Issue Date	September 15, 2005
Audit Report Number	2005-FW-1015

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

FROM: Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: MortgageIT Incorporated Did Not Follow HUD Requirements When Processing Two Loans

HIGHLIGHTS

What We Audited and Why

We reviewed Federal Housing Administration loans sponsored by MortgageIT Incorporated (MortgageIT) of New York, New York. During an audit of a Federal Housing Administration-approved loan correspondent, we identified three loans sponsored by MortgageIT that did not appear to be properly originated according to U. S. Department of Housing and Urban Development (HUD) regulations. Because the sponsor of the loans is ultimately responsible for loan processing deficiencies, we addressed these deficiencies to MortgageIT to determine whether it complied with HUD requirements.

What We Found

MortgageIT did not comply with HUD regulations, procedures, and instructions in the processing of two of the three Federal Housing Administration-insured single-family mortgages we reviewed. For one loan, the lender charged the borrower $1,407 in loan discount points without reducing the borrower's interest rate. For another loan, the lender did not ensure the appraisal met HUD standards. As a result, the risk to HUD's insurance fund was increased, and a borrower incurred excessive costs for a loan.

What We Recommend

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgage Review Board, require MortgageIT to reimburse the appropriate parties for $1,407 in unearned fees and ensure MortgageIT's controls over appraisals are adequate.

Auditee's Response

On September 2, 2005, MortgageIT provided a written response to our report. MortgageIT generally agreed with our report findings. It provided evidence of a principal reduction for the $1,407 in unearned fees and agreed to take steps to remind its underwriters that appraisers must consider the sales contract in determining the appraised value. The complete text of MortgageIT's response can be found in Appendix B. We omitted the attachments due to Privacy Act concerns.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

MortgageIT Incorporated (MortgageIT) is a nonsupervised lender that began originating Federal Housing Administration loans in 1999.

During the audit of a loan correspondent,[1] we identified three Federal Housing Administration loans sponsored by MortgageIT that did not appear to be originated according to U. S. Department of Housing and Urban Development (HUD) regulations. To resolve these deficiencies, we performed a review of MortgageIT's underwriting of these loans.

Our objective was to determine whether MortgageIT complied with HUD regulations, procedures, and instructions when processing these Federal Housing Administration mortgages that it sponsored for a loan correspondent.

1 Report Number 2005-FW-1009, Allied Home Mortgage Capital Corporation, Nonsupervised Loan Correspondent, Houston, TX, issued May 24, 2005.

RESULTS OF AUDIT

Finding: MortgageIT Did Not Follow HUD Requirements When Processing Two Federal Housing Administration Loans

MortgageIT did not comply with HUD regulations, procedures, and instructions in the processing of two Federal Housing Administration-insured single-family mortgages. For one loan, the lender charged the borrower loan discount points without reducing the borrower's interest rate. For another loan, the lender did not ensure the appraisal met HUD standards. As a result, the risk to HUD's insurance fund was increased, and a borrower incurred excessive costs for a loan.

MortgageIT Did Not Follow HUD Requirements

MortgageIT did not follow HUD requirements for two of the three loans we reviewed. The following paragraphs summarize the deficiencies with the loans. For more detailed information, see appendix C.

Case number 492-6908815

MortgageIT allowed the loan correspondent to charge the borrower $1,407 in loan discount points without reducing the borrower's interest rate. Instead, the loan correspondent charged the borrower an above-market interest rate. MortgageIT compensated the loan correspondent for the higher interest rate through the payment of a yield spread premium of $2,373. HUD believes yield spread premiums can be a legitimate tool to reduce the borrower's closing costs through a higher interest rate. However, the loan correspondent could not provide documentation to show that the borrower received anything of value for the discount points charged. The Real Estate Procedures Act prohibits giving or accepting any part of a charge for services not performed. MortgageIT concurred and agreed to repay the $1,407.

Case number 491-8097408

MortgageIT did not ensure the appraisal met HUD standards. In determining the appraised value, the appraiser did not analyze the subject sales contract. The sales contract showed the seller agreed to pay the borrower's closing costs up to $8,500. The appraiser indicates that the sales contract was not available but does not provide further explanation. Since the appraiser did not consider the terms of the contract, MortgageIT cannot be certain of the accuracy of the appraised value. MortgageIT concurred that the appraiser should have provided an explanation for not reviewing the contract.

Conclusion

The underwriting deficiencies on these two loans unnecessarily increase the risk to the insurance fund. Further, the unearned fees unfairly imposed costs on the borrower without providing a benefit in return. MortgageIT should repay the appropriate parties for the $1,407 in unearned discount points.

Recommendations

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

1A. Require MortgageIT to reimburse the appropriate parties for $1,407 in unearned fees.

1B. Ensure MortgageIT's controls over appraisals are adequate to provide reasonable assurance that its appraisals include an analysis of the subject sales contract.

MortgageIT provided evidence of a principal reduction for the $1,407 in unearned fees. It also agreed to take steps to remind its underwriters that appraisers must consider the sales contract in determining the appraised value. The recommendations are therefore closed. No further action is required.

SCOPE AND METHODOLOGY

We reviewed MortgageIT's processing of three Federal Housing Administration loans that it sponsored for a Federal Housing Administration-approved loan correspondent. During our audit of that loan correspondent, we reviewed loans closed from July 1, 2002, through June 30, 2004, that defaulted within the first three years of closing. We identified three loans sponsored by MortgageIT that appeared to be improperly underwritten. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed the deficiencies to MortgageIT.

To accomplish our objective, we prepared case narratives of loan processing deficiencies identified and provided the information to MortgageIT. We allowed MortgageIT an opportunity to provide additional information that could resolve the deficiencies identified. MortgageIT provided a written response, which we evaluated in reaching our conclusions.

In conducting our audit, we used computer-processed data contained in HUD's Neighborhood Watch system. However, we did not rely on the data to accomplish our audit objective. Accordingly, we did not assess the reliability of the data in the system.

We did not assess MortgageIT's underwriting controls because they were not significant to our objective of reviewing these three loans.

We performed the work from May through July 2005. The audit was conducted in accordance with generally accepted government auditing standards.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible 1/
1A	$1,407

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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation	Auditee Comments

MortgageIT

September 2, 2005

Ms. Laura Nixon
Senior Auditor
US Dept of Housing and Urban Development
Region VI, Office of the Inspector General
819 Taylor St, Suite 13A09
Fort Worth, TX 76102

RE: HUD OIG Audit Report – Response from MortgageIT, Inc.

Dear Ms. Nixon:

Comment 1

Pursuant to your Audit Report dated 8/10/2005, the OIG recommended that MortgageIT reimburse the appropriate parties $1407 in unearned fees and ensure MortgageIT's controls over appraisals are adequate.

Comment 2

Attached hereto is documentation proving MortgageIT has made a principal reduction in the amount of $1407 which was applied to the mortgage loan balance on FHA Case number 492-6908815.

In addition, an Underwriting Bulletin has been drafted and a conference call will be held with mandatory attendance for our DE underwriters. The Underwriting Bulletin and call will reiterate HUD's requirement that appraisers obtain and analyze all sales contracts in determining a property's appraised value.

We thank you for the opportunity to respond to your findings. Please feel free to contact me with any additional questions or concerns.

Sincerely,

Jayne Schumann
MortgageIT, Inc., Director of Government Lending
1350 Deming Way, 3rd Floor
Middleton, WI 53562
(608) 824-2425
jschumann@mortgageit.com

Attachments

Corporate Headquarters 33 Maiden Lane New York, NY 10038 212.651.7700

OIG Evaluation of Auditee Comments

Comment 1 We concur with MortgageIT's response to our report findings. The recommendations are therefore closed. No further action is required.

Comment 2 We omitted the attachments due to Privacy Act concerns.

Appendix C

CASE STUDIES OF IMPROPERLY ORIGINATED LOANS

Case number: 492-6908815

Mortgage amount: $70,339

Gift amount: $0

Date of loan closing: September 23, 2003

Status as of March 31, 2005: Modification

Payments before first default reported: 0

Summary:

Ineligible Closing Cost Charged to Borrower

MortgageIT allowed the loan correspondent to charge $1,407 in loan discount points without reducing the borrower's interest rate. Rather than reducing the interest rate, the loan correspondent charged the borrower an above-market interest rate, resulting in a yield spread premium of $2,373. The loan correspondent did not provide documentation to show the borrower received anything of value for the discount points charged. HUD allows lenders who originate Federal Housing Administration-insured loans to charge borrowers a 1 percent loan origination fee and eligible closing and prepaid costs; however, additional fees should be for specific services performed beyond the normal loan processing and underwriting. Section 8 of the Real Estate Settlement Procedures Act prohibits giving or accepting any part of a charge for services not performed. Since the loan correspondent charged loan discount points without reducing the interest rate, the discount points were unearned fees in violation of the Real Estate Settlement Procedures Act.

Case number: 491-8097408

Mortgage amount: $143,744

Gift amount: $2,290

Date of loan closing: August 29, 2003

Status as of March 31, 2005: Foreclosure started

Payments before first default reported: 1

Summary:

Appraisal Did Not Include an Analysis of the Subject Sales Contract or List Price

The appraiser did not analyze the subject sales contract. The sales contract, dated before the date of the appraisal, showed the seller agreed to pay the borrower's closing costs up to $8,500. The appraiser noted that the contract was not available for review but did not provide further explanation. HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Uniform Standards of Professional Appraisal Practice rule 1-5(a) requires the appraiser to analyze all agreements of sale, options, or listings of the subject property in determining a property's appraised value. Rule 2-2(a)(ix) states that if the information is unobtainable, the appraiser must provide a statement on efforts made to obtain the information.