlantic were incorrect due to overstated overtime income of $281. We calculated the two years' monthly average overtime income as $454 based on the employment verification information, while Security Atlantic calculated $735. Based upon our calculation, the debt to income ratios would be 32.24 and 50.11 percent, respectively.

D. 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 should 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 mortgage credit analysis worksheet listed the borrower's available assets as $8,683 and a seller concession of $7,921. However, the borrower needed $18,434 to close. Therefore, the borrower's cash reserves would be negative $1,830.

E. <u>Closing Not in Compliance with Loan Approval</u>

Handbook 4155.1, REV-4, CHG 1, section 3-12B, provides 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 $6,628, which was $1,293 lower than the amount of $7,920 indicated on the mortgage credit analysis worksheet, and did not list a $7,000 gift. In addition, the HUD-1 settlement statement indicated that the borrower made a $3,000 earnest money deposit, while the mortgage credit analysis worksheet listed it as $1,000. We located a canceled checked (check no. 0510) for $1,000 as support for the earnest deposit in the file. The remaining $2,000 was unsupported. Both the gift and earnest money were needed for closing.

F. <u>Ineligible/Unsupported Commitment Fee</u>

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $445 was included on the HUD-1 settlement statement, which was paid by the borrower on July 31, 2003 (closing date). However, the file did not contain the lock-in confirmation document. Therefore, the $445 is an unsupported fee.

Case number: 352-5090016
Loan amount: $275,674
Settlement date: July 31, 2003
Status: Reinstated by borrower who retains ownership

Pertinent Details

A. 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 exceeds 2 percent of the sales price or appears excessive, based on the borrower's history of accumulating savings, the lender must verify the amount of deposit and the source of funds. A HUD-1 settlement statement in the file listed an earnest money deposit of $4,000. An escrow letter in the file stated that the borrower's realtor was in possession of $1,000 of a $5,000 earnest money deposit. To support the amount held by the realtor, the file included a canceled check and corresponding bank statements from the borrower for $1,000. The escrow letter also stated that the remaining $4,000 portion of the earnest money deposit was being held by the borrower's attorney. The file, however, did not include attorney correspondence, supporting bank statements, or a cancelled check to adequately source the remaining $4,000 earnest money deposit. In addition, available bank statements in the file revealed the borrower's inability to accumulate savings. The $4,000 earnest deposit claimed on the HUD-1 settlement statement was needed for closing, and the borrower went into default after one payment.

B. 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 lender must obtain an explanation and evidence of the source of funds from the borrower. There was a large increase in the borrower's personal funds without explanation. The file included two bank statements for the period February 27 to April 26, 2003, that disclosed negative beginning and ending balances of ($96) and ($137), respectively. A third bank statement for the period May 28 to June 25, 2003, disclosed a beginning and ending balance of $5,827 and $2,043, respectively. This would indicate that in excess of $6,000 was deposited into the borrower's bank account between April 27 and May 27, 2003. However, the bank statement for this period was not in the file. This significant increase should have been sourced according to HUD Handbook 4155.1, REV-4, CHG 1, section 2-10B. This amount was needed for closing.

C. 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 $450 as an appraisal fee and a broker fee of $2,068. Although, the file contains an appraisal report showing that an appraisal was performed, the file does not contain documentation showing the cost of the appraisal or whether fees were paid. 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.

D. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $445 was included on the HUD-1 settlement statement, which was paid by the borrower on July 31, 2003 (closing date). However, the case file did not contain a lock-in sheet or other document explaining the $445 commitment fee charge. Therefore, the $445 was an unsupported fee.

Case number:	352-4961335
Loan amount:	$211,678
Settlement date:	September 12, 2003
Status:	Delinquent

A. 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 exceeds 2 percent of the sales price or appears excessive, based on the borrower's history of accumulating savings, the lender must verify the amount of deposit and the source of funds. The HUD-1 settlement statement lists an earnest deposit of $9,000, which exceeds 2 percent of the sales price. The endorsement file contains supporting documentation showing that the borrowers made an earnest deposit of $8,500, not $9,000. Moreover, the file did not contain bank documentation showing the borrower's history of accumulating savings. The borrowers needed the earnest money deposit to close on the property.

B. Ineligible/Unsupported Commitment Fee

Mortgagee Letter 94-7, section IV, provides that a commitment or lock-in fee 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. A commitment fee of $395 was included on the HUD-1 settlement statement, which was paid by the borrower on September 12, 2003 (closing date). However, the case file did not contain a lock-in sheet or other document explaining the $395 commitment fee charge. Therefore, the $395 was an unsupported fee.

C. Inadequate Underwriting Documentation

HUD Handbook 4155.1, REV-4, CHG 1, section 3-1, provides 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. The file contained seven Internal Revenue Service W-2 forms from different employers for the year 2002 (one year before closing). These employers did not match with the employment information on the verification of employment forms in the loan file.

Case number: 352-5052966
Loan amount: $263,088
Settlement date: August 28, 2003
Status: Repayment

Pertinent Details

A. 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 lender must obtain an explanation and evidence of the source of funds from the borrower. Security Atlantic did not obtain an explanation for numerous nonpayroll deposits totaling more than $11,000 ($1,000 on May 13, 2003, $2,691 on May 29, 2003, $1,500 on June 16, 2003, and $6,000 on June 16, 2003). We also noted that the account's beginning balance was zero, which may indicate that this account was recently opened. These deposits were needed for closing.

B. Inadequate Evaluation of Savings Pattern

HUD Handbook 4155.1, REV-5, section 2-1, requires the lender to evaluate the borrower's capacity to make payments. Section 3-1 also requires that when standard documentation does not provide enough information to support this decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower. The file contained bank statements with a beginning balance of zero and an ending balance of $150 for the period of May 12 to July 17, 2003. As mentioned in section A, the borrower made $11,191 in nonpayroll deposits into the bank account during the same period and withdrew $11,041 in two months. The file contained a canceled check for $2,000 for the first down payment; however, this amount was not disclosed on the HUD-1 settlement statement. No other explanation about the remaining $9,041 expenses was provided in the file. As a result, we concluded that the borrower did not demonstrate her savings ability, and may lack the capacity to make mortgage payment. Security Atlantic did not evaluate the borrower's ability to repay as required.

C. Inadequate Funds to Close on Mortgage Credit Analysis Worksheet

A mortgage credit analysis worksheet, dated August 26, 2003, did not list discount points of $1,973 as stated on the HUD-1 settlement statement, and discount points on the good faith estimate were $2,863. Since the interest rate was 3 percent on the good faith estimate but 6 percent on the mortgage credit analysis worksheet, we concluded that the underwriting was not conducted based on the good faith estimate. Therefore, we used the discount points on the HUD-1 settlement for our calculation. The mortgage credit analysis worksheet listed assets as

$11,009. Based on the bank statements and other supporting documents, such as canceled checks, we noted that the borrower had a bank balance of $150 as of July 17, 2003, and an earnest deposit of $2,000 (which was not disclosed on the HUD-1 settlement statement or mortgage credit analysis worksheet) according to the real estate sales contract and a canceled check. Considering the overstated available assets and omitted discount points, the borrower would have a negative cash reserve of $4,619, instead of $6,218 as reported. In addition, the worksheet indicated that the seller concession was $7,997, of which $3,437 was used to pay closing costs. Therefore, with the remaining seller concession of $4,560, the cash reserve would be negative $59.

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

HUD Handbook 4155.1, REV-4, CHG 1, section 2-10, provides 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. Cash due from the borrower on the HUD-1 settlement statement was $3,037. As of July 17, 2003, the borrower's available assets were $150 according to the bank statement. After including $2,000 nondisclosed earnest money as stated in section B, the borrower would have an $887 deficit at closing.

Case number:	352-5033337
Loan amount:	$166,639
Settlement date:	October 30, 2003
Status:	Foreclosure completed

Pertinent Details

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

The ratios calculated by Security Atlantic are incorrect due to an overstatement of income by $2,275. After considering this deficiency, we calculated the debt to income ratios to be 35.07 and 35.07 percent, respectively, instead of 21.655 and 21.655 percent as listed on mortgage credit analysis worksheet. The overstatement of income appears to be due to a number of factors. First, Security Atlantic double counted the borrower's base salary of $1,533 per month. Second, Security Atlantic included monthly income of $767 derived from seminars provided by the borrower; however, there is no evidence that this income would continue as required by HUD Handbook 4155.1, REV-5, section 2-7. Third, we noted payments from the U.S. Department of Veterans Affairs for one coborrower was $429, while Security Atlantic used $404, and we could not determine how Security Atlantic computed the Social Security income of $748, for which we calculated $838.

C. 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 two 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 two years. In addition, Mortgagee Letter 97-26 provides that the lender may perform telephone verification of current employment when the alternate income documentation procedure is used. The file contained a letter from one coborrower, who was the president of a not-for-profit organization. This letter indicated the borrower's job title and salary information but did not provide the organization's address or telephone number or starting date of employment. The file also contained a verification of employment from the same organization, which verified the borrower's current employment as well as prior employment in another company. Therefore, we consider that Security Atlantic did not properly verify the borrower's prior employment.

D. Closing Not in Compliance with Loan Approval

Handbook 4155.1 REV-4, CHG 1, section 3-12B, provides 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 $10,000, which was $183 higher than the amount of $9,817 indicated on the mortgage credit analysis worksheet.

E. Verification of Paid-Outside-Closing Costs Not Obtained

Handbook 4155.1, REV-4, CHG 1, section 2-10, provides 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 an appraisal fee of $450 had been paid before closing without reducing the funds available to close.

F. Inadequate Credit Analysis

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. Section 2-3 also requires that the lender develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider for the borrowers who do not use traditional credit. The credit report in the file indicated that the three borrowers did not have sufficient credit histories. Alternative credit support provided, such as receipts from a drug store, a hunting club membership, and a magazine subscription, are not acceptable. Further, the credit report listed numerous collections that were unexplained.

G. Inadequate Disclosure of Liabilities

According to HUD Handbook 4155.1, REV-4, CHG 1, 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. The HUD-1 settlement statement indicated $3,250 was used to satisfy judgments; however, no creditor information was provided.

H. Inadequate Verification of Power of Attorney

Handbook 4155.1, REV-5, section 3-5 B, provides that the lender must provide evidence that the signer has authority to purchase the property and to obligate the borrower. Acceptable evidence includes a durable power of attorney specifically designed to survive incapacity and avoid the need for court proceedings. We noted that the borrower signed as power of attorney on behalf of both co-borrowers for the documents such as the sales contract, mortgage applications, HUD-1 settlement statement, and mortgage and adjustable rate note before or on the closing date of October 30, 2003. However, one power of attorney for one co-borrower was dated October 29, 2003, and the other October 31, 2003, which was one day after closing. Therefore, we concluded that the borrower signed certain documents for the two co-borrowers before the power of attorney was effective.

I. <u>Nonitemized Lender Credit</u>

HUD Handbook 4155.1, Rev-4, section 1-9A, part 1, provides 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 HUD-1 settlement statement listed a realtor closing cost credit of $380 without providing itemized information.

J. <u>Inadequate Underwriting Documentation</u>

HUD Handbook 4155.1, REV-4, CHG-1, section 3-1, indicated that when standard documentation does not provide enough information to support a lender's decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower. The age of one coborrower was inconsistent. On the application the age was listed as 67 years, while a U.S. Department of Veterans Affairs hospital memorandum indicated the age would be 74, and a life insurance document indicated 66.

SCHEDULE OF TIER PRICING VIOLATIONS

#	Case #	Loan amount	Lock date	Disc. points	Int. rate	Ineligible amount	Metropolitan statistical area
1	352-4802330/703	$164,937	10/25/02	3.00%	6.000	$1,649	Newark
	352-4805690	$282,119	10/25/02	0.00%	6.000		Newark
	352-4791369	$264,823	10/30/02	0.00%	6.500		Newark
2	352-4819648	$159,862	10/30/02	2.25%	6.500	$400	Newark
3	3524758010	$101,246	11/04/02	3.00%	7.500	$1,012	Newark
	352-4810524	$142,353	11/04/02	0.00%	7.500		Newark
4	352-4761423	$247,964	11/18/02	3.00%	7.000	$2,480	Newark
	352-4771551	$211,627	11/18/02	0.00%	7.000		Newark
	352-4862993	$260,855	01/13/03	0.00%	6.000		Newark
5	352-4804138	$144,840	01/13/03	3.00%	6.000	$1,448	Newark
6	352-4882079	$167,373	01/23/03	3.00%	6.500	$1,674	Newark
	352-4900925	$193,459	01/23/03	0.00%	6.500		Newark
7	351-4352891	$91,350	03/07/03	3.00%	6.000	$913	Monmouth-Ocean
	351-4389725	$149,205	03/07/03	0.00%	6.000		Monmouth-Ocean
8	352-4911861	$162,450	03/11/03	3.00%	6.500	$1,625	Newark
	352-4938835	$189,805	03/11/03	0.00%	6.500		Newark
	352-4927730	$265,371	03/20/03	0.00%	6.000		Newark
9	352-4942172	$194,118	03/20/03	3.00%	6.000	$1,941	Newark
	352-4899509	$192,139	03/24/03	0.00%	6.500		Newark
	352-4931469	$182,700	03/24/03	0.00%	6.500		Newark
10	352-4909057	$216,601	03/24/03	3.00%	6.500	$2,166	Newark
	352-4865070	$240,098	04/17/03	0.00%	6.500		Newark
11	352-4892756	$284,200	04/17/03	3.00%	6.500	$2,842	Newark
12	352-4959064	$108,300	05/28/03	3.00%	6.500	$1,083	Newark
13	352-4977086	$95,501	05/28/03	3.00%	6.500	$955	Newark
	3524963709	$244,107	05/28/03	0.00%	6.500		Newark
	352-4853492	$131,950	06/02/03	0.00%	6.500		Newark
14	352-4972700	$236,292	06/02/03	3.00%	6.500	$2,363	Newark

#	Case #	Loan amount	Lock date	Disc. points	Int. rate	Ineligible amount	Metropolitan statistical area
	352-4897304	$320,955	06/20/03	0.00%	6.500		Newark
	352-4999437	$223,100	06/20/03	0.00%	6.500		Newark
	351-4440293	$55,374	06/20/03	0.00%	6.500		Newark
	352-5019805-703	$143,673	06/20/03	0.00%	6.500		Newark
	352-5010575-703	$196,910	06/20/03	0.00%	6.500		Newark
15	352-4987582	$188,993	06/20/03	3.00%	6.500	$1,890	Newark
	352-4921540	$153,000	06/20/03	0.00%	6.500		Newark
	352-4977965	$147,175	06/26/03	0.00%	6.000		Newark
	352-5002591-703	$189,805	06/26/03	0.00%	6.000		Newark
16	352-4977491	$114,796	06/26/03	3.00%	6.000	$1,148	Newark
	3524993559	$182,700	06/26/03	0.75%	6.000		Newark
	352-4966031	$105,082	06/26/03	0.00%	6.000		Newark
17	352-4988355	$172,500	07/16/03	2.75%	6.500	$1,294	Newark
	352-5033684	$187,064	07/16/03	0.00%	6.500		Newark
18	352-5007395	$199,863	07/16/03	3.00%	6.500	$1,999	Newark
	352-5052841-703	$190,312	08/05/03	0.00%	6.500		Bergen-Passaic
19	352-5039839	$284,910	08/05/03	3.00%	6.500	$2,849	Bergen-Passaic
20	352-5045069	$176,234	08/08/03	3.00%	6.000	$1,762	Newark
	352-5014105	$181,837	08/08/03	0.00%	6.000		Newark
	352-5083133-703	$324,489	08/08/03	0.00%	6.000		Newark
	352-5096614	$133,980	08/20/03	0.00%	5.875		Newark
21	352-5109368	$175,445	08/20/03	3.00%	5.875	$1,754	Newark
22	352-5066761	$135,867	09/05/03	3.00%	6.500	$1,359	Newark
	352-5077417-703	$94,993	09/05/03	0.00%	6.500		Newark
	352-5045081-703	$202,746	09/15/03	0.00%	6.500		Newark
23	352-5097848	$328,860	09/15/03	2.50%	6.500	$1,644	Newark
	352-5093239	$239,489	09/22/03	0.00%	6.500		Newark
24	352-5115124	$133,726	09/22/03	2.50%	6.500	$669	Newark
	352-5130506	$279,174	09/23/03	0.00%	6.500		Newark
25	352-4999069	$193,956	09/23/03	2.50%	6.500	$970	Newark

#	Case #	Loan amount	Lock date	Disc. points	Int. rate	Ineligible amount	Metropolitan statistical area
26	352-4686946	$146,160	10/02/03	3.00%	6.500	$1,462	Newark
	352-5126734	$180,500	10/02/03	0.00%	6.500		Newark
	352-5104383	$243,600	10/07/03	0.00%	6.500		Newark
27	352-5079815-703	$211,627	10/07/03	2.50%	6.500	$1,058	Newark
	352-5110871	$296,887	10/14/03	0.00%	6.500		Newark
28	352-5090176-703	$115,202	10/14/03	3.00%	6.500	$1,152	Newark
	352-5124234	$284,707	10/14/03	0.00%	6.500		Newark
29	352-5129957	$148,190	10/22/03	3.00%	4.500	$1,482	Newark
	352-5033337	$166,639	10/22/03	0.00%	4.500		Newark
	352-5110191	$176,204	10/29/03	0.00%	6.000		Newark
	352-5137606	$223,492	10/29/03	0.00%	6.000		Newark
30	352-5124394-703	$226,446	10/29/03	3.00%	6.000	$2,264	Newark
	352-5125768	$223,300	11/19/03	0.00%	6.500		Newark
	352-5084004	$238,073	11/19/03	0.00%	6.500		Newark
31	352-5145099	$227,461	11/19/03	3.50%	6.500	$3,412	Newark
	352-5139750	$121,250	12/01/03	0.50%	6.500		Monmouth-Ocean
32	351-4539346	$55,000	12/01/03	3.00%	6.500	$275	Monmouth-Ocean
33	352-5180321	$108,605	01/20/04	4.00%	5.000	$1,086	Newark
	352-5190119	$187,840	01/20/04	1.00%	5.000		Newark
	352-5188319	$204,294	02/25/04	0.25%	6.000		Newark
34	352-5199465	$125,352	02/25/04	3.00%	6.000	$940	Newark
	352-5195405	$262,996	02/25/04	1.00%	6.000		Newark
	352-5234068	$352,468	05/12/04	0.00%	6.500		Jersey City
35	352-5149026	$197,000	05/12/04	4.00%	6.500	$3,940	Jersey City
	352-5231396	$225,887	05/27/04	0.00%	6.000		Newark
36	352-5286984	$181,177	05/27/04	2.75%	6.000	$1,359	Newark
37	352-5270331	$238,017	06/14/04	2.50%	6.500	$1,190	Monmouth-Ocean
	3525267476	$113,680	06/14/04	0.00%	6.500		Monmouth-Ocean
	352-5245690	$110,888	07/01/04	0.00%	6.500		Newark
38	352-5199797	$207,313	07/01/04	2.50%	6.500	$1,037	Newark
						$60,546	

Appendix F

SCHEDULE OF INELIGIBLE AND UNSUPPORTED FEES

Ineligible/Unsupported Fees				
FHA Case #	**Ineligible Commitment Fee**	**Ineligible Shipping Fee**	**Unsupported Credit Report Fee**	**Unsupported Commitment Fee**
352-4762508	$395			
352-4927551	$395		$21	
352-4779975	$495		$16	
352-4894655	$495		$44.	
352-5049757	$495			
352-5069903	$495		$29	
352-5083379	$495			
352-5097014	$495			
352-5167620	$495			
351-4404800				$495
352-4779692				$395
351-4475365				$395
352-5089740				$495
352-4957069				$445
352-5049179				$395
352-5090016				$445
352-4734667				$395
352-4735633				$445
352-4758844				$395
352-4779549				$395
352-4835578				$445
352-4891251		$70		$395
352-4961335				$395
352-5010076				$395
352-5135809				$395
352-5094184		$50	$44	
Total: 26 cases	**$4,255**	**$120**	**$154**	**$6,720**