audit report

Issue Date
September 15, 2005

Audit Case Number
2005-AT-1014

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

James D. McKay

FROM: James D. McKay
Regional Inspector General for Audit, 4AGA

SUBJECT: National City Mortgage Company, Miamisburg, OH
Did Not Always Comply with Federal Housing Administration Requirements

HIGHLIGHTS

What We Audited and Why

We audited loans National City Mortgage Company (National City) underwrote at the Altamonte Springs, Florida, and Alpharetta, Georgia, branch offices for seven loan correspondents that originated loans for properties located in central and northern Florida. National City is a nonsupervised direct endorsement lender with headquarters located in Miamisburg, Ohio. We selected the two branch offices and the seven loan correspondents because their default rates were significantly higher than the Florida average.

Our audit objective was to determine whether National City acted in a prudent manner and complied with the U.S. Department of Housing and Urban Development's (HUD) regulations, procedures, and instructions in the underwriting process for cash assets, income, and general creditworthiness of its Federal Housing Administration-insured loans.

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What We Found

National City did not always follow HUD requirements when underwriting Federal Housing Administration-insured loans. It improperly underwrote 9 of the 19 loans reviewed. These loans contained deficiencies that affected the insurability of the loans, including improper assessment of borrowers' income, debts, and credit histories. As a result, HUD insured nine loans that placed the Federal Housing Administration insurance fund at risk for $326,132 in questioned costs and $153,674 in funds to be put to better use.

What We Recommend

We recommend that the assistant secretary for housing-federal housing commissioner take appropriate administrative action against National City based on the information contained in this report. This action should, at a minimum, include requiring indemnification of $153,674 for two defaulted loans, $159,690 for claims paid on two loans, and reimbursement of $166,442 for losses incurred for five loans.

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

Auditee's Response

National City generally agreed with our finding and case studies. We provided the draft report to National City on August 9, 2005, and requested a response by August 26, 2005. National City provided written comments on August 22, 2005.

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

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BACKGROUND AND OBJECTIVES

National City Mortgage Company (National City) is a nonsupervised lender and a subsidiary of National City Bank of Indiana. National City's home office is located in Miamisburg, Ohio. The company has more than 300 offices in 37 states. It services the remaining continental United States through telephone and Internet service centers.

We audited loans National City underwrote at the Altamonte Springs, Florida, and Alpharetta, Georgia, branch offices for seven loan correspondents. The loan correspondents originated loans for properties located in central and northern Florida that closed between January 1, 2002, and December 31, 2004. During this period, the two branch offices underwrote 1,024 loans originated by the seven correspondents. Of the 1,024 loans, 65 went into default and 28 were claim terminated for an overall 9 percent default rate. This default rate was significantly higher than the Florida average.

Our audit objective was to determine whether National City acted in a prudent manner and complied with the U.S. Department of Housing and Urban Development's (HUD) regulations, procedures, and instructions in the underwriting process for cash assets, income, and general creditworthiness of its Federal Housing Administration-insured loans.

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RESULTS OF AUDIT

Finding 1: Two Branch Offices of National City Did Not Fully Comply With HUD's Underwriting Requirements

National City did not follow HUD requirements when underwriting 9 of the 19 Federal Housing Administration-insured loans reviewed for compliance. The loans contained deficiencies that affected the credit quality (insurability) of the loans. The loan underwriting deficiencies occurred because National City's underwriters did not adequately evaluate information presented by its loan correspondents for compliance with requirements before approving the loans. The underwriters also allowed questionable information to be entered into the systems used for automated underwritten loans. As a result, HUD insured nine loans that placed the Federal Housing Administration insurance fund at risk for $326,132 in questioned costs and $153,674 in funds to be put to better use.

Loans Did Not Comply with HUD Requirements

National City underwrote nine loans with mortgages totaling $805,810 that contained significant loan underwriting deficiencies. These deficiencies primarily involved improper assessment of borrowers' income, debts, and credit histories. These conditions occurred because National City's underwriters did not adequately evaluate information presented by its loan correspondents for compliance with requirements before approving the loans. The underwriters also allowed questionable information to be entered into the systems used for automated underwritten loans.

The following table presents the deficiency categories noted for the nine loans.

Deficiency	Number of loans
Income not properly assessed	6
Credit not properly assessed	6
Gifts not properly verified	7
Other	2

Each of the nine loans contained one or more significant deficiencies that are summarized below. Appendix C presents a table summarizing the loan deficiencies, and appendix D contains a detailed case study for each of the nine loans.

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Income Not Properly Assessed

National City did not properly assess income for six borrowers. The six cases included three (091-3646793, 091-3701492, and 094-4640149) in which National City's lack of proper verifications caused it to overstate the borrowers' monthly income. The following two examples demonstrate the conditions identified during the review:

- For case 094-4640149, National City did not document verification of $1,863 of the borrower's $3,150 gross monthly income. National City's loan file contained no pay stubs covering the most recent 30-day period and the verbal verification did not document the borrower's pay rate or likelihood of continued employment. We, therefore, excluded the $1,863 in our analysis and calculated a debt-to-income ratio of 76.86 percent, compared to the 32.02 percent rate National City calculated.

- For case 091-3646793, National City counted the coborrower's projected increased income without documenting when the increase would take effect. Without this information, the file did not support use of the higher projected income amount. National City's representatives also reviewed the file and made a similar observation. Excluding the projected increased income and other adjustments noted during the audit resulted in a debt-to-income ratio of 62.41 percent, compared to the 36.26 percent rate National City calculated and used to approve the loan.

For the remaining three cases (094-4677762, 091-3604055, 091-3797093), National City did not properly assess the stability of the borrowers' employment and their likelihood of continued employment. To illustrate, the file for case 094-4677762 shows during the two years preceding National City's loan approval, the borrower worked for six separate employers in three different states. The loan application also indicated unexplained gaps in the borrower's employment. HUD's Neighborhood Watch system shows the loan went into default due to curtailment of borrower income. The default reason was consistent with the borrower's inconsistent employment history. A National City representative reviewed the file during the course of our audit and observed that the borrower lacked job stability.

Handbook 4155.1, REV 4, provides that anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt. Income from any source that will not continue may not be used in calculating the borrower's income ratios. To analyze the probability of continued employment, lenders must examine the borrower's

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past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. HUD does not impose an arbitrary minimum length of time a borrower must have held a position to be eligible. However, the lender must verify the borrower's employment for the most recent two full years. The borrower must also explain any gaps in employment of a month or more.

Credit Not Properly Assessed

National City did not consider and/or properly evaluate debts and/or credit history before approving six of the loans. We selected two case examples to demonstrate this condition:

- For case 091-3556249, National City did not input into its automatic underwriting system and consider two outstanding debts with monthly payments totaling $627. National City's file contained no explanation for not considering the two debts. The debts had monthly payments of $427 and $200, respectively, and both may require longer than 10 months to pay off. The credit report showed the debt with payments of $200 was 60 days delinquent. When considered, the borrower's debt-to-income ratio amounted to 61.69 percent, versus the 38.42 percent rate National City calculated. National City reviewed the loan file during the course of the audit and noted its omission of the two debts.

- For case 094-4677762, National City's file did not support the exclusion of $531 in monthly child support payments shown on the credit report. In addition, the file provided no explanation for approving the loan despite the borrower's disregard for past child support obligations. The credit report showed the borrower had $11,906 in delinquent child support payments. The automatic underwriter finding report requested support for omitting the child support obligations. The underwriter did not document the file to provide the requested explanation. National City's representative reviewed the file during the course of the audit and noted that the file did not document the basis for eliminating several obligations. The additional debts resulted in a 45.17 percent debt-to-income ratio, compared to the 26.85 percent rate National City calculated and used to approve loan.

Handbook 4155.1, REV 4, provides that if the credit history reflects continuous slow payments, judgments, and delinquent accounts, HUD requires strong compensating factors to approve the loan. HUD requires lenders to consider all recurring obligations that meet HUD's stipulations when evaluating a loan application. When computing debt-to-income ratios, HUD requires lenders to

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include all recurring charges, including payments for child support or separate maintenance payments extending 10 months or more.

Gifts Not Properly Verified

National City did not properly verify gift funds paid to closing agents for seven of the borrowers. In five of the cases, the gifts were from nonprofit donors, and we independently confirmed that they provided the gifts although National City did not properly verify the gift amounts. In the other two cases (091-3647861 and 094-4677762), the loan files showed part or all of the gifts came from relatives of the borrower. However, in both cases, National City did not confirm that the relatives provided the gifts.

To illustrate for case 091-3647861, National City allowed the loan to close without proper verification of gift funds that included $2,000 from the borrower's mother and $1,132 from the borrower's cousin. The file contained copies of separate cashier's checks the mother and cousin supposedly purchased and made payable to the closing agent for the gifts. The closing agent showed no record of receiving the checks. Instead, the closing agent's loan escrow ledger showed it received two different cashier's checks from the seller. The checks were completed to show they came from the relatives. Copies of bank checks obtained from the closing agent showed the mother provided a gift of $1,138, versus $2,000, and the cousin provided a gift of $2,000, versus $1,132. National City did not obtain documents from the closing agent needed to confirm receipt of the gifts. That documentation would have identified discrepancies and required resolution before loan closing.

Handbook 4155.1, REV 4, requires that if the gift funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift. HUD also requires that the lender verify the source of the donor's funds to ensure they were not derived in any manner from a party to the sales transaction.

Other Less Significant Deficiencies

National City also underwrote eight loans that contained less significant underwriting deficiencies. The deficiencies involved some of the same violations cited for the three categories discussed above. However, we considered the deficiencies less significant because they did not affect the overall credit quality (insurability) of the individual loans. Thus, the deficiencies would not support indemnification of the defaulted loans or repayment of losses on claims. This fact does not relieve National City from following all facets of HUD requirements when originating Federal Housing Administration-insured loans. We provided details of these deficiencies to National City during our review. Appendix C presents a table summarizing the less significant deficiencies for the eight loans.

Conclusion

National City's underwriters did not adequately evaluate information presented by its loan correspondents for compliance with requirements before approving the loans and allowed questionable information to be entered into its system for automated underwriting loans. This resulted in National City approving nine loans that did not meet HUD requirements and submitting them to HUD for Federal Housing Administration endorsement. As a result, HUD insured nine loans that placed the Federal Housing Administration's insurance fund at risk for $326,132 in questioned costs and $153,674 in funds to be put to better use.

Recommendations

We recommend that the assistant secretary for housing-federal housing commissioner

1A. Take appropriate administrative action against National City for not complying with HUD requirements, including requiring National City to indemnify $153,674 for two defaulted loans, $159,690 for claims paid on two loans, and reimbursement of $166,442 for losses incurred for five loans.

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SCOPE AND METHODOLOGY

National City's Altamonte Springs, Florida, and Alpharetta, Georgia, branch offices underwrote 1,024 loans that closed between January 1, 2002, and December 31, 2004, for the seven loan correspondents. The loans were originated for properties located in central and northern Florida. The 1,024 loans included 65 that went into default and 28 that were claim terminated for an overall 9 percent default rate. This default rate was significantly higher than the state of Florida's average. We selected and reviewed 19 of the 93 defaulted loans that went into default before the eighth payment.

To achieve our objective, we reviewed HUD's rules, regulations, and guidance for proper origination and submission of Federal Housing Administration loans. We also reviewed previous HUD reviews of National City and HUD case binders. In addition, we interviewed HUD staff to obtain background information on HUD requirements and National City.

We interviewed National City's management and staff to obtain information regarding its policies, procedures, and management controls. We reviewed National City's written policies and procedures to gain an understanding of how its processes are designed to function. We also reviewed National City's quality control review of early payment defaults related to our scope. Additionally, we reviewed National City's case binders for the 19 defaulted loans selected in our sample.

We relied upon computer-processed data contained in HUD's Single Family Data Warehouse system. We assessed the reliability of these data, including relevant general and application controls, and found them to be adequate.

We performed our audit from January 28, 2005, through July 27, 2005. We performed our review in accordance with general accepted government auditing standards.

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INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Controls over underwriting of Federal Housing Administration loans.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following item is a significant weakness:

- National City did not have adequate controls over underwriters' evaluation and assessment of information provided by loan correspondents for loan approval.

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APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	$166,442	$159,690	$153,674

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 polices or regulations.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of 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.

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Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

National City.
Mortgage
A Division of National City Bank of Indiana

August 19, 2005

James McKay
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of the Inspector General for Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Re: Draft Audit Report – August 9, 2005
National City Mortgage Co.
Audit of Altamonte Springs, FL & Alpharetta, GA
Branch Offices

Dear Mr. McKay:

National City Mortgage Co. (NCM) is pleased to provide you with our response to the Office of Inspector General's (OIG) draft audit report. On August 17, 2005, the exit interview was conducted by representatives from the OIG with management from National City Mortgage Operations Risk and Wholesale divisions in attendance.

National City Mortgage takes the audit findings very seriously. We have reviewed HUD's findings and believe that our continued focus on operations risk in our branch network is paramount to improving our overall loan origination practices. As stated in our exit interview, National City Mortgage continues to being fully committed to strict compliance with HUD/FHA requirements.

In accordance with the audit report, National City Mortgage agrees to indemnify the nine loans identified as having underwriting deficiencies which affect the credit quality of the loans.

We concur that the deficiencies are documentation issues and inadequate underwriter evaluation before loan approval. Although we feel it is critical that the underwriters did not follow HUD guidelines, we can report that three of the four underwriters are no longer employed with National City Mortgage and these deficiencies are being discussed with the fourth underwriter who remains in our employ.

Attached are our comments and we hope that you will find them satisfactory and acceptable to your audit standards. If you have any questions or comments, please feel free to contact me at (937) 910-4127.

Sincerely,

Lynn J. Rowland
Sr. Vice President Credit Risk & Analysis
National City Mortgage
3232 Newmark Dr.
Miamisburg, OH 45342

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ATTACHMENT 1

CASE STUDIES OF IMPROPERLY UNDERWRITTEN LOANS

Case number:	**091-3556249**
Loan number:	1261114
Borrower:	Groesser
Audit findings:	Credit Not Properly Assessed, Gift Not Properly Verified, & Documents Not Properly Executed of Retained.
NCM response:	Concur with audit findings.
Case number:	**091-3646793**
Loan number:	1738188
Borrower:	Diaz
Audit findings:	Credit Not Properly Assessed, Income Not Properly Assessed, & Gift Not Properly Verified.
NCM response:	Concur with audit findings.
Case number:	**094-4677762**
Loan number:	1562817
Borrower:	Haraison
Audit findings:	Credit Not Properly Assessed, Income Not Properly Assessed, & Gift Not Properly Verified.
NCM response:	Concur with audit findings.
Case number:	**091-3604055**
Loan number:	1534578
Borrower:	McGhee
Audit findings:	Completion of Repairs Not Verified or Documented, Income Not Properly Assessed, & Gift Not Properly Verified.
NCM response:	Concur with audit findings.

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	Case number:	**091-3701492**
	Loan number:	2198749
	Borrower:	Lundy
	Audit findings:	Income Not Properly Assessed & Gift Funds Not Properly Verified.
	NCM Response:	Concur that income was not properly calculated.
Comment 1		Disagree that gift funds were not properly verified. Copies of the signed contract addendum, congratulations letter from Futures Home Assistance Program, & a copy of the gift fund check from Futures for the gift amount of $1947.00 were located in the loan file.
	Case number:	**091-3797093**
	Loan number:	2808456
	Borrower:	Shelton
	Audit findings:	Income Not Properly Assessed, Credit Not Properly Assessed, & Gift Not Properly Verified.
	NCM response:	Concur with audit findings.
	Case number:	**091-36487861**
	Loan number:	1698689
	Borrower:	Reep
	Audit finding:	Gift Not Properly Verified.
	NCM response:	Concur with finding.
	Case number:	**094-4640149**
	Loan number:	1393349
	Borrower:	Marsden
	Audit findings:	Income Not Properly Assessed & Credit Not Properly Assessed.
	NCM response:	Concur that income was not properly assessed.
Comment 2		Disagree that credit was not properly assessed. HUD guidelines state collections are not required to be paid prior to closing. The borrower did submit in writing that all collections are medical and that she is disputing them with the insurance company.
	Case number:	**093-5382708**
	Loan number:	1669988
	Borrower:	Martisofski
	Audit finding:	Credit Not Properly Assessed.
	NCM response:	Concur with finding.

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OIG Evaluation of Auditee Comments

Comment 1 We acknowledge that National City's file contained the noted documents from the donor. However, the file did not contain the required documentation to support that the closing agent received the gift funds from the donor.

Comment 2 We agree with National City's comment that HUD guidelines do not require collections to be paid prior to closing. This was not the point of the finding. Our concern, as stated in the report, was that National City approved the loan without first resolving whether the medical expenses listed in the credit report were obligations of the mortgagor or of the mortgagor's medical insurance company.

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Appendix C

SUMMARY OF LOAN UNDERWRITING DEFICIENCIES

Loans with deficiencies that affected insurability

Case number	Income not properly assessed	Credit not properly assessed	Gift not properly verified	Other	Total errors per loan	Questioned costs Ineligible	Questioned costs Unsupported	Funds to be put to better use
091-3556249		X	X	X (1)	3	$ 51,232		
091-3646793	X	X	X		3	$ 28,050		
094-4677762	X	X	X		3	$ 27,465		
091-3604055	X			X(2)	2			$ 68,820
091-3701492	X		X		2	$ 40,988		
091-3797093	X	X	X		3			$ 84,854
091-3647861			X		1		$ 83,356	
094-4640149	X	X			2	$ 18,707		
093-5382708		X	X		2		$ 76,334	
						$ 166,442	**$ 159,690**	
Subtotal							**$ 326,132**	**$ 153,674**
Total	**6**	**6**	**7**					**$ 479,806**

(1) Loan application not properly signed, and the executed HUD-1 settlement statement was not on file.
(2) Repairs not verified as completed.

Loans with less significant deficiencies

Case number	Gift not properly verified	Credit not properly assessed	Income not properly assessed	Total errors per loan
091-3615954	X		X	2
091-3666168	X	X		2
091-3651820	X			1
091-3843849	X			1
093-5338974	X			1
091-3620006	X			1
094-4572706	X			1
091-3568985	X		X	2
Total errors per deficiency	**8**	**1**	**2**	**11**

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Not all errors pertaining to income, credit, or liabilities were considered material deficiencies. Only those errors that could have changed the underwriting decision were considered material. For instance, some errors in income or liabilities did not significantly affect the housing and debt ratios.

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Appendix D

CASE STUDIES OF IMPROPERLY UNDERWRITTEN LOANS

Case number:	091-3556249
Loan purpose:	Purchase
Underwriter type:	Loan prospector
Date of loan closing:	May 21, 2002
Insured amount:	$112,411
Debt-to-income ratio:	61.69 percent
Status:	Claim/sold
HUD's loss on resale:	$51,232

Credit Not Properly Assessed

National City did not consider two outstanding debts with monthly payments totaling $427 and $200, respectively, during its credit analysis. Both debts may require longer than 10 months to pay off the principal and interest balances. The credit report showed the debt with payments of $200 was 60 days delinquent. National City did not input the debts into its automated underwriting system for consideration in determining the borrower's eligibility for the loan. National City processed the loan showing the borrower had no debts other than the mortgage. National City's file contained no explanation for not considering the two debts. When considered, the borrower's debt-to-income ratio amounted to 61.69 percent, as opposed to the 38.42 percent rate National City calculated. National City's representative reviewed the loan file during the course of the audit and noted omission of the two debts.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-11A, requires the lender to consider all recurring obligations extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after the loan closing. This is especially true if the borrower will have limited or no cash assets after loan closing.

Gift Not Properly Verified

National City's file contained no documentation that it verified receipt of a $31,237 gift paid to the closing agent by a nonprofit donor. Thus, National City allowed the loan to close without support that the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. OIG verified the receipt of the gift funds with the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation does not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

Documents Not Properly Executed or Retained

National City's file did not contain a properly signed loan application or a copy of the final HUD-1 settlement statement signed by all parties to document closing of the loan. The borrower signed the loan application, but a National City representative did not sign it. We obtained a copy of the executed HUD-1 settlement statement from the closing agent.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 3-1, requires that uniform residential loan applications be signed and dated by all borrowers and the lender. The lender's file should also contain a copy of the final HUD-1 settlement statement used to close the loan.

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Case number:	091-3646793
Loan purpose:	Purchase
Underwriter type:	Manual underwriting
Date of loan closing:	October 30, 2002
Insured amount:	$113,124
Debt-to-income ratio:	62.41 percent
Current status:	Claim/sold
HUD's loss on resale:	$28,050

Credit Not Properly Assessed

National City's loan files contained no evidence of follow-up on a credit inquiry that resulted in additional monthly debt of $491 for an automobile loan. The borrower made the loan in October 2002, the same month National City closed the borrower's home loan. The credit report, dated October 25, 2002, showed an October 04, 2002, inquiry by the creditor who made the auto loan. The loan file contained no follow-up to the inquiry. The additional debt was shown on a credit report National City obtained on April 14, 2005, in response to questions we raised because National City could not support that it performed the required review of this early default loan. In response to this request, National City reviewed the loan, and its representative observed the additional debt and lack of follow-up to credit inquiries before or at the time the loan was approved. The additional debt and income issues (discussed below) resulted in a 62.41 percent debt-to-income ratio, compared to the 36.26 percent rate National City calculated and used to approve loan.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-3B, states that the lender must determine the purpose of any recent debts, and the borrower must explain all inquiries shown on the credit report.

Income Not Properly Assessed

National City inappropriately counted the coborrower's projected income of $1,300 per month, versus the verified income of $785 per month. This resulted in a $515 per month overstatement of the coborrower's income. National City based the projected income on a confirmation from the employer that stated the coborrower's hourly rate and weekly hours would increase. The confirmation did not indicate when the increase would take effect. Without this information, the files did not support use of the higher projected income amount. National City's representatives reviewed the file during the course of our review and concluded the file contained inadequate support for using the projected income amount. National City also miscalculated the borrower's income, resulting in a $76 per month overstatement. The total income overstatement amounted to $591 per month. The overstated income and unreported liability (discussed above) resulted in a debt-to-income ratio of 62.41 percent, compared to the 36.26 percent rate National City calculated and used to approve the loan.

HUD Requirements

HUD Handbook 4155.1, Rev 4, paragraph 2-7Q, provides that except in certain situations, projected or hypothetical income is not acceptable for qualifying purposes. Exceptions are permitted for income from cost-of-living adjustments, performance raises, bonuses, etc., verified by the employer and scheduled to begin within 60 days of loan closing.

Gift Not Properly Verified

National City's file contained no documentation that it verified receipt of a $2,947 gift paid to the closing agent by a nonprofit donor. Thus, National City allowed the loan to close without support that the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. OIG verified the receipt of the gift funds with the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation does not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

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Case number:	094-4677762
Loan purpose:	Purchase
Underwriter type:	Desktop underwriter
Date of loan closing:	September 24, 2002
Insured amount:	$101,200
Debt-to-income ratio:	45.17 percent
Current status:	Claim/sold
HUD's loss on resale:	$27,465

Credit Not Properly Assessed

National City's file did not support the exclusion of $531 in monthly child support payments from its credit analysis, nor did the file adequately document the borrower's disregard for child support obligations. The loan application showed the borrower had two dependents, ages ten and seven. The most recent credit report, dated September 4, 2002, showed the borrower was obligated to make $531 per month child support payments. The payments included $292 per month for Georgia and $239 for Colorado. The automatic underwriter finding report requested support for omitting the child support obligations. The underwriter did not document the file to provide the requested explanation. National City's representative reviewed the file during the course of the audit and noted that the file did not document the basis for eliminating several obligations. The additional debts resulted in a 45.17 percent debt-to-income ratio, compared to the 26.85 percent rate National City calculated and used to approve loan.

Further, National City's credit analysis did not adequately consider the borrower's consistent disregard for child support obligations. The most recent credit report, dated September 4, 2002, showed $11,906 in delinquent child support payments, of which $6,272 was not supported as paid by the borrower. The amount included $5,634 for Georgia, $4,869 for North Carolina, and $1,403 for Colorado. The $5,634 due for Georgia was paid at loan closing using proceeds from the gift discussed below. The $4,869 for North Carolina was shown as a collection write-off. The file showed no evidence that the $1,403 due for Colorado had been paid. The file contained an earlier credit report, dated August 27, 2002, that showed the Colorado balances (no amount indicated) were transferred to Georgia. However, the amount did not agree with the later credit report that continued to show separate balances for Georgia ($5,634) and Colorado ($1,403). The file contained no explanation for the discrepancies between the two credit reports.

HUD Requirements

HUD Handbook 4155.1, Rev 4, paragraph 2-11, provides that in computing the debt-to-income ratio, the lender must include all recurring charges, including payments for child support or separate maintenance payments extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing. Paragraph 2-3 states that strong offsetting factors would be needed to approve the loan if the credit history reflects continuous slow payments, judgments, and delinquent accounts. The file did not contain the required support. Further, paragraph 2-3C requires court-ordered judgments to be paid off before the mortgage loan is eligible for Federal Housing Administration insurance endorsement.

Income Not Properly Assessed

National City approved the loan although the file showed the borrower had an unstable employment history. During the two years preceding National City's loan approval, the borrower worked for six separate employers in three different states. Two of the employers were not listed on the loan application. The loan application also indicated unexplained gaps in the borrower's employment from June to September 2001 and July to September 2002. HUD's Neighborhood Watch system shows the loan went into default due to curtailment of borrower income. The default reason was consistent with the borrower's inconsistent employment history. National City could not locate its independent review of this early payment default loan. Therefore, it had its staff to review the file during the course of our audit. National City determined the borrower lacked job stability because of various jobs not in the same line of work.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-6, provides that HUD does not impose an arbitrary minimum length of time a borrower must have held a position to be eligible. However, the lender must verity the borrower's employment for the most recent two full years. The borrower must also explain any gaps in employment of a month or more. To analyze the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. A borrower who changes jobs frequently within the same line of work but continues to advance in income or benefits should be considered favorably. In this case, the borrower did not meet these criteria. Chapter 2, section 2, further states that income that is not stable may not be used to calculate the borrower's debt-to-income ratios.

Gift Not Properly Verified

The loan file did not contain proper verification of a $9,000 gift shown as made to the borrower by a cousin. The gift was supported by a bank check, dated September 24, 2002, and a transaction summary for a $9,000 withdrawal on the same date. The file also contained a personal banking account detail that showed the account was opened on March 18, 2002. The account detail showed a large unexplained $18,773 deposit on September 13, 2002, only 11 days before the alleged gift. The files contained no explanation for the large deposit. National City allowed the loan to close without proper verification that the donor purchased the bank check with funds that came from an acceptable source.

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HUD Requirements

HUD Handbook 4155.1, paragraph 2-10C, provides that an outright gift of the cash investment is acceptable if the donor is a relative of the borrower. As a rule, our concern is not with how the donor obtains the gift funds, provided they are not derived in any manner from a party to the sales transaction. The lender did not verify the source of the large deposit to the donor's account needed to make this determination. Section 2-10C further provides that if the gift is provided at closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift. The lender did not properly verify who purchased the cashier check used for the gift.

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Case number: 091-3604055
Loan purpose: Purchase
Underwriter type: Manual underwriter
Date of loan closing: August 23, 2002
Insured amount: $68,820
Status: Default/no claim paid

Completion of Repairs Not Verified or Documented

National City did not verify or document completion of repiping work before it allowed the loan to close or be submitted for endorsement. The appraisal stated that the subject property had undergone complete renovation but noted that the house needed to be repiped. The conditional commitment included a condition that required repiping. National City's loan file contained a $1,700 invoice from a plumbing company but did not contain the required certification that the work was completed. National City reviewed the file during the course of the audit and made this same observation.

HUD Requirements

HUD Handbook 4000.2, paragraph 2-19, provides that repair requirements outstanding on the conditional commitment or the appraisal report must be satisfied before the mortgage is submitted for endorsement.

Income Not Properly Assessed

National City did not verify the borrower's likelihood of continued employment. His most recent employer employed the borrower for only 18 months before the loan. Documentation of the borrower's continued employment was needed to assess the likelihood of continuous income needed to pay the mortgage. HUD's system shows the borrower defaulted due to curtailment of income.

HUD Requirements

HUD Handbook 4155.1, REV-4, chapter 2, section 2, provides that anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt. Income from any source that will not continue may not be used in calculating the borrower's income ratios. Paragraph 2-6, Stability of Income, provides that to analyze the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. The file did not contain this documentation.

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Gift Not Properly Verified

National City's loan file contained no documentation to support that National City properly verified a $1,997 gift paid to the closing agent by a nonprofit donor. Thus, National City allowed the loan to close with no evidence that it properly verified the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. OIG verified the receipt of the gift funds with the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation do not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

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Case number: 091-3701492
Loan purpose: Purchase
Underwriter type: Manual underwriter
Date of loan closing: March 25, 2003
Insured amount: $73,742
Debt-to-income ratio: 52.55 percent
Status: Claim/sold
HUD's loss on resale: $40,988

Income Not Properly Assessed

The $1,211 monthly income National City used for Social Security and child support was overstated by $761 due to amounts not supported by the file ($501) and ineligible child support ($260). National City used the $1,211, although the file only supported $710, an overstatement of $501. The file did not contain information needed to resolve this difference. The balance of the overstatement $260 ($761-$501) was for ineligible child support payments. The underwriter approved the loan although the payer of the child support owed more than $20,000 in back payments and the file contained a six-month versus the required twelve-month payment history. In addition, National City allowed the child support income without obtaining copies of the divorce decree, legal separation agreement, or voluntary payment agreement. Thus, we adjusted the borrowers' income from $3,199 to $2,438. The adjusted income resulted in a 52.55 percent debt-to-income ratio, compared to the 39.48 percent rate National City calculated.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-7F, provides requirements for alimony, child support, or maintenance income. The requirements provide that income in this category may be considered as effective if such payments are likely to be consistently received for approximately the first three years of the mortgage. The borrower must provide a copy of the divorce decree, legal separation agreement, or voluntary payment agreement and evidence that payments have been received during the last 12 months. Acceptable evidence of regularity of payments includes cancelled checks, deposit slips, tax returns, court records, etc. Periods of less than 12 months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender.

Gift Funds Not Properly Verified

National City's file contained no documentation to support that National City verified a $1,947 gift paid to the closing agent by a nonprofit donor. Thus, National City allowed the loan to close without first verifying that the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. In addition, the borrower did not sign the gift

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letter located in National City's loan file. OIG verified the receipt of the gift funds with the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation do not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

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Case number:	091-3797093
Loan purpose:	Purchase
Underwriter type:	Desktop underwriter
Date of loan closing:	October 7, 2003
Insured amount:	$84,854
Status:	Default/no claim paid

Income Not Properly Assessed

National City did not establish and document the stability of employment and the likelihood of continued employment for the borrower and the coborrower. This information was required so that the lender could determine the borrower's capacity to repay the mortgage debt. National City established the borrower's income using a one-week pay stub and a verbal verification that only confirmed the borrower had been an employee for nine months and his position. The verbal verification did not confirm the borrower's pay rate and likelihood of continual employment. For the coborrower, National City only obtained a two-week pay stub and a verbal verification that did not contain sufficient information. The verbal confirmation did not reflect the coborrower's pay rate, employment date, and likelihood of continued employment. Further, the verbal confirmation was obtained from a receptionist at the place of employment where the coborrower also held a receptionist position. The file indicated an individual who was not the coborrower provided the verbal confirmation.

HUD Requirements

HUD Handbook 4155.1, REV-4, chapter 2, section 2, provides that anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt. Income from any source that will not continue may not be used in calculating the borrower's income ratios. Paragraph 2-6, provides that to analyze the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment. The file did not contain this documentation.

Credit Not Properly Assessed

National City did not properly assess the borrower's poor credit performance despite having sufficient income to pay bills. The credit report showed the borrower had one write-off and three collection accounts with balances that totaled $1,260 within the last 12 months. The file did not document an explanation for the collections and write-off nor did the underwriter document compensating factors considered to override these adverse credit characteristics. The automated underwriter findings report commented that no further explanation was required for any adverse or other derogatory credit information. However, the collections and write-off were inconsistent

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with the borrower's low 25.20 percent debt-to-income ratio and should have generated questions about the borrower's responsibility toward financial obligations. HUD's system showed the borrower defaulted due to excessive obligations.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligation and predicting a borrower's future actions. It further states that if the credit history reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve a loan. Major indications of derogatory credit, including judgments, collections, and any other recent credit problems, require sufficient written explanation from the borrower.

Gift Not Properly Verified

National City's loan file contained no documentation to support that the lender verified receipt of a $4,400 gift by a nonprofit donor. Thus, National City allowed the loan to close without first verifying that the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. OIG confirmed the gift amount with the nonprofit. However, OIG's confirmation does not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

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Case number:	091-3647861
Loan purpose:	Purchase
Underwriter type:	Loan prospector underwriter
Date of loan closing:	December 23, 2002
Insured amount:	$71,497
Status:	Claim (not resold)
HUD costs incurred:	$83,356 (claim paid)

Gift Not Properly Verified

National City allowed the loan to close without proper verification of gift funds totaling $23,565 from the borrower's mother ($2,000), a cousin ($1,132), and a nonprofit donor ($20, 433). The file contained copies of separate cashier's checks the mother and cousin supposedly purchased and made payable to the closing agent for the gifts. Neither of the withdrawal documents contained preprinted bank account identification needed to support that the withdrawal accounts belong to the donors. The closing agent showed no record of receiving the checks. Instead, the closing agent's loan escrow ledger showed it received two different cashier's checks from the seller. The checks were completed to show they came from the relatives. Copies of bank checks obtained from the closing agent showed the mother provided a gift of $1,138, versus $2,000, and the cousin provided a gift of $2,000, versus $1,132. The checks were dated December 30, 2002, although the loan closed on December 23, 2002. National City did not obtain documents from the closing agent needed to confirm receipt of the gifts. That documentation would have identified discrepancies and required resolution before loan closing.

National City's loan file also did not contain documentation to support that it verified a $20,433 gift paid to the closing agent by a nonprofit donor. In addition, the borrower did not sign the nonprofit gift letter. OIG verified the receipt of the gift funds with the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation do not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required and showing the donor's name, address, telephone number, and relationship to the borrower.

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Case number:	094-4640149
Loan purpose:	Purchase
Underwriter type:	Manual underwriter
Date of loan closing:	August 15, 2002
Insured amount:	$111,244
Debt-to-income ratio:	76.86 percent
Status:	Claim/sold
HUD’s loss on resale:	$18,707

Income Not Properly Assessed

National City did not properly verify or document verification of $1,863 of the $3,150 gross monthly income it used to qualify the borrower for the loan. The $1,863 represented the borrower’s primary income from employment. National City’s loan file contained no pay stubs covering the most recent 30-day period from the full-time employer to support the $1,863 monthly income amount. The file contained a verbal verification that showed the borrower had worked for the employer for about seven months. The verbal verification did not document confirmation of the borrower’s pay rate or likelihood of continued employment, and the file provided no other confirmations needed to validate this information. We, therefore, excluded the income amount in our analysis and calculated a debt-to-income ratio of 76.86 percent, compared to the 32.02 percent rate National City calculated.

HUD Requirements

HUD Handbook 4155.1, REV-4, chapter 2, section 2, provides that the anticipated amount of income and likelihood of its continuance must be established to determine the borrower’s capacity to repay the mortgage debt. Income from any source that cannot be verified, is not stable, or will not continue may not be used in calculating the borrower’s income ratios.

Credit Not Properly Assessed

National City approved the loan despite the borrower’s poor credit history. The borrower had 17 medical accounts in collection status totaling $3,629. The loan file contained a written explanation from the borrower stating that she had been working unsuccessfully with her insurance company to cover the expenses. National City approved the loan without resolving whether the debts were obligations of the borrower or the insurance company. National City should not have approved the loan before resolving this issue and documenting the file to support its decision. The automated underwriter system referred the loan to manual underwriting because of the credit risk. National City’s quality control audit identified the borrower as having an unacceptable credit history.

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HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligation and predicting a borrower's future actions. It further states that if the credit history reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve a loan. Major indications of derogatory credit, including judgments, collections, and any other recent credit problems, require sufficient written explanation from the borrower. The handbook also states both collections and judgments indicate the borrower's regard for credit obligations and must be considered in the analysis of creditworthiness.

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Case number:	093-5382708
Loan purpose:	Purchase
Underwriter type:	Desktop underwriter
Date of loan closing:	November 4, 2002
Insured amount:	$68,918
Debt-to-income ratio:	56.34 percent
Status:	Claim (not resold)
HUD costs incurred:	$76,334 (claim paid)

Credit Not Properly Assessed

National City omitted an automobile loan with monthly payments of $436 from its automated underwriting system assessment of the borrower's eligibility for the loan. The automated underwriting system's finding report contained a handwritten note that the loan had fewer than 10 payments remaining. This comment was incorrect. More than 10 months would have been required to pay off the $4,273 balance and related interest. This debt accounted for 50 percent of the borrower's monthly installment debts. HUD requires consideration of obligations that affect the borrower's ability to make the mortgage payment during the months immediately after loan closing. We included the $436 in our analysis, and it increased the debt-to-income ratio to 56.34 percent, compared to the 39.52 percent rate National City calculated.

HUD Requirements

HUD Handbook 4155.1, Rev 4, paragraph 2-11, provides that in computing the debt-to-income ratio, the lender must include all recurring charges extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing.

Gift Not Properly Verified

National City's file contained no documentation that it verified receipt of a $2,100 gift paid to the closing agent by the nonprofit donor. Thus, National City allowed the loan to close without support that the closing agent received the nonprofit gift used to pay the borrower's required investment in the property. OIG verified that the gift funds were provided to the closing agent and confirmed the gift amount with the nonprofit. However, OIG's verification and confirmation does not relieve National City of its responsibility to verify the transfer of gift funds before loan closing.

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HUD Requirements

HUD Handbook 4155.1, REV-4, paragraph 2-10C, provides that the lender must document the transfer of the funds from the donor to the borrower. If the funds are not deposited to the borrower's account before closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift.

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