| | |
|---|---|
| Issue Date | June 16, 2006 |
| Audit Report Number | 2006-FW-1011 |

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

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

SUBJECT: Premier Mortgage Funding, Inc., Austin, Texas, and Its Sponsor, JPMorgan Chase, Did Not Comply With HUD Underwriting Requirements and Did Not Meet All Quality Control Requirements

# HIGHLIGHTS

## What We Audited and Why

We selected Premier Mortgage Funding, Inc. (Premier), a nonsupervised loan correspondent, for audit because it's default rate was 378 percent of the average of all lenders in the San Antonio, Texas, U.S. Department of Housing and Urban Development (HUD) jurisdiction. We focused on Premier's Austin branch because it originated 36 of 41 loans that defaulted within the first year of origination. Our audit objectives were to determine whether Premier and its sponsors acted in a prudent manner and complied with HUD requirements in the origination of the Federal Housing Administration-insured single-family mortgages selected for review and whether their quality control plans, as implemented, met HUD requirements.

## What We Found

Premier and its sponsor, JPMorgan Chase Bank NA (JPMorgan Chase), did not meet HUD underwriting or quality control requirements. As a result, HUD insured 11 loans totaling $1,169,226 that the sponsor approved with inaccurate credit information. This occurred mainly because Premier and its sponsor did not ensure the accuracy of the borrower's credit information. Further, Premier and its sponsors charged borrowers $163 in ineligible closing costs and approved 31 loans with appraisals that did not meet HUD requirements. These deficiencies increased the Federal Housing Administration insurance fund's risk of loss. As of April 28, 2006, HUD has lost $394,110 on these loans, according to HUD's Neighborhood Watch system.

## What We Recommend

We recommend that the assistant secretary for housing – federal housing commissioner and chairman of the Mortgagee Review Board require JPMorgan Chase to reimburse HUD $394,110 for losses incurred on six loans, indemnify HUD for six loans totaling $647,061, and buy down loans or repay HUD for other deficiencies. We further recommend that the assistant secretary require Premier and JPMorgan Chase to take action to correct quality control deficiencies and require JPMorgan Chase to ensure that appraisals meet HUD requirements. Finally, we recommend that the assistant secretary take appropriate administrative sanctions against Premier and JPMorgan Chase for entering incorrect data into the automated underwriting system and certifying its integrity.

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 draft report to Premier and to JPMorgan Chase on April 25, 2006, and we had an exit conference with Premier on May 8, 2006 and JPMorgan Chase on April 19, 2006. We received their written comments. Premier said it was the sponsor's responsibility to ensure all underwriting standards were met and to conduct quality control reviews. JPMorgan Chase said it acknowledged that certain deficiencies may exist in a few instances but disagreed with most instances of noncompliance. JPMorgan Chase took exception to any assertion that its employees knowingly certified to the integrity of inaccurate data supplied by Premier and said that in those cases where data entered into Loan Prospector by Premier were inaccurate, the underwriter simply failed to spot the inaccuracy. The complete text of their responses, without attachments, along with our evaluation of the responses, can be found in appendix B of this report.

# TABLE OF CONTENTS

# BACKGROUND AND OBJECTIVES

Section 203(b)(1) of the National Housing Act, as amended, authorizes the U.S. Department of Housing and Urban Development (HUD) to provide mortgage insurance for single-family homes. HUD must approve a lender that originates, purchases, holds, or sells Federal Housing Administration-insured loans. Lenders must follow the statutory and regulatory requirements of the National Housing Act and HUD's instructions, guidelines, and regulations when originating insured loans. Lenders that do not follow these requirements are subject to administrative actions.

Premier Mortgage Funding, Inc. (Premier), a nonsupervised loan correspondent, had the third highest compare ratio of defaults within the first year in the San Antonio HUD jurisdiction as of July 12, 2005. The compare ratio for Premier was 378 percent[1] of defaults within the first year of loan origination as of July 12, 2005, the third highest compare ratio in the San Antonio, Texas HUD jurisdiction. Premier originated 274 loans during the two-year period from June 1, 2003, through May 31, 2005, and had 41 defaults within the first year. Premier's home office is located at 3001 Executive Drive, Suite 330, Clearwater, Florida.

Premier has a Web site that solicits mortgage professionals to open branch offices using its name. The cost is $1,500 per month. The Austin branch, located at 2711 West Anderson Lane, Suite 200, Austin, Texas, originated 36 of the 41 defaulted loans. The branch was authorized in March 2003 and was voluntarily terminated in December 2004. We limited our reviews to the 36 loans originated by the Austin branch.

JPMorgan Chase Bank NA (JPMorgan Chase) is the primary lender sponsor for the defaulted loans. Sponsors underwrite loans processed by their loan correspondents. HUD holds lender sponsors primarily responsible for loan integrity, and normally will seek indemnification or claims recovery for improperly originated or underwritten loans from the sponsor.

Our audit objectives were to determine whether Premier and it sponsors 1) acted in a prudent manner and complied with HUD requirements in the origination of the Federal Housing Administration-insured single-family mortgages selected for review and 2) whether their quality control plans, as implemented, met HUD requirements.

---

1 The compare ratio is the value that reveals the largest discrepancies between the subject's default percentage and the default percentage to which it is being compared. The percentages being compared are the percentages of originations that first defaulted during a selected period. A higher ratio is indicative of a lender that has an unusually high default percentage in comparison with the lender's surrounding area.

# RESULTS OF AUDIT

## Finding: Premier and JPMorgan Chase Did Not Comply With HUD Underwriting Requirements and Did Not Meet All Quality Control Requirements

Premier materially violated HUD requirements for 11 of 36 loans reviewed totaling $1,169,226. Premier did not enter correct data into an automated underwriting system or perform required quality control reviews. In addition, the sponsor, JPMorgan Chase, certified to the integrity of the data Premier entered into the system and did not perform adequate quality control reviews. This occurred because Premier and its sponsor did not ensure the accuracy of the borrowers' credit information, and Premier did not have specific processing policies and/or procedures that branch offices must follow. Premier and its sponsor also charged borrowers unallowable closing costs on two loans. Further, the sponsor did not ensure that appraisals for 31 loans met HUD requirements. These deficiencies increased HUD's risk of loss on Federal Housing Administration loans. As of April 28, 2006, HUD had lost $394,110 on these loans.

---

**Premier Entered Inaccurate Credit Information into the Automated Underwriting System**

Premier and JPMorgan Chase originated 11 of 36 loans reviewed that were approved based on inaccurate credit information that did not meet Federal Housing Administration standards.

On the feedback certificates, Loan Prospector provided documentation guidelines that instructed Premier to verify the reserves reported, include all debt, document one full month of earnings, and verify current and previous employment. The feedback certificates stated that the lender is responsible for documenting according to HUD requirements any situation not addressed on the feedback certificate. Also, Loan Prospector instructed Premier that a representative must attest to data integrity. Premier did not follow Loan Prospector's instructions regarding income, debt, reserves, or documentation for 28 of the 36 loans reviewed. The deficiencies were material enough to affect loan approval for 11 of the loans (see appendix C-2).

For these 11 loans, Premier

- Overstated income (five loans),
- Did not verify the stability and/or history of income (two loans),

- Understated the borrowers' liabilities (seven loans),
- Did not verify reserves and/or deposits (seven loans), and
- Originated loans in which the actual note terms (principal, interest, and term) differed significantly from the terms entered into Loan Prospector (one loan).

In addition to these deficiencies, 9 of the 11 loans had ratios that exceeded HUD's recently revised debt-to-income ratio guidelines.[2] Further, in one of the loans, in addition to entering inaccurate credit information into Loan Prospector, Premier included on the loan a borrower with a delinquent federal debt. HUD will not insure a loan when a borrower is delinquent on any federal debt.[3] Also in another case, in addition to inaccurate credit information being entered into Loan Prospector, the loan was not eligible for insurance because the seller did not own the property for the required 90 days.[4] According to the local tax appraisal district, the seller acquired the property on or around May 29, 2003; the sales contract for the borrower was executed on May 16, 2003.

These deficiencies occurred because Premier and JPMorgan Chase did not ensure the accuracy of the borrower's credit or other information. Instead, Premier relied on JPMorgan Chase to identify and resolve underwriting deficiencies, but JPMorgan Chase apparently accepted the data and certified their accuracy without further examination. Also, Premier did not have specific processing policies and/or procedures that branch offices must follow.

## Premier Did Not Perform Quality Control Reviews

Premier did not comply with HUD's quality control requirements.[5] Premier officials told us they never performed a quality control review of any kind on the Austin branch, nor were they aware of any quality control reviews by JPMorgan Chase.

---

2 Mortgagee Letter 05-16, dated April 13, 2005, increased the qualifying debt-to-income ratios to 31:43.

3 HUD Handbook 4155.1, REV-5, paragraph 2-5 B, states that if the borrower is delinquent on any federal debt, the borrower is not eligible until the delinquent account is brought current or a repayment plan is established and verified by the federal agency owed.

4 Mortgagee Letter 03-07, dated May 22, 2003, states, "If a property is resold 90 days or fewer following acquisition by the seller, the property is not eligible for a mortgage insured by FHA [Federal Housing Administration]. FHA defines the seller's date of acquisition as the date of settlement on the seller's purchase of that property. The resale date is the date of execution of the sales contract by the buyer that will result in a mortgage to be insured by FHA."

5 HUD Handbook 4060.1, REV-1, chapter 6, contains the minimum requirements of a lender's quality control plan. Paragraph 6-1 requires all lenders to implement and continuously have in place a quality control plan for the origination of insured mortgages as a condition of maintaining Federal Housing Administration approval.

Premier's home office officials explained that they did not have sufficient staff to keep up with the quality control requirements, and contracted quality control firms also could not keep up with the requirements.

In an effort to implement quality control, Premier executed a contract with an outside company to perform most of the quality control review functions in September 2005. It provided a copy of the contract but did not have a copy of the quality control plan. Premier said it established a team of 13 individuals who are responsible for office visits and "office compliance."

The lack of quality control placed HUD at an increased risk of loss to the Federal Housing Administration insurance fund.

## The Sponsor's Quality Control Reviews Needed Improvement

JPMorgan Chase conducted quality control reviews on loans originated by Premier's Austin branch. However, the reviews were deficient as follows:

- Reviewers only performed desk reviews of the appraisals, although HUD required field reviews on all early payment defaults;
- Reviewers did not perform quality control reviews on 2 of 11 early payment default loans that should have been reviewed; and
- The quality control reviews did not adequately address corrective actions, and the sponsor did not take any corrective action.[6]

We compared the 36 loans we reviewed to the reviews that JPMorgan Chase provided. Eleven loans defaulted in six payments or fewer. JPMorgan Chase reviewed 9 of the 11 loans but did not take corrective action for deficiencies found. It did not review the remaining two loans.

In 2004, HUD performed a nationwide comprehensive review of JPMorgan Chase[7] and found that it did not meet reporting and corrective action requirements. HUD closed the finding in July 2005.

## Premier Charged Ineligible Closing Costs

---

[6] HUD Handbook 4060.1, REV-1, paragraph 6-6 D, requires a quality control review of all loans going into default within the first six payments. Paragraph 6-6 E (3) requires a field review of the appraisals for those loans. Paragraph 6-3 I requires the final report of a quality control review to identify corrective actions being taken, the timetable for their completion, and any planned follow-up activities.

[7] HUD's review was conducted during the period of our scope – June 1, 2003, through May 31, 2005.

Premier charged $163 in ineligible closing costs in two of the loans reviewed. On one loan, Premier charged $79 for an inspection fee, but did not provide support. Only the actual cost for services may be charged to the borrower. Premier also charged $69 for an ineligible tax service fee.[8] The sponsor needs to buy down the loan for the ineligible closing costs. For another loan, Premier charged the borrower $19 on a streamline refinance. HUD will not reimburse credit report charges for streamline refinances.[9] This loan has been conveyed to HUD; therefore, the sponsor should reimburse HUD for the $19 in ineligible closing costs.

**The Sponsor Approved 31 Loans with Technically Deficient Appraisals**

HUD requires the lender to ensure that the Federal Housing Administration appraisal meets HUD's requirements.[10] Further, on July 20, 2004, HUD issued a final rule on 24 CFR [*Code of Federal Regulations*] Parts 25 and 203, regarding lender accountability for appraisals. The final rule clarifies HUD's position that those lenders who submit appraisals to HUD that do not meet Federal Housing Administration requirements are subject to sanctions by the HUD Mortgagee Review Board. The rule applies to sponsors and correspondents.

We found several technical deficiencies in the appraisals (see appendix D) as follows:

- There was no evidence in the files to show that the appraiser reviewed the subject sales contract as required in 18 of the 36 files reviewed,[11]
- The pictures of the subject property did not meet HUD requirements in 18 of the 36 loans,[12] and

---

8 Mortgagee Letter 06-04, dated January 27, 2006, rescinds paragraph 5-2 of HUD Handbook 4000.2, REV-3. However, only the actual cost for the service may be charged to the borrower. Tax service fees are still ineligible.

9 HUD Handbook 4155.1, REV-5, paragraph 1-12 D 1, does not require a credit report for streamline refinances.

10 24 CFR [*Code of Federal Regulations*] 203.5 (e)(1).

11 HUD Handbook 4150.2, CHG-1, paragraph 4-0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Standards Rule 1-5 requires appraisers to analyze sales contracts, options, and listings. Standards Rule 2-2(a)(ix) requires appraisers to document efforts undertaken to obtain the information when the appraiser was unable to obtain the information.

12 HUD Handbook 4150.2, CHG-1, paragraph 3-1, requires the appraiser to take pictures that show the sides, front, and rear of the subject property and all improvements on the property with any contributory value.

- At least 16 of the 36 loans reviewed had Federal Housing Administration comparables that were not adjusted downward to reflect sales concessions as required.[13]

Based on the number of technical violations found, we concluded that the sponsor's underwriters either were not aware of HUD's appraisal requirements or ignored them during the desk review of the appraisals before loan approval. The audit did not determine whether the technical violations affected the property values. However, the appraisals did not meet HUD requirements; therefore, the sponsor could not assure HUD that the appraisals were accurate.

**HUD's Risk of Loss Increased**

Premier entered and JPMorgan Chase certified inaccurate credit information and did not have adequate quality control reviews. This caused HUD to insure 11 loans totaling $1,169,226. Further, Premier charged two borrowers a total of $163 for ineligible closing costs. In addition, JPMorgan Chase could not ensure the accuracy of the appraised values of 31 properties. Because of these deficiencies, Premier and JPMorgan Chase increased HUD's risk of loss. As of April 28, 2006, HUD had lost $394,110 on loans for which HUD paid claims or paid mortgage insurance claims and sold properties at a loss. The original loan amounts for the other active loans total $647,061. HUD has done an analysis that indicates it loses an average of about 29 percent of the loan amount when HUD pays a claim and the property is resold. Therefore, we are estimating HUD's potential loss on the six active loans to be $187,648 ($647,061 * .29). JPMorgan Chase should reimburse HUD for any losses on these loans.[14] We are classifying $187,648 as funds put to better use in appendix A.

---

13 HUD Handbook 4150.2, CHG-1, paragraph 4-6 B, requires appraisers to account for and adjust the sales price of comparable properties for any special sale or financing terms.

14 Code of Federal Regulations, Title 24, Section 202.8, paragraph (b)(7), provides that each sponsor shall be responsible to the Secretary for the actions of its loan correspondent lenders or mortgagees in originating loans or mortgages, unless applicable law or regulation requires specific knowledge on the part of the party to be held responsible. If specific knowledge is required, the Secretary will presume that a sponsor has knowledge of the actions of its loan correspondent lenders or mortgagees in originating loans or mortgages and the sponsor is responsible for those actions unless it can rebut the presumption with affirmative evidence.

## Recommendations

We recommend that the assistant secretary for housing – federal housing commissioner and chairman of the Mortgagee Review Board require JPMorgan Chase to

1A. Reimburse HUD $394,110 for claims and losses incurred on six loans.

1B. Indemnify HUD for future losses for six loans, amounting to $647,061, which are still active (one loan is still active but HUD has paid a loss mitigation claim of $875 included in recommendation 1A).

1C. Reimburse HUD $19 in ineligible closing costs for one loan that has foreclosed and buy down one loan for $144 in ineligible closing costs.

1D. Implement a quality control plan that conforms to all HUD quality control requirements and contains effective corrective action.

1E. Ensure that the appraisals submitted to HUD meet all HUD requirements.

Further, we recommend the assistant secretary for housing - federal housing commissioner and chairman of the Mortgagee Review Board

1F. Ensure Premier's current quality control plan meets HUD requirements and is implemented.

1G. Consider appropriate sanctions against Premier and JPMorgan Chase for entering incorrect data into the automated underwriting system and certifying their integrity.

# SCOPE AND METHODOLOGY

To accomplish our objectives, we

- Reviewed applicable handbooks and mortgagee letters;
- Interviewed HUD staff, Premier management, JPMorgan Chase staff, and nine borrowers;
- Reviewed applicable title company records;
- Reviewed JPMorgan Chase's quality control plan and quality control reviews;
- Performed site visits to 13 properties;
- Reviewed 36 loans originated by Premier's Austin branch during the two-year period from June 1, 2003, through May 31, 2005, with a first default reported within the first year. We selected the loans originated by the Austin branch because Premier had 41 defaults within the first year (in the San Antonio HUD jurisdiction), and 36 of those loans were originated by the Austin branch; and
- Reviewed the appraisals of Federal Housing Administration properties that were used as comparables for the properties we reviewed.

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 the system.

We conducted our fieldwork from September 1, 2005, through February 24, 2006. We performed our fieldwork at the San Antonio HUD office, Premier's main office, and borrower homes. We performed the audit 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:

- Quality control plan as implemented and
- Loan origination process.

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:

- Premier and JPMorgan Chase did not comply with HUD requirements in originating all loans. They originated loans based on inaccurate credit information, charged two borrowers ineligible closing costs, and did not meet HUD's quality control or appraisal requirements (finding 1).

# 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 | $394,110 | |
| 1B | | $187,648 |
| 1C | $163 | |
| **Totals** | **$394,273** | **$187,648** |

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 estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. Implementation of our recommendation to indemnify loans that were not originated in accordance with FHA requirements will reduce FHA's risk of loss to the insurance fund. The amount above reflects that, upon sale of the mortgaged property, FHA'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**

JPMorganChase

**JPMorgan Chase Bank, N.A.**
Retail Financial Services
Mortgage Banking
194 Wood Avenue South
Iselin, NJ 08830

**Mark A. Nelson**
Senior Vice President
Phone: (732) 452-8920
Fax: (732) 452-8031

May 17, 2006

**VIA FEDERAL EXPRESS**

Frank E. Baca
Regional Inspector General for Audit, 6AGA
Office of Inspector General
U.S. Department of Housing and Urban Development
Northwest/Alaska Region 10
909 First Avenue
Suite 126
Seattle, Washington 98104-1000

**Re: JP Morgan Chase Bank, N.A.**
**HUD OIG Draft Audit Report**

Dear Mr. Baca:

JP Morgan Chase Bank, N.A. ("Chase" or "Company") is in receipt of a draft audit report ("Report") from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of 36 Federal Housing Administration ("FHA") insured mortgage loans originated by Premier Mortgage Funding, Inc. ("Premier"), a non-supervised loan correspondent, which Chase underwrote and closed as the sponsoring lender. The OIG performed its review over six months, between September 1, 2005 and February 26, 2006, and the audit covered loans originated between June 1, 2003, and May 31, 2005.

The Report contains one finding, alleging that Premier and Chase did not comply with HUD underwriting conditions in a handful of cases or satisfy all Quality Control requirements. The Report states that the purpose of the OIG audit was twofold: (1) to determine whether Premier and its sponsors acted in a prudent manner and complied with HUD requirements in the origination of FHA-insured single-family mortgage loans; and (2) to determine whether Premier and its sponsors maintain and implement Quality Control Plans in compliance with HUD/FHA requirements.

Contrary to the suggestion in the Report, Chase substantially complied with HUD/FHA requirements in connection with the cited loans and performed vigorous Quality Control reviews that satisfied the applicable FHA requirements. Chase acted

Comment 1

Comment 2

Comment 1



prudently in individual transactions and implemented a satisfactory Quality Control Plan that, in many respects, exceeds the FHA's expectations. Having said that, we recognize that there is always room for improvement and that the OIG may have identified deficiencies in certain instances. Please note, however, that any such deficiencies reflect isolated occurrences, not a pattern or practice within the Company. Chase originated/underwrote approximately 875,000 mortgage loans between June 1, 2003, and May 31, 2005, including about 45,000 FHA-insured loans, and the 12 loans with purportedly material underwriting deficiencies identified by the OIG do not represent Chase's portfolio. Chase dedicates substantial time and resources to quality reviews of loan production, and the Department itself has acknowledged the Company's excellent loan performance and consistent maintenance of FHA default/claim rates below the national average.

The OIG has provided Chase with an opportunity to submit written comments on the draft findings for inclusion in the OIG's final report. This response therefore: (I) summarizes Chase's background and operations; and (II) addresses the individual findings in the Report. It contains information clarifying certain errors and misconceptions that Chase identified in the draft Report, as well as responds to the OIG's specific allegations and recommendations. After reviewing this response and the supporting documentation enclosed, we hope the OIG will agree not only that Chase substantially complied with FHA requirements in connection with the matters raised in the Report, but that the recommendations in the Report are disproportionate to the alleged deficiencies. We appreciate this opportunity to comment on the OIG's initial findings and recommendations, and we hope you will consider our reply in crafting a final report.

**I. BACKGROUND**

Chase is a subsidiary of JPMorgan Chase & Co., a leading financial services firm with operations in over 50 countries, the fourth largest retail branch network in the United States with over 2,500 retail banking centers in 17 states, and one of the industry's leading providers of mortgages and home equity loans. Its home finance operations have yielded nearly $200 billion in home loan originations as of June 2005, and its participation in FHA programs dates back to 1964.

Several different subsidiaries of JPMorgan Chase & Co. have originated FHA mortgage loans under the "Chase" brand over the years. Chase has originated FHA loans since its inception. Prior to that time, however, Chase Manhattan Mortgage Corporation ("Chase Mortgage"),[1] which was headquartered in Edison, New Jersey,

[1] Chase Mortgage's successor entity is Chase Home Finance, LLC, which services, but does not originate, any mortgage loans.

Mr. Frank E. Baca
May 17, 2006
Page 3

originated FHA loans, except in New York, where JP Morgan Chase Bank ("Chase Bank")[2] was headquartered and originated FHA loans. Chase is headquartered in Columbus, Ohio. It operates in all 50 states and the District of Columbia and has 50 FHA-approved branch offices. Chase sponsors 876 loan correspondents and acts as an authorized agent for 11 principals, and approximately five percent of its mortgage lending business consists of FHA lending. During the relevant period covered by the OIG audit, from June 1, 2003 through May 31, 2005, Chase originated 877,933 mortgages totaling approximately $171 billion, including 44,127 FHA-insured mortgage loans totaling approximately $5.2 billion.

While the number of FHA loans that Chase originated/underwrote during the audit period is a relatively small percentage of the total number of loans it originated or underwrote during that time, Chase takes its responsibilities in working with HUD to offer mortgage loans to deserving individuals seriously, values its good working relationship with HUD, and is committed to excellent customer service and full compliance with HUD/FHA requirements. As a national lender committed to low/moderate-income and minority borrowers, who constitute approximately 33.9% and 21.8% of the Company's clientele, respectively, Chase is dedicated to the FHA program and diligently educates and trains its employees on issues regarding FHA compliance. The language in the Report suggests that Chase knowingly approved ineligible loans for FHA insurance endorsement and thereby somehow poses a threat to the FHA. To the contrary, however, Chase never knowingly would violate FHA requirements and Chase's default/claim rates evidence the quality of its loan originations. For example, Comment 1 **HUD's FHA Connection/Neighborhood Watch reflects that, for the two year period ending on March 31, 2006, Chase originated 14,202 FHA loans, only 2.18 percent of which have gone into default or claim, yielding a compare ratio of only 69% when compared to the national average of 3.17 percent**.

As previously noted, Chase sponsors 876 loan correspondents, including Premier, which Chase has sponsored since July 2002. As it does for loans originated by all of its loan correspondents, Chase consistently has reviewed the loans submitted by Premier and approved only those loans it found eligible for FHA insurance endorsement. Moreover, Chase diligently has performed Quality Control reviews of loans originated by its loan correspondents, including Premier, and worked hard to ensure the quality and integrity of its wholesale business. Note that the loans reviewed Comment 3 by the OIG were originated through Premier's Austin, Texas branch location, which Chase terminated in November of 2005. Chase determined that the quality of loans originated at this Premier branch was unsatisfactory and prudently terminated its sponsorship of this branch. Having said that, the loans cited in the OIG Report are only a small sample of Premier's loans and do not reflect the loan correspondent's general

[2] Chase Bank merged into Chase.

Comment 1

Comment 4



production. Premier has submitted close to 1,000 loans to Chase for underwriting and approval over the past four years, including 324 FHA loans, only 12 of which are identified in the Report as containing potentially material deficiencies.

## II. RESPONSE TO FINDINGS

The Report contains one finding with recommendations for administrative action by HUD. Specifically, the Report alleges that Premier entered incorrect data into an automated underwriting system in 12 cases and Chase certified to the integrity of this data, and that Chase did not perform adequate Quality Control reviews in certain instances. The Report attributes these alleged deficiencies to the purported failure of both Premier and Chase to ensure the accuracy of the borrower's credit information and Premier's failure to maintain specific processing policies and/or procedures that branch offices must follow. The Report further alleges that both Premier and Chase charged borrowers unallowable closing costs in three cases and over-insured one loan, and that Chase did not ensure that the appraisals in 31 cases met HUD requirements.

The OIG recommends that HUD take certain action against Chase in connection with the matters raised in the Report. These recommendations include indemnification of 12 loans,[3] a payment of $37 to HUD and a buydown of $144 for ineligible closing costs charged in three cases, a buydown of $5,647 in one case where the loan allegedly was over-insured, certain changes with respect to Quality Control, and assurance that appraisals will meet all HUD requirements. The Report also recommends that the HUD Mortgagee Review Board consider imposing sanctions against Chase in connection with the inputting of inaccurate data into an automated underwriting system.

After receiving the draft Report, Chase performed its own stringent analysis of the loans cited by the OIG. Based on its diligent examination, Chase acknowledges that certain deficiencies may exist in a few cases, but takes exception to the OIG's assertion that Company employees knowingly certified to the integrity of inaccurate data supplied by Premier and disagrees with most instances of alleged non-compliance. Contrary to the allegations in the Report, Chase substantially complied with FHA requirements in the transactions at issue, and the OIG's recommendations are disproportionate to the alleged deficiencies. We do not believe that administrative

[3] With respect to indemnifications, the Report recommends reimbursement to HUD of $347,201 for losses incurred on four loans and $862,850 for future losses on eight loans that have not had claims paid. Please note that these figures do not reflect "losses" incurred by the Department. Rather, they reflect the aggregate dollar amounts of the loans or claims paid by HUD, but not the actual losses incurred by HUD as a result of claims paid. Notably, when the FHA requires indemnification, it requires reimbursement of its losses, which will be substantially lower than the amounts referenced in the Report.

Mr. Frank E. Baca
May 17, 2006
Page 5

sanctions are appropriate in this case and accordingly hope the OIG will amend its recommendations in a final report. We address each matter raised in the Report below.[4]

**A. Automated Underwriting**

Comment 5

The Report alleges that Premier originated 12 loans that Chase approved based on inaccurate credit information and that did not meet FHA standards. It alleges that Premier did not follow the instructions set forth in Loan Prospector ("LP") feedback certificates regarding income, debt, reserves or documentation, and that the deficiencies materially affected the loan approval in these 12 cases. The Report suggests that, while Premier relied on Chase to identify and resolve underwriting deficiencies, Chase accepted the data submitted by Premier and certified their accuracy without further examination.

Comment 4

The implication in the Report that Chase approved loans knowing that file documentation was inaccurate is unfounded. At no time did Chase knowingly certify to the accuracy of incorrect data. The Company has meaningful controls in place to ensure the quality of its underwriting, and Company management does not tolerate poor underwriting performance. Following is a summary of Chase's underwriting operations and the 12 files allegedly containing inaccurate data.

**1. Chase's Underwriting Operations**

Comment 1

Chase conducts underwriting from eight Underwriting Centers throughout the United States, each of which is staffed by underwriters who are overseen by a Center Manager. The Company's underwriters consist of experienced personnel with extensive knowledge of underwriting requirements, including Direct Endorsement ("DE") underwriters who are intimately familiar with FHA criteria. As a national lender with historical roots dating back over 200 years, Chase places a premium on underwriting quality. To this end, Chase's National Underwriting Operations group performs an annual site review of each Underwriting Center, which includes individual file reviews for each underwriter. Moreover, Chase's underwriters are subject not only to these annual reviews and typical Quality Control reviews performed by the Company's Home Mortgage Quality Assurance department, but to three additional tiers of quality reviews.

First, in light of Chase's continuing emphasis on loan quality and risk management, each Underwriting Center Manager is required to perform loan quality

---

[4] Chase understands that Premier has submitted a separate response to the OIG replying to the allegations in the Report. Thus, please note that this response addresses only those allegations pertaining to Chase, and not allegations related only to Premier.

reviews for all underwriters at his or her center. Specifically, each Center Manager must review at least three files per underwriter each month for guideline integrity and loan quality. For each DE underwriter, at least one of these three files must be an FHA loan.[5] The Center Manager must adhere to an enumerated list of review criteria and complete a Monthly Loan File Review form for each loan reviewed. The Monthly Loan File Review form includes 17 questions regarding credit, income, assets, collateral, final decision, and documentation, and a certain number of points are assigned to each answer. When a loan file review is unacceptable, the Center Manager must address the deficiencies identified and may take such courses of action as increased file reviews (perhaps including review of the 10 previous loans underwritten by the individual to determine any trend), closer examinations of Quality Control reports, counseling of or remedial action against the underwriter, and even termination of employment. In addition, if points are assessed in connection with any of the answers, the reviewer must explain the assessment, discuss the issues identified with the underwriter, print and sign the Monthly Loan File Review form, and obtain the underwriter's signature/date on the form acknowledging discussion of the issues contained therein.

Center Managers must retain copies of review forms for at least 12 months in the underwriters' personnel files, and data entered in the forms are retained in a Loan Quality Review database. This database records the results and identifies them to Company management. Each Underwriting Center has its own Loan Quality Review database, and Center Managers must forward their databases to the National Underwriting Operations Support group on a monthly basis by the fifth of each month. Additionally, if an individual underwriter has more than six errors in any report, the Center Manager must provide a written explanation of corrective action and forward such explanation to Chase's Manager of National Underwriting Operations Support.

Second, in order to ensure that potential issues discovered during Quality Control and/or early payment default ("EPD") reviews are addressed properly, Chase has developed a procedure requiring manager follow-up. Specifically, Chase's National Underwriting Operations group informs Center Managers of underwriters who appear on Quality Assurance and/or EPD reports with critical errors. Upon receiving such information, a Center Manager must arrange a meeting with the underwriter to discuss the files at issue, determine if the concerns reflect isolated incidents or pose training needs, arrange for the underwriter to receive assistance and/or training in the specific area(s) of concern, and possibly increase the random reviews of the underwriter's files to ensure that errors are not being repeated. The Center Manager also must complete an Underwriter Review Form, obtain the underwriter's signature on the form

[5] Depending on the number of files underwritten by any particular underwriter, this quality review may consist of up to seven loan files, with the review of FHA loans increasing proportionately for DE underwriters.

acknowledging the review, forward a copy of the signed form to the National Underwriting Operations group within 30 days of receiving the initial notification of the underwriter's critical error, and retain a copy of the form for at least six months. The Center Manager then must conduct follow-up discussions with the underwriter. This process ensures that discussions and follow-up counseling and training that result from Quality Control and EPD reviews are completed and documented in writing, and that Center Managers provide Chase's National Underwriting Operations group with written documentation of initial and follow-up conversations as well as corrective action taken.

Finally, Chase's National Underwriting Operations group prepares a Quarterly Exception Report for each underwriter summarizing the results of the aforementioned Monthly Loan Quality, Quality Assurance, and EPD reviews. If an underwriter falls into the highest 10% error rate for the quarter, the Center Manager will receive a copy of the report for that quarter and must review the report and act upon it as appropriate with the underwriter. The National Underwriting Operations group also will review additional files underwritten by that individual and assess a grade of "pass," "fail," or "caution." The first time an underwriter appears on a Quarterly Exception Report could result in such action as counseling or additional training. If the underwriter receives a "pass," no action will be required. If the underwriter receives a "caution," the Center Manager must discuss the report with the underwriter, develop an action plan with suggestions for improvement, perform at least six additional quality reviews, sign a review form, and obtain the underwriter's signature on the form. If the underwriter receives a "fail," the Center Manager may reduce the underwriter's file volume, suspend the underwriter's lending authority for two weeks, review 100% of the underwriter's files, develop an action plan with suggestions for improvement, sign the action plan and obtain the underwriter's signature on the plan, and perform at least six additional loan quality reviews. If an underwriter appears on a Quarterly Exception Report two quarters in a row, Center Managers are required to take additional action, including increased file reviews, lengthy suspension of lending authority, co-signatures on all files, and written warnings. Termination of employment becomes a strong possibility if an underwriter appears on the Quarterly Exception Report for more than two consecutive quarters.

**2. The 12 Files Cited in the Report**

As the loan correspondent in the 12 cases cited in the Report in connection with automated underwriting, Premier originated the loans, gathered pertinent verifications and financial documentation from the borrowers, and entered the relevant data into LP. Premier then submitted the loan packages and LP Feedback Certificates to Chase's wholesale Underwriting Center in Dallas, Texas.

When Chase receives an automatically underwritten loan file from a broker, it is the Company's policy to validate the file prior to approving the loan. Specifically, the

Comment 1

underwriter is required to review the loan documentation supplied by the broker to ensure that the file supports the data that the broker entered into the automated underwriting system. If the underwriter determines that any information used to obtain a rating of "Accept" from the automated underwriting system is incomplete, inconsistent with other information in the file, or inaccurate, the underwriter must identify the correct information and/or obtain clarifying documentation and re-submit the loan to the automated underwriting system with the correct data. Chase underwriters diligently adhere to this policy and understand that any deviation from these requirements may result in disciplinary action. As described above, Chase has a rigorous multi-tier program for reviewing underwriting quality and Company management does not tolerate poor performance.

Comment 4

Having said that, we recognize that certain of the data Premier entered into LP in the 12 cases cited in the Report is inaccurate and that the underwriters should have identified and remedied the inaccuracies before approving the loans. Please note, however, that any deficiencies in these cases were unintentional, isolated, and do not reflect a systemic issue at the Company. Contrary to the OIG's suggestion, in those cases where data entered into LP by Premier were inaccurate, the underwriter simply failed to spot the inaccuracy. In no case did the underwriter intentionally certify to the integrity of incorrect data supplied by Premier. As explained above, it is Chase's policy and practice to validate every file submitted to LP and, Company underwriters are held to high standards in this regard. In fact, of the four underwriters involved in these 12 files, only one underwriter still is employed by Chase.

Comment 5

Moreover, Chase takes exception to certain of the OIG's allegations in the cited cases, as detailed in Appendix E of the Report. For example, in the [redacted]s case, **FHA Case No. 495-6173073**, the Report alleges that the loan did not close as approved, stating that LP accepted the loan based on a principal of $104,139 with a six percent interest rate for 240 months, but that the actual note was $129,920 with a 6.125 percent interest rate for 300 months. It further alleges that the property address entered into LP differs from the address of the property purchased, and that the total monthly debt entered into LP was understated by at least $52, noting $1,076 instead of $1,128. Contrary to these allegations, however, the file contains an updated Mortgage Credit Analysis Worksheet ("MCAW") **(Exhibit A-1)** and LP Feedback Certificate **(Exhibit A-2)** supporting the correct loan amount, interest rate, term of loan, property address, and monthly debt of $1,127.94. In compliance with Chase's policies and procedures, the underwriter identified the inaccuracies in data Premier submitted to LP and prudently obtained an updated LP Feedback Certificate based on corrected information. In addition, the Report suggests that Premier did not verify the stability of the borrower's income in this case because the employer described the borrower's probability of continued employment as "unknown" and Premier did not analyze or clarify this comment. While we agree that this comment should have been clarified, the borrower's employment was stable. The borrower had been working for the same employer for over five years, as reflected on the written Verification of Employment form **(Exhibit A-3)**.

Comment 5

Furthermore, in the **C**[redacted] case, **FHA Case No. 495-6834667**, the Report alleges that Premier did not provide debt information for the non-purchasing spouse or otherwise document that it included the non-purchasing spouse's debts in its calculation of the qualifying ratios. It states that the loan application and ratios on the MCAW reflect that the borrower did not have any debt, but there is no evidence that Premier inquired into the non-purchasing spouse's debts. To the contrary, the file contains a joint credit report for both the borrower and the non-purchasing spouse reflecting that there was no additional debt reported for the non-purchasing spouse **(Exhibit B)**.[6]

**B. <u>Quality Control Reviews</u>**

The Report alleges that, while Chase conducted Quality Control reviews on loans originated by Premier's Austin branch, its reviews were deficient. Specifically, the Report alleges that Chase: (1) performed only desk reviews of appraisals and did not perform field reviews on all EPDs; (2) did not review two of 11 EPDs that should have been reviewed; and (3) did not adequately address corrective actions or take any corrective action with respect to the loans reviewed.

Comment 2

The OIG's allegations pertaining to Quality Control are misplaced. Chase has implemented a complex Quality Control program to which it adheres meticulously, and it strictly complied with all applicable FHA requirements in connection with the Quality Control matters raised in the Report. Following is a summary of Chase's Quality Control operations and replies to the specific issues noted by the OIG.

**1. Chase's Quality Control Operations**

Chase consistently has demonstrated a strong commitment to FHA credit quality. To this end, it has implemented a comprehensive and robust Quality Assurance program and dedicated significant time and resources to FHA Quality Control, including

---

[6] In 10 of the 12 cases, the Report also alleges that the loan did not close in the HUD-approved lender name. In each of these cases, the Report states that the loan closed with AustinLoan.com as the lender, rather than Premier Mortgage Funding, Inc., d/b/a Austin.Loan.com. Please note that this finding reflects an error. These loans should have closed in the name of Premier Mortgage Funding, Inc., d/b/a Austin.Loan.com, and we have reminded Company employees of the requirement in this regard. Any deficiency in connection with this matter, however, was isolated, does not reflect a Company policy or practice, and will not recur. Moreover, the deficiency in these cases did not affect the loans' integrity or marketability, and Chase can obtain a novation on the deed in each file to the extent HUD deems it necessary.

monthly executive management attentiveness to key FHA performance metrics. As summarized below, Chase's FHA Quality Assurance program was specifically designed to achieve, and in some aspects to exceed, HUD's Quality Control requirements.

Chase's Home Mortgage Quality Assurance Department, which is responsible for Quality Control, employs 55 individuals and is comprised of five departments: (1) Branch Audit; (2) Production Quality Assurance; (3) EPD; (4) Servicing Quality Assurance; and (5) Fraud Operations. The first four departments, excluding Fraud Operations, report to a single manager, who in turn reports to Chase's Risk Management department. The Home Mortgage Quality Assurance Department is an independent division of Chase that is completely separate and apart from all daily loan operations.

Chase's Quality Assurance personnel adhere to a detailed Quality Control Plan and comply with HUD/FHA requirements respecting Quality Control reviews. In fact, as noted in the Report, HUD conducted a comprehensive nationwide review of Chase's Quality Control functions in 2004, which included most of the period covered by the OIG audit, and closed its findings in July 2005, thereby confirming that Chase's Quality Control procedures are acceptable to the Department. Chase, however, has continued to improve various aspects of its Quality Control since HUD's comprehensive review. For example, although HUD did not identify deficiencies concerning Chase's sampling methodology during the 2004 review, in addition to selecting a standard random sample of FHA mortgage loans for Quality Control review each month, Chase includes a supplemental sample in addition to the mandated sample of FHA loans to ensure its review of a greater number of FHA transactions and increase the depth of its FHA analyses. In addition, Chase now creates FHA-specific Quality Control reports, rather than including FHA reporting in general Quality Control reports covering all production.

Chase dedicates substantial resources to its Quality Control functions. In 2005, Chase performed 167 on-site branch reviews and reviewed nearly 15,000 loans, including new production, EPDs, and servicing files. On the servicing side, Quality Control personnel use at least 35 testing templates when reviewing loans and complete reviews within 45 days of selecting the loans for review. Company managers hold forums where monitoring plans and corrective actions are discussed, and Quality Control personnel routinely review Neighborhood Watch data to track the Company's FHA performance. Significantly, for the two-year period ending December 31, 2005, Chase's compare ratio was only 85% of the national average. Moreover, a review of Neighborhood Watch data over the past couple of years reflects that Chase's numbers have improved while the national average has deteriorated. This fact evidences Chase's successful implementation of a compliant Quality Control program.

Comment 7

Comment 6

Comment 1



### 2. Chase Takes Exception to the OIG's Quality Control Findings

As previously noted, the OIG alleges in the Report that Chase should have performed field reviews of appraisals on all EPDs, did not review two of 11 EPDs, and did not adequately address or take corrective action with respect to the loans it did review. These allegations are unsupported and at variance with the facts. For the reasons set forth below, we respectfully request that the OIG dispense with these findings in its final report.

#### a. Chase Performed the Required Field Reviews of Appraisals on EPDs

First, the Report alleges that Chase performed only desk reviews of appraisals and did not perform field reviews on all EPDs. Chase understands and appreciates the FHA Handbook requirement that a lender must perform field reviews of appraisals for EPDs. See HUD Handbook 4060.1 REV-1, CHG-1, ¶ 6-6(E)(3). Chase's Quality Assurance program is designed to comply with such requirements, subject to certain variances approved by HUD. With respect to field reviews of appraisals for EPDs, Chase's Quality Assurance program provides for a 10% field review. Notably, in February of 2000, HUD expressly approved the Company's Quality Assurance program, stating that it complies with HUD requirements, and thereby has permitted Chase to perform a 10% field review of appraisals on EPDs rather than a 100% field review. **See Exhibit C-1**. Chase has complied with its program requirements and consistently performed field reviews on 10% of EPD appraisals. Significantly, the loans cited in the Report were not included in the 10%, and Chase was not required to perform field reviews of the appraisals in these cases. Chase submitted its Quality Assurance program to HUD again during the Department's 2004 audit, at which time HUD neither questioned nor criticized the 2000 approval.

Moreover, as explained in greater detail below, Chase does not rely solely on post-closing field reviews to ensure the quality of appraisals. For example, during the latter part of 2003, Chase implemented the use of a pre-closing collateral evaluation tool that quantitatively assesses the reliability of appraisals submitted by mortgage brokers. Specifically, Chase obtains HistoryPro reports that provide sales history information and comparable property data for specific markets dating back three years in sufficient detail to identify property flips, flip markets, and valuation patterns. The reports are intended to measure collateral risks and assist lenders in detecting potential fraud. HistoryPro results have become a factor in many third-party credit decisions, and Chase's proactive implementation of this process exceeds the FHA Quality Control requirements. Note that our records indicate Chase pulled 17 HistoryPro reports in the course of validating value conclusions on the loans subject to this audit.

Comment 7

Comment 6



b. <u>Chase Performed the Required Reviews of EPDs</u>

Second, the Report alleges that Chase did not review two of 11 EPDs. Chase, however, was not required to perform a Quality Control review of these two files.

Chase understands and appreciates the FHA Handbook requirement that a lender must perform a Quality Control review of all EPDs, which are defined by HUD as loans going into default within the first six payments. <u>See</u> HUD Handbook 4060.1 REV-1, ¶ 6-6(D). The Department, however, often grants variances to such Quality Control sampling requirements based on the substantial number of loans that a particular lender may originate/underwrite, with such variances still assuring a 95% confidence level. Significantly, given that Chase originates/underwrites about 20,000 FHA loans per year, the Department granted Chase a variance from the Handbook allowing Chase to define an EPD as a 90-day delinquency within the first 12 months for the purpose of Quality Control reviews. By letter dated March 31, 2005 **(Exhibit C-2)**, the Department acknowledged the fact that Chase's default/claim rate has remained below the national average since December 2003, and it approved a continuation of the variance granted in May 2004, which permits Chase to act according to its definition of EPD as a loan with a 90-day delinquency within the first 12 months. Because Chase's definition of EPD differs from the definition contained in the FHA Handbook, its sampling of EPD reviews will not correlate to information contained in FHA Connection or Neighborhood Watch. In other words, FHA Connection/Neighborhood Watch will identify as EPDs all Chase loans that have gone into default within the first six payments. Absent a variance from HUD, Chase would be expected to perform a Quality Control review of each of these loans. The Department, however, has issued written permission to Chase for the Company to define EPDs differently for purposes of its Quality Control reviews. In accordance with this variance, Chase identifies each loan with a 90-day delinquency within the first 12 months and performs a Quality Control review of these loans.

Significantly, Chase's methodology with respect to EPDs not only has received HUD approval, but captures those loans where fraud perpetrators knowingly make the first six monthly payments to avoid HUD's Quality Control requirement and avoids the inefficiency associated with reviewing loans that appear to be defaults but actually are errors associated with first payment funding transfers and first payment statement delays. In addition, Chase's sampling incorporates loans that fall seriously delinquent during the first year, and Chase ultimately reviews approximately 22% more loans than it would review under HUD's definition of EPD.

In sum, Chase was not required to review all 11 EPDs identified by the OIG. Given the Company's use of a different definition of EPD for Quality Control purposes, as approved by HUD, Chase was required to review, and in fact did review, only nine EPDs.

Comment 1



c. Chase Has Adequately addressed and Taken Corrective Action

Finally, the Report alleges that Chase did not adequately address corrective actions or take any corrective action with respect to the loans reviewed. This allegation is in error.

The OIG audit was limited to case binder and loan level Quality Assurance reporting and cannot effectively assess the impact of Chase's corrective actions. The Company's quality initiatives are driven by robust analytics and are managed for each project at the platform level. For example, following is a list of several FHA-specific quality initiatives in which Chase has engaged over the past two years:

- the Chase Executive Risk Committee receives a monthly risk report detailing key FHA metrics;
- National Operations Management receives weekly government loan quality reporting;
- accountability for government loan product quality has been implemented organizationally via automated error tracking and accountability reporting by processor, underwriter, closer, and government insuring analyst;
- government insuring quality targets have been added to performance objectives;
- FHA loan policies, procedures, and training aids have been reviewed and updated, and wide-scale training has been disseminated to more than 1,000 employees;
- post-closing quality initiatives in the Government Insuring group have resulted in the cancellation of approximately 440 FHA cases that did not meet our quality standards for FHA loans and that were moved on to Chase's balance sheet with mortgage insurance premiums refunded to borrowers;
- Chase submits 95% of its FHA loans for endorsement within 50 days of funding and its NOR rate has been more than 500bps better than the industry average for each month during the past quarter;

Comment 2

Comment 14



- as of April 1, 2006, Chase had only one rejected loan in its uninsured inventory and only 15 loans that were more than 60 days old in its insured inventory;
- in addition to routine reporting, Chase has established a monthly forum for discussion and escalation of FHA loan review findings and follow-up; and
- during 2005, Chase enhanced its underwriting monitoring and performance management processes.

In addition, as explained above, Chase has established a three-tier program to review underwriting quality, which requires the creation of management reports and the implementation and reporting of corrective actions.

While specific evidence of these initiatives is not contained in loan level Quality Assurance reporting or in case binders, their impact can be measured by Chase's continuously improving default/claim rates and compare ratios. According to Neighborhood Watch, Chase's compare ratio was 107% at the end of 2004, and 85% at the end of 2005, reflecting a 22% improvement. Similarly, Chase's default/claim rate was 3.15% at the end of 2004, and 3.03% at the end of 2005, reflecting 12bps improvement. Moreover, as noted above, HUD performed a nationwide comprehensive review of Chase's Quality Control program in 2004. Chase worked diligently and expeditiously to address every issue that HUD raised during the review, and HUD closed all of its findings in July 2005.

**C. Closing Costs and Maximum Mortgage Amounts**

The Report alleges that Premier and/or Chase charged ineligible closing costs in three cases and caused HUD to over-insure one loan. Chase's policy consistently has been to charge FHA borrowers only those fees permitted by HUD requirements. See HUD Handbook 4000.2 REV-2, ¶ 5-2 (applicable at the time the loans cited in the Report were underwritten and closed). We are careful to ensure that underwriting and closing personnel are aware of what fees are permissible and review loan files to assure that FHA borrowers are charged accordingly. To the extent Chase or a mortgage broker charged an ineligible fee in any particular case, the charge was inadvertent and does not reflect the Company's general policies or procedures. The Report details the OIG's findings in these four cases in Appendix E, and we address the findings in each case below.

Mr. Frank E. Baca
May 17, 2006
Page 15

**1. – FHA Case No. 495-6719226**

In this case, the Report alleges that the mortgage was over-insured by $5,647.50 because Premier did not subtract an $8,000 gift of equity from the sales price when calculating the maximum mortgage amount. It notes that the gift was from the seller, who did not have a familial relationship with the borrower.

Comment 8

Chase understands and appreciates that FHA provisions require that "[o]nly family members may provide equity credit as a gift on a property being sold to other family members." HUD Handbook 4155.1 REV-5, ¶ 2-10(C). In accordance with this requirement, it is Chase's policy and procedure to treat any gift of equity received from someone other than a family member as an inducement to purchase resulting in a dollar-for-dollar reduction to the sales price prior to determining the maximum mortgage amount. In this case, however, we have been unable to identify the relationship between the borrower and the seller. If the seller is in fact related to the borrower, the gift of equity was permissible and the loan is not over-insured.

**2. FHA Case No. 495-6325937**

In this case, the Report alleges that Premier charged $144 in ineligible closing costs. Specifically, it states that the borrower paid $75 for lender inspection fees with no support and $69 for ineligible tax service fees. The Report notes that Mortgagee Letter 06-04 stipulates that only the actual cost of a service may be charged to a borrower and that tax service fees are ineligible.

Comment 9

Initially, please note that, as acknowledged in Appendix E of the Report, this loan was endorsed on January 6, 2004. Mortgagee Letter 06-04, however, which the OIG cites as the basis of its allegations, was not issued until January 27, 2006, and therefore did not apply to this loan transaction. At the time this loan closed, Paragraph 5-2 of the FHA Single Family Mortgagees' Handbook was in effect. With respect to inspections, the Handbook provided that "[i]nspection fees may be collected from the borrower for any inspections that must be conducted on the property" and that "[h]ome inspection fees up to $300, or the actual cost, may be included as closing costs in meeting the borrower's minimum investment." HUD Handbook 4000.2 REV-3, ¶ 5-2(A), 5-2(F). Nevertheless, we recognize that the $75 lender inspection fee was charged in error in this case because the appraisal was completed "as is" and no final inspection of the property was necessary. With respect to tax service fees, while the applicable Handbook did not address this type of fee, FHA guidelines did prohibit tax service fees at the time and the $69 tax service fee therefore should not have been charged in this case. See Mortgagee Letter 94-7. Please note that Chase does not charge tax service fees as a practice for FHA loans and the fee in this case reflects an isolated incident that is not reflective of Company policies or procedures. While the fees referenced in the Report were charged in error in this case, please note that there is a lender credit on the HUD-1 Settlement Statement ("HUD-1") for $894 **(Exhibit D)**. Although the lender inspection and tax service fees were not specifically included in this lender credit, we respectfully submit that the credit should be used to offset these two fees.

**3. FHA Case No. 495-6763242**

In this case, the Report alleges that Premier charged the borrower $19 in ineligible closing costs. Specifically, it alleges that the borrower paid $19 for a credit report, but that HUD does not require a credit report for streamline refinances, and that if a lender must obtain a credit report, the fee must be paid out of pocket and may not be financed.

Comment 9

The S r transaction was a no cash out refinance without an appraisal, and the credit report was obtained only for purposes of verifying the borrower's payment history on the mortgage. We recognize, however, that the underwriter should have obtained the payment history from the prior lender and should not have charged the borrower for a credit report. Please note that this fee was in error and does not reflect a Company-wide practice. We have reminded Company employees of their obligations in this regard and are confident that any such deficiency will not recur.

**4. FHA Case No. 495-6696017**

In this case, the Report alleges that Premier overcharged the borrower for a credit report by $18, charging $130 when it provided support only for $112.

Comment 5

Contrary to this allegation, the file contains three credit reports, each reflecting the price of the report and totaling $130 **(Exhibit E)**. The fee to the borrower was supported in this case.

**D. <u>Appraisals</u>**

Finally, the Report alleges that Premier and Chase submitted appraisals to HUD with technical deficiencies in 31 cases. The purported deficiencies include: (1) a lack of conclusive evidence in the files to show the appraiser reviewed the subject sales contract in 18 cases; (2) pictures of the subject properties that did not meet HUD requirements in 18 cases; and (3) the appraiser's failure to adjust FHA comparables downward to reflect sales concessions in 16 cases. The Report concludes that Chase's underwriters either were not aware of HUD's appraisal requirements or ignored them during the desk reviews of appraisals prior to loan approval. The Report notes that the OIG did not determine whether the alleged appraisal deficiencies affected the property valuations.

Comment 2

Mr. Frank E. Baca
May 17, 2006
Page 17

Chase takes appraisal review seriously. It not only requires its underwriters to carefully review each and every appraisal report for accuracy, consistency, and compliance with applicable rules and regulations, but has established stringent guidelines with respect to appraiser qualifications and management-level review of appraiser performance. Following is a summary of Chase's appraisal procedures and responses to the specific allegations in the Report, as well as confirmation that the OIG's findings do not affect the property valuations.

**1. Chase's Appraisal Procedures**

While Chase does not have staff appraisers and relies on independent appraisers, it accepts appraisal reports only from appraisers meeting certain criteria enumerated by the Company. Chase maintains a contractual relationship with Hansen Quality Loan Services ("HQLS"), which is responsible for processing all appraiser status requests, including a branch office's request for initial approval to do business with a particular appraiser. The approval process consists of a review of appraiser references, licensing or certification status, Errors & Omissions insurance, and at least three sample appraisals less than six months old. An appraiser also must have completed at least two education courses with a recognized appraisal organization, college or university, have at least three years of continuous experience (five years in California) immediately preceding application to Chase for approval, and not appear on Freddie Mac's Exclusionary List. After HQLS reviews the documentation for conformance with applicable requirements, it provides a summary of the qualifications with pertinent comments to Chase's Appraiser Panel Management, which communicates any subsequent action necessary to HQLS and the requesting branch to complete the approval process. If an appraiser's application for Chase approval is rejected, he or she may not re-submit an application for at least 12 months.

Chase also has implemented program-specific requirements for appraisers. For example, a licensed or certified appraiser must complete appraisals for loans less than or equal to $750,000. Provisional appraisers or appraiser trainees may not perform appraisals for Chase due to their limited education, experience and training, and a supervisory appraiser must countersign any of their reports and perform an interior inspection of the subject property when such inspection is a loan-level requirement. Certified-residential or certified-general appraisers must conduct complex assignments for loan amounts above $250,000, and Private Investor Programs may dictate an alternative qualification level for appraisers, depending on the specific product or program. Further, appraisals for loans greater than $750,000 cannot be completed by Appraiser Panel Management "Review List" appraisers, but must be completed or supervised by a Chase-approved certified-residential appraiser or a Chase-approved certified-general appraiser. Chase imposes additional eligibility criteria for appraisers in

Mr. Frank E. Baca
May 17, 2006
Page 18

connection with Construction Loan Products, including, among other things, at least five years of documented experience in appraising new construction properties and a resume detailing the number of such appraisals performed on an annual basis.

Comment 2

Not only has Chase established high standards for appraisers with whom it will do business, but it has implemented more stringent quality reviews than required by the FHA. For example, Chase engages in periodic Quality Assurance sampling of appraisals above and beyond the required Quality Control reviews. The Quality Assurance department selects an appropriate sample of appraisals from all appraisers each month and sends them to the current independent, Chase-approved, appraisal review firm; the Credit Risk Management department then reviews the reports it receives back to address any areas of concern and ensure minimum standards are maintained.

Based on the aforementioned reviews, various circumstances will lead to a designation of review status for an appraiser, including:

- an unresolved difference of 20% or more in the estimate of value indicated by the appraiser, compared to the estimate of value given in a field review or other second opinion of value;
- an unresolved difference of over 10% in two appraisals, compared to the estimate of value given in the respective second opinions, within a 12-month period;
- the omission of material information from the original appraisal; or
- the appraiser's involvement in unethical business practices with Chase or another lender, where the practice has been documented, including the appraiser's appearance on Freddie Mac's Exclusionary List.

Appraisers identified in Chase's Appraiser Panel Management Review List may not complete appraisals in connection with loans greater than $750,000, and a field review by a Chase-approved appraiser must be performed prior to loan approval in connection with appraisals performed by Review List appraisers for any loans less than or equal to $750,000. To be eligible for removal from the Review List, Chase must receive five consecutive acceptable field reviews of the individual's appraisals. Chase also has created a Watch List for appraisers. An appraisal will be designated for the Watch List when Chase identifies deficiencies in his or her reports, but not items egregious enough to warrant placement on the Review List. Watch List appraisers are subject to extra careful evaluation of each aspect of their appraisal reports and may be required to submit additional information and documentation in individual transactions to support appraisal conclusions. An underwriter also has increased authority and latitude to require field reviews on these appraisers' properties. All documentation concerning Review List and Watch List appraisers, including field reviews, must be delivered to Chase's Appraiser Panel Management for reconciliation and tracking purposes.

In addition to creating high qualification standards for appraisers doing business with Chase and subjecting appraisers to various Quality Assurance reviews, as explained above, Chase uses HistoryPro to quantitatively assess the reliability of appraisals received from mortgage brokers. The HistoryPro reports assist Chase in determining the accuracy of appraisal data and conclusions in individual transactions and further demonstrate Chase's commitment to ensuring accurate property valuations.

Comment 1

**2. Chase Substantially Complied with Appraisal Requirements and the Findings in the Report Do Not Affect the Property Valuations**

As previously noted, the Report alleges that 18 files do not evidence the appraiser's review of the subject sales contract, the pictures were deficient in 18 cases, and the appraiser did not adjust FHA comparables downward to reflect sales concessions in 16 cases. The OIG further suggests that Chase cannot assure HUD that these deficiencies did not affect the property valuations.

Comment 10

Chase disagrees with many of the findings in the cases cited in the Report and objects to the OIG's suggestion that Chase's underwriters either were not aware of or ignored HUD's appraisal requirements. Company underwriters are knowledgeable of FHA appraisal requirements and routinely review appraisal reports to ensure they meet the applicable guidelines. While we recognize that a technical deficiency may have occurred in a few of the 31 cases, in no case did the underwriter ignore HUD's appraisal requirements and in no case did the deficiency affect the property valuation. Moreover, note that 11 different appraisers were involved in these loans, only three of whom ever have appeared on Chase's Review or Watch List, and Chase used HistoryPro reports to validate the appraisers' conclusions in 17 of the 31 cases prior to approving the loans. As detailed below, Chase substantially complied with FHA appraisal requirements in the cited cases and the property valuations are supported.

a. <u>Appraisers' Review of Sales Contracts</u>

First, the Report alleges that 18 files lack conclusive evidence that the appraiser reviewed the subject sales contract. It is Chase's policy and practice to furnish a copy of the sales contract for the subject property to the appraiser in every case where Chase orders an appraisal report. In this case, however, Premier, not Chase, ordered the appraisal reports and was required to furnish copies of the subject sales contracts to

Mr. Frank E. Baca
May 17, 2006
Page 20

the appraisers. We recognize, however, that in those cases where the appraisal report expressly states that the sales contract was unavailable, the underwriter should have furnished a copy of it to the appraiser and requested an amended report.

Chase respects the FHA requirement that strict compliance with the Uniform Standards of Professional Appraiser Practice ("USPAP") is required in FHA transactions, see HUD Handbook 4150.2, CHG-1, ¶ 4-0, and it is Chase's policy and practice to ensure, to the best of its ability, that appraisals satisfy the applicable criteria. We are unaware, however, of any requirement that a file contain "conclusive evidence" that the appraiser reviewed the subject sales contract. The USPAP Standards Rule 1-5, cited in the Report, requires an appraiser to analyze the sales contract, and Standards Rule 2-2(a)(ix), also cited in the Report, requires the appraiser to "describe the information analyzed, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions" and to provide "a summary of the results of analyzing the subject sales" and "efforts undertaken by the appraiser to obtain the information[.]" These rules, however, do not require an express statement in the appraisal report that the sales contract was reviewed. The lack of such a statement in any given appraisal report therefore does not constitute a violation of either FHA requirements or the USPAP.

Comment 5

Comment 11

Note that, of the 18 referenced cases, nine appraisals, copies of which are enclosed as **Exhibits F-1** through **F-9**, do not identify either way whether the appraiser reviewed the subject sales contract. Again, the lack of any such identification does not violate applicable rules. Thus, there is no reason in these cases to suspect that the contract was not reviewed. Documentation of the review in the appraisal report is not required, and the fact that an appraisal report does not include a written statement that the appraiser reviewed the sales contract in no way suggests that the appraiser did not review the contract. The allegation in these nine cases therefore is unsupported. Moreover, even if the appraisers did not review the sales contracts in these nine cases, given that the files are silent on this matter, Chase neither knew nor should have known that the appraisers did not review the contracts. Significantly, HUD does not hold lenders responsible for appraisal deficiencies of which they had no reason to know. The Report cites a final rule issued by HUD on July 20, 2004, for the proposition that lenders are held responsible, along with appraisers, for the quality of appraisals in FHA insured mortgage loan transactions. This rule, however, did not become effective until August 19, 2004, after the majority of the loans cited in the Report were originated and closed. Moreover, this final rule clarified that lenders are not held to a strict liability standard for the quality of appraisals and that, consistent with existing HUD Handbooks and Mortgagee Letters, a lender will be subject to administrative sanctions only if the lender knew or should have known of appraisal deficiencies. See 69 Fed. Reg. 43504 (July 20, 2004). Contrary to the suggestion in the Report, Chase neither knew nor

Comment 10

Mr. Frank E. Baca
May 17, 2006
Page 21

should have known of appraisal deficiencies in these cases and is not responsible if the appraisers failed to review the sales contracts or note this fact in their reports.

Having said that, in eight of the 18 referenced cases, the appraisal report notes that the sales contract was not available for review and that the mortgage broker or lender supplied the sales price. While it is Chase's policy to ensure the appraiser receives a copy of the subject sales contract in each case, including in cases like the ones at issue here where the broker orders the appraisal report, we recognize that the appraisers did not receive the sales contracts in these eight cases. This oversight is contrary to Chase's procedures, and we have reminded Company employees that appraisers must review sales contracts for the subject properties. Please note, however, that the appraiser's failure to review the subject sales contract in any given case had no impact on the property's appraised value.[7] As explained below, the subject sales contracts do not contain any sales or financing concessions that required adjustment beyond adjustments made by the appraisers.

b. <u>Photographs</u>

Second, the Report alleges that pictures of the subject properties contained in 18 appraisal reports did not meet HUD requirements. While the Report fails to explain what deficiencies purportedly exist in each case, our review of the appraisal reports has revealed that all of the pictures are compliant with the exception that there are no pictures of the sides of the properties.

Chase understands and appreciates the specific FHA requirements regarding photographs to be included in appraisal reports. In compliance with these requirements, Chase makes efforts to ensure that appraisers make complete visual inspections of the interior and exterior of subject properties and take photographs that show the sides, front and rear of the properties, including all improvements on the subject property with any contributory value and photographs of the street frontage. Chase likewise requires the submission of photographs of comparable properties. <u>See</u> HUD Handbook 4150.2, CHG-1 ¶ 3-1. Again, in the cases cited in the Report, each appraisal report includes photographs that meet the aforementioned requirements with the exception of the lack of side photographs. We therefore have emphasized the requirement for side photographs to personnel and are confident that future appraisals will include them. The absence of side photographs in the cited cases, however, had no bearing on the subject properties' appraised values. The appraisers certified that they inspected the interiors and exteriors of the subject properties, which would include the

---

[7] Chase has been unable to locate one of the 18 files: HA Case No. 495-6738304. The servicer in this case has not released the file to us for review, and we therefore have not discussed this file in our response above.

Mr. Frank E. Baca
May 17, 2006
Page 22

sides of the properties, and noted any apparent or known adverse conditions on the subject site.

c. Adjustments to Comparable Sales

Comment 12

Finally, the Report alleges that 16 loans had FHA comparables that were not adjusted downward to reflect sales concessions as required, and it cites an FHA provision that requires appraisers to account for and adjust the sales price of comparable properties for any special sale or financing terms. See HUD Handbook 4150.2, CHG-1, ¶ 4-6(B). Chase understands and appreciates that an appraiser must make adjustments to the sales price of comparable properties for special sale or financing terms, including sales concessions, nonmarket financing terms, points, buydowns, closing terms. and swaps/exchanges. We believe that this requirement was met in the 16 cases cited in the Report and we are uncertain of the basis for the OIG's allegation.

In these 16 cases, the appraisal reports identify any sales or financing concessions on the comparable properties and adjust the sales prices of the comparables accordingly. The sales contracts for the subject properties in these cases do not identify any sales or financing concessions requiring further adjustment to the comparables. Copies of the appraisal reports for these loans are enclosed for your review as **Exhibits F-1, F-6, F-7, F-9, and F-10 through F-19**. Copies of the sales contracts for the subject properties are enclosed for your review as **Exhibits G-1 through G-15**.[8] These documents evidence the appraisers' compliance with FHA requirements and USPAP guidelines in connection with adjustments to comparable sales.

Moreover, please note that the appraisers were independent contractors in these cases, not employees of Chase. Chase had no supervision or control over the appraisers' work, and the Company reasonably relied on their experience and expertise in performing the appraisals. Chase has no reason to question the appraisers' decisions not to adjust the comparable properties' sales prices, and nothing in the loan files suggests that additional adjustments should have been made. In addition, the Appraiser's Certification in each case provides that the appraiser made all required adjustments. For example, in the case, **FHA Case No. 495-6696017**, the Appraiser's Certification states:

[8] Note that appraisal reports for th s cases, **FHA Case Nos. 495-6738304** and **495-6173073**, respectively, and the sales contract for the Rios property, are not enclosed. We have been unable to locate the file in the Rios case and the servicer has not released their file to us for review. We likewise have been unable to locate a copy of the appraisal in the Owens case.

Mr. Frank E. Baca
May 17, 2006
Page 23

> I have researched the subject market area and have selected a minimum of three recent sales of properties most similar and proximate to the subject property for consideration in the sales comparison analysis and have made a dollar adjustment when appropriate to reflect the market reaction to those terms of significant variation. If a significant item in a comparable property is superior to, or more favorable than, the subject property, I have made a negative adjustment to reduce the adjusted sales price of the comparable and, if a significant item in a comparable property is inferior to, or less favorable than the subject property, I have made a positive adjustment to increase the adjusted sales price of the comparable.

Comment 12

**See Exhibit F-2.** The appraisal report in each of the other cited cases contains an identical or similar certification, and Chase has no reason to question the appraisers' representations. Furthermore, as explained above, the Department's position is that a lender should be held responsible for deficiencies in an appraisal only when the lender knew or should have known of the deficiencies. Here, Chase has no reason to believe that downward adjustments may have been necessary for the comparable sales beyond those adjustments made by the appraisers, and, according to the Department, therefore should not be held liable in connection with this matter.

d. The Appraised Values are Accurate

The OIG suggests that Chase cannot assure HUD that the appraisals accurately valued the subject properties. This suggestion is erroneous.

Comment 13

The fact that the appraisers did not review the subject sales contract or provide side photographs in certain cases in no way impacted the property valuations, and the appraisers appear to have made all necessary adjustments to the comparable sales. Furthermore, Chase has obtained field review appraisals of the properties. Significantly, the field reviews generally confirm the original appraised values.[9] Thus, Chase can assure HUD that the properties were accurately valued and that any deficiencies the OIG believes may have occurred in connection with the appraisals constituted at worst harmless error and had no effect on the insurability of the loans or valuation of the collateral.

---

[9] In a few cases, the field review did not support the original appraised value. In these cases, however, the reasons for the lower values are entirely unrelated to the matters raised by the OIG, the lower values result from the review appraisers' use of a different approach with respect to comparable properties than the original appraisers, which is not necessarily better than the original appraisers' approach and may not even be appropriate, and the review appraisers relied on information of which the underwriter neither knew nor could have known at the time the loans were underwritten and closed. Thus, the OIG's findings in these cases had no impact on the properties' appraised values.

Mr. Frank E. Baca
May 17, 2006
Page 24

## III. CONCLUSION

Comment 2

Comment 4

Comment 1

The Report portrays Chase as employing poorly managed underwriters who disregarded loan origination requirements and as failing to perform satisfactory Quality Control. This characterization is unfair, untrue, and unsupported by the evidence in this case. Contrary to the suggestion in the Report, Chase at no time knowingly certified the veracity of inaccurate file data, it substantially complied with FHA requirements in the cited cases, and it performed satisfactory Quality Control reviews in compliance with FHA requirements. In fact, the Company routinely performs more frequent and more stringent Quality Control reviews than required by HUD and its underwriters face severe consequences for their failure to underwrite loans in compliance with FHA requirements and in accordance with Chase's high standards. While we recognize that there is always room for improvement and that certain deficiencies may have occurred in connection with a handful of the cited loans, any such deficiencies constitute isolated occurrences and do not represent Chase's loan portfolio. Chase has rigorous controls in place to monitor loan quality and cure any shortcomings identified, and its consistent maintenance of default/claim rates below the national average is a testament to the Company's success in this regard.

Comment 5

Throughout this proceeding, we hope the OIG will consider this response and supporting documentation. We trust that, after reviewing these materials, you will agree that the penalties recommended in the Report are disproportionate to any deficiencies that may have occurred and that the imposition of such penalties against Chase would be unwarranted in this instance. If you have any questions concerning the matters discussed herein, please contact Chase's Washington counsel, Phillip L. Schulman, at (202) 778-9027.

Thank you for your kind consideration.

Sincerely,

Mark A. Nelson

Mark A. Nelson maw
Senior Vice President

Enclosures

cc: Phillip L. Schulman, Esq.

PREMIER
Mortgage Funding, Inc.

May 5, 2006

Frank E. Baca
Regional Inspector General
United States Department of Housing & Urban Development
Regional Office of The Inspector General
819 Taylor Street, Room 13A09
Fort Worth, Texas 76102

Reference: Premier Mortgage Funding, Inc., Austin, Texas, and Its Compliance with HUD Underwriting Requirements and Quality Control Requirements

Dear Inspector General Baca:

We appreciate the opportunity to respond to the allegations reported in the OIG draft audit provided to us dated April 25, 2006. It is not disputed that Premier Mortgage Funding did originate the subject loans identified in the report. It is also not disputed that our sponsor, JPMorgan Chase, reviewed and was responsible for and did underwrite each of these loans.

Comment 15

We maintain that Premier Mortgage Funding does have a qualified Quality Control plan (see attachment A) and conducts on a regular basis on-site branch audits (see attachment B) as required by the FHA quality control guidelines.

In the 31 cases where the primary issue was inadequate or incomplete appraisals, Premier Mortgage Funding used appraisers approved by the sponsor; the sponsor reviewed the appraisals for accuracy; and in each instance, accepted the appraisal as submitted by the appraiser. Once we received notification of these appraisal related issues from HUD, we ceased our relationship with the subject appraisal companies.

In the cases where the OIG believed that there were inconsistencies with the accuracy of the borrower's credit information, Premier Mortgage Funding collected the required and necessary documentation to meet the HUD underwriting guidelines. However, because the sponsor was the underwriting authority who closed and funded these loans, it was the sponsor's duty to ultimately ensure that the FHA credit underwriting standards were met. In addition, it was the sponsor's responsibility to conduct quality control reviews as well as conduct the necessary re-verifications.

As you can see from the dates of origination, all of the subject loans were originated and/or endorsed from FY 2003 and FY 2004. Premier Mortgage Funding continually updates and improves its processing policies and procedures to help ensure that the branch offices have the best information available to remain complaint (see attachment C). The issues that resulted in apparent over insuring and charging for non-allowables has been addressed with the branches and will continue to be a source for training.

Thank you for the opportunity to respond to these issues and please call me if you need additional information at (877) 742-4374.

Sincerely,

Jerry Cugno
CEO
Premier Mortgage Funding, Inc.

## OIG Evaluation of Auditee Comments

**Comment 1** As indicated in the report, we limited our review to the loans originated by the Austin, Texas branch of Premier Mortgage Funding, Inc., Chase's loan correspondent for these loans. We did not review the overall underwriting operations of JPMorgan Chase.

**Comment 2** All actions by Chase, as a result of any quality control efforts, were ineffective at its loan correspondent level. The home office officials and the branch manager of the loan correspondent were unaware of any Chase quality control effort at the Austin branch.

**Comment 3** As indicated by our report, Premier's Austin Branch that we reviewed was voluntarily terminated in December 2004.

**Comment 4** The report does not say that company employees "knowingly' certified to the integrity of inaccurate data. Our report says they did not ensure the accuracy of the data before they certified the data. They should ensure the accuracy by examining supporting documentation contained in the loan file and not certify based on any missing documentation.

**Comment 5** We reviewed the comments and revised or clarified our report as needed.

**Comment 6** Cha**se** did not require field reviews of any early payment default appraisals from its loan correspondent, the Austin branch of Premier Mortgage Funding, Inc., although its early payment default rate was significantly above average. Regardless of any variance HUD may have approved for Chase's routine quality control program, HUD handbook 4060.1, Rev. 1, paragraph 6-6 D, provides that in addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. As defined here, early payment defaults are loans that become 60 days past due. Paragraph 6-6 E 3 provides factors for selecting loans for appraisal reviews and states that in addition, field reviews should be performed on loans selected in accordance with paragraph 6-6 D.

**Comment 7** Subsequent to the written response, we requested payment histories for the two early payment defaults that the response says Chase was not required to review. We determined and Chase agreed that the two loans were delinquent 90 days or more within the first year and met Chase's definition of early payment defaults and were required to be reviewed. Chase personnel said they did not review one of the loans because they could not find the file and did not review the other because the loan became current.

**Comment 8** After our draft was issued, we were able to determine the seller was related to the borrower. Therefore, we removed this loan from the deficient loans contained in the report.

**Comment 9** Chase agrees that the borrower should not have been charged the fees.

**Comment 10** We concluded that the Chase underwriters were either unaware of or ignored the HUD appraisal requirements because the technical deficiencies occurred without correction. As the report says, we did not determine the technical deficiencies affected the property valuations.

**Comment 11** Our report does not say an "express statement" is required. We believe the language contained in the standards is clear and requires the appraiser to analyze the sales contract and the appraisal report should describe the information analyzed. The underwriters did not require this.

**Comment 12** Every case identified in the report had one or more comparable properties on the appraisal that were not appropriately adjusted for applicable sales concessions. Chase may not have known this because the loan correspondent arranged for the appraisals and the appraisal reports did not disclose the sales concessions. Further, as mentioned earlier, Chase did not conduct field reviews of appraisals related to early payment default loans originated by the loan correspondent.

**Comment 13** As mentioned in the report, we did not determine whether the technical deficiencies affected property values. However, the appraisals contained technical deficiencies that were not addressed by the underwriter. Chase's response shows that subsequent field reviews of the appraisals did not support the original appraised values in a few cases regardless of the matters raised by us.

**Comment 14** Neighborhood Watch showed these loans as originated by Premier, not Chase. Ten loans in our report contained violations that were material enough to affect loan approval. Chase quality control reviewers generally had similar findings related to the loans they reviewed but Chase was unable to provide any documentation to reflect any type of corrective action. HUD's 2004 comprehensive review of Chase's quality control program contained similar findings of lack of corrective action.

**Comment 15** Premier provided us a copy of its quality control plan dated April 10, 2006, and operational policies and procedures. Premier will need to submit any revised quality control plans, policies, and procedures to HUD for review and approval.

# Appendix C-1

## SUMMARY OF QUESTIONED COSTS BY LOAN

| | | INDEMNIFICATION | Reimbursement to HUD | | | | Ineligible closing costs | |
|---|---|---|---|---|---|---|---|---|
| **Loan number** | **Mortgage amount** | **Indemnification requested** | **Claims paid by HUD** | ***Claims paid + other costs to HUD/ property resold*** | ***HUD sale price*** | **Net loss/(gain)** | **Buydowns** | **Reimburse to HUD** |
| 495-7010256 | $115,304 | $115,304 | | | | | | |
| 495-6738304 | $109,670 | | $110,582 | | | | | |
| 495-6900244 | $102,921 | $102,921 | | | | | | |
| 495-6696017 | $141,592 | | | *$157,350* | *($84,000)* | $73,350 | | |
| 495-6173073 | $129,920 | $129,920 | $875 | | | | | |
| 495-6702555 | $121,394 | | $124,607 | | | | | |
| 495-6828191 | $115,151 | $115,151 | | | | | | |
| 495-6781217 | $26,948 | | $33,294 | | | | | |
| 495-6325937 | $77,292 | | | | | | $144 | |
| 495-6794279 | $45,928 | $45,928 | | | | | | |
| 495-6973264 | $137,837 | $137,837 | | | | | | |
| 495-6490206 | $122,561 | | | *$136,892* | *($85,490)* | $51,402 | | |
| 495-6763242 | $112,360 | | | | | | | $19 |
| | | **$647,061** | **$269,358** | | | **$124,752** | **$144** | **$19** |

| | | | |
|---|---|---|---|
| **Indemnification requested** | | **$647,061** | |
| ***Reimbursement to HUD:*** | | | |
| Reimbursement for claims | $269,358 | | |
| Reimbursement for net losses | $124,752 | *subtotal losses to HUD:* | *$394,110* |
| Reimbursement for ineligible closing costs loan foreclosed & HUD has paid claims | $19 | | |
| **Total reimbursement to HUD** | | **$394,129** | |
| ***Loan buydowns*** | | | |
| Ineligible closing costs | $144 | | |
| **Total loan buydowns** | | **$144** | |

*Total amount of loans originated based on bad data* *$1,169,226*

# Appendix C-2

# SCHEDULE OF LOANS WITH QUESTIONED DATA INTEGRITY

**Schedule of Questioned Loans by Deficiency**

| Borrower | | Income | | Liabilities | | Reserves & deposits | Other LP* data integrity | Ratios | Ineligible |
|---|---|---|---|---|---|---|---|---|---|
| Loan number | Mortgage amount | Income overstated | Income stability/history not verified | Liabilities understated | Delinquent federal debt | Reserves &/or deposits not properly verified | Note info in LP inconsistent with actual | Debt-to-income ratios exceed HUD limits | Seller did not own the property for 90 days |
| 495-7010256 | $115,304 | X | | | | X | | X | |
| 495-6738304 | $109,670 | | | X | | X | | X | |
| 495-6900244 | $102,921 | X | | | | | | X | |
| 495-6696017 | $141,592 | | X | X | | | | X | |
| 495-6173073 | $129,920 | | X | | | X | | | X |
| 495-6702555 | $121,394 | X | | X | X | | | | |
| 495-6828191 | $115,151 | | | X | | X | X | X | |
| 495-6781217 | $26,948 | | | X | | X | | X | |
| 495-6794279 | $45,928 | X | | X | | | | X | |
| 495-6973264 | $137,837 | | | X | | X | | X | |
| 495-6490206 | $122,561 | X | | | | X | | X | |
| **Totals** | $1,169,226 | 5 | 2 | 7 | 1 | 7 | 1 | 9 | 1 |

**LP = Loan Prospector*

## Appendix D

# APPRAISALS WITH TECHNICAL DEFICIENCIES BY LOAN

| Borrower | | Appraisal | | |
|---|---|---|---|---|
| Loan number | Mortgage amount | Appraisal adjustments inadequate (sales concessions) | Subject sales contract not analyzed | Subject pictures deficient |
| 495-7010256 | $115,304 | | X | |
| 495-6757037 | $139,613 | X | X | X |
| 495-6749053 | $121,749 | X | | X |
| 495-6764747 | $132,863 | X | X | X |
| 495-6738304 | $109,670 | X | | X |
| 495-6665729 | $122,459 | | X | |
| 495-6900244 | $102,921 | X | X | X |
| 495-6696017 | $141,592 | | X | |
| 495-6490206 | $122,561 | X | | |
| 495-6173073 | $129,920 | X | | X |
| 495-6702555 | $121,394 | X | | |
| 495-6867041 | $133,066 | | X | X |
| 495-6802641 | $128,143 | X | | X |
| 495-6828191 | $115,151 | X | X | |
| 495-6781217 | $26,948 | | X | |
| 495-6762218 | $43,594 | | | X |
| 495-6764622 | $70,999 | | X | X |
| 495-6832512 | $96,932 | X | X | |
| 495-6686604 | $146,616 | | X | |
| 495-6751057 | $113,781 | X | X | |
| 495-6590529 | $134,893 | | X | X |
| 495-6719226 | $76,175 | | | X |
| 495-6796740 | $135,553 | | | X |
| 495-6729818 | $104,037 | | | X |
| 495-6740678 | $133,421 | | | X |
| 495-6794279 | $45,928 | | X | X |
| 495-6815254 | $63,133 | X | X | |
| 495-6834667 | $94,395 | X | | X |
| 495-6973264 | $137,837 | | X | |
| 495-6988036 | $120,683 | X | X | X |
| 495-6703009 | $142,353 | X | | |
| | | | | |
| | | | | |
| Totals | $3,423,684 | 16 | 18 | 18 |

## Appendix E

# CASE NARRATIVES

| | |
|---|---|
| **Case number:** | **495-7010256** |
| Lender number: | 1849200674 |
| Loan amount: | $115,304 |
| Contract sales price: | $119,595 |
| Endorsement date: | August 5, 2004 |
| Default date: | October 1, 2004 |
| Current loan status: | Foreclosure started (as of March 31, 2006)<br>Reinstated by borrower who retains ownership (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier overstated the borrower's monthly income by $102. It used monthly income of $6,493 to approve the loan in Loan Prospector, but file documents support monthly income of $6,391. The lower monthly income amount increased the back-end ratio (total fixed payment to effective income) to 47 percent. Currently, HUD's maximum ratios are 31 percent (front-end ratio) and 43 percent (back-end ratio).

3. Premier overstated reserves/deposits in Loan Prospector and did not identify the source of funds. Premier reported reserves/deposits of $2,762. However, it did not provide current bank statements for the borrower or explain a large deposit of $2,500 on the statement date as required by HUD and Loan Prospector. HUD Handbook 4155.1, REV-5, paragraph 2-10 B, requires the lender to obtain a credible explanation for the source of funds when there is a large increase in an account. Loan Prospector's feedback certificate states that the lender is responsible for documenting, according to HUD requirements, any situation not addressed on the feedback certificate. Without the unexplained deposit, we calculated reserves/deposits at $262, significantly less than the amount submitted to Loan Prospector.

| | |
|---|---|
| **Case number:** | **495-6738304** |
| Lender number: | 1849200674 |
| Loan amount: | $109,670 |
| Contract sales price: | $115,590 |
| Endorsement date: | January 5, 2004 |
| Default date: | June 1, 2004 |
| Current loan status: | Accelerated claim disposition. Claims paid as of April 28, 2006: $110,582 |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier understated liabilities by at least $294. It did not include any revolving debt in its calculation of monthly liabilities and reported total monthly debt of $1,140. We calculated monthly revolving debt to be $320 and total monthly debt to be $1,434. The higher monthly liability amount changed the monthly qualifying debt-to-income ratios to 37 percent (mortgage payment expense to effective income) and 54 percent (total fixed payment to effective income). Currently, HUD's maximum ratios are 31 percent (front-end ratio) and 43 percent (back-end ratio).

3. Premier overstated reserves/deposits in Loan Prospector and did not identify the source of funds. It reported reserves/deposits of $2,500. However, it did not explain a large deposit of $2,200 on the same date as the Loan Prospector approval. HUD Handbook 4155.1, REV-5, paragraph 2-10 B, requires the lender to obtain a credible explanation for the source of funds when there is a large increase in an account. Loan Prospector's feedback certificate states that the lender is responsible for documenting, according to HUD requirements, any situation not addressed on the feedback certificate. Without the unexplained deposit, we calculated deposits to be $300.

4. Premier reported gift funds of $10,101 to Loan Prospector, and the amount was credited on the HUD-1 settlement statement. However, Premier did not obtain a gift letter as required by the Loan Prospector feedback certificate. The settlement statement shows a $10,101 credit to the buyer from a nonprofit organization and a $10,701 charge to the seller.

5. The loan did not close in the HUD-approved lender name. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier used AustinLoan.com as the lender on the mortgage note and deed of trust.

6. As of April 28, 2006, HUD had paid claims on this property totaling $110,582.

| | |
|---|---|
| **Case number:** | **495-6900244** |
| Lender number: | 1849200674 |
| Loan amount: | $102,921 |
| Contract sales price: | $106,746 |
| Endorsement date: | July 13, 2004 |
| Default date: | December 1, 2004 |
| Current loan status: | Reinstated by borrower who retains ownership (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier overstated monthly income by $2,333. It used monthly income of $5,491 to qualify the borrower in Loan Prospector. The loan file shows the borrower's self-employment income declining. Because of this, the loan file supports monthly income of only $3,158. The lower monthly income amount increased the monthly qualifying debt-to-income ratios to 31 percent (mortgage payment expense to effective income) and 48 percent (total fixed payment to effective income). The total fixed payment-to-income ratio exceeds HUD's current guidelines, which provide the maximum of 43 percent for loan approval.

| | |
|---|---|
| **Case number:** | **495-6696017** |
| Lender number: | 1849200674 |
| Loan amount: | $141,592 |
| Contract sales price: | $155,000 |
| Endorsement date: | February 3, 2004 |
| Default date: | October 1, 2004 |
| Current loan status: | Property conveyed to HUD. Sold on June 14, 2005 |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier understated monthly debt by $19. It reported the estimated principal, interest, tax, and insurance payment of $1,301 to Loan Prospector for underwriting. We calculated monthly payment to be $1,320. The higher monthly liabilities increased the monthly qualifying debt-to-income ratios to 29 percent (mortgage payment expense to effective income) and 50 percent (total fixed payment to effective income). The total fixed payment-to-income ratio significantly exceeds HUD's recently revised limits of 43 percent.

3. The Loan Prospector feedback certificate instructed Premier to obtain an explanation for employment gaps greater than 60 days. Premier did not obtain an explanation for a 13-month gap for the borrower. The borrower had held his current position for only six months, and there was no verification of employment from the employer to verify his probability of continued employment. We were not able to determine his income stability.

4. The loan did not close in the HUD-approved lender name. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier used AustinLoan.com as the lender name on the HUD-1 settlement statement, mortgage note, and deed of trust.

5. HUD's losses on the property totaled $73,350.

| | |
|---|---|
| **Case number:** | **495-6173073** |
| Lender number: | 1849200674 |
| Loan amount: | $129,920 |
| Contract sales price: | $160,000 |
| Endorsement date: | January 2, 2004 |
| Default date: | August 1, 2005 |
| Current loan status: | Reinstated by borrower who retains ownership (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. The subject property is not eligible for Federal Housing Administration insurance. The seller entered into a sales agreement with the borrower 13 days before purchasing the subject property. HUD requires a seller to hold a property at least 90 days before it can be eligible for HUD mortgage insurance.

3. Premier entered a gift amount of $34,352 into Loan Prospector. According to the HUD-1 settlement statement and gift letter, the actual gift was $34,423.

4. Premier reported unsupported reserves of $2,153 to Loan Prospector. Loan Prospector instructed Premier to verify all reserves submitted. Also, HUD requires the lender to ensure that the loan application package contains all documents used to support its decision. Although the borrowers most recent pay check stub identified $7402 as a pension balance, we were unable to determine the vested amount. We were only able to verify the borrower’s bank deposits of $761.

5. Premier did not verify the stability of borrower income. The employer described the borrower’s probability of continued employment as “unknown.” Premier did not document its analysis or obtain clarification of the employer’s comments.

6. Premier did not use the HUD-approved lender name on closing documents. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier listed AustinLoan.com as the lender on the mortgage note, deed of trust, and the HUD-1 settlement statement.

7. As of April 28, 2006, HUD had paid claims totaling $875.

| | |
|---|---|
| **Case number:** | **495-6702555** |
| Lender number: | 1849200674 |
| Loan amount: | $121,394 |
| Contract sales price: | $127,835 |
| Endorsement date: | December 9, 2003 |
| Default date: | August 1, 2004 |
| Current loan status: | Property conveyed to HUD. Total claims paid as of April 28, 2006: $124,607 |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier originated the loan when the coborrower had a delinquent federal debt. The coborrower was delinquent on debt to the Department of Veterans Affairs at the time of application. Premier provided no evidence of repayment. HUD Handbook 4155.1, REV-5, paragraph 2-5 B, states that if the borrower is delinquent on any federal debt, the borrower is not eligible until the delinquent account is brought current or a repayment plan is established and verified by the federal agency owed.

3. Premier understated monthly debt by at least $211. It reported to Loan Prospector monthly debt of $1,837. However, it did not include the monthly car payment of $200 and understated by $11 the student loan payment that was coming due five months after closing.

4. Premier overstated income by $73. It reported monthly income to Loan Prospector of $4,971. We calculated the monthly income to be $4,898.

5. Premier did not use the HUD-approved lender name on closing documents. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier listed the lender as AustinLoan.com on the HUD-1 settlement statement, mortgage note, and deed of trust.

6. Premier did not provide a gift letter signed by the borrower. HUD Handbook 4155.1, REV-5, paragraph 2-10 C, requires the gift letter to be signed by the donor and the borrower.

7. As of April 28, 2006, HUD had paid claims totaling $124,607.

| | |
|---|---|
| **Case number:** | **495-6828191** |
| Lender number: | 1849200674 |
| Loan amount: | $115,151 |
| Contract sales price: | $117,000 |
| Endorsement date: | January 16, 2004 |
| Default date: | Neighborhood Watch shows “N/A” in the “Number of Payments before First Default” field. |
| Current loan status: | Preclaim (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier understated debt by $139. It reported to Loan Prospector monthly debt of $1,419. However, this loan closed with a buydown agreement. Therefore, Premier should have used total monthly debt of $1,558, which reflects mortgage payments at the note rate. The additional debt increased the monthly qualifying debt-to-income ratios to 34 percent (mortgage payment expense to effective income) and 55 percent (total fixed payment to effective income). Both ratios exceed HUD’s recently revised limits of 31 percent and 43 percent.

3. The loan did not close as approved. We concluded that Premier did not enter the gift and buydown information into the Loan Prospector system because the feedback certificate does not list the buydown agreement or the gift. HUD Handbook 4155.1, REV-5, paragraph 3-10 B, requires the lender to close the loan in the same manner as it was underwritten and approved.

4. Premier did not properly execute and complete loan documents. It did not sign the buydown agreement, and the buydown agreement did not include a provision to apply unused buydown funds to the mortgage balance. HUD Handbook 4155.1, REV-5, paragraph 2-14 B 2, requires the lender to demonstrate that the eventual increase in mortgage payments will not affect the borrower adversely and will not likely lead to default.

5. Premier did not use the HUD-approved lender name on closing documents. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier listed the lender as AustinLoan.com on the HUD-1 settlement statement, mortgage note, and deed of trust.

6. Premier did not provide a gift letter signed by the borrower. HUD Handbook 4155.1, REV-5, paragraph 2-10 C, requires the gift letter to be signed by the donor and the borrower.

| | |
|---|---|
| **Case number:** | **495-6781217** |
| Lender number: | 1849200674 |
| Loan amount: | $26,948 |
| Contract sales price: | $39,661 |
| Endorsement date: | December 23, 2003 |
| Default date: | June 1, 2004 |
| Current loan status: | Property conveyed to HUD. Total claims paid as of April 28, 2006: $33,294 |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier understated liabilities by $19. It reported to Loan Prospector monthly debt of $293 per month. We calculated monthly debt at $312. The higher monthly liability amount increased both of the monthly qualifying the debt-to-income ratios to 42 percent. The mortgage payment expense-to-effective income ratio exceeds HUD’s recently revised limit of 31 percent.

3. Premier overstated reserves/deposits in Loan Prospector and did not identify the source of funds. It reported to Loan Prospector reserves/deposits of $572. The borrower made two deposits on October 15, 2003, into a certificate of deposit and his personal checking account totaling $877. This amount is higher than the borrower’s monthly income, and there is no explanation in the loan file to support the source of funds for the large deposits. We could only verify $50 in earnest money. HUD Handbook 4155.1, REV-5, paragraph 2-10 B, requires the lender to obtain a credible explanation for the source of funds when there is a large increase in an account.

4. The loan did not close in the HUD-approved lender name. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier used AustinLoan.com on the mortgage note and deed of trust**.**

5. As of April 28, 2006, HUD had paid claims totaling $33,294.

| | |
|---|---|
| **Case number:** | **495-6325937** |
| Lender number: | 1849200674 |
| Loan amount: | $77,292 |
| Contract sales price: | $90,700 |
| Endorsement date: | January 6, 2004 |
| Default date: | June 1, 2005 |
| Current loan status: | Reinstated by borrower who retains ownership (as of April 28, 2006) |

Summary:

Premier charged $144 in ineligible closing costs. The borrower paid $75 for lender inspection fees with no support and $69 for ineligible tax service fees. Mortgagee Letter 06-04 stipulates that only the actual cost of a service may be charged to a borrower, and tax service fees are ineligible.

| | |
|---|---|
| **Case number:** | **495-6794279** |
| Lender number: | 1849200674 |
| Loan amount: | $45,928 |
| Contract sales price: | $57,000 |
| Endorsement date: | December 8, 2003 |
| Default date: | None |
| Current loan status: | Repayment Plan (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier overstated the borrower’s monthly income by $66. It used monthly income of $970 to qualify the borrower in Loan Prospector. The borrower’s employment documentation supports monthly income of $903.

3. Premier understated the borrower’s monthly debt. It used monthly debt of $483 to qualify the borrower in the automated underwriting system. However, the mortgage note and settlement statement support monthly debt of $489.

4. The lower monthly income and higher monthly liability amount increased both of the monthly qualifying debt-to-income ratios to 54 percent. Both ratios exceed HUD’s recently revised limits of 31 percent (mortgage payment expense to effective income) and 43 percent (total fixed payment to effective income).

5. Premier did not use the HUD-approved lender name. Premier listed AustinLoan.com as the lender on the HUD-1 settlement statement, mortgage note, and deed of trust. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com.

| | |
|---|---|
| **Case number:** | **495-6973264** |
| Lender number: | 1849200674 |
| Loan amount: | $137,837 |
| Contract sales price: | $140,000 |
| Endorsement date: | July 20, 2004 |
| Default date: | None |
| Current loan status: | Delinquent (as of April 28, 2006) |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system.

2. Premier understated the borrower's monthly debt by $117. It used monthly debt of $342 to qualify the borrower in Loan Prospector. The loan file supports monthly debt of $459. The additional $117 in monthly debt increased the borrower's monthly qualifying debt-to-income ratios to 38 percent (mortgage payment expense to effective income) and 52 percent (total fixed payment to effective income). Both ratios exceed HUD's recently revised limits of 31 percent and 43 percent.

3. Premier overstated borrower deposits by $1,935 and reserves by $2,314. It reported deposits of $2,068 and reserves of $3,037 to Loan Prospector. However, the borrowers were overdrawn in their bank account by $213. The borrowers had a 401K retirement account balance of $576. HUD Handbook 4155.1, REV-5, paragraph 2-10 K, provides that assets such as 401K retirement accounts may be included in the underwriting analysis up to only 60 percent of the value unless the borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and any withdrawal penalties. We calculated deposits to be $133 (60 percent of $576 = $346 – overdraft of $213) instead of $2,068. Because of the overstated deposits, we calculated the borrowers' reserves to be $723 instead of $3,037 as reported to Loan Prospector. Loan Prospector relied on the numbers reported in determining its accept rating.

4. Premier did not use the HUD-approved lender name on the HUD-1 settlement statement. Premier listed Austin Loan Corp. as the lender on the HUD-1 settlement statement. The HUD-approved lender name is Premier Mortgage Funding, Inc., d/b/a AustinLoan.com.

| | |
|---|---|
| **Case number:** | **495-6490206** |
| Lender number: | 1849200674 |
| Loan amount: | $122,561 |
| Contract sales price: | $124,500 |
| Endorsement date: | January 13, 2004 |
| Default date: | December 1, 2004 |
| Current loan status: | Property conveyed to HUD. Sold April 27, 2006. |

Deficiencies:

1. The sponsor (JPMorgan Chase) certified to the integrity of incorrect data that Premier entered into the automated underwriting system. The incorrect data are material enough to affect loan approval.

2. Premier overstated the borrower's monthly income by $1,354. It reported to Loan Prospector the borrower's monthly income as $2,834. The borrower had recently been earning overtime pay. However, the borrower's verification of employment stated that overtime, bonuses, etc., are not guaranteed. Therefore, in accordance with paragraph 2-7 A of HUD Handbook 4155.1, REV-5, we included only the borrower's base pay in our calculation. The verification of employment shows the borrower's annual base pay to be $24,419. We calculated her monthly pay to be $2,035. The borrower also had automatic deductions from her paychecks to pay two loans from her 401K retirement account. The monthly amount of deductions was $555. After we subtracted the 401K monthly payments to the retirement account, we calculated monthly income to be $1,480. Premier overstated the borrower's income by $1,354 ($2,834 – $1,480). The lower monthly income increased the monthly qualifying debt-to-income ratios to 77 percent (mortgage payment expense to effective income) and 83 percent (total fixed payment to effective income). Both ratios exceed HUD's recently revised limits of 31 percent and 43 percent.

3. The loan did not close in the HUD-approved lender name. The loan closed with AustinLoan.com as the lender rather than Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. The HUD-approved lender name is Premier Mortgage Funding, Inc., or Premier Mortgage Funding, Inc., d/b/a AustinLoan.com. Premier used AustinLoan.com on the HUD-1 settlement statement, mortgage note, and deed of trust.

4. HUD's loss on the property totaled $51,402.

| | |
|---|---|
| **Case number:** | **495-6763242** |
| Lender number: | 1849200674 |
| Loan amount: | $112,360 |
| Contract sales price: | Streamline refinance without an appraisal |
| Endorsement date: | December 3, 2003 |
| Default date: | September 1, 2004 |
| Current loan status: | Property conveyed to HUD.  Property sold on June 16, 2005. |
| Net loss to HUD: | $59,675 |

Deficiencies:

1. Premier charged the borrower $19 in ineligible closing costs.  The borrower paid $19 for the credit report.  HUD Handbook 4155.1, REV-5, paragraph 1-12 D, states that HUD does not require a credit report for streamline refinances.  If a lender must obtain a credit report, the borrower may pay the fee out of pocket (not financed).