



Issue Date March 23, 2006

Audit Report Number 2006-PH-1008

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

FROM:  John P. Buck, Regional Inspector General for Audit, Philadelphia Regional
Office, 3AGA

SUBJECT: 1st Preference Mortgage Corporation, York, PA, and Greenbelt, MD, Did Not
Originate All Federal Housing Administration Loans in Accordance with
HUD Requirements

HIGHLIGHTS

What We Audited and Why

We audited the York, Pennsylvania, and Greenbelt, Maryland, branch offices of 1st Preference Mortgage Corporation (1st Preference), a nonsupervised mortgage company approved to originate Federal Housing Administration single-family mortgage loans. We selected these branch offices because their average default rates were above the states' average default rates. Our audit objective was to determine whether 1st Preference 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 origination of Federal Housing Administration loans.

What We Found

1st Preference's York, Pennsylvania, and Greenbelt, Maryland, branch offices did not originate 38 percent of the Federal Housing Administration loans selected for

review in accordance with HUD's loan origination requirements. Of the 16 loans we selected to review,¹ the branch offices did not fully comply with Federal Housing Administration requirements for six loans valued at \$561,506. 1st Preference did not exercise due diligence in the review of assets and gifts obtained during the loan closing process. These deficiencies were caused by a lack of due professional care at the branch offices and contributed to an increased risk to the Federal Housing Administration insurance fund. In addition, 1st Preference did not complete timely quality control reviews or site reviews of its branch offices or document the review of loans that went into early default. These deficiencies occurred because 1st Preference did not have adequate internal controls in place to ensure the reviews were completed in a timely manner or that the reviews of the branch offices and defaulted loans were documented. As a result, 1st Preference did not identify or correct problems with the accuracy, validity, and completeness of its loan origination in a timely manner.

What We Recommend

We recommend that the assistant secretary for housing – federal housing commissioner request 1st Preference to develop internal procedures to more closely monitor its origination and underwriting procedures. In addition, we recommend that 1st Preference strengthen its internal control procedures to ensure reviews are completed in a timely manner and reviews of the branch offices and defaulted loans are documented.

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

We provided a draft report to 1st Preference on February 17, 2006. We discussed the report with 1st Preference at the exit conference on March 6, 2006. 1st Preference provided written comments to our draft findings on March 15, 2006. The complete text of 1st Preference's response, along with our evaluation of that response, can be found in appendix A of this report.

¹ Originally valued at \$1,858,620.

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BACKGROUND AND OBJECTIVES

The National Housing Act, as amended, established the Federal Housing Administration, an organizational unit within the U.S. Department of Housing and Urban Development (HUD). The Federal Housing Administration provides insurance to private lending institutions under Section 203 of the National Housing Act. HUD designates these institutions as supervised lenders, nonsupervised lenders, loan correspondents, investing lenders, and government institutions. Depending upon its designation, the institution has the authority to originate, purchase, hold, service, or sell Federal Housing Administration-insured mortgages. A nonsupervised lender is a financial institution, the principal activity of which is lending or investing funds in real estate mortgages.

In 1983, HUD implemented the direct endorsement program, which authorized approved lenders to underwrite loans without HUD's prior review and approval. HUD can place the lenders on credit watch status or terminate their approval if their rate of defaults and claims exceeds the normal rate for the area. Many sanctions are available for taking actions against lenders or others who abuse the program.

1st Preference Mortgage Corporation (1st Preference) was incorporated to perform all aspects of mortgage lending on September 4, 1990, under the laws of the state of Maryland. On August 8, 1991, HUD authorized 1st Preference as a nonsupervised mortgage company. 1st Preference's main office is located at 9423 Bel Air Road, Nottingham, Maryland.

The York and Greenbelt branches of 1st Preference are two of its seven active branch offices. Between July 1, 2003, and June 30, 2005, 1st Preference originated 771 Federal Housing Administration-insured mortgages totaling \$94,786,292. 1st Preference's overall compare ratio² for the company was 79 percent and its default rate was below the national average. The York and Greenbelt branch offices originated 321 loans totaling \$39,133,272. Of these, we reviewed 16 loans, originally valued at \$1,858,620, that were in default status with 12 payments or fewer.

		Branch originations	Loan value	Default loans	Default loan value
Branch	York	138	\$12,358,113	9	\$ 789,309
	Greenbelt	183	\$26,775,159	7	\$1,069,311
	Total	321	\$39,133,272	16	\$1,858,620

HUD's Quality Assurance Division's March 2004 review of 1st Preference's loan origination procedures cited several loan origination deficiencies. 1st Preference did not adequately document the source and/or adequacy of funds used for gift funds, down payments, and closing costs.

² According to Neighborhood Watch, this ratio reveals the discrepancy between the subject's default and claim percentage to which it is being compared.

The objectives of our review were to determine whether 1st Preference originated Federal Housing Administration-insured loans in accordance with prudent lending practices and HUD requirements and whether the lender implemented a quality control plan that met HUD's requirements.

RESULTS OF AUDIT

Finding 1: 1st Preference's York and Greenbelt Branch Offices Did Not Fully Comply with HUD's Loan Origination Requirements

1st Preference did not always originate Federal Housing Administration-insured loans in compliance with HUD requirements. For 6 of the 16 loans we reviewed, originally valued at \$561,506, 1st Preference did not exercise due diligence in the review of assets and gifts obtained during the loan closing process (see appendix C). The deficiencies occurred due to a lack of due professional care at the branch offices. Consequently, 1st Preference increased the risk to the Federal Housing Administration insurance fund. Therefore, 1st Preference should develop and implement control procedures to more closely monitor its origination and underwriting procedures.

1st Preference Did Not Adequately Verify Borrowers' Assets

Unsupported Source of Earnest Money Deposit

HUD requirements³ state that if the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of the funds. For case 441-7306314, 1st Preference did not adequately document the source of an earnest money deposit. The earnest money deposit in this case exceeded 5 percent of the contract sales price and appeared excessive based upon the borrowers' savings history. Instead of obtaining a bank statement or canceled check to support the source of funds, 1st Preference obtained a letter from the seller acknowledging the receipt of the earnest money. However, a letter from the seller acknowledging receipt does not support that the deposit was from the borrowers' own funds. As of August 1, 2005, legal action has commenced to start the foreclosure process. We would request indemnification for this loan with an unpaid loan balance of \$98,421 since we

³ HUD Handbook 4155.1, REV-5, paragraph 2-10.

have no assurance the earnest money was from the borrowers' own funds. However, this loan was paid off on March 10, 2006.

Inaccurate Use of Child Support as Effective Income

1st Preference did not adequately support the use of child support income in one case, resulting in an overstatement in the borrower's financial ability to meet her new housing obligations. HUD requirements⁴ state that child support may be included as effective income if the payments are likely to continue for the next three years and there is evidence that payments have been received during the last 12 months. For case 241-7417716, 1st Preference's loan files did not demonstrate the child support had been received for three of the previous 12 months as required. Since this is only a technical deficiency, it does not warrant indemnification. The loan was in default, but the borrower is making repayments to bring the loan current.

Sources of Gift Funds Not Identified

HUD requirements⁵ state that the lender must document the transfer of gift funds from the donor to the borrower to ensure that the gift funds are provided from acceptable sources. In three of the cases reviewed, 1st Preference did not adequately identify the sources of gift funds as required by HUD. For cases 441-7433424, 442-2465417, and 241-7220158, 1st Preference did not obtain the wire transfer receipts or copies of the gift checks to document the transfer of the funds. Without identifying the sources of the gifts, there was no assurance the funds were provided from acceptable sources. Since these are only technical deficiencies and we were able to determine that the organizations providing the funds were legitimate, we are not requesting that these loans be indemnified.

Secondary Financing Terms Not Clearly Identified

HUD requirements⁶ state that if a borrower is obtaining secondary financing, each transaction must be documented, and the loan instruments must be included in the endorsement binder. In two cases, 1st Preference did not obtain the required loan instruments for the secondary financing the borrowers received.

- In case 441-7433424, an incomplete draft copy of the loan instrument was provided in the file. It lacked the borrower's name, signature, and loan amount. The actual loan amount the borrower received differed considerably from the amount originally stated in the gift letter.
- In case 241-7523242, the loan instrument was not provided. Therefore, the secondary loan amount and contingencies were not clearly identified.

⁴ HUD Handbook 4155.1, REV-5, paragraph 2-7(F).

⁵ HUD Handbook 4155.1, REV-5, paragraph 2-10.

⁶ HUD Handbook 4155.1, REV-5, paragraph 1-13.

Had the secondary financing not been received, the borrower would not have had sufficient funds to close.

We were able to obtain copies of the loan instruments, so we are not requesting indemnification on these loans. However, it is 1st Preference's responsibility to obtain these documents to ensure the funds were provided from acceptable sources and that the terms were allowable under HUD regulations.

Recommendations

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

- 1A. Require 1st Preference to develop and implement internal control procedures to more closely monitor its origination and underwriting process (specifically in the areas of earnest money deposits, child support, gift funds, and secondary financing).

Finding 2: 1st Preference's Quality Control Plan and Its Implementation Did Not Comply with HUD Requirements

1st Preference's quality control reviews and plan did not fully comply with HUD regulations. 1st Preference did not complete its quality control reviews within 90 days, complete site reviews of its branch offices, or document its review of loans that went into early default. These deficiencies occurred because 1st Preference did not have adequate internal controls in place to ensure the reviews were completed in a timely manner or that the reviews of the branch offices and defaulted loans were documented. As a result, 1st Preference did not identify or correct problems with the accuracy, validity, and completeness of its loan origination in a timely manner.

Quality Control Reviews Were Not Completed within the 90-Day Requirement

HUD Handbook 4060.1⁷ states that loans must be reviewed within 90 days of the closing of the loan. To ensure that the 90-day goal is met, 1st Preference contracted out the review process to Qualimae.⁸ Each month, Qualimae selected 10 percent of all of the loans issued to determine that the files were complete and all necessary verifications were completed. Once Qualimae completed its review, it provided a status report to 1st Preference, denoting any discrepancies found in the file.

We reviewed the quality control reviews for 11 loans that closed from April 2004 through March 2005 and found that only five of the reviews were performed within the 90-day requirement. The remaining six loans were reviewed from 91 to 162 calendar days after the loan closed.

Part of the reason the reviews were not completed within the 90-day requirement was that 1st Preference did not submit the copies of the loan files to Qualimae in a timely manner. In addition, 1st Preference did not ensure that Qualimae completed the reviews. For example, in September 2005, we requested copies of the Qualimae reports for loans that closed in January 2005. 1st Preference did not realize it had never received the reports from Qualimae. As a result of these untimely reviews, 1st Preference was unable to identify loan origination

⁷ Paragraph 6-6(A).

⁸ Qualimae was hired by 1st Preference to conduct its post closing reviews.

deficiencies in a timely manner and take prompt corrective actions when necessary.

Required Reviews of Branch Offices Were Not Documented in Plan

HUD Handbook 4060.1⁹ states that a lender's quality control plan should include plans to complete site reviews of traditional and nontraditional branch offices engaged in origination or servicing of Federal Housing Administration-insured loans. However, 1st Preference's quality control plan did not require site reviews. Thus, there was limited assurance that 1st Preference's branch offices were in compliance with HUD's requirements and that its staff was knowledgeable of HUD's loan origination and underwriting requirements.

Review of Defaulted Loans Was Not Documented

HUD Handbook 4060.1¹⁰ states that all loans going into default within the first six payments must be reviewed. 1st Preference's quality control plan did not require its independent agent to review early default loans as required by HUD. Instead, 1st Preference officials reviewed the early default loans themselves, but did not formally document their review. Review of early default loans assists in detecting loan origination deficiencies in a timely manner. Since 1st Preference's quality control process did not formally document early default reviews, we have limited assurance that HUD was protected from unacceptable risk; guarded against errors, omissions, and fraud; and assured that swift and appropriate corrective action would be taken when necessary in the origination of Federal Housing Administration-insured loans.

Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner require 1st Preference to

- 2A. Develop and implement procedures to ensure its quality control reviews are performed/completed within HUD's required timeframe.

⁹ Paragraph 6-3(G).

¹⁰ Paragraph 6-6(D).

- 2B. Revise its quality control plan to comply with HUD requirements, thus ensuring site reviews and early default loan reviews are completed and documented.

SCOPE AND METHODOLOGY

To accomplish our objectives, we

- Reviewed 100 percent of the Federal Housing Administration-insured loans (16 cases) originated by 1st Preference's branch offices in York, Pennsylvania, and Greenbelt, Maryland, between July 1, 2003, and June 30, 2005, that had gone into default at least once.
- Examined records and related documents of 1st Preference.
- Reviewed applicable HUD handbooks, mortgagee letters, and other relevant HUD publications.
- Conducted interviews with officials and employees of 1st Preference and the HUD Quality Assurance Division.

In addition, we relied in part on data maintained by HUD in its Neighborhood Watch system. We did not perform a detailed analysis of the reliability of this data.

The audit generally covered the period from July 1, 2003, to June 30, 2005. When applicable, the audit period was expanded to include current data through December 31, 2005. We conducted our field work from September through December 2005.

We performed our review in accordance with generally accepted government auditing standards.

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:

- Loan origination process – Policies and procedures that management has in place to reasonably ensure that the loan origination process complies with HUD program requirements.
- Quality control plan – Policies and procedures that management has in place to reasonably ensure implementation of HUD's quality control requirements.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- 1st Preference did not operate in accordance with HUD requirements as they relate to loan origination and quality control.

The deficiencies are discussed in detail in the Results of Audit section of this report.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



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 14th, 2006

John P. Buck, Regional Inspector General for Audit
US Dept of HUD/OIG – Audit
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100 Penn Square East Room 1005
Philadelphia, PA 19107

Re: Audit Draft # 2006-PH-XXXX

Dear Mr. Buck:

I have received your Draft Audit of 1st Preference Mortgage; I offer the following response for your review.

Comment 1

You asked that we Indemnify HUD for loan number 441-7306314:

While I agree that the “normal documentation” usually provided on EMD over 2% is missing in this file, I do feel that the Underwriter made an educated decision that based on the age of the EMD (1.5yrs before the contract; upon buyers initial rental agreement), she had sufficient documentation to reach a reasonable conclusion.

While I would accept your decision of Indemnification, I would like to submit documentation that the aforementioned loan was paid off on March 10, 2006, through a Sale of the property by the borrower at no cost to HUD.

Comment 2

A technical deficiency for child support as effective Income on loan number 241-7417716:

There is a letter in the file from the borrower that the missing three months of child support was at a time that the borrower and ex-spouse were reconciled. Since there was documentation before and after this time, the Underwriter accepted this as there was “sufficient documentation to demonstrate consistency of payments and a willingness to pay”. As you state, this loan is in repayment by the borrower.

Comment 3

Sources of Gift Funds not Identified for loans numbers 441-7433424, 442-2465417, & 241-7220158:

These were technical deficiencies; we have taken action to correct this. While these gift funds from non-profits were noted on the HUD1 by the Title Companies, we did not ask the Title company for their actual wire transfer of the gifts. (we assumed that the Title company, documenting on the HUD1 that they had received the noted funds, was sufficient). We have corrected and added this to our closing instructions to the Title company; we will follow through with our Closing/Shipping/Insuring Departments to get this documentation when the package is received back from the Title Company. Your auditors secured all these wire transfers, so it is possible to stay on the Title Companies until they can get us a copy of the actual wire transfer for these Non-profits, even after the fact.

Comment 4

Secondary Financing terms not clearly identified for loan numbers 441-7433424 & 241-7523242:

Both of these have NO financing terms because they were specified as Grants. In the former loan, "the actual loan amount the borrower received differed considerably from the amount originally stated in the gift letter"; again, this was a Grant, not a loan, and the Grants are lowered to maximize at what is actually needed for closing.

Comment 5

1st Preference's Quality Control :

1st Preference has contracted with Qualimae for the past 5 years to conduct our outside Quality Control; we have received only two fair reports, on two loans, in all those five years.

"six loans were reviewed from 91-162 calendar days after the loan closed". We have taken measures to ensure that Qualimae will receive a list of all our closed loans within 15 days following every closed month. We will guarantee that all reviews will be completed within the 90 days. Our Marketing department will now email me a copy of the list sent to Qualimae on the 15th of every month.

While our Corporate Supervisor, Margie Winkelman, did review all findings from Qualimae, and she also personally reviewed any defaulted loans, these findings were reported to me in a verbal presentation. I have instructed Ms.Winkelman to also put her findings in writing after her report to me, and maintain a file of these findings.

Comment 6


Reviews of Branch offices were not documented:

I personally visit every Branch of 1st Preference at least twice a month, except for Florida, Texas, and South Carolina, which are visited at least 4-7 times a year. I personally interview all processors and Loan Officers on each of my visits. All of these offices also have a Manager who reports to me. The only documentation to these visits are my many letters of corrections and reiteration of company policy, from time to time, that I send out to Managers, Loan Officers, and Processors. I either send these out to individual offices or individuals, but more times than not, to the company in general. I have found that if I see something that needs fixing/correcting in one office or with one person, it usually is worth sending to the company as a whole; Reiteration of company policy is a continuing reinforcement.

Comment 7

While I will admit that there is always room for improvement, I do feel that we do an exemplary job in protecting the interests of HUD, VA, FNMA, and our Investors. While I realize, as you say, you are all auditors, and it is your job to find faults, I hope you also agree that we strive to meet all of HUD's guidelines in conducting business on their behalf. I hope I have sufficiently responded to all your concerns.

Sincerely,



William J. Parisi, President 1st Preference Mortgage

CUSTOMER LOAN INQUIRY

Account Number [REDACTED] M/P/A WARN 5 LOCK 0 STOP - 10-26-30CERT FND0
 [REDACTED] (H) V (W)X0
 [REDACTED] (H) V (W) X 0
 INV41084 LEHMAN BROTHERS
 LNTYPE 2 FHA SUB 0 CONTACT
 [REDACTED] *CONTRACT

--- PAYMENT DATA--- -- LAST TAX/HAZ TRANSACTION--- --- BAL/VIEW(B/U)
TOTAL DUE 0.00 **-----BALANCES-----**
NEXT DUE 04/01/05 ORIG 93227.00
RECD 0.00 **----- OTHER DATA-----** PRIN 0.00
P&I 665.11 **1st PMT** 10/01/03 **RATE** 7.00000 **ESCROW** 37.26
ESC 224.94 **BALLOON** 00/00/00 **TERM** 360 **BUYDOWN** .00
OPT PRD 0.00 **MAT DT** 09/33 **Orig** 00/00 **CLS CD** 3 **UNAP ...Z** 6253.46
ANCIL 0.00 **ASUM** **GRACE** **MERS** Y
LT CHG 35.60 **P/O QUOTE** 03/10/06 **LC %** 4.000 **PREPAID MONTHS** 03
TOTAL 925.65 **OF P&I&E** **MONTHLY BILLING**
PART PMT DT 00/00/00 **LST ESC ANL** **LC ASSESS** **LST PAYMENT**
O/S 0.00 **INT METH** 0 **FR4417306314703**
FLDMAN **COUNS**

CUSTOMER/LOAN INQUIRY

681 3/14/2006 4:05:54 PM ET PFSP213

ACCOUNT NUMBER [REDACTED] N/P/A [E] Warn 5 Lock 0 Stop - 1 0 - 2 6 - 3 0 Cert Fnd 0

[REDACTED] (H) V [REDACTED] (W) X 0
[REDACTED] (H) V [REDACTED] (W) X 0

Inv 41084 LEHMAN BROTHERS

Lntyp 3 FHA Sub 0 Cntact [REDACTED]

*Contract

-- Payment Data --		--- Last Tax/Haz Transaction ---		--- Bal/View (B/U) B ---	
Total Due	0.00	TRX	893	08/26/05	-1522.78
Next Due	04/01/05	HAZ	E20	08/02/05	-237.00
Recd	0.00	----- Other Data -----			
P&I	665.11	1st Pmt	10/01/03	Rate	7.00000
Esc	224.94	EARLCOH	00/00/00	Term	360
Opt Prd	0.00	Mat Dt	09/33	Orig	00/00
Ancill	0.00	Asum	0	0-00/00	Lc Ases
Lt Chg	35.60	PCL POST	03/10/06	LC #	4.000
Total	925.65	OF PAID			
Part Pmt Dt	00/00/00	Lst Esc Ani	02/05	Lst Pmt	03/16/05
		O/S	0.00	Int Meth	0

Fidman Couns

... [REDACTED] ... 03/08/05 ... 02/03/05

message:

Command:

Submit Reset PrintAll

OIG Evaluation of Auditee Comments

- Comment 1** We have verified loan 441-7306314 was paid off on March 10, 2006, through a sale of the property by the borrower. The report has been revised to reflect this change.
- Comment 2** For loan 241-7417716, we disagree with 1st Preference's assessment to include child support as part of the borrower's effective income. Based upon the payments documented, we do not believe 1st Preference obtained sufficient documentation to demonstrate both the consistency of and a willingness to pay child support payments. HUD Handbook 4155.1, REV-5, paragraph 2-7(F) states that there must be evidence that payments have been received during the last twelve months prior to receiving the loan. Periods of less than twelve months may be acceptable, provided the payer's ability and willingness to make timely payments is adequately documented by the lender. The file contained documentation to support the borrower received child support payments for 9 of the previous 12 months. However, the loan entered early default due to a curtailment in the borrower's income. This curtailment of the borrower's income may be related to the borrower not receiving regular child support payments. The letter provided by the borrower explaining the missing three months worth of child support payments due to a reconciliation period was not adequate to conclude the nine months worth of child support received established consistency and a willingness to pay. As a result, the child support payments should not have been included as effective income.
- Comment 3** We are pleased that 1st Preference has started to take corrective action by updating its closing instructions to include obtaining a copy of the wire transfers of gift funds from the Title Companies. Though we have not audited this action, we hope this action will bring 1st Preference into full compliance with HUD's gift fund documentation requirements found in HUD Handbook 4155.1, REV-5, paragraph 2-10(C).
- Comment 4** We agree that the funds the borrower received in loan 441-7433424 were labeled a grant from Dauphin County on the HUD-1 Settlement Statement. However, based upon documentation reviewed in the loan file, the borrower received a second or subordinated mortgage for \$3,266. Though no interest is attached to this fund, the program stipulates the entire amount of the mortgage received will be repaid upon the sooner of (1) the sale of the property, (2) the transfer of legal or equitable title, or (3) the repayment of all borrowed principal. Thus, the borrower's receipt of the funds creates a secondary financing agreement. For loan 241-7523242, the borrower received \$4,750 from the Housing Venture Fund. The reservation request form for this funding clearly stated the funds were secured. Also, program information specified the repayment contingencies for the funds. The borrower is required to live in the property for a minimum of five years, with 20% of the amount provided reduced each year. If the property is sold within this

five-year period, a lien is created against the property. Since secondary financing is created, completed loan instruments are required in this case as well. HUD Handbook 4155.1, REV-5, paragraph 1-13 states that any financing, other than a Federal Housing Administration-insured first mortgage, that creates a lien against the property is considered secondary financing and not a gift, and copies of the loan instrument are to be included in the loan files.

- Comment 5** We are encouraged that 1st Preference is taking steps to ensure that its quality control reviews are performed within HUD's 90-day requirement, and that it is going to begin documenting management reviews of Qualimae reports, as well as any defaulted loans. We hope these steps taken by 1st Preference will bring them in full compliance with HUD's quality control guidelines found in HUD Handbook 4060.1, REV-1 paragraphs 6-6(A) and 6-6(D).
- Comment 6** Based on the results of our review, there was no documentation to support that 1st Preference completed site reviews in compliance with requirements stated in HUD Handbook 4060.1, REV-1, paragraph 6-3(G). Specifically, some of HUD's requirements include confirming the following: (1) ensuring the offices are properly registered with HUD with its current address, (2) operations are conducted in a professional, businesslike environment, and (3) the offices are sufficiently staffed with trained personnel. Also, 1st Preference's quality control plan did not require site reviews. Though 1st Preference's President may visit his branch offices regularly, there is no documentation to support his visits entailed the review of the required elements specified in paragraph 6-3(G).
- Comment 7** In 1st Preference's conclusion, its President stated, "you are all auditors, and it is your job to find faults." On the contrary, our main objective in this audit was to determine whether the lender acted in a prudent manner and complied with established requirements when originating Federal Housing Administration-insured loans.

Appendix B

SCHEDULE OF 16 FEDERAL HOUSING ADMINISTRATION-INSURED LOANS SELECTED FOR REVIEW

The following shows the 16 loans selected for review:

Case number	Mortgage amount	Default Information		Current servicing sponsor
		Currently in default	Status code as of Dec. 30, 2005	
081-0777169	\$148,393	Y	12	Wells Fargo Bank
241-6990028	\$100,434	Y	68	Wells Fargo Bank
241-7417716	\$173,615	Y	12	Wells Fargo Bank
249-4796890	\$155,295	NR	20	Chase Home Finance
241-7220158	\$ 70,350	Y	12	SunTrust Mortgage
249-4807515	\$267,452	N	13	Washington Mutual
249-4853742	\$153,772	N	13	Washington Mutual
441-7433611	\$ 63,945	N	20	Wells Fargo Bank
442-2489051	\$ 83,331	Y	68	Wells Fargo Bank
442-2465417	\$ 40,904	N	19	Chase Home Finance
241-7523242	\$118,958	N	20	National City Mortgage
441-7551464	\$112,106	N	20	National City Mortgage
441-7306314	\$ 93,227	Y	68	GMAC Mortgage
441-7217278	\$137,786	N	20	GMAC Mortgage
441-7433424	\$ 64,452	Y	12	Washington Mutual Bank
441-7427169	\$ 74,600	N	20	M&T Bank

Default status	
Codes	Descriptions
12	Repayment
13	Paid in full
19	Partial reinstatement
20	Reinstated by borrower who retains ownership
68	First legal action to commence foreclosure
NR	Not reported in Neighborhood Watch

Appendix C

SCHEDULE OF CASE FILE DISCREPANCIES

Case number	Original mortgage amount	Unpaid principal balance	Incomplete asset support
441-7433424	\$ 64,452	\$ 63,349	X
442-2465417	\$ 40,904	\$ 39,189	X
441-7306314	\$ 93,227	\$ 98,421	X
241-7523242	\$118,958	\$131,255	X
241-7220158	\$ 70,350	\$ 68,019	X
241-7417716	\$173,615	\$170,828	X
TOTAL	\$561,506	\$571,061	