



Issue Date	September 30, 2005
Audit Report Number	2005-KC-1009

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

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: Washington Mutual Bank Did Not Follow HUD Regulations When
Underwriting Six Loans

HIGHLIGHTS

What We Audited and Why

We reviewed 10 Federal Housing Administration loans sponsored by Washington Mutual Bank (Washington Mutual) of Seattle, Washington. During an audit of a Federal Housing Administration-approved loan correspondent that originated the loans, we concluded that eight loans sponsored by Washington Mutual did not appear to be properly underwritten according to U.S. Department of Housing and Urban Development (HUD) regulations. In addition, Washington Mutual charged the borrower fees prohibited by HUD on five loans, three of which were also questionable loan originations. Because the sponsor of the loans is ultimately responsible for loan processing deficiencies, we addressed these deficiencies to Washington Mutual to determine whether it complied with HUD regulations, procedures, and instructions when processing the mortgages.

What We Found

Washington Mutual did not comply with HUD regulations, procedures, and instructions in the underwriting of six Federal Housing Administration-insured mortgages. The deficiencies involved unverified property repairs required to support the appraised value, unsupported income, improper refund of gift funds to the borrower, unsupported assets, and questionable ownership of one subject property. Upon further evaluation of the two other loans initially questioned as

improper originations, we concluded that Washington Mutual adequately followed HUD regulations and are no longer questioning these loans.

Washington Mutual charged prohibited fees (totaling \$922) on five loans, three of which were also identified as improperly underwritten loans.

What We Recommend

We recommend that the assistant secretary for housing - federal housing commissioner take appropriate administrative action against Washington Mutual for not complying with HUD underwriting requirements. This action, at a minimum, should include requiring indemnification for three actively insured loans with original mortgage amounts totaling \$223,476, two loans on which HUD has incurred losses of \$87,639, and one loan that is overinsured by \$1,425.

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

Washington Mutual agreed with our conclusions and to indemnify HUD for potential losses on loans currently insured, and losses already incurred. We provided the draft report to Washington Mutual on September 2, 2005 and requested a response by September 17, 2005. Washington Mutual provided written comments on September 27, 2005.

The complete text of the auditee's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Washington Mutual Bank (Washington Mutual) is a supervised lender that began originating Federal Housing Administration loans in 1979.

During the audit of a loan correspondent, we identified eight Federal Housing Administration loans sponsored by Washington Mutual that did not appear to be underwritten according to U.S. Department of Housing and Urban Development (HUD) regulations. We also identified five loans, three of which were also questionable loan originations, on which Washington Mutual charged prohibited fees to the borrowers. To resolve these deficiencies, we performed a review of Washington Mutual's underwriting of these loans.

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

RESULTS OF AUDIT

Finding: Washington Mutual Did Not Follow HUD Regulations When Underwriting Six Loans

Washington Mutual did not comply with HUD regulations, procedures, and instructions in the underwriting of six Federal Housing Administration-insured single-family mortgages. The loans contained deficiencies that affected the credit quality (insurability) of the loans. As a result, HUD insured three improperly underwritten loans with original mortgage amounts totaling \$223,476 and one loan that is overinsured by \$1,425, thereby unnecessarily placing the insurance fund at risk for \$224,901. HUD incurred losses of \$87,639 on two additional loans when it paid a claim to the lenders and incurred losses on the sale of the insured properties.

Washington Mutual Did Not Follow HUD Underwriting Requirements

Washington Mutual sponsored six loans that contained significant underwriting deficiencies. The deficiencies involved unverified property repairs required to support the appraised value, unsupported income, improper refund of gift funds to the borrower, unsupported assets, and questionable ownership of one subject property.

Case Number 321-3198432

The appraised value of the property was contingent on required roof repairs, but Washington Mutual did not ensure that the roof repairs were completed before the loan closing. It cleared all underwriting conditions related to the roof repairs; however, the loan file contained no documentation certifying that the roof repair was completed and that the appraisal conditions had been met. Washington Mutual agreed with our conclusion.

Case Number 321-2201134

Washington Mutual gained loan approval from an automated underwriting system using an unsupported monthly income amount for the coborrower. Using only the supported monthly income, the borrowers' debt ratio would have increased to 48.8 percent, well above HUD's limit of 41 percent. While the loan documentation indicated possible compensating factors, these factors were not sufficient to overcome the negative factors also present in the loan file. Washington Mutual agreed that it had not adequately supported the borrowers' income.

Case Number 581-2396531

Washington Mutual approved a mortgage amount that was higher than allowed by HUD regulations, resulting in an overinsured mortgage. In closing the loan, the

borrower received a nonprofit gift of \$5,554 and a \$765 property tax credit, which totaled \$6,319, but the borrower needed only \$4,464 to close the loan. The lender allowed the refund to the borrower of \$1,855 instead of reducing the sales price used to calculate the maximum mortgage by the amount of the excess funds.

Lenders are allowed to reimburse a borrower for fees paid outside of closing when other allowable sources of funds become available for the reimbursement. Therefore, the overage of \$1,855 should be offset by the \$430 paid by the borrower outside of closing for hazard insurance, thus reducing the excess funds paid to the borrower in error to \$1,425. As a result, this loan is overinsured by \$1,425. Washington Mutual agreed with our conclusion.

Case Number 161-1980353

Washington Mutual did not adequately verify the assets claimed and required to close the loan. In obtaining loan approval, the borrowers claimed \$3,676 in available assets (bank accounts and stock options) and needed \$3,651 to close the loan. Verifications of bank accounts obtained just before the loan closed showed that the borrowers had \$2,683 available. However, the average savings account balance for the previous two months was only \$327. Washington Mutual did not research the large increase in the savings account or obtain the required bank statements to review for questionable transactions. It also did not confirm whether the borrowers received funds from the stock options used to qualify for the loan. Washington Mutual agreed that it had not adequately supported the borrowers' claimed assets.

Case Number 161-1979463

Washington Mutual did not verify that the borrower was currently employed, nor did it support the monthly income claimed because it did not obtain a verification of employment or a recent pay stub. The borrower claimed \$3,045 in monthly base pay, which included employee and self-employment income. The lender did not obtain adequate documentation to verify either form of income. Using the inadequately documented employee monthly income of \$2,515 and the self-employment monthly net profit of \$303, the borrower's monthly income was only \$2,818 per month.

In addition, the borrower's base monthly income remained steady for the most recent 2.5 years (i.e., was not increasing) and the current self-employment income decreased significantly from the two prior years by approximately \$250 per month. Although the \$2,818 per month was sufficient to qualify within HUD's financial ratio limits, the lender did not adequately verify the validity or stability of this income. Washington Mutual agreed that it had not adequately supported the borrower's employment history and monthly income claimed.

Case Number 161-1975505

The borrowers needed a substantial gift of equity to close the loan, but Washington Mutual did not obtain adequate documentation to ensure that the gift of equity was from an allowable source. Only family members may provide equity credit as a gift on a property being sold to other family members. In some instances, the loan documentation indicated that the borrower's grandmother owned the property and

provided the gift of equity. However, the loan files also contained multiple discrepancies regarding who actually owned and was selling the property and whether the transaction met HUD's identify-of-interest stipulations. If the seller was not a family member, then the loan is overinsured. Washington Mutual agreed that it had not adequately verified that the seller of the property was a relative and that the gift of equity and other loan elements were appropriate.

Appendix C contains more detailed analyses of the loans.

Unallowable Fees Charged to Borrowers

Washington Mutual charged five borrowers unallowable fees (totaling \$922) that are prohibited on Federal Housing Administration mortgages.

Case number	Description of unallowable charges	Total unallowable charges
321-2195941	Excessive appraisal fee and improper overnight courier fee	\$425
581-2396531	Commitment fee without written agreement and overcharge on credit report fee	\$416
161-1975505	Overcharge on credit report fee	\$42
321-2201134	Overnight courier fee on nonrefinance loan	\$25
161-1984269	Overcharge on credit report fee	\$14
	TOTAL	\$922

Washington Mutual agreed with our analysis of the unallowable charges and that it owes refunds to the appropriate parties.

Conclusion

Washington Mutual Bank did not comply with HUD requirements when underwriting six Federal Housing Administration loans. The deficiencies involved required property repairs that it did not confirm were completed before closing the loan, unsupported income, excess gift funds improperly refunded to the borrower, unsupported assets, and unverified ownership of one subject property. Therefore, HUD is unnecessarily at risk for three loans with original mortgage amounts totaling \$223,476 and one loan that is overinsured by \$1,425. In addition, HUD incurred losses of \$87,639 when it paid claims on two additional loans and incurred losses on the sale of the properties.

Because the monetary value of the unallowable fees is minimal, and Washington Mutual agreed with our analysis and that it owes refunds to the appropriate parties, we have made no formal recommendations to HUD in this regard.

Recommendation

We recommend that the assistant secretary for housing - federal housing commissioner and chairman, Mortgage Review Board

- 1A. Take appropriate administrative action against Washington Mutual for not complying with HUD underwriting requirements. This action, at a minimum, should include requiring Washington Mutual to indemnify HUD for three actively insured loans with original mortgage amounts totaling \$223,476, two loans on which HUD has incurred losses of \$87,639, and one loan that is overinsured by \$1,425 (see appendix C).

SCOPE AND METHODOLOGY

We performed a review of Washington Mutual's processing of 10 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 June 1, 2002, through May 31, 2004, that defaulted within the first two years after closing. Of the 10 loans sponsored by Washington Mutual, we identified eight loans that appeared to be improperly underwritten. We also identified five loans, including three that were also improperly underwritten, on which Washington Mutual charged unallowable fees to the borrowers. Because the sponsor of the loans is ultimately responsible for loan processing deficiencies, we addressed these deficiencies to Washington Mutual.

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

We relied on computer-processed data contained in HUD's Single Family Data Warehouse system. During the audit of the loan correspondent, we assessed the reliability of the data, including relevant general and application controls, which we found to be adequate. We also performed sufficient tests of the data, and based on the assessments and testing, we concluded that the data are sufficiently reliable to be used in meeting our objectives.

We did not assess Washington Mutual's underwriting controls because they were not significant to our objective of reviewing these 10 loans.

We performed audit work from March through mid-August 2005. The audit was conducted in accordance with generally accepted government auditing standards.

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	\$ 87,639	\$ 224,901

- 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/ “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.

Appendix B

AUDITEE COMMENTS



Government Lending Administration

September 27, 2005

Ronald J. Hosking
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
Region VII Office of Audit
Gateway Tower II – 5th Floor
400 State Avenue
Kansas City, Kansas 66101-2406

Dear Mr. Hosking,

Washington Mutual Bank appreciates the opportunity to provide written comments to the final Audit Report dated September 2nd, 2005, delivered by Housing and Urban Development - Office of Inspector General. These loans were originated by Mortgage Express, Inc., a sponsored correspondent of Washington Mutual Bank.

Washington Mutual Bank does not believe that the loans audited by the OIG are representative of our actual lending practices and this sampling does not reflect the quality control measures that exist today in our current environment. We do not disagree; however, with the findings of the eight loans listed below and are prepared to take the following action:

Case Number: 321-2198432:

Washington Mutual Bank agrees to reimburse HUD for the loss on sale in the amount of \$49,120.00.

Case Number 321-2201134:

Washington Mutual Bank agrees to reimburse HUD for the loss on sale in the amount of \$38,519.00. Additionally, Washington Mutual Bank agrees to reimburse the borrower in the amount of \$25.00 for the refund of non-allowable fees charged to the borrower at settlement.

Case Number 161-1980353:

Washington Mutual Bank agrees to indemnify HUD for \$93,024.00 the insured amount of the loan.

Case Number 161-1979463:

Washington Mutual Bank agrees to indemnify HUD for \$79,748.00 the insured amount of the loan.

Case Number 161-1975505:

Washington Mutual Bank agrees to indemnify HUD for \$50,704.00 the insured amount of the loan and to apply a principal reduction in the amount of \$42.00 for the refund of non-allowable fees charged to the borrower.

Case Number 581-2396531:

Washington Mutual Bank agrees to apply a principal reduction in the amount of \$416.00 for the refund of non-allowable fees charged to the borrower and \$1,425.00 for the amount that HUD over-insured the loan.

Case Number 161-10894269:

Washington Mutual Bank agrees to apply a principal reduction in the amount of \$14.00 for the refund of non-allowable fees charged to the borrower.

Case Number 321-219541:

Washington Mutual Bank agrees to apply a principal reduction in the amount of \$425.00 for the refund of non-allowable fees and excessive appraisal fees charged to the borrower.

We will provide evidence of all principal reductions, if not already attached to this document.

Washington Mutual Bank would also like to inform the Office of the Inspector General that in October of 2002, Washington Mutual Bank was the subject of a HUD Quality Assurance Comprehensive Lender Monitoring Audit. The findings of the audit prompted a number of significant changes in the processing of FHA loans at Washington Mutual Bank in the Retail, Wholesale and Correspondent channels.

Correspondent Lending Policies and Procedures were revised to enhance the quality and uniformity of the Underwriting and the file review process. Policy and Procedures are updated as required by changes in HUD/FHA requirements and monitored periodically to ensure consistency with HUD guidelines.

Weekly reports are provided to senior management from the National Post Closing Operations/Government Insuring Departments. These reports have enabled the Insuring Department, located at the same site, to address insuring and documentation issues and resolve them quickly.

Washington Mutual Bank has established stricter criteria for its review of new DE Underwriters and has increased the requirements necessary for granting of DE sponsorship by Washington Mutual Bank.

Home Loans Credit Quality Teams have been established with the responsibility of monitoring overall performance of all employees' loan quality and underwriting judgment. In order to maintain WaMu sponsored FHA and VA credit underwriting authority, underwriters must consistently receive a satisfactory review of loan files on a routine basis that covers the following:

- o Appraisal Competency
- o Risk Layering
- o Compliance and Regulatory guidelines

While other changes and enhancements have been made in the processing of FHA loans since the origination of the above referenced loans by Mortgage Express Inc., Washington Mutual Bank believes those outlined above have the most significant impact on reducing the deficiencies found in the loans audited by the OIG.

Washington Mutual Bank would like to thank the Office of the Inspector General for the opportunity to provide input to the final audit report and ask that any further correspondence regarding this matter be directed to the party indicated below.

Vicki Schneider
Asst. Vice President
(949) 833-4742
Vicki.schneider@wamu.net

Sincerely,



Mark J. Brown
Senior Vice President
Productions Operations

Cc: Jake Domer
Paddy Steffey
Jennifer Fierling
Thomas A. Gallaher
Vicki Schneider

Appendix C

CASE STUDIES OF IMPROPERLY ORIGINATED LOANS

Case number: 321-2198432

Insured amount: \$69,903

Section of Housing Act: 203(b)

Status upon selection:

Default status after eight months

Date of loan closing: July 12, 2002

HUD costs incurred:

\$49,120 loss of sale of property

Property Value/Appraised Value Not Supported

The lender did not verify and adequately document that required roof repairs were completed before the loan closing. The conditional commitment/direct endorsement statement of appraised value, dated June 3, 2002, clearly stated that the property value assigned was contingent upon an inspection by a roofing professional and successful completion of any required roof repairs. The specific commitment conditions required the lender to furnish a certificate stating that required repairs had been examined and satisfactorily completed.

The roof inspection, dated June 12, 2002, stated the “rear section of roof will NOT exceed 1 year without repair,” and a lender note on the inspection states that the roof “MUST BE REPAIRED.” The loan correspondent’s file contained a note stating the roof was being worked on. An underwriter condition sheet showed that on June 25, 2002, the lender cleared all underwriting conditions related to the required roof repairs and inspection. However, the loan file contained no documentation certifying that the roof repair was completed and that the appraisal conditions had been met. The lender should not have submitted the loan for insurance endorsement without verifying and properly supporting that the repairs were completed.

HUD Requirements

The Desktop Underwriter report required the lender to obtain a uniform residential appraisal report and form HUD 92800-5B, conditional commitment/direct endorsement statement of appraised value.

HUD Handbook 4000.2, REV-2, chapter 2-19, notes that repair requirements outstanding on the conditional commitment or the appraisal report must be satisfied before the mortgage is submitted for endorsement. Generally, satisfaction of repair requirements is indicated on a HUD-92051, compliance inspection report, prepared by an appraiser or inspector.

Case number: 321-2201134

Insured amount: \$125,530

Section of Housing Act: 203(b)

Status upon selection:

Default status after five months

Date of loan closing: June 21, 2002

HUD costs incurred:

\$38,519 loss on sale of property

Unsupported Income

The lender did not adequately support income claimed to qualify the borrowers for the loan. The Fannie Mae Loan Prospector report showed monthly base employment income of \$1,638 claimed for the coborrower. However, the coborrower's recent pay stub showed year-to-date income through April 20, 2002, of only \$1,458 per month ($\$5,271/110 \text{ days} = \$47.92 \text{ per day} \times 365 \text{ days} = \$17,491 \text{ per year}/12 \text{ months} = \$1,458 \text{ per month}$). The verification of employment for this same job also supported the lower amount of monthly income. The coborrower listed other employment on the loan application, but the loan file contained no pay stubs from the second employer, and the verification of employment sent to the second employer was returned with a note stating: "No record of employment." Therefore, the lender gained approval from Loan Prospector using an unsupported monthly income amount for the coborrower.

Using only the supported monthly income, the borrowers' debt ratio would have increased to 48.8 percent, well above HUD's limit of 41 percent. While the loan documentation indicated possible compensating factors, these factors were not sufficient to overcome the negative factors also shown in the loan file.

For example, the lender indicated that it had not included possible ancillary income (bonuses, commissions, and overtime) in the monthly income used to qualify the borrowers. However, ancillary income would not have materially affected the borrowers' financial ratios. Although the borrower earns ancillary income, her total monthly income averaged only \$2,780 over the 28.25 months before the loan closed and only \$2,896 for the previous 16.25 months. Both monthly averages are below the current base monthly income claimed (\$2,942) to approve the loan. Further, for the 8.5 months that the coborrower had been in his current job, he had earned an average of only \$35 per month in overtime, which would not have materially affected the ratios.

While the loan documentation showed that the borrowers had acceptable credit scores and potential reserves (a retirement account), the loan file also contained negative factors, including

- Housing costs increased from \$200 per month to \$1,124 per month.
- Borrowers had liquid assets of only \$866, and \$580 of this amount was needed for closing, leaving liquid reserves of less than one monthly housing payment.
- Borrowers needed a substantial gift (\$3,825) from a nonprofit for downpayment assistance to close the loan.

HUD Requirements

Mortgagee Letter 98-14 says that the Federal Housing Administration has approved Freddie Mac's Loan Prospector for use on Federal Housing Administration-insured mortgages, effective March 2, 1998. The lender remains accountable for compliance with Federal Housing Administration guidelines and those credit, capacity, and documentation aspects not addressed in the Loan Prospector Users Guide.

Freddie Mac's Loan Prospector Automated Underwriting Service Training and Users Guide, section 2, states that the data the user inputs into Loan Prospector must match the application, underwriting documentation, and delivery information at the time the data is entered and that the user is responsible for data integrity.

HUD Handbook 4155.1, REV-4, CHG-1, chapter 2-12-B, states that if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

Unallowable Charges

The HUD-1 settlement statement showed that the borrower was charged a \$25 overnight courier fee. This was not a refinance loan.

HUD Requirement

HUD Homeownership Center Reference Guide, chapter 2, "Mortgage Credit Guidelines," pages 2-15, "Closing Costs and Other Fees," states that all closing items associated with a HUD-insured loan, including paid outside of closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Overnight courier fees are allowable only on refinance loans and under certain conditions.

Case number: 581-2396531

Insured amount: \$94,141

Section of Housing Act: 203(b)

Status upon selection:

Default status after 21 months

Date of loan closing: July 31, 2002

HUD costs incurred:

\$625 in loss mitigation

Overinsured Loan

Washington Mutual approved a mortgage amount that was higher than allowed by HUD regulations because it improperly allowed the borrower to receive a substantial refund of gift funds at closing instead of reducing the sales price used to calculate the maximum mortgage by the amount of the excess funds. As a result, HUD overinsured the loan by \$1,425.

The mortgage credit analysis worksheet showed that the borrower needed \$5,901 to close the loan. However, the HUD-1 settlement statement showed that settlement charges to the borrower totaled only \$3,605. The HUD-1 settlement statement also showed that a \$5,554 nonprofit gift and a \$765 property tax credit were applied to the funds paid on behalf of the borrower. We were unable to determine how the nonprofit determined its gift amount, but it was likely derived from the required downpayment, estimated closing costs, and prepaid expenses. It appears that a portion of the excess gift funds was derived from the underwriter overestimating closing costs and prepaid expenses when estimating the cash needed to close at \$5,901.

The nonprofit gift and property tax credit totaled \$6,319, but the borrower needed only \$4,464 to close the loan. The lender allowed the borrower to receive the \$1,855 in excess funds instead of considering the funds as expenses paid on the borrower's behalf that should have been considered inducements to purchase. The lender should have reduced the sales price and, therefore, the amount of the insured mortgage by the amount of the inducement.

Lenders are allowed to reimburse a borrower for fees paid outside of closing when other allowable sources of funds are available for the reimbursement. Therefore, the overage of \$1,855 should be offset by the \$430 paid by the borrower outside of closing for hazard insurance, thus reducing the excess funds paid to the borrower in error to \$1,425. As a result, this loan is overinsured by \$1,425.

HUD Requirements

HUD Handbook 4155.1, REV-4, CHG-1, chapter 1-7, says that HUD expects the estimate of closing costs used to calculate the mortgage amount during processing and underwriting to be a reasonable reflection of actual closing costs at the time of settlement. If the estimated closing costs used to calculate the mortgage exceed the actual charges by more than \$250, the mortgage amount must be recalculated and reduced before settlement. It is the lender's responsibility to assure that its loans close in compliance with this requirement.

Chapter 1-7-B says that certain other expenses (beyond those described in chapter 1-7-A) 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 loan-to-value ratio. The expenses described in chapter 1-7-A are the seller contributions to the buyer's expenses. HUD permits sellers to contribute up to 6 percent of the property's sales price toward the buyers actual closing costs, prepaid expenses, discount points, and other financing concessions. Closing costs normally paid by the borrower are considered contributions if paid by the seller.

Unallowable Charges

The HUD-1 settlement statement showed that the borrower paid a \$406 commitment fee, but the loan file did not contain a lock-in or commitment agreement which guaranteed the interest rate or discount points, as required. The borrower was also charged a \$55 fee for credit reports. The actual cost of the credit reports was \$45 (\$34 and \$11), an overcharge of \$10. Therefore, the borrower paid \$416 in unallowable fees.

HUD Requirement

HUD Homeownership Center Reference Guide, chapter 2, "Mortgage Credit Guidelines," pages 2-15, "Closing Costs and Other Fees," states that all closing items associated with a HUD-insured loan, including paid-outside-closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Commitment fees are only allowable if the lock-in or commitment agreement for which a fee is charged is in writing and guarantees the rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Credit reports are to be charged at actual cost.

Case number: 161-1980353

Insured amount: \$93,024

Section of Housing Act: 203(b)

Status upon selection:

Default status after 18 months

Date of loan closing: July 19, 2002

HUD costs incurred:

None identified

Unsupported Assets

The lender did not obtain bank statements to support the borrowers' assets claimed. According to the mortgage credit analysis worksheet, the borrowers had \$3,676 in available assets (\$1,276 in liquid assets + \$2,400 in stock options) and needed \$3,651 to close the loan, leaving \$25 in reserves after closing.

Based on the July 11, 2002, verifications of deposit (one week before the loan closed), the borrowers had \$2,683 in available liquid assets [\$1,362 available in checking accounts (\$247 + \$1,115) and \$1,321 available in savings accounts (\$1,311 + \$11)]. However, the average savings account balance for the previous two months was only \$327 (\$316 + \$11). The loan file did not contain an explanation for the large increase in the savings account or the required bank statements to review for questionable transactions. According to the HUD-1 settlement statement, the borrowers paid a \$200 earnest deposit and \$2,817 in cash at closing.

The lender also did not obtain adequate documentation to support receipt of funds from stock options. While the loan file contained a July 15, 2002, stock options summary, there was no evidence that the borrower received the funds to use for the loan closing.

HUD Requirements

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1-F states that mortgage credit analysis requires documentation of assets by verification of deposit and most recent bank statements (i.e., most recent at time of application and provided the document is not more than 120 days old when the loan closes). As an alternative to obtaining a verification of deposit, the lender may choose to obtain original bank statements covering the most recent three-month period or the two most recent consecutive statements, provided the bank statements show the previous month's balance.

HUD Handbook 4155.1, REV-4, CHG-1, chapter 2-10-L, notes that when the borrower claims assets through the sale of stocks and bonds, the value of these securities must be verified from the stockbroker or by photocopies of the stock certificates, along with a dated newspaper stock price list. Actual receipt of funds must be verified.

Case number: 161-1979463

Insured amount: \$79,748

Section of Housing Act: 203(b)

Status upon selection:

Default status after 13 months

Date of loan closing: July 29, 2002

HUD costs incurred:

None identified

Unsupported Income

The lender did not verify that the borrower was currently employed, nor did the lender support the monthly income claimed because it did not obtain a verification of employment or a recent pay stub. Further, the lender included the borrower's self-employment income in the base income amount without proper support.

According to the mortgage credit analysis worksheet, the borrower's monthly income included \$3,045 in base pay from insurance sales. However, the lender did not adequately verify the income claimed.

- For 2002 employee income, the borrower provided an employee earnings summary, which showed only the period from April 1 through May 16, 2002, and that the borrower earned \$2,515 per month (\$3,773 / 1.5 months). The earnings summary activity report did not contain the Social Security number or year-to-date earnings of the borrower.
- For 2002 self-employment income, the borrower provided an informal profit and loss statement for January 1 through July 15, 2002, that showed an average of \$508 per month in gross receipts (\$3,300 / 6.5 months) but only \$303 per month in net profit (\$1,971 / 6.5 months). Although required to support self-employment income, the lender did not obtain a year-to-date balance sheet for 2002.
- For the prior years of income, the lender obtained Internal Revenue Service Form W-2 for 2001 but did not obtain the 2001 federal tax return. The lender obtained only the unsigned schedules related to self-employment income. For 2000, the lender obtained an Internal Revenue Service Form W-2 and an incomplete, unsigned federal tax return.

Using the inadequately documented employee monthly income of \$2,515 and the self-employment monthly net profit of \$303, the borrower's monthly income was only \$2,818 per month. In addition, the borrower's base income remained the same for the two and one-half years (i.e., was not increasing), and the self-employment monthly income decreased from the two prior years to the year-to-date in 2002 by approximately \$250 per month. Although the \$2,818 per month was sufficient to qualify within HUD's financial ratio limits, the lender did not adequately verify the validity or stability of this income.

HUD Requirements

HUD Handbook 4155.1, REV-4, CHG-1, chapter 3-1-E, states that a verification of employment and the most recent pay stub must be used to support employment income. As an alternative to obtaining a verification of employment, the lender may choose to obtain from the borrower original pay stub(s) covering the most recent 30-day period, along with original copies of the previous two years' Internal Revenue Service Form W-2s. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. The lender must also verify by telephone all current employers. The loan file must include a certification from the lender that original documents were examined and the name, title, and telephone number of the person with whom employment was verified.

HUD Handbook 4155.1, REV-4, CHG-1, chapter 2-9-B, states that HUD requires the following documents to support self-employment income:

- 1) Signed and dated individual tax returns, plus all applicable schedules, for the most recent two years;
- 2) Signed copies of federal business income tax returns for the last two years, with all applicable schedules, if the business is a corporation, an S corporation, or a partnership;
- 3) A year-to-date profit and loss statement and balance sheet; and
- 4) A business credit report on corporations and S corporations.

Case number: 161-1975505

Insured amount: \$50,704

Section of Housing Act: 203(b)

Status upon selection:

Default status after 14 months

Date of loan closing: July 15, 2002

HUD costs incurred:

None identified

Seller/Owner Inconsistencies, Questionable Gift of Equity, and Overinsured Loan

The lender did not obtain adequate documentation to ensure that the gift of equity needed to close the loan was from an allowable source. Only family members may provide equity credit as a gift on a property being sold to other family members. In some instances, the loan documentation indicated that the borrower's grandmother owned the home and provided the gift of equity. However, the loan documentation also contained multiple discrepancies regarding who actually owned and was selling the property. These discrepancies call into question the validity of the gift of equity and may be indications of fraudulent activity.

If the grandmother was not the seller, the actual seller contributed significantly more than 6 percent of the sales price allowed by HUD regulations and paid the borrowers' \$1,882 court judgment in violation of HUD rules. With a sales price of \$51,500, an unrelated seller would be limited to contributions of \$3,090. An unrelated seller would have caused the loan to be overinsured because the 6 percent limit was exceeded (seller contributions included a \$4,600 gift of equity, and the seller settlement charges included at least \$2,300 in closing costs normally attributed to the borrower, excluding the court judgment).

Further, if the grandmother was the actual seller, the various documents call into question whether the grandmother was living in the subject property, and if not, the identity-of-interest limitation of 85 percent presents additional questions regarding the legitimacy of the transaction. The lender noted on the mortgage credit analysis worksheet that the identity-of-interest exclusion was met and that the borrowers were long-term tenants of the subject property. The credit report showed that at least one of the borrowers lived at the subject property as early as 1993, but the loan files contained no evidence that the borrowers rented the property, other than the borrowers' application, which states that they have rented the property for 10 years. The property was appraised at \$53,000, and loan was insured for \$50,704.

The loan file contained two purchase agreements, each for \$51,500.

- The first (dated May 11, 2002) was between the borrowers and an individual other than the grandmother (hereafter referred to as "person A"). This purchase agreement said that the seller would pay up to \$3,000 in borrower prepaids and closing costs by providing a \$2,000 gift of equity and paying off the borrowers' judgment to Hawkeye Inc.
- The second (dated June 14, 2002) was between the borrowers and the grandmother and indicated that the seller would pay up to \$3,500 in borrower prepaids and closing costs by

providing a \$2,700 gift of equity and paying off the borrowers' judgment to Hawkeye Inc.

The appraisal (dated May 29, 2002) listed person A as the seller/owner; however, the title insurance documents (dated June 21, 2002) indicated that another party owned the property (hereafter referred to as "person B"). The title insurance also showed that multiple real estate documents had to be filed to clear the title to the property, including

- Record a release of real estate contract made by person B to the grandmother in the amount of \$28,500, dated October 15, 1987, and filed October 16, 1987. Interest in the real estate contract was transferred to person A by a quit claim deed, filed on June 25, 1990.

The loan file also contained a June 28, 2002, gift of equity letter for \$4,600 from the grandmother, but the letter did not identify the borrowers and was not signed by the borrowers.

The HUD-1 settlement statement (dated July 15, 2002) was signed by person A as the seller of the property and showed a \$4,600 gift of equity; however, person A was not the grandmother and was not the indicated donor or a relative of the borrowers. The HUD-1 settlement statement also showed multiple borrower charges paid for by the seller, including a payoff of a first mortgage to person B.

HUD Requirements

HUD Handbook 4155.1, REV-4, CHG-1, chapter 2-10-A, states that only family members may provide equity credit as a gift on a property being sold to other family members.

Chapter 1-7-A states that sellers are permitted to contribute up to 6 percent of the property's sales price toward the buyer's actual closing costs, prepaid expenses, discount points, and other financing concessions. Each dollar exceeding the Federal Housing Administration's 6 percent limit must be subtracted from the property's sales price before applying the appropriate loan-to-value ratio.

Chapter 1-7-B states that certain other expenses (beyond those described in chapter 1-7-A) 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 loan-to-value ratio.

Chapter 1-8-A states that identity-of-interest transactions on principal residences are usually restricted to a maximum loan-to-value ratio of 85 percent. "Identity-of-interest" is defined as a transaction between family members, business partners, or other business affiliates. Maximum financing above an 85 percent loan-to-value ratio is permissible under the certain circumstances, including when one family member is purchasing another family member's

- 1) principal residence or
- 2) property that he or she has rented for at least six months predating the sales contract. A lease or other written evidence must be submitted verifying occupancy.

Unallowable Charges

The HUD-1 settlement statement showed that the borrower was charged a \$55 credit report fee. Mortgage Express ordered a three repository merged credit report on February 15, 2002, for \$14 and a full residential mortgage credit report on July 2, 2002, for \$14. Because the residential

mortgage credit report was ordered after the merged credit report, the borrowers should have been charged only for the residential mortgage credit report. Therefore, the borrowers were overcharged \$42.

HUD Requirement

HUD Homeownership Center Reference Guide, chapter 2, “Mortgage Credit Guidelines,” pages 2-15, “Closing Costs and Other Fees,” states that all closing items associated with a HUD-insured loan, including paid-outside-closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Credit reports are to be charged at actual cost. If the lender orders a three repository merged credit report and then orders a full residential mortgage credit report, the borrower may only be charged for the residential mortgage credit report.

Case number: 321-2195941

Insured amount: \$63,995

Section of Housing Act: 203(b)

Status upon selection:

Default status after 16 months

Date of loan closing: June 5, 2002

Unallowable Charges

The HUD-1 settlement statement showed that the borrower was charged \$850 for the property appraisal. The customary appraisal fee for this area was \$450; therefore, the borrower was overcharged \$400. The HUD-1 settlement statement also showed that the borrower was charged a \$25 overnight courier fee, payable to a title company. This was not a refinance loan. In total, the borrower was overcharged \$425 to close this loan.

HUD Requirement

HUD Homeownership Center Reference Guide, chapter 2, "Mortgage Credit Guidelines," pages 2-15, "Closing Costs and Other Fees," states that all closing costs associated with a HUD-insured loan, including paid-outside-closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Allowable appraisal fees for non-HUD-owned properties are the customary charge for the area. Overnight courier fees are only allowable on refinance loans.

Case number: 161-1984269

Insured amount: \$49,227

Section of Housing Act: 203(b)

Status upon selection:

Default status after seven months

Date of loan closing: July 30, 2002

Unallowable Charges

The HUD-1 settlement statement showed that the borrower was charged a \$44 credit report fee. The actual cost of the three credit reports totaled \$30 (June 19, 2002 - \$3.00; June 21, 2002 - \$14; July 3, 2002 - \$14). Therefore, the borrower was overcharged \$13.

HUD Requirements

HUD Homeownership Center Reference Guide, chapter 2, "Mortgage Credit Guidelines," pages 2-15, "Closing Costs and Other Fees," states that all closing costs associated with a HUD-insured loan, including paid-outside-closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Credit reports are to be charged at actual cost.