audit report
OFFICE OF INSPECTOR GENERAL

Issue Date	October 26, 1995
Audit Case Number	96-CH-221-1003

TO: Nicholas P. Retsinas, Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgagee Review Board

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Erin Mortgage Company
Single Family Mortgage Insurance Program
Eastpointe, Michigan

We completed an audit of the books and records of Erin Mortgage Company, a former loan correspondent and a direct endorsement mortgagee since December 1994. We selected Erin Mortgage Company for audit because of the high default rate it experienced in East Detroit. The audit objectives were to determine whether Erin Mortgage Company originated its HUD/FHA mortgages according to HUD's requirements and prudent lending practices.

We reviewed 15 HUD/FHA delinquent or defaulted loans that were originated by Erin Mortgage Company. Ten of the loans were originated under HUD's section 221(d)(2) program and five under HUD's section 203(b) program. We concluded that Erin did not originate nine loans originated under section 221(d)(2) in accordance with HUD's requirements or prudent lending practices. We did not find any problems with the other six loans. The nine loans were originated by three loan officers. Erin did not properly verify: (1) the validity and reasonableness of expenses for nine borrowers; and (2) the rental payment history for four borrowers. Proper verifications are necessary to show the borrowers' ability to make mortgage payments, accumulate savings and manage their financial affairs. Erin also did not always ensure that its quality control reviews were conducted according to its quality control plan and HUD requirements.

If you have any questions, please contact me at (312) 353-7832.

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Executive Summary

We completed an audit of the books and records of Erin Mortgage Company, a former loan correspondent and a direct endorsement mortgagee since December 1994. We selected Erin Mortgage Company for audit because of the high default rate it experienced in East Detroit. The audit objectives were determine whether Erin Mortgage Company originated its HUD/FHA mortgages according to HUD's requirements and prudent lending practices.

We concluded that Erin did not originate nine of the 15 HUD/FHA loans according to HUD's requirements or prudent lending practices. The nine loans were originated under HUD's section 221(d)(2) program. Erin did not: (1) properly verify the validity and reasonableness of expenses for nine borrowers; (2) properly verify the rental payment history for four borrowers; and (3) ensure that its quality control reviews were conducted, according to its quality control plan and HUD requirements. We did not find any problems with the other section 221(d)(2) loan or the five section 203(b) loans.

Erin Did Not Originate Loans According To HUD's Requirements and Prudent Lending Practices

Erin Mortgage Company improperly originated nine of the 15 HUD/FHA insured loans we reviewed. The nine loans were originated under HUD's section 221(d)(2) program. Erin did not properly verify: the validity and reasonableness of nine borrowers' expenses; and four borrowers' rental payment histories. Proper verifications are necessary to show the borrowers' ability to make mortgage payments, accumulate savings and manage their financial affairs. Erin's quality control procedures needed improvement. Erin did not always follow prudent lending practices and did not always follow the recommendations of its quality control review firm to improve the loan origination process. Because HUD relied on Erin's origination process, HUD assumed abnormally high risks when it insured the nine loans for $229,050.

We recommend that the Mortgagee Review Board take appropriate action based on the information contained in the Finding.

We presented our draft finding and narrative case presentations to Erin Mortgage Company and the Michigan State HUD Office during the audit. We held an exit conference with Erin Mortgage on October 5, 1995. Erin Mortgage Company provided written comments to our finding and narrative case presentations. We included excerpts from the comments with our finding and narrative case presentations. Appendix C contains the complete text of the Erin's written comments.

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Introduction

HUD approved Erin Mortgage Company as a loan correspondent mortgagee in June 1990. HUD approved Erin Mortgage Company as a Direct Endorsement Mortgagee in December of 1994. Erin originates HUD/FHA insured loans, Veterans Administration loans, and conventional loans. The 15 loans we reviewed were underwritten by a Direct Endorsement Sponsor, Community Mortgage Services.

Erin Mortgage Company is located in Eastpointe, Michigan. Between January 1, 1993 and December 1994 HUD endorsed 234 loans originated by Erin. We could not determine which program the loans were originated under without a detailed review of each case file. However, we obtained a Lender Profile Report on Erin and found that 20 Section 221(d)(2) loans, 8 Section 203(b) loans and one Section 248 loan were delinquent or in default. We selected 15 of the defaulted loans for review. As of July 1995, the status of the 15 loans was as follows:

Status	Number of Loans
Current	2
Delinquent	2
Foreclosure	3
Claim Paid	8
Total	15

Erin Mortgage Company originated HUD/FHA loans under three home mortgage insurance programs authorized by the National Housing Act: Section 203(b), Section 221(d)(2), and Section 248.

Under the Section 203(b) Program, one-to-four family dwellings are insured for up to 98.75 percent of their value plus a percentage of closing costs if the value is $50,000 or less, or 97.75 percent if the value is over $50,000 and less than the statutory maximum loan limits. The borrower's minimum investment must be at least three percent of the home value unless the occupant is 60 years or older. Occupant borrowers at least 60 years old may borrow all of the required downpayment.

The Section 221(d)(2) Program insures mortgagees against losses on mortgage loans used to buy low-cost, one-to four family dwellings for eligible families. Eligible families have either low or moderate income, or have been displaced by the Government. Homes are insured up to 100 percent of their value plus closing costs or up to 97 percent of their value plus closing and prepaid costs. The loans are restricted to the statutory maximum limits and the minimum investment must be met. The statutory loan limit depends on the size of the family and is between $36,000 and $42,000 for single family dwellings in high cost areas. The borrower's minimum investment must be at least three percent of value, or $200 for displaced families.

The Section 248 Program insures single family dwellings for Native Americans on reservations. The Program covers one- to four-family dwellings. The Borrower must be a member of a tribe, and the tribe must have adopted eviction procedures acceptable to HUD.

Erin Mortgage Company's books and records are located at 21011 Gratiot, Eastpointe, Michigan. The President of Erin Mortgage Company is Richard Schneider.

Audit Objective

Our audit objective was determine whether Erin Mortgage Company originated its HUD/FHA mortgages according to HUD's requirements and prudent lending practices.

Audit Scope and Methodology

Our audit included tests of compliance with HUD's requirements for the origination of HUD/FHA insured loans. The purpose was to evaluate the propriety and accuracy of: (1) the borrower's income; (2) liabilities; (3) previous use of credit; and (4) occupancy certifications. We performed in-depth reviews on 15 loans. Ten of the loans were originated under HUD's section 221(d)(2) program and five were originated under section 203(b).

We interviewed HUD staff and Erin Mortgage Company employees to evaluate Erin's internal controls and procedures. We reviewed HUD's and Erin's FHA case files to ensure they contained the same information. We reviewed Erin's loan origination procedures and its quality control reviews. We verified the borrowers' income, expenses, and rent histories. We interviewed nine of the 15 borrowers. The other six borrowers could not be located.

Our audit covered the period January 1, 1993 through March 31, 1995. We extended our audit coverage as necessary. We conducted the audit at Erin Mortgage Company between April 1995 and September 1995.

The audit was conducted in accordance with generally accepted government auditing standards. We provided a copy of this report to the president of Erin Mortgage Company.

Erin Did Not Originate Loans According To HUD Requirements Or Prudent Lending Practices

Erin Mortgage Company improperly originated nine of the 15 HUD/FHA-insured loans we reviewed. All nine loans were originated under HUD's Section 221(d)(2) program. Erin did not properly verify: (1) the validity and reasonableness of nine borrowers' expenses; and (2) four borrowers' rental payment histories. Proper verifications of the ability to save and to make timely rent payments are necessary to show the borrowers' ability to make mortgage payments, accumulate savings, and manage financial affairs. Erin's quality control procedures needed improvement. Erin did not always follow prudent lending practices and did not always implement the recommendations of its quality control review firm to improve the loan origination process. Because HUD relied on Erin's origination process, HUD assumed abnormally high risks when it insured the nine loans for $229,050.

HUD Requirements

HUD Handbook 4000.4 REV-1, Single Family Direct Endorsement Program, paragraph 2-1, requires a mortgagee to conduct its business operations according to accepted sound mortgage lending practices, ethics and standards.

HUD Handbook 4155.1 REV-4, Mortgage Credit Analysis for Mortgage Insurance, paragraph 2-1 requires the mortgagee to determine the borrower's ability and willingness to repay the mortgage debt. The ability to repay the debt includes measuring the history and stability of income, the projected increase in housing costs, cash reserves after closing, and other non-mortgage obligations. Willingness to repay the debt includes measuring the history of paying debts.

Paragraph 2-3(D) of the Handbook says, when new housing expenses will significantly exceed the previous housing expenses, and the borrower has not exhibited an ability to accumulate savings or otherwise manage financial affairs, strong compensating factors must be present to allow for borrower approval.

Paragraph 2-3(B) of the Handbook says, for those borrowers who choose not to use credit or have not yet established credit, the lender must develop a credit history from rent verifications, utility payment records, or other means.

HUD Handbook 4000.2, REV-2, Mortgagee's Handbook, Application through Insurance (Single Family), paragraph 3-6 says verification forms must not pass through the hands of the applicant, real estate agent, or other interested third parties.

HUD Handbook 4060.1, REV-1, Mortgagee Approval Handbook, Chapter 6, paragraph 6-1E requires that mortgagees, using outside firms to perform required quality control reviews, must carefully review and analyze the results of the reviews and take prompt corrective measures when specific deficiencies are noted.

Paragraph 6-1D(3) of Handbook 4060.1, REV-1 requires that all loans which go into default within the first six months must be analyzed. Paragraph 6-3 requires the mortgagee's quality control plan to include a review of a minimum of 10 percent of the rejected loans.

Loans Were Not Properly Originated

Erin Mortgage Company did not properly originate nine of the 15 HUD/FHA-insured loans we reviewed. The nine loans were originated under HUD's Section 221(d)(2) program. Erin did not properly verify the borrowers' expenses to determine the borrowers' ability to save and to repay the mortgage debt for all nine loans. Additionally, in four of the nine loans, Erin did not obtain proper rent verifications. Weak quality control procedures contributed to the deficiencies and the resulting defaults. The deficiencies are summarized below and discussed in more detail in the Narrative Case Presentations (Appendices B-1 through B-9).

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with our conclusions and believed the loan files required further information before the loans were approved.

Expenses Were Not Verified And Were Unrealistic

Erin did not verify nine borrowers' expenses to determine the borrowers' abilities to save when the borrowers' new housing expenses significantly exceeded their previous housing expenses. In all nine cases, the borrowers signed undated affidavits showing their income and expenses. Erin verified the borrowers' income but did not verify and determine the reasonableness of the expenses. For example:

> The borrower signed an undated affidavit for FHA Case Number 261-5902870 to show the borrower's monthly income and expenses. The affidavit showed an income of $1,521 and expenses of $800 with a monthly savings of $721. The expenses included: $300 for rent; $100 for utilities; and $400 for food and clothing. The expenses did not include items like telephone, transportation, and general household expenses.
>
> The expenses were unrealistic for a family of nine. The borrower received assistance from the Michigan Aid to Families with Dependent Children Program. The Department of Social Services estimated a monthly utilities cost of $205, and a food cost of $501. Although the loan file contained the income and expense affidavit and the Social Services estimate, it did not contain an explanation for the differences between the two.
>
> The Michigan Aid to Families with Dependent Children Program provides assistance to help families pay for living expenses such as shelter, heat, utilities, clothing, food and personal care items. The Program's brochure says because there is a maximum amount that can be given for these needs, the grant probably cannot cover all of the bills. To receive aid, family assets cannot exceed $1,000. Based on the program criteria, Erin should have questioned and verified the expenses reported by the borrower.
>
> The borrower said the affidavit showing her income and expenses was blank when she signed it. The borrower said she did not write the monthly expenses on the affidavit and she could not save $721 per month as indicated. Her statement is consistent with the fact that public assistance is calculated to cover necessary expenses and not to create savings. Additionally, at a savings rate of $721 a month, the borrower would have been ineligible for the State aid within two months.

Rent Payment History Was Not Properly Verified

Erin did not always properly establish acceptable credit for borrowers. Erin did not properly verify three borrowers' rent payment histories and did not obtain a rent verification for a fourth borrower. One rent verification was signed by an unknown person and the remaining two were signed by relatives. The verifications were incorrect. For example:

Erin Mortgage Company submitted a false rent verification to HUD for FHA Case Number 261-5995026. The rent verification form was signed by the borrower's child's grandmother. The verification indicated that the borrower resided at an address owned by the grandmother for seven years and paid $200 a month for rent. The borrower said she did not rent from the grandmother. She said the house where she resided was owned by her parents and she did not pay rent.

The grandmother agreed that she never rented any property to the borrower and did not own the house listed on the rent verification form. She said the borrower brought the form to her and she signed it. She thought the form only verified that she knew the borrower.

The borrower told us that she signed an undated blank affidavit to verify the amount of rent. The borrower said the statement in the affidavit that she paid $200 to her grandmother was false.

Prudent business practices dictate that Erin Mortgage Company should have had the borrower provide a copy of the lease and/or rent receipts, especially when a close relative was indicated to be the landlord. HUD's regulations say verification forms must not pass through the hands of the applicant, a real estate agent, or other interested third parties.

Quality Control Procedures Were Weak

Erin Mortgage did not ensure that its quality control reviews were conducted according to its quality control plan and HUD requirements. The outside firm that performed the reviews for Erin did not review: loans that went into default within six months of origination; and ten percent of the rejected loans. Erin also did not always implement its quality review firm's recommendations to improve Erin's quality controls. Consequently, deficiencies in the loan origination process were not identified and corrected.

The President of the quality control review firm said her firm did not review Erin's defaulted and rejected loans because Erin did not provide her firm a list of the defaulted and rejected loans.

Erin Mortgage Company's President and its underwriter said they were rarely advised of early defaulted loans that Erin originated and sold to other mortgagees. However, since HUD requires all loans that default within the first six months to be reviewed, it is Erin's responsibility to obtain the information so it can be reviewed.

In October 1994, HUD's Office of Lender Activities and Land Sales Registration cited Erin for the lack of quality control reviews for defaulted and rejected loans. In February 1995, Erin informed HUD that it would take prompt corrective measures. Until the above deficiencies are resolved, there is less assurance that Erin's loan processing procedures meet HUD's requirements.

Erin Mortgage Company also did not always implement its quality review firm's recommendations to improve Erin's internal controls. For example, the quality review firm recommended that Erin obtain additional evidence to support rent verifications when the landlord is the seller or a close relative. The recommendation was based on a review of a Veterans Administration insured loan. However, the review firm reviewed HUD/FHA and Veterans Administration loans together and the recommendation related to overall prudent loan procedures. The firm suggested getting 12 months of rent receipts or cancelled checks to verify that rent was paid.

Erin's President said, the Veterans Administration did not require 12 months of rent receipts for rent verification; therefore, the recommendation was not implemented. HUD's regulations do not mandate how a verification should be done, but require that a verification be performed. We believe, as did the quality review firm, that sound lending practices require a verification to include a review of some evidence that corroborates written statements.

Auditee Comments

Erin Mortgage Company became a Correspondent Lender in June of 1990 and a Direct Endorsement Lender in December of 1994. Erin has always conducted its business operations in accordance with accepted sound mortgage lending practices, ethics, and standards. Erin Mortgage has an established policy to promote affirmative marketing and the availability of mortgage credit in low and moderate income areas, including minority and other underserved areas. Erin Mortgage is in full compliance with the HUD regulations regarding verification forms.

OIG Evaluation of Auditee Comments

HUD's directives do not specifically state how a verification should be accomplished, but require a mortgagee to conduct its business operations in accordance with accepted sound mortgage lending practices. Since Erin Mortgage did not always verify borrowers' claimed expenses and rental payment histories, we believe it did not follow accepted sound lending practices when it approved loans.

Auditee Comments

We have observed that in the reviewer's recitation of the HUD requirements it appears to be somewhat selective in it's narrative of the aforementioned requirements. For example, paragraph 2-3(B) of the HUD Handbook 4155.1 REV-4, which if read in it's entirety states that for borrowers who choose not to use credit or have not yet established credit, the lender must develop a credit history from rent verifications, utility payment records or other means. However, neither the lack of credit history nor the lifestyle of the borrowers may be used as a basis for rejection. It is puzzling that the reviewer apparently failed to consider the last sentence in it's finding.

OIG Evaluation of Auditee Comments

We agree that the last sentence of paragraph 2-3 (B) of HUD Handbook 4155.1 REV-4 does say that neither the lack of credit history nor the lifestyle of the borrowers may be used as a basis for rejection. We did not include this sentence in our finding because we did not find a violation of the reference. However, the sentence does not mean that an applicant must be approved for a loan if the applicant has no credit. The mortgagee must develop a credit history using a method like verification of past rent payments. The loan decision can then be made using this information as a credit rating. Our finding shows that Erin did not properly verify rent payment histories and, therefore, did not satisfactorily base loan decisions on an acceptable credit rating.

Auditee Comments

In an overwhelming majority of the loans reviewed there was little change in housing costs, i.e. current rent amount versus proposed mortgage payments. In fact, in some cases, the proposed mortgage payment was less than the current rent.

Some of HUD's typical compensating factors include: (1) receipt of food stamps, or commodities which reduce the outlay of food. (2) free medical services to low-income families. (3) welfare cases where the welfare agency or community provides services. (4) persons having living needs which permit them to live on less than families whose needs are expanding. (5) families not having automobiles depending on public transport.

OIG Evaluation of Auditee Comments

In eight of the nine cases we cited, the projected new housing expenses considerably exceeded the previous housing expenses. Erin's response only compared past rent payments to mortgage payments. Erin did not include utilities and maintenance expenses in its comparison. We found that including just utilities was a significant increase in expenses considering the borrowers' incomes.

Erin's comments list five compensating factors for approving a loan when new housing expenses significantly exceed previous housing expenses. We considered these factors when we cited Erin for not verifying the borrowers' expenses to determine their ability to save.

Considering factor 1, Erin added the amount of food stamps to the borrower's income. However, Erin did not include an amount equal to the amount of food stamps as an expense. For example, in FHA Case Number 261-5902870, Erin added the amount of food stamps, $501, to the borrower's public assistance of $1,020 to show an income of $1,521. However, on the expense side, Erin unrealistically included only $400 to cover food and clothing for a family of nine. Erin should have at least included a food expense of $501 plus an allowance for clothing.

Considering factor 5, we believe it is appropriate to include transportation costs as an expense and cited Erin for not doing so. Erin's files did not demonstrate that factors 2,3 and 4 had any affect on the borrowers' expenses or ability to meet financial obligations; and, we did not question these items or include them as expenses.

Auditee Comments

All lenders must rely, in part, on the integrity of their loan applicants. This is especially true at the time of the initial application, when basic information is obtained from the borrowers; such as, present address, employers name and address, length of employment, rental information, name of landlord, obligations, etc. Erin then attempts to verify the information via HUD mandated requirements.

In the low to moderate income areas, it is not uncommon to have relatives living with or renting from other relatives. Erin Mortgage has always complied with HUD regulations regarding rental verifications.

If an applicant indicates that he/she rents from a family member and provides a name and address of the person to whom they pay rent, we cannot arbitrarily accuse them of prevarication. We make every effort to verify all the facts prior to rendering a final decision.

OIG Evaluation of Auditee Comments

We agree that all lenders must rely in part on the information provided by loan applicants and it is not uncommon for applicants to rent from family members. However, HUD requires the information to be verified and prudent lending practices dictate that the verification involve reviewing independent information to corroborate the information provided by loan applicants.

The purpose of a verification is to provide an independent and unbiased statement on an applicant's payment history. When a landlord is a close relative or a seller, it is necessary and a prudent practice to ask the applicant for rent receipts, a lease or some other documentation to establish that payments were actually made. It is also the responsibility of a lender to verify the information in accordance with HUD's requirements and prudent lending practices. In not a single instance did Erin provide documentation that showed it even asked the applicants to provide rent receipts or a lease.

Auditee Comments

Erin Mortgage Company has never engaged in lending practices that were anything but prudent. Erin has always made every effort to comply with what it considers to be the vexing problem relating to a borrower's ability to save assets needed to consummate a mortgage loan.

It is well known within the mortgage industry in and around the city of Detroit that there is no "cookie cutter" or "one size fits all" approach to an applicant's ability to save funds. Every case is treated differently, but always within the intent of the regulations foremost in our mind. As we have previously stated, applicants have displayed an amazing ability to economize their cash funds in order to purchase a home.

We believe that the affidavit currently being used to show an applicant's ability to save is a good faith attempt to comply with a confusing and all but impossible requirement.

The majority of the 15 loans, which were reviewed over a 6 month period, were low income applicants. A majority of those loans reflected that many of the applicants did not have a bank or credit union account. What this infers is that these applicants have displayed an ability to manage their affairs in the form of cash in the past and should be able to manage their affairs in the future.

It should be pointed out that, while the reviewer criticized Erin Mortgage for failing to properly verify the applicants ability to save the necessary funds to consummate their loans, there is absolutely no evidence that the applicants acquired the funds from any source other than what they stated on an affidavit.

There were no new loans reflected on the respective credit reports nor were there any inquiries which would raise questions regarding any possible new debts. All funds were verified on deposit with the broker, per his letter and copies of ledgers, deposits, etc.

OIG Evaluation of Auditee Comments

Erin Mortgage Company verified the borrowers' income but did not establish the reasonableness of their expenses. We believe if Erin had used prudent business practices, it would not have overlooked expenses for items such as utilities, telephone, transportation and automobiles. Erin would have also included food expenses equal to at least the amount of food stamps received. The finding was not developed assuming Erin should have used a cookie cutter approach to making loans.

We reviewed the ability to save affidavits to determine if they showed the borrowers' had the ability to make mortgage payments and manage their financial affairs, an important consideration in preventing a default. Our objective was not to show the source of downpayment funds as Erin indicates in its comments. Our finding does not address the source of downpayment funds as a problem.

Erin Mortgage Company says the lack of a bank or credit union account and use of cash infers that loan applicants are able to manage their future financial affairs. We believe that the use of cash and no financial institution accounts could also be an indicator of financial irresponsibility. For example, a person who recently filed for bankruptcy would be on a cash basis and may not have a bank account. HUD requires a properly prepared and verified ability to save affidavit as evidence that a borrower has the ability to make payments and manage financial affairs.

Auditee Comments

In our files there are at least four references to the penalties possible if an applicant provides false or fraudulent information that the applicants read, sign and date. These references are mentioned in detail on the following documents: (1) Section IX of the 1003, (2) Paragraph 5 of the Acknowledgment Statement, (3) FHA Occupancy Statement, (4) Borrower's Notification and Interest Rate Disclosure Statement.

The "1010" Warning also appears on all affidavits signed by the applicants regarding any explanations.

Erin Mortgage Company believes if any applicant reads, signs, and dates these documents, then we must accept the statements made by them as correct. Again, we must state our firm belief that we cannot dispute the veracity of statements made by an applicant after they have been advised of the possible ramifications of providing false information. A review of the loans in question will result in a discovery that each and every file contains the aforementioned documents.

Erin Mortgage Company resents the accusations contained in the audit findings indicating that Erin Mortgage Company failed to comply with HUD's mandates. We especially resent the manner in which the draft of the finding enlarged the heading on page one. It is unreasonable that the reviewers have apparently chosen to accept as fact statements made by borrowers who signed the documents detailing the warnings and penalties of providing false information. We would hope that any statements made by persons who have demonstrated an inability to be forthright in their dealings in the past would, at the very least, be considered suspect in their accusations against Erin Mortgage Company.

OIG Evaluation of Auditee Comments

It is true that applicants signed documents referring to penalties for false information. Erin Mortgage Company, however, is still responsible to verify that the information provided by potential borrowers is correct.

The finding showed that not all loans were originated according to HUD's requirements and prudent lending practices. Our finding was based on file reviews, independent verifications and interviews with borrowers and Erin Mortgage personnel. Disregarding the statements of the borrowers, the information obtained still shows that Erin Mortgage did not follow expected procedures.

Auditee Comments

The draft of the proposed audit finding states that Erin Mortgage Company's President and its Underwriter said they were not aware that the company was responsible to identify early defaulted loans it originated and sold to other mortgagees. Erin Mortgage Company denies ever making such statements. What we did say is that we are rarely advised of early defaulted loans we originate and sell to other mortgagees. On those occasions when we are advised of a default, we have made every effort to cure the default including picking up payments, interviewing the applicants to discover the cause, etc. In fact, in one case, we went with the borrower to the Wayne County Neighborhood Legal Services and she received financial assistance from the Eviction Prevention Program.

OIG Evaluation of Auditee Comments

We changed the statement in the finding to agree with the wording in Erin's response. However, in order to satisfy HUD's requirement for review of early defaulted loans, Erin has the responsibility to identify early defaulted loans and provide the information to its quality control review firm.

Auditee Comments

Erin Mortgage Company elected not to use an outside firm to perform quality control on rejected loans. Please note that the Underwriter did not state that she did not think to obtain quality reviews for the rejected loans, but said our outside firm was not performing the reviews.

All rejected loans were reviewed by myself, the underwriter and our senior processor. The reasons given for the rejection were reviewed and determined to be valid. We ensured that the requirements of the Equal Credit Opportunity Act were met and documented in each file. Immediate corrective action was taken where possible discrimination was noted.

Out of ten cases reviewed, nine were insured under HUD's Low and Moderate Income Section 221(d)(2) Program. Erin Mortgage Company renders a substantial service to our customers, and to the Secretary, specifically, in such high risk areas as Detroit where the majority of lenders arbitrarily will not participate in the HUD programs.

OIG Evaluation of Auditee Comments

During the audit, the underwriter told us that none of the rejected loans had been subjected to quality control review because Erin Mortgage Company was waiting for its quality control review firm to ask for them. The underwriter never indicated that the reviews were done by the President, the underwriter and the senior loan processor, as reflected in Erin's comments. The internal review, however, does not meet HUD's requirements for an independent evaluation. Paragraph 6-1 of HUD Handbook 4060.1 REV-1, Mortgagee Approval Handbook, says a mortgagee's quality control plan must provide for independent evaluation of the significant information gathered in relation to the loans.

Our finding now cites nine cases with problems and all were insured under HUD's Low and Moderate Income, Section 221(d)(2) Program. We agree Erin Mortgage Company may have provided substantial services in a high risk area, like Detroit. This, however, does not release Erin from its responsibilities to follow HUD's requirements and prudent lending practices. Also, the value of such services is questionable when the procedures Erin followed may have increased the occurrence of defaulted loans.

Auditee Comments

Erin Mortgage Co. has no record of receiving a recommendation from our quality control firm regarding obtaining 12 months of rent receipts, cancelled checks or money orders on any HUD loans. Erin did not say that HUD did not require this information.

Erin has always responded with prompt action to our quality control firm's reviews regarding any recommendations that they may have had.

Erin Mortgage Company's actions have always been consistent with conducting our operations according to accepted sound mortgage lending practices, ethics and standards.

OIG Evaluation of Auditee Comments

In June 1993, based on a review of a HUD/FHA insured loan, Erin's quality control review firm suggested to strengthen the loan file, twelve months of rent checks should be obtained. Erin did not comment on this recommendation. In September 1994, based on a review of a Veterans Administration insured loan, the quality review firm suggested that there was a need to obtain twelve months of cancelled checks to support a rental history when the landlord was also the seller of the subject property. Erin did not implement the recommendation. Erin's President said the Veterans Administration did not require it. However, the quality control review firm reviews HUD/FHA and Veterans Administration loans together. Therefore, prudent lending practices applicable to Veterans Administration loans should also apply to HUD-insured loans.

Recommendations

We recommend that:

(A) The Mortgagee Review Board take appropriate action based on the information contained in the Finding.

Internal Controls

In planning and performing our audit, we considered the internal controls relating to Erin Mortgage Company's HUD/FHA loan origination process to determine our auditing procedures and not to provide assurance on internal controls. Internal controls consist of the plan of organization, methods, and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Relevant Internal Controls

We determined the following internal controls applied to our audit objectives:

- HUD Program Regulations, Handbooks, and Directives.
- Quality Control Plan.
- Administrative controls over loan origination and loan closing.

We assessed all the relevant controls identified above.

Significant Weaknesses

It is a significant weakness if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

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

- <u>HUD/FHA Loan Origination</u>. Erin did not properly verify borrowers expenses and rent payment histories. Erin also did not review loans that went into default within six months of origination; and ten percent of the rejected loans (See Finding 1).

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Follow Up On Prior Audits

This is the first OIG audit of Erin Mortgage Company. The mortgagee's last independent audit report for the year ended December 31, 1994 contained one finding on its Quality Control Plan. The finding was not related to deficiencies cited in this report.

The last monitoring review by HUD's Office of Lender Activities and Land Sales Registration was done in September 1994. The monitoring letter, dated October 20, 1994, cited five findings including one finding on the outside firm's contract for quality control reviews. As of September 30, 1995, all findings were closed.

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Summary of Deficiencies

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Introduction to Narrative Case Presentations

Appendices B-1 through B-9 represent nine case-by-case narrative discussions summarizing and detailing the deficiencies cited in the Finding.

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Appendix B-1

Page 1

FHA Case No.: 261-5824607

Insured Amount: $25,000

Section of Housing Act: 221(d)(2)

Date Underwritten: September 9, 1992

Underwriting Company: Community Mortgage Services

Underwriter Number: 6602

Status: Claim Paid (One payment made)

Summary:

Erin Mortgage Company did not properly verify the borrowers' or co-borrower's ability to save. According to the co-borrower, the borrower (her brother) never moved into the property. The co-borrower said she could not afford to make the mortgage payments and got behind on the payments. She said HUD would not work with her to keep the house. The co-borrower said a HUD official told her that her income was too low to make mortgage payments. Accurate verifications are necessary to show the borrowers' ability to make mortgage payments and manage financial affairs.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Affidavit Was Not Verified

The borrower and co-borrower signed an undated affidavit showing their monthly income and expenses. Erin Mortgage verified the income but did not verify the propriety of the expenses.

The borrower's affidavit showed income from work of $834 and expenses of $373 with a monthly savings of $491. The expenses included $60 for food and clothing, $128 for monthly debts, and $185 for taxes. An estimate of $60 a month for food and clothing is unrealistically low. The expenses also did not include items like rent, telephone, transportation, automobile expenses and other general household expenses. The applications

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showed that the borrower owned an automobile. We could not locate the borrower to conduct an interview. The co-borrower said the borrower lived with relatives and was paying rent.

The borrower's affidavit also showed the co-borrower's monthly income from the Michigan Aid to Families with Dependent Children Program. The income was $954 with expenses of $50 for food and clothing and a monthly savings of $904. The expenses did not include items like utilities, telephone, transportation, and general household expenses. The expenses were unrealistic for a family of five. The co-borrower was on the Michigan Aid to Families with Dependent Children Program. The Department of Social Services estimated food costs of $296 and housing costs of $325. Although the loan files contained the income and expenses affidavit, and the Social Services estimate, it did not contain an explanation for the difference between the two.

The Michigan Aid to Families Program provides assistance to help families pay for living expenses such as shelter, heat, utilities, clothing, food and personal care items. The Program's brochure says because there is a maximum amount that can be given for these needs, the grant probably cannot cover all of the bills. To receive aid, family assets cannot be more than $1,000. Based on the program criteria, Erin's acceptance of the expense estimates without verification was not reasonable or a prudent business practice. The amount of savings reported by the co-borrower would invalidate her for state aid in less than two months.

Auditee Comments

At the initial application on June 6, 1992, the borrower stated that he intended to occupy the property as his primary residence. On August 5, 1992, when the borrowers signed the FHA application for commitment for insurance, both the borrower and co-borrower signed a statement that they would move into the home, with the understanding that the failure to do so constituted fraud.

On September 18, 1992, at the closing, both the borrower and co-borrower again signed the statement that they would move into the home, with the understanding that the failure to do so constituted fraud.

The ability to save affidavit showed combined income from work and public assistance of $1,788 and expenses of $423, with a monthly savings of $1,365. The borrowers deposited $1,200 over a two month span.

Both the borrower and co-borrower were boarding with family members.

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OIG Evaluation of Auditee Comments

We agree that Erin Mortgage Company was not responsible for the borrower not occupying the residence.

Erin Mortgage did not provide comments to explain why it did not verify the expenses on the ability to save affidavit. The affidavit did not include normal items such as; telephone, transportation, and other general household expenses. The expenses listed on the affidavit were also unrealistic. For example, the borrower reported it took $50 a month to feed a family of five. We acknowledge that the borrower and co-borrower deposited $1,200 with Erin; however, proper verification of the ability to save is necessary to show the borrower's and co-borrower's ability to make mortgage payments when the borrowers' projected housing expenses considerably exceed their previous housing expenses. In this case, the projected increase was approximately $522, including utilities. The previous expense was zero.

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Page 1

FHA Case No.: 261-5869337

Insured Amount: $22,500

Section of Housing Act: 221(d)(2)

Date Underwritten: November 17, 1992

Underwriting Company: Community Mortgage Services

Underwriter Number: C126

Status: Claim Paid (Two payments made)

Summary:

Erin Mortgage Company did not adequately verify the borrower's ability to save or obtain a proper rent verification. Proper verifications of the ability to save and rent are necessary to show the borrower's ability to make mortgage payments, accumulate savings and manage financial affairs. We could not locate the borrower to conduct an interview or determine why the default occurred.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit showing the borrower's monthly income and expenses. The affidavit showed an income of $1,077 and expenses of $750 with a monthly savings of $347. Erin verified the borrower's income but did not verify and determine the reasonableness of the expenses. The expenses included $275 for rent, $100 for utilities, $120 for food and clothing, and $235 for taxes. The expenses did not include items like telephone, transportation, automobile including insurance and general household expenses. The application showed that the borrower owned an automobile.

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Rent Verification Was Not Properly Reviewed

The documents in the loan file showed the rent verification was signed by a person with the same last name as the borrower's girl friend. We could not locate the borrower or the person who signed the rent verification to conduct interviews.

Prudent business practices dictate that Erin Mortgage Company should have had the borrower provide a copy of the lease and/or rent receipts. This is important when the landlord is unknown or may have an identity of interest relationship with the borrower.

Auditee Comments

We feel the paid satisfactory account listed on the borrower's credit report, along with no derogatory credit showed the borrower had the ability to manage financial affairs. The borrower deposited monies with the broker over an eight week span.

Prior to submission for underwriting, applicants are interviewed regarding, among other things, their ability to save the required investment from their incomes. It has been noted that for countless reasons, many people do not have a bank or credit union account. This is very prevalent in the Detroit area, especially within the City of Detroit. A majority of persons who do not have a bank or credit union account, save money at home. It is very difficult to verify a dollar for dollar accounting of all funds on deposit with a broker.

Our affidavit breaking down income and expenses on a monthly basis is a good faith attempt on Erin Mortgage Company's part to comply with the HUD mandates. It should be pointed out that historically, potential homebuyers begin to accumulate funds well in advance of actively looking for a home.

We believe that due to the prevalence of potential mortgagors not having a bank account in the Detroit metro area, the affidavit used allows a realistic overview of these individuals ability to accumulate the required funds.

OIG Evaluation of Auditee Comments

The borrower did not have a recent credit history. The one account listed on the credit report was over five years old. It was paid off in January 1987 and the mortgage was approved in November 1992. Erin Mortgage Company needed a proper rent verification to establish a recent credit history. Erin did not explain why they did not verify the stated rent payments with a lease or receipts for the payments.

Erin Mortgage Company did not provide comments to explain why the expenses on the ability to save affidavit were not properly verified. The affidavit did not include normal items like

telephone, automobile expenses including insurance and other general household expenses. Proper verification of the ability to save and the obtaining of a proper rent verification are necessary to show the borrower's ability to make mortgage payments when the projected new housing expenses considerably exceed previous housing expenses.

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Page 1

FHA Case No.: 261-5891335

Insured Amount: $28,450

Section of Housing Act: 221(d)(2)

Date Underwritten: April 16, 1993

Underwriting Company: Community Mortgage Services

Underwriter Number: K291

Status: In Foreclosure (Three payments made)

Summary:

Erin Mortgage Company did not adequately verify the borrower's ability to save. Proper verification of the ability to save is necessary to show the borrower's ability to make mortgage payments, accumulate savings and manage financial affairs. We could not locate the borrower to conduct an interview and determine why the default occurred.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit showing the borrower's monthly income and expenses. The affidavit showed an income of $1,430 and expenses of $992 with a monthly savings of $438. Erin verified the borrower's income but did not verify and determine the reasonableness of the expenses. The expenses included $350 for rent, $250 for food and clothing for a family of four, and $392 for taxes. The expenses did not include items like utilities, telephone, transportation, automobile including insurance and general household expenses. The application showed that the borrower owned an automobile.

Auditee Comments

The borrower filed his 1992 income tax return on February 7, 1993. The refund was $1,717. The borrower made deposits to the broker on March 11, 1993 in the amount of $500 and on April 2, 1993 in the amount of $900. The borrower stated in the affidavit that he did have a

small savings at his credit union and the money on deposit came from household savings and a tax refund.

The borrower worked 50 hours a week and received overtime and a shift premium, which was not included in his monthly effective income. We feel this is adequate verification of the ability to save.

OIG Evaluation of Auditee Comments

We did not question the borrower's ability to make the required investment for the downpayment. We did, however, question the borrower's ability to save and make mortgage payments when the projected new housing expenses considerably exceeded past expenses. Erin Mortgage Company did not explain why it did not verify the expenses on the ability to save affidavit. The affidavit did not include normal items like telephone, automobile including insurance and other general household expenses. The ability to make a one-time downpayment does not equate to the ability to make continual mortgage payments and maintain a house.

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Page 1

FHA Case No.: 261-5995026

Insured Amount: $25,850

Section of Housing Act: 221(d)(2)

Date Underwritten: September 17,1993

Underwriting Company: Community Mortgage Services

Underwriter Number: C126

Status: Claim Paid (Two payments made)

Summary:

Erin Mortgage Company submitted a false rent verification to HUD to establish the borrower's credit and did not properly verify the borrower's ability to save. Erin mishandled the rent verification affidavit that established the amount of rent the borrower paid. The affidavit also contained false data. Properly processed and completed affidavits and accurate verifications are necessary to show the borrower's ability to make mortgage payments and manage financial affairs. The borrower said she defaulted on the mortgage because she could not afford to make required repairs.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Rent Verification Was False

Erin Mortgage Company submitted a false rent verification to HUD. The rent verification form was signed by the borrower's child's grandmother. The verification indicated that the borrower resided at an address owned by the grandmother for seven years and paid $200 a month for rent. The borrower said she did not rent from the grandmother. She said the house where she resided was owned by her parents and she did not pay any rent.

The grandmother agreed that she never rented any property to the borrower and did not own the house listed on the rent verification form. She said the borrower brought the form to her and she signed it. She thought the form only verified that she knew the borrower.

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Prudent business practices dictate that Erin Mortgage Company should have had the borrower provide a copy of the lease and/or rent receipts, especially when a close relative is indicated to be the landlord. Additionally, HUD Handbook 4000.2 REV-2, Mortgagees' Handbook, Application Through Insurance (Single Family), paragraph 3-6, states that verification forms must not pass through the hands of the applicant, a real estate agent, or other interested third party.

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit showing the borrower's monthly income and expenses and that the borrower had the ability to save and manage her financial affairs. The affidavit showed income from the Michigan Aid to Families with Dependent Children Program of $1,193 and expenses of $500 with a monthly saving of $633. Erin Mortgage only verified the income and did not verify the propriety of the expenses. The expenses included $200 for rent and $300 for food and clothing for five persons. The expenses did not include items like utilities, telephone, transportation, and general household expenses.

The Michigan Aid to Families with Dependent Children Program provides assistance to help families pay for living expenses such as shelter, heat, utilities, clothing, food and personal care items. The Program's brochure says because there is a maximum amount that can be given for these needs, the grant probably cannot cover all of the bills. To receive aid, family assets cannot be more than $1,000. Based on the program criteria, Erin's acceptance of the expense estimates without verification was not reasonable or a prudent business practice.

Borrower's Affidavit Contained False Data

The borrower told us she signed an undated blank affidavit to verify the amount of rent. The borrower said that the statement in the affidavit that she paid $200 to her grandmother was false.

Auditee Comments

Based on the information we received from the borrower at the initial application, the borrower stated she lived at 15684 Mapleridge, Detroit, Michigan for seven years. The borrower also stated that the home belonged to her deceased parents and that she paid rent to her grandmother in the amount of $200. She provided us with her grandmother's name and address and we mailed the verification of rent to the address given to us by the borrower. We would have no other source to obtain this information from other than the borrower. The verification of rent was completed and mailed back to our office in our return envelope. We are confused as to why

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the grandmother completed and signed the form as landlord, when in fact she now states she was not the landlord. Also, she never contacted our office concerning any questions she may have had about why the form was mailed to her. We did overlook the fact that the borrower did not date the affidavit when she signed it, however, it was not blank.

OIG Evaluation of Auditee Comments

We agree that Erin Mortgage Company did not have a source other than the borrower to obtain past rental information. However, we believe Erin has an obligation under prudent business practices to validate the information by requesting a lease and/or rent receipts when a close relative is indicated to be the landlord.

Erin Mortgage Company did not explain why it did not verify the expenses on the ability to save affidavit. The affidavit did not include normal items like telephone, transportation and other general household expenses. Proper verification of ability to save and obtaining a proper rent verification are necessary steps to show the borrower's ability to make mortgage payments when the projected new housing expenses considerably exceed the previous housing expenses.

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Page 1

FHA Case No.: 261-6107014

Insured Amount: $26,500

Section of Housing Act: 221(d)(2)

Date Underwritten: March 1, 1994

Underwriting Company: Community Mortgage Services

Underwriter Number: K-291

Status: Delinquent (3 Payments Overdue at July 1, 1995)

Summary

Erin Mortgage Company did not properly verify the borrower's rent payment history to establish credit or verify the borrower's ability to save. An accurate verification of a borrower's payment history and ability to save is necessary to show the borrower's ability to make mortgage payments and manage financial affairs. The borrower said she has a tendency to get behind on payments but always gets caught up.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Rent Verification Was Not Obtained

Erin Mortgage did not obtain a rent verification to establish an acceptable credit history for the borrower. The borrower's credit report showed that the borrower did not have acceptable credit. The report listed five accounts. Four accounts had derogatory information and one account with a high balance of $100 was current. The four accounts with derogatory information showed: one account with a balance owing of $319 was in collection and was resolved; two accounts with a utility company with balances of $100 each were charged off; and one account with a balance of $170 was in collection and paid off.

Erin Mortgage did not obtain a rent verification for the address where the borrower lived for the last 12 months before applying for the mortgage. The borrower stated in an affidavit that she did not get along with the landlord and had filed a harassment charge against the

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landlord. The borrower further stated that she doubted that the landlord would provide her a reference. Although the borrower told us she resided at the address in the loan file, she could not remember the name of her landlord or the correct address of the property. The address in the loan file does not exist.

Prudent business practices would dictate Erin Mortgage Company should have had the borrower either provide a copy of the lease or rent receipts.

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit to show the borrower's monthly income and expenses and that the borrower had the ability to save and manage her financial affairs. The affidavit showed an income from the Michigan Aid to Families with Dependent Children Program of $1,205 and expenses of $350 with monthly savings of $855. The borrower had four children. Erin Mortgage Company verified the income but did not verify the expenses.

The borrower's total monthly expenses included $350 for food and clothing. The affidavit did not show any expenses for rent, utilities, telephone, transportation, and general household expenses.

The Michigan Aid to Families with Dependent Children Program provides assistance to help families pay for living expenses such as shelter, heat, utilities, clothing, food and personal care items. The Program's brochure says because there is a maximum amount that can be given for these needs, the grant probably cannot cover all of the bills. To receive aid, family assets cannot be more than $1,000. Based on the program criteria, Erin's use of the expense estimates without verification was not reasonable or a prudent business practice.

Auditee Comments

The credit report mentioned did, in fact, list five accounts on behalf of the borrower. Four of these accounts were reported under a heading of "collection accounts".

The $170 collection account was paid off in November 1992, over a year prior to the borrower applying for this mortgage.

The two collection accounts with less than $100 owing were paid in full in September 1991, again well over two years prior to application, and in February 1994, respectively. Please note that the second $100 collection was in the amount of $25, well below the $100. A receipt for this account is part of our file.

The $319 collection account was through no fault of the borrower. Documentation to this effect is also in our file. At the time of the initial application, the borrower was living with her mother

at 8300 Yolanda, Detroit, Michigan. She stated that she had lived there for approximately two weeks. We inquired as to the borrower's previous addresses and the borrower stated they were 19300 Elmdale and 14446 Wade. We had no way of knowing that the address of 19300 Elmdale was non-existent. The borrower stated she could not provide rent receipts for the Elmdale property. However, she did in fact provide a print out from the Department of Social Services verifying that the borrower had lived at 13136 Wade and that her rent was vendored by Social Services. The previous address of 14446 Wade given to us by the borrower was an error. It is not uncommon for applicants not to retain rent receipts. Leases and/or rental agreements are rarely in writing. Many landlords rent on a month to month basis.

OIG Evaluation of Auditee Comments

We agree with the credit information that Erin provided. Although the accounts were paid off or charged off, four of them contained derogatory information that should have led Erin to question the borrowers claimed credit rating. Based on the borrower's credit history, Erin Mortgage Company should have obtained a rent verification to further determine the borrower's ability to make mortgage payments. If Erin had made an attempt to send a rent verification to the borrower's landlord, Erin would have known that the address of 19300 Elmdale did not exist.

Erin did not provide comments to explain why it did not verify the expenses on the ability to save affidavit.

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Page 1

FHA Case No.: 261-5882379

Insured Amount: $26,900

Section of Housing Act: 221(d)(2)

Date Underwritten: May 14, 1993

Underwriting Company: Community Mortgage Services

Underwriter Number: K291

Status: Claim Paid (Eight payments made)

Summary:

Erin Mortgage Company did not properly verify the borrowers' ability to save funds. Proper verifications are necessary to show the borrowers' ability to make mortgage payments and manage financial affairs. The borrower passed away after the default. The co-borrower said the default occurred because they could not afford to maintain the property.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Was Not Verified

Erin Mortgage Company did not determine the borrower and co-borrower's ability to save funds for the downpayment and to make mortgage payments. The income verifications showed that both the borrower and co-borrower each received an income of $468 per month from social security.

The borrower's rent verification showed that she was paying $400 a month for rent. As a result, the borrower had only $68 a month for food, clothing, utilities, transportation, and other expenses for a family of three. The co-borrower's rent verification showed that she was paying $450 a month for rent. Consequently, she had only $18 a month for food, clothing, utilities and other expenses. It is unrealistic to assume that the borrower and co-borrower could have survived and saved a downpayment on these amounts. The loan file did not contain any information to explain the inconsistencies. HUD requires the lender to

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provide additional explanatory statements or additional documentation to make a sound underwriting decision when standard documentation does not provide enough information to support the lender's decision.

Auditee Comments

The borrower maintained three savings accounts at Comerica, as evidenced by the verification of deposit in the file. The borrower withdrew a total of $975 from these accounts on April 12, 1993. On April 13, 1993, $930 was deposited with the broker. Based on the bank statements in the file, we feel that this adequately verified the source of required funds.

OIG Evaluation of Auditee Comments

We did not question the source of funds for the borrowers' deposits. Our concern was that the borrowers' did not provide realistic information to determine that they had the ability to make mortgage payments and manage their financial affairs. Information in the file showed one borrower had $18 left after her rent payment for food, clothing and other expenses. The other borrower had $68 left after her rent payment for food, clothing and other expenses for a family of three. HUD requires the lender to provide additional explanatory information when standard documentation does not provide enough information to support the lender's decision.

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FHA Case No.: 261-5894007

Insured Amount: $26,450

Section of Housing Act: 221(d)(2)

Date Underwritten: December 23, 1992

Underwriting Company: Community Mortgage Services

Underwriter Number and : K291

Status: Claim Paid (Two payments made)

Summary:

Erin Mortgage Company did not adequately verify the borrower's ability to save. Proper verification of the ability to save is necessary to show the borrower's ability to make mortgage payments, accumulate savings, and manage financial affairs. The borrower said she defaulted on the mortgage because her sister for whom she bought the house could not afford to make the mortgage payments.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit showing the borrower's monthly income and expenses. The affidavit showed an income of $1,701 and expenses of $520 with a monthly savings of $1,181. Erin verified the borrower's income which included $829 in public assistance and $872 in social security benefits for two disabled children. Erin did not verify and determine the reasonableness of the expenses. The expenses included $350 for rent, $70 for utilities, and $100 for food and clothing. The expenses did not include items like telephone, transportation, and general household expenses.

The expenses were unrealistic for a family of seven, especially food and clothing of $100, and utilities of $70. The Department of Social Services estimated a monthly utilities cost of $205. Although the loan file contained the income and expense affidavit and the Social

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Services estimate, it did not contain an explanation for the difference between the two. Additionally, according to the Department of Social Services' policy, a family cannot receive public assistance if assets including cash are over $1,000. The income and expenses affidavit showed the borrower was able to save more than this amount in one month.

Auditee Comments

At the initial application on December 17, 1992, the borrower stated that she would be occupying the property as her primary residence. At the closing, the borrower signed an affidavit stating that she would occupy the property. We had no reason to question the borrower's statements. We relied on the information that she gave us for occupancy status.

The borrower received $659 monthly in public assistance, $872 in social security benefits for two disabled children and food stamp benefits of $170 totaling $1,701 a month. The borrower deposited $1,000 over a five week period and stated that it came from her savings.

The borrower had lived at her present address for three years with a satisfactory payment history. The borrower's housing expense was decreasing.

OIG Evaluation of Auditee Comments

We agree that Erin Mortgage Company was not responsible for the borrower not occupying the residence.

Erin did not provide an explanation why it did not verify the reasonableness of expenses to establish the borrower's ability to save. Erin also did not explain the unrealistic expenses claimed for a family of seven. For example, the borrower showed only $100 a month was needed to feed and cloth the family of seven. Proper verification is necessary to show the borrower's ability to make mortgage payments when the projected new housing expenses considerably exceed the previous housing expenses. Erin said the housing expenses were decreasing; however, Erin did not consider utilities and maintenance expenses in reaching that conclusion.

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FHA Case No.: 261-5902870

Insured Amount: $22,400

Section of Housing Act: 221(d)(2)

Date Underwritten: April 28, 1993

Underwriting Company: Community Mortgage Services

Underwriter Number: C126

Status: Claim Paid (Two payments made)

Summary:

Erin Mortgage Company did not adequately verify the borrower's ability to save. The affidavit showing income and expenses contained false information. Proper verification of the ability to save and proper handling of the income and expense affidavit are necessary to show the borrower's ability to make mortgage payments, accumulate savings and manage financial affairs. The borrower defaulted because she became disgruntled with the house when it immediately needed a new furnace.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details:

Ability To Save Affidavit Was Not Verified

The borrower signed an undated affidavit showing the borrower's monthly income and expenses. The affidavit showed an income of $1,521 and expenses of $800 with a monthly savings of $721. Erin verified the borrower's income but did not verify and determine the reasonableness of the expenses. The expenses included: $300 for rent; $100 for utilities; and $400 for food and clothing. The expenses did not include items like telephone, transportation, and general household expenses.

The expenses were unrealistic for a family of nine. The borrower was on the Michigan Aid to Families with Dependent Children Program. The Department of Social Services

estimated a monthly utilities cost of $205, and a food cost of $501. Although the loan file contained the income and expense affidavit, and the Department of Social Services' estimate, it did not contain an explanation for the difference between the two.

The Michigan Aid to Families with Dependent Children Program provides assistance to help families pay for living expenses such as shelter, heat, utilities, clothing, food and personal care items. The Program's brochure says because there is a maximum amount that can be given for these needs, the grant probably cannot cover all of the bills. To receive aid, family assets cannot be more than $1,000. Based on this program criteria, Erin's use of the expense estimates without verification was not reasonable or a prudent business practice.

Affidavit Contained False Information

The borrower said the affidavit showing income and expenses was blank when she signed it. The affidavit was also undated. The borrower said she did not write the monthly expenses on the affidavit. She said she could not save $721 per month as indicated. Her statement is consistent with the fact that public assistance is calculated to cover necessary expenses and not to create savings.

Auditee Comments

The borrower made deposits with the broker over an eight month period. The Michigan Aid to Families with Dependent Children's brochure clearly states recipients can spend their money as they wish or need.

The information shown on the affidavit was given to us by the borrower. We did overlook the fact that the borrower did not date it. However, it was not blank.

OIG Evaluation of Auditee Comments

We agree that recipients of Michigan Aid to Families with Dependent Children can spend money as they wish or need. However as stated in the case narrative, at a savings rate of $721 per month, the borrower would have been ineligible for aid in less than two months. Therefore, Erin should have realized that the expenses were unrealistic and should have verified the expense items to determine the borrower's ability to manage her financial affairs.

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FHA Case No.: 261-6080252

Insured Amount: $25,000

Section of Housing Act: 221(d)(2)

Date Underwritten: January 20, 1994

Underwriting Company: Community Mortgage Services

Underwriter Number: K291

Status: Claim Paid (No payments made)

Summary:

Erin Mortgage Company submitted a false rent verification to HUD to establish the borrower's credit and did not properly verify the borrower's ability to save. Erin also mishandled the affidavits that showed the borrower's income and expenses and her prior address. Properly processed and completed affidavits and accurate verifications are necessary to show the borrower's ability to make mortgage payments and manage financial affairs.

Although the borrower was present during our interview, we could not ascertain her reasons for the default since she had a stroke and could not talk. The borrower's daughter said the default occurred because her mother had Alzheimer Disease and stopped making mortgage payments.

The Chief of HUD's Single Family Production Branch, Office of Housing, Michigan State Office agreed with the audit conclusions and believed the loan files required further information before the loan should have been approved.

Pertinent Details

Rent Verification Was false

Erin Mortgage Company submitted a false rent verification to HUD. The borrower did not have a recent credit history and said in an undated, but signed affidavit that she was not a seeker of credit and paid cash for all purchases. Therefore, a proper rent verification was essential to establish the borrower's credit worthiness.

The rent verification form was signed by the borrower's granddaughter who was acting as a conservator. The granddaughter said a person from the mortgage company brought the

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rent verification form to her at 4350 Buckingham, Detroit. The granddaughter said the person told her to write $275 per month as rent and that the borrower lived with her for six years. The granddaughter said the borrower lived with her for approximately 8 months prior to buying the house. She said she did not tell anyone that she was the landlord, but did tell the mortgage company that her grandmother, the borrower, lived at 1310 Pallister, Detroit. Prior to living with her granddaughter, the borrower lived at 1310 Pallister for 12 years and had an acceptable payment history.

The actual landlord of 4350 Buckingham said the granddaughter rented the house and lived there for about a year before moving out in January 1994. The landlord said the rent was $400 per month and the granddaughter moved out owing nine months back rent.

Prudent business practices dictate that Erin Mortgage Company should have had the borrower provide a copy of the lease and/or rent receipts, especially when a close relative is indicated to be the landlord.

Ability To Save Affidavit Was Not Verified

The borrower provided an undated affidavit showing the borrower's income and expenses, and establishing that the borrower had the ability to save and manage financial affairs. The affidavit showed income of $933 and expenses of $550 with monthly savings of $383. Erin Mortgage Company verified the income but did not verify the reasonableness of the monthly expenses. The expenses only included $275 for rent, $75 for utilities and $200 for food and clothing. The monthly expenses did not include items like telephone, transportation, and general household expenses.

Signed Affidavits Were Mishandled

The borrower's granddaughter said her grandmother signed blank affidavits showing income and expenses and the borrower's prior address of 4350 Buckingham. The granddaughter said she was present when her grandmother signed the affidavits. The granddaughter said the information regarding borrower's prior address was false.

Auditee Comments

At the time of the initial application, the borrower stated she currently lived at 4350 Buckingham, Detroit, Michigan. She stated that she had lived there for six years. This information was written in the appropriate section of the uniform residential application. Questions regarding the amount of rent and to whom it was paid were asked and answered as indicated on the application.

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The rental verification was mailed to the address provided by the borrower. The form was completed and returned to our office in the return envelope provided and the document was placed in our file. At no time did anyone employed by, or associated with, Erin Mortgage Company tell anyone what to write as rent in this case or another case.Erin Mortgage Company strictly complies with HUD requirements regarding verification forms.

The borrower had two previous satisfactory accounts at Chrysler Credit appearing on her credit report. It is not uncommon for family members to reside with other family members and pay rent or board. It is indeed rare that rent receipts are given in cases such as this. Erin Mortgage relied on information provided by the borrower in order to reach its decision in this case.

It seems very suspicious that the granddaughter making these accusations is a reliable source due to the fact that she was living with her grandmother, stated she was the landlord and moved from the Buckingham property owing nine months rent. As a conservator she was responsible for paying all expenses on behalf of her grandmother.

OIG Evaluation of Auditee Comments

The borrower's conservator said the mortgage company brought the rent verification form to her and told her what to put on it. She also said the borrower signed blank affidavits showing income and expenses. Erin Mortgage Company refuted this information; however, neither Erin Mortgage nor the borrower had documentation to support their position. Erin Mortgage did not provide a response to explain why it did not verify the rent information by having the borrower provide a lease and/or rent receipts. Erin said it is rare that rent receipts are given in cases like this; however, when a close relative is involved or an unknown landlord, prudent business practice dictates that some form of verification be obtained.

Erin did not explain why it did not verify the reasonableness of monthly expenses when preparing the ability to save affidavit.

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Auditee Comments

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