




Issue Date September 26, 2006

Audit Report Number: 2006-CH-1017

TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing
Commissioner, H
John W. Herold, Associate General Counsel for Program Enforcement, CE


FROM: Heath Wolfe, Regional Inspector General for Audit, 5AGA

SUBJECT: Community Central Bank, Supervised Lender, Mount Clemens, Michigan,
Generally Complied with HUD's Requirements Regarding Underwriting of
Loans but Not Its Quality Control Reviews

HIGHLIGHTS

What We Audited and Why

We audited Community Central Bank (Community Central), a supervised lender approved to originate, underwrite, and submit insurance endorsement requests under the U.S. Department of Housing and Urban Development's (HUD) single-family direct endorsement program. The audit was part of the activities in our fiscal year 2006 annual audit plan. We selected Community Central for audit because of its high default to claim rate. Our objectives were to determine whether (1) Community Central complied with HUD's regulations, procedures, and instructions in the underwriting Federal Housing Administration-insured loans and (2) Community Central's quality control plan, as implemented, met HUD's requirements.

What We Found

Community Central generally complied with HUD's requirements for underwriting Federal Housing Administration loans. However, it approved 3 of 29 Federal Housing Administration loans reviewed that did not fully meet HUD's requirements. The three loans defaulted early and/or went to claim between October 1, 2003, and

September 30, 2005. Further, Community Central incorrectly certified to the due diligence used in underwriting the three loans. During the audit period, Community Central's quality control plan did not comply with HUD's requirements, and quality control reviews were not performed in a timely manner. Its deficient quality control may have contributed to the underwriting deficiencies. For the loans in question, the risk to the Federal Housing Administration fund was increased.

What We Recommend

We recommend that HUD's assistant secretary for housing-federal housing commissioner require Community Central to indemnify HUD for any future losses on two loans with a total mortgage value of more than \$140,000, reimburse HUD any future net loss once the associated property is sold, and ensure that quality control reviews under its quality control plan are timely and properly documented.

We also recommend that HUD's associate general counsel for program enforcement determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Community Central and/or its principals for the three incorrect certifications cited in this audit report.

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 the results of our underwriting and quality control reviews to Community Central's management during the audit. We also provided our discussion draft report to Community Central's president and chief executive officer and HUD's staff during the audit. We conducted an exit conference with Community Central's vice president on September 15, 2006.

We asked Community Central's president and chief executive officer to provide written comments on our discussion draft by September 27, 2006. Community Central's vice president provided comments to the discussion draft dated, September 13, 2006. Community Central generally agreed with finding 1 and agreed with finding 2. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: Community Central Generally Complied with HUD’s Underwriting Requirements.	5
Finding 2: Community Central Did Not Fully Comply with HUD’s Quality Control Requirements	9
Scope and Methodology	12
Internal Controls	13
Followup on Prior Audits	15
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	16
B. Auditee Comments and OIG’s Evaluation	17
C. Federal Requirements and Community Central’s Requirements	21
D. Summary of Quality Control Deficiencies Using HUD’s Requirements	24
E. Narrative Case Presentations	25

BACKGROUND AND OBJECTIVES

Community Central Bank's (Community Central) headquarters is located in Mount Clemens, Michigan, and it was founded in 1996. It operates two branches serving consumers, small to mid-sized businesses, and government entities in Mount Clemens and Rochester Hills, Michigan. In February 2002, the U.S. Department of Housing and Urban Development (HUD) approved Community Central as a supervised direct endorsement lender to originate Federal Housing Administration-insured loans. As a direct endorsement lender, Community Central determines that the proposed mortgage is eligible for insurance under the applicable program regulations and submits the required documents to HUD without its prior review of the origination and closing of the mortgage loan. Community Central is responsible for complying with all applicable HUD regulations and handbook instructions.

As of September 25, 2006, Community Central had five loan correspondents and two authorized agents. Community Central is primarily a retail residential lender offering Federal Housing Administration, U.S Department of Veterans Affairs, and conventional mortgage financing. It also sponsors the Federal Housing Administration loans that its mortgage company (Community Central Mortgage Company) originates.

We audited Community Central as part of the activities in our fiscal year 2006 annual audit plan. Between October 1, 2003, and September 30, 2005, Community Central originated/sponsored 754 Federal Housing Administration loans totaling more than \$80 million in original mortgage amounts. Of these, 54 loans totaling more than \$5.1 million in original mortgage amounts went to claim, and/or the borrowers defaulted on their mortgage payments within the first six payments. Community Central's default to claim rate was 12.53 percent for October 2003 through September 2005.

Our objectives were to determine whether (1) Community Central complied with HUD's regulations, procedures, and instructions in the underwriting Federal Housing Administration-insured loans and (2) Community Central's quality control plan, as implemented, met HUD's requirements.

RESULTS OF AUDIT

Finding 1: Community Central Generally Complied with HUD's Underwriting Requirements

Community Central generally complied with HUD's underwriting requirements for Federal Housing Administration loans. However, before Community Central improved its underwriting procedures, it approved 3 of 29 Federal Housing Administration loans reviewed that did not fully meet HUD's requirements. The three loans defaulted early and/or went to claim between October 1, 2003, and September 30, 2005. The underwriting deficiencies were material as well as technical and included errors and documentation omissions clearly contrary to prudent lending practices. Further, Community Central incorrectly certified to the due diligence used in underwriting the three loans. The problems occurred because Community Central lacked adequate procedures and controls over its underwriting of Federal Housing Administration-insured loans and did not have a quality control plan that complied with HUD's requirements (see finding 2). As a result of the improperly underwritten loans, the risk to the Federal Housing Administration fund was increased, and HUD paid more than \$78,000 for a claim on one loan.

Underwriting Deficiencies of Federal Housing Administration Loans

Using HUD's Single Family Data Warehouse system, we determined that Community Central sponsored 754 Federal Housing Administration-insured loans totaling more than \$80 million between October 1, 2003, and September 30, 2005. Of these, nine loans totaling more than \$700,000 in original mortgage amounts went to claim. Further, of the 754 sponsored loans, the borrowers for 49 loans totaling \$4.7 million in original mortgage amounts defaulted on their mortgage within the first six payments. Of the 49 loans, we statistically selected 21 early payment defaulted loans to review. One of the loans was a claim and included in the review of the nine loans. Therefore, we reviewed 29 loans (nine claims and 20 early payment defaulted loans) for compliance with HUD's underwriting requirements.

Community Central improperly underwrote three of the loans reviewed with a total mortgage value of more than \$200,000. All three loans were purchase loans. As of September 25, 2006, HUD paid a claim of more than \$78,000 for one loan with underwriting deficiencies. The remaining two loans hold active Federal Housing Administration insurance as of September 25, 2006.

Excessive Debt-to-Income Ratios

Community Central improperly approved two loans (case numbers 261-8628398 and 261-8597097) when the borrowers' debt-to-income ratios exceeded HUD's requirements and submitted them for insurance without valid compensating factors. For example, Community Central approved loan number 261-8597097 when one of the coborrowers was no longer employed as indicated by the credit report in the loan file. However, the coborrower's income was used to qualify for the loan.

Paragraphs 2-12 and 2-13 of HUD Handbook 4155.1, REV-5, specify that the ratio of mortgage payments to effective income (front ratio) generally may not exceed 29 percent and the ratio of total fixed payments to effective income (back ratio) may not exceed 41 percent unless significant compensating factors are presented. The handbook allows greater latitude in considering compensating factors for the front ratio than the back ratio. However, Community Central approved the loans when the borrowers' mortgage payments to effective income for two of the loans were 39 and 41 percent, respectively.

Overstated/Unsupported Income

Community Central did not properly assess the borrowers' income. For loan number 261-8597097, the coborrower was unemployed before the loan closed. The coborrower's credit report contained in the loan file clearly indicated that he was no longer employed at the prior employer listed on the universal residential loan application. For loan number 261-8812331, commission or overtime income was included in the borrowers' income calculation without Community Central justifying the inclusion of the income for qualifying purposes and establishing an earnings trend in accordance with HUD Handbook 4155.1, REV-5.

For loan number 261-8628398, Community Central included child support payments in the borrower's effective income calculation without adequate documentation, such as a final divorce decree, legal separation, or voluntary payment agreement. Also, the borrower's loan file did not contain evidence that this funding would continue.

Incorrect Underwriter's Certifications Submitted to HUD

We reviewed the certifications for the three manually underwritten loans for accuracy. Community Central's direct endorsement underwriter incorrectly certified that due diligence was used in underwriting the three loans. When underwriting a loan manually, HUD requires a direct endorsement lender to certify that it used due diligence and reviewed all associated documents during the

underwriting of a loan. Appendix C of this report provides details of the federal requirements regarding underwriting of Federal Housing Administration loans as well as a citation under the Program Fraud Civil Remedies Act.

Improvements Initiated in Loan Underwriting

Community Central's procedures and controls for underwriting Federal Housing Administration-insured loans needed improvement, and it did not have a quality control plan that complied with HUD's requirements (see finding 2). However, in November 2004, Community Central initiated improvements to its underwriting of Federal Housing Administration loans. It closed its Dearborn and Warren branch offices, which according to the president of Community Central Mortgage Company originated approximately 75 percent of the Federal Housing Administration loans during 2003 and 2004. The loans from these two branches presented a degree of increased risk. Further, in December 2004, Community Central improved its procedures for underwriting Federal Housing Administration loans to ensure greater compliance with HUD's guidelines.

During our review, we determined that eight of the nine loans on which HUD paid claims and 57 percent of the loans on which the borrowers defaulted within the first six payments were originated by Community Central's Dearborn or Warren offices. Therefore, the improvements made by Community Central and the implementation of its revised quality control plan should protect HUD from unacceptable risk and guard against errors, omission, and fraud thus decreasing the risk to the Federal Housing Administration fund.

Recommendations

We recommend that HUD's assistant secretary for housing-federal housing commissioner require Community Central to

- 1A. Indemnify HUD for any future losses on the two loans (261-8628398 and 261-8812331) with a total mortgage value of \$142,346 cited in this finding. The estimated risk to the Federal Housing Administration insurance fund is \$41,280.
- 1B. Reimburse HUD for any future loss from the claim paid on loan 261-8597097 once the associated property is sold. The estimated risk to the Federal Housing Administration fund is \$22,752.

We recommend that HUD's associate general counsel for program enforcement

- 1C. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Community Central and/or its principals for incorrectly certifying that due diligence was exercised during the underwriting of the three loans.

Finding 2: Community Central Did Not Fully Comply with HUD's Quality Control Requirements

Community Central did not comply with HUD's quality control requirements. During the period of October 1, 2003, through September 30, 2005, Community Central lacked a written quality control plan that met HUD's requirements and quality control reviews were not performed in a timely manner. The problems occurred because Community Central relied on its contractor to perform quality control reviews on its Federal Housing Administration loans and it failed to provide the loans to the contractor in a timely manner. As a result, HUD lacked assurance of the accuracy, validity, and completeness of its loan origination files.

Loan Universe and Sample Selections

Using HUD's Single Family Data Warehouse system and Community Central's data, we identified 49 loans totaling more than \$4.7 million in original mortgage amounts that were sponsored by Community Central and closed between October 1, 2003, and September 30, 2005. The loans went to claim, and/or the borrowers defaulted within the first six payments. Of the 49 loans, Community Central only quality control reviewed 30. We statistically selected 21 loans totaling more than \$2 million in original mortgage amounts from the universe of 30 loans that Community Central quality control reviewed to determine whether the reviews complied with HUD's quality control requirements.

As of August 16, 2006, Community Central had performed quality control reviews on eight of the 19 loans that were not previously reviewed. The remaining 11 loans had not been reviewed as required.

Community Central's Quality Control Plan Deficient and Reviews Not Always Performed

Community Central did not comply with HUD's quality control requirements. During the period October 1, 2003, through September 30, 2005, Community Central did not have a written quality control plan that met HUD's requirements. HUD's Quality Assurance Division performed a quality assurance review in June 2005 and determined that Community Central's plan did not contain all of the requirements outlined in HUD Handbook 4060.1, REV-1.

Community Central did not perform quality control reviews on 11 early payment defaulted loans. In accordance with HUD Handbook 4060.1, REV-1, all loans going into default within the first six months must be reviewed as part of HUD's quality control plan requirements. We statistically selected 21 early payment defaulted

loans to determine whether Community Central's quality control reviews were in compliance with HUD's requirements. For the 21 loans, 12 were not quality control reviewed in a timely manner. The number of days ranged from 103 to 224 days after the loans defaulted. See appendix D of this report for a listing of the 23 (11 loans not reviewed and 12 loans not reviewed timely) loans.

Contractor Relied on to Perform Reviews

Since 2001, Community Central has contracted with Wetzel Trott Contract Mortgage Services (Wetzel Trott) to quality control review its Federal Housing Administration-insured loans. Wetzel Trott's quality control plan was in compliance with HUD's requirements; therefore, Community Central did not ensure its own plan complied with HUD's requirements. Additionally, on a quarterly basis, Community Central provided its contractor a list of the early payment defaulted loans for quality control review. However, some of the loans were never reviewed. According to the vice president of compliance for Community Central Mortgage Company, due to management restructuring/reorganization in 2003, some of the early payment defaulted loans were overlooked, thus resulting in loans not being reviewed or reviewed in an untimely manner.

As a result of Community Central's deficient plan and untimely submissions of its loans for quality control reviews, underwriting errors were not always minimized or prevented, thus increasing the risk to the Federal Housing Administration insurance fund (see finding 1).

Community Central's Quality Control Process Improved

Since October 2005, Community Central has improved its quality control plan to meet HUD's requirements and execution of its revised plan by submitting loans to its contractor for review monthly instead of quarterly. According to the vice president of compliance for Community Central Mortgage Company, the monthly submission of the early payment defaulted loans to its contractor has greatly improved its audit compliance and timeliness.

Recommendation

We recommend that HUD's assistant secretary for housing-federal housing commissioner require Community Central to

- 2A. Ensure that quality control reviews for its early payment defaulted loans are timely and properly documented.

SCOPE AND METHODOLOGY

We performed our audit between January and August 2006. We conducted the audit at Community Central's Mount Clemens, Michigan, office and HUD's Chicago regional and Detroit field offices. The audit covered the period October 1, 2003, through September 30, 2005. We extended this period as necessary. We conducted the audit in accordance with generally accepted government auditing standards.

To achieve our objectives, we relied on computer-processed data contained in HUD's Single Family Data Warehouse and Community Central's data files. In addition, we interviewed HUD's and Community Central's management and staff, borrowers' employers, and the contractor's management. Further, we reviewed HUD's rules, regulations, and guidance for the underwriting and quality control review of Federal Housing Administration loans.

Using HUD's data systems, we identified that Community Central originated/sponsored 754 Federal Housing Administration loans with closing dates from October 1, 2003, to September 30, 2005. The original mortgage value of these loans totals more than \$80 million. Of these, nine loans totaling more than \$739,000 in original mortgage amounts went to claim. We performed a 100 percent testing on the nine loans that went to claim.

Of the 754 loans, for 49 loans totaling more than \$4.7 million in original mortgage amounts the borrowers defaulted on their mortgage payments within the first six payments. We determined that Community Central did not perform quality control on 19 of the early payment defaulted loans, so we excluded these loans from our sampling universe. Of the 30 loans, we statistically selected 21 to review for compliance with HUD's underwriting and quality control requirements. One of the loans was included as part of the nine claims. Our sampling criteria used a 90 percent confidence level, 5 percent estimated error rate, and a precision of plus or minus 20 percent. We also reviewed the certifications for the three loans that were improperly underwritten for accuracy.

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,
- Compliance with applicable laws and regulations, and
- Safeguarding resources.

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:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

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 Weakness

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

- Community Central needs to implement its revised quality control plan for reviewing loans that are early payment defaults to ensure compliance with HUD's requirements (see finding 2).

FOLLOWUP ON PRIOR AUDITS

This is the first audit of Community Central by HUD's Office of Inspector General (OIG). The two most recent independent auditor's reports for Community Central covered the years ending December 31, 2003, and 2004. Both reports resulted in no findings. In June 2003 and 2005, HUD's Quality Assurance Division performed quality assurance reviews of Community Central. The reviews resulted in findings related to underwriting and the quality control plan. All of the findings were closed as of January 4, 2006.

APPENDIXES

Appendix A

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

Recommendation number	Unsupported 1/	Funds to be put to better use 2/
1A		\$41,280
1B	<u>\$22,752</u>	
Totals	<u>\$22,752</u>	<u>\$41,280</u>

- 1/ 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. The amount above reflects that, upon sale of the mortgaged property, the Federal Housing Administration's average loss experience is about 29 percent of the claim amount based upon statistics provided by HUD.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reduction in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. Implementation of our recommendation to indemnify loans that were not originated in accordance with Federal Housing Administration requirements will reduce the Federal Housing Administration's risk of loss to the insurance fund. The amount above reflects that, upon sale of the mortgaged property, the Federal Housing Administration's average loss experience is about 29 percent of the claim amount based upon statistics provided by HUD.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



September 15, 2006

Ms. Kelly Anderson
Assistant Regional Inspector General for Audit
United States Department of HUD-Office of Inspector General
77 West Jackson Blvd, Ste 2646
Chicago Illinois, 60604-3507

Dear Ms. Anderson:

Community Central Bank has taken great pride in establishing a FHA origination, processing, underwriting and insuring process that meets all FHA guidelines. Community Central Bank also has taken great pride in lending to low and moderate income groups. It should be noted that the policy of Community Central Bank is to strictly adhere to the underwriting guidelines as set forth in HUD Handbook 4155.1 Rev-5 at all times and every effort is made by the Senior Management Team and Underwriting Department to maintain compliance with said guidelines. The items addressed here that appear to be out of compliance are aberrations and not in any way indicative of Community Central Bank's normal policies and procedures. Every effort is made to insure that the risks associated with every loan file underwritten at Community Central Bank are acceptable under the guidelines in the HUD Handbook 4155.1 Rev-5 and do not represent an unacceptable risk to the FHA insuring fund.

We would like to thank the IG Audit team for their professional conduct and for adhering to their original outline of scheduling and processing for this audit. Community Central Bank will use the findings of this audit in our continuing effort to improve as a HUD/FHA supervised lender.

The following are the specific responses to the findings:

Respectfully,

A handwritten signature in black ink, appearing to read 'Charles U. Shreve', is written over a light blue horizontal line.

Charles U. Shreve
Vice President

120 N. Main Street, P.O. Box 7 / Mt. Clemens, MI 48046-0007 / PH 586.783.4500 / FAX 586.783.8934
1467 N. Rochester Road / Rochester Hills, MI 48307 / PH 248.601.7700 / FAX 248.601.0635
www.communitycentralbank.com

Ref to OIG Evaluation

Auditee Comments

Comment 1

Finding 1: Underwriting Requirements

Please accept these explanations/clarifications regarding your findings on the following loan files:

261-8597097

This loan was initially submitted to underwriting with a credit report dated 08/13/03. At that time the credit report showed the co-borrower was employed and had been for 1.5 years which coincided with the VOE. Before the loan closed an updated credit report was ordered. The updated credit report was reviewed for additional debt and inquires but the fact that the credit report reflected that the co-borrower was no longer employed was an oversight. This oversight was in no way intentional or fraudulent.

Based on this we agree with the findings on this case.

261-8727601

The credit report in this file was Residential Mortgage Credit Report (RMCR) not a Residential Merged Credit Report (TRMCR) as stated in the findings. The RMCR meets the requirements in accordance with HUD Handbook 4155.1, Rev-5.

This borrower has been employed as a sales representative for the same company for the last 8 years and has continually earned commissions in addition to her base salary. The commission earnings were averaged for the previous 17.5 months (MCAW mistakenly indicates 14.5 months). This average was a conservative estimate of the borrower's earnings as it is actually lower than the average for the previous 29.5 months and substantially lower than the actual YTD average. In addition, the borrower has a verified part-time job and receives child support income, neither of which was included in qualifying income. The borrower's tax returns were included in the file in order to document the fact that she does not incur any business expenses related to her primary sales job. These factors all appear to be in compliance with the guidelines as put forth in HUD Handbook 4155.1 Rev-5.

Based on this we disagree with the findings on this case and respectfully request that this exception be eliminated from your final report.

Comment 2

261-8812331

The credit report in this file was Residential Mortgage Credit Report (RMCR) not a Residential Merged Credit Report (TRMCR) as stated in the findings. The RMCR meets the requirements in accordance with HUD Handbook 4155.1, Rev-5.

Ref to OIG Evaluation

Auditee Comments

Justification for using over-time income on this file was based upon the fact that the borrower has worked for the same employer for the last 5 years and has proven over-time earnings over the last 2.5 years. Since the borrower is a union employee (AFSCME Local 3309) and has received contractual payroll increases, her over-time was based upon her most recent 18.5 month average earnings. These factors all appear to be in compliance with the guidelines as put forth in HUD Handbook 4155.1 Rev-5.

Based on this we disagree with the findings on this case and we respectfully request that this exception be eliminated from your final report.

261-8628398

The income labeled child support was actually income received from the State of Michigan Department of Social Services -Aid to Dependent Children (ADC) Division. . The borrower's 2002 tax return transcripts in the file show she had been receiving ADC and the copy of the voucher for \$150.00 in the file shows she was receiving funding. As a matter of policy the Department does not verify this income nor will they indicate the probability of it continuing. It is a known fact that this type of government subsidy will continue for as long as the recipient qualifies for it. The underwriter as a matter of policy in keeping with HUD's guidelines would have asked for additional information as to the child/children age(s) to document continuance if it was not presented at the time of underwriting. However this documentation is missing from the file. This could be contributed to a post closing copying error.

Based on the fact that documentation is missing from the file we agree with the findings on this case.

Finding 2: Quality Control Requirements

We agree with this finding in that Community Central did not fully comply with HUD's quality control requirements in the past. As stated in the findings, there was a management restructuring/reorganization that resulted in some EPD audits being overlooked. Since that time we have improved our QC plan and execution of the plan. We have gone from quarterly audits to monthly audits which has greatly improved our audit compliance and timeliness.

OIG Evaluation of Auditee Comments

- Comment 1** Community Central disagreed that the underwriting for case number 261-8727601 did not comply with HUD's underwriting requirements. After we reviewed the supporting documentation provided by Community Central, we agree that this loan was properly underwritten. Therefore, this loan was removed as an improperly underwritten loan in this audit report.
- Comment 2** Community Central claimed that the underwriting for case number 261-8812331 complied with HUD's underwriting requirements. However, we disagree. The residential mortgage credit report contained in the borrower's loan file did not meet HUD's requirements. The credit report did not identify the date the borrower's employment information was verified. Further, overtime income was used when calculating the borrower's effective income; however, the borrower's current pay documentation did not identify overtime earned. The borrower earned this income less than two years; therefore, the borrower's file should have contained documentation justifying the inclusion of the overtime income for qualifying purposes, and the underwriter should have established and documented an earnings trend for the overtime income. Since Community Central did not provide documentation to support that HUD's underwriting requirements were met, this loan remained as an improperly underwritten loan in this audit report.

Appendix C

FEDERAL REQUIREMENTS AND COMMUNITY CENTRAL'S REQUIREMENTS

Loan Underwriting Requirements

Chapter 2, section 2-3, of HUD Handbook 4155.1, REV-5, CHG-1, states that when delinquent accounts are revealed, the lender must determine whether late payments were due to a disregard for or inability to manage financial obligations or to factors outside of the borrower's control. Major indications of derogatory credit, including judgments or collections or recent credit problems, require sufficient written explanation from the borrower. When reviewing the borrower's credit report, the lender must pay particular attention to recent and undisclosed debts. The lender must account for any significant debt shown on the credit report but not listed on the loan application and must obtain explanation for all credit report inquiries.

Chapter 2, section 2-7(a), of the handbook states that both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past two years, and the employment verification must not state that such income is unlikely to continue. Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

Chapter 2, section 3, paragraph 2-10, of the handbook states that all funds for the borrower's investment in the property must be verified and documented. Paragraph 2-10c states that the lender must document the gift funds by obtaining a gift letter signed by the donor and borrower that specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. In addition, the lender must document the transfer of funds from the donor to the borrower.

Chapter 2, section 5, paragraph 2-12, of the handbook states that debt-to-income ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership. If the mortgage payment expense-to-effective income ratio exceeds 29 percent and/or the total fixed payment-to-effective income exceeds 41 percent, significant compensating factors should be documented and recorded on the mortgage credit analysis worksheet.

Quality Control Requirements

HUD Handbook 4060.1, REV-1, "Mortgagee Approval Handbook," chapter 6, requires

- The quality control plan to be in writing. Lenders must have fully functioning quality control programs from the date of their initial Federal Housing Administration approval until final surrender or termination of the approval.

- Quality control of servicing to be an ongoing function. Due to the importance of the aspects of servicing, lenders must perform monthly reviews of delinquent loan servicing, claims, and foreclosures.
- The quality control program to provide for the review and confirmation of information on all loans selected for review.
- Each direct endorsement loan selected for a quality control review to be reviewed for compliance with HUD's underwriting requirements, sufficiency of documentation, and soundness of the underwriting.

Community Central's and/or Contractor's Early Payment Default Quality Control Plan Requirements

Community Central's quality control department generates a report from HUD's Neighborhood Watch system to identify all loans that went 60 days delinquent within the first six payments. All government loans that are 60 days delinquent are targeted for review, and the selection of the loans is based solely upon the timing of the defaults. The purpose of the review of the early payment default is to evaluate the accuracy, validity, and completeness of the loan's origination operation and note any patterns of deficiencies.

All early payment defaults (loans that are 60 days or more past due within the first six months) will be chosen for a full review based upon lender notification of the default. The lender is responsible for sending the list of rejected loans monthly so that the contractor may select 10 percent of all rejected loans for review to determine that

- * The reasons given for rejection were valid and
- * Each rejection has the concurrence of an officer or senior staff person of the company or a committee chaired by a senior staff person or officer.

The review process includes verifying the accuracy of the residential loan application as compared to the documents in the loan file; comparing the new credit report to the original credit report in the file and noting any discrepancies or additional debts to aid in the determination of the delinquency; verifying the automated underwriting system findings as compared to the documents in the file; verifying that the underwriting conditions are documented in the loan file; verifying the accuracy of the income and assets as compared to documents in the loan file; performing written reverification of employment for the borrower/coborrower and if unobtainable, verbal verification of employment to the employer; verifying the accuracy of the purchase contract as compared to documents in the loan file; reviewing the appraisal for issues using the history pro/prefunding report and if discrepancies are noted, ordering automated value models; and verifying unallowable service fees and requesting refund to the borrower if applicable.

Program Fraud Civil Remedies Act Of 1986

Title 231, *United States Code*, section 3801, “Program Fraud Civil Remedies Act of 1986,” provides federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to recompense such agencies for losses resulting from such claims and statements; to permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and to deter the making, presenting, and submitting of such claims and statements in the future.

Appendix D

SUMMARY OF QUALITY CONTROL DEFICIENCIES USING HUD'S REQUIREMENTS

<i>Loan number</i>	<i>Quality control review not performed</i>	<i>Untimely quality control review</i>
261-8605640	X	
261-8610720	X	
261-8604572	X	
261-8600281	X	
261-8617973	X	
261-8618991	X	
261-8632804		
261-8599994	X	
261-8714768	X	
261-8710802	X	
261-8748922	X	
261-8684853		X
261-8628398		X
261-8701916		X
261-8812331		X
261-8784944		X
261-8769472		X
261-8790128		X
261-8693304		X
261-8675073		X
261-8703135		X
261-8683365		X
261-8831931		X
Totals	<u>11</u>	<u>12</u>

Appendix E

NARRATIVE CASE PRESENTATIONS

Loan number: 261-8597097

Mortgage amount: \$73,915

Section of Housing Act: 203(b)

Date of loan closing: December 22, 2003

Status as of September 25, 2006: Claim

Prior status: Active

Payments before first default reported: Not available

Summary:

Community Central's underwriter (J922) approved this loan using the coborrower's income although documentation in the loan file indicated that the coborrower was no longer employed as of October 22, 2003. The loan closed December 22, 2003. Therefore, excluding the coborrower's income, this loan exceeded one of HUD's qualifying ratios by 12 percent.

Loan number: 261-8628398

Mortgage amount: \$62,009

Section of Housing Act: 203(b)

Date of loan closing: December 22, 2003

Status as of September 25, 2006: Active

Prior status: Not applicable

Payments before first default reported: Five

Summary:

Community Central's underwriter (J922) approved the loan without sufficient documentation of the borrower's child support payments. The payments were included in the borrower's effective income calculation without adequate documentation, such as a final divorce decree, legal separation, or voluntary payment agreement. Additionally, the loan file did not contain evidence that this funding would continue. Therefore, excluding this income the borrower exceeded HUD's qualifying ratios.

Loan number: 261-8812331

Mortgage amount: \$80,337

Section of Housing Act: 203(b)

Date of loan closing: August 19, 2004

Status as of September 25, 2006: Active

Prior status: Active

Payments before first default reported: Four

Summary:

Community Central's underwriter (J922) approved the loan using a residential mortgage credit report that did not meet HUD's requirements. Additionally, overtime income was included in the borrower's income calculation without the underwriter justifying the inclusion of the income for qualifying purposes and establishing an earnings trend in accordance with HUD Handbook 4155.1, REV-5, since the income was not earned for over a two-year period.