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| Audit Report Number 2007-LA-1011 |

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

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Suburban Mortgage Company Did Not Comply with HUD Requirements in the
Origination of FHA-Insured Single-Family Mortgages

HIGHLIGHTS

What We Audited and Why

We audited Suburban Mortgage, Inc. (Suburban), a U.S. Department of Housing and Urban Development (HUD)-approved direct endorsement lender located in Phoenix, Arizona. Suburban was selected for review because it had a consistently higher than normal default-to-claim ratio on its defaulted Federal Housing Administration (FHA)-insured loans. Our audit objectives were to determine whether Suburban acted in a prudent manner and complied with HUD requirements in the origination of the FHA-insured single-family mortgages selected for review. Based upon the results of our initial survey, special emphasis was placed on the adequateness of Suburban's review of appraisals related to FHA-insured mortgages on individual units in two condominium complexes.

What We Found

Suburban did not adequately review selected condominium appraisals and did not comply with HUD requirements in the origination of FHA-insured single-family mortgages. As a result, HUD insured mortgages on 38 properties that were overvalued by approximately 40 percent and some of which did not have occupancy authorization from the City of Phoenix. The property overvaluations resulted in a corresponding overinsurance of the

FHA-insured mortgages and an increased risk to HUD. Additionally seven¹ of forty eight mortgages we reviewed had significant underwriting deficiencies that should have precluded their approval and submission to HUD for insurance, such as unacceptable credit, inadequate income or unstable employment, excessive qualifying ratios without compensating factors, and unallowable seller contributions.

What We Recommend

We recommend that HUD's assistant secretary for housing – federal housing commissioner initiate settlement negotiations with Suburban, requesting reimbursement and/or indemnification for HUD's actual and potential losses on the 34 active and 4 foreclosed loans involving the overvalued condominiums and the seven loans that had significant underwriting deficiencies. Additionally, we recommend that Suburban be required to obtain new appraisals on other FHA-insured mortgages that it originated, involving the two appraisers and the seller involved with the condominium projects we reviewed. We also recommend that appropriate administrative action be taken against the two appraisers for their failure to follow HUD appraisal requirements.

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 Suburban a draft report on March 12, 2007, and held an exit conference on April 5, 2007. Suburban provided written comments on April 4, 2007. Suburban generally disagreed with our report. The complete text of its memorandum response, along with our evaluation of that response, can be found in Appendix B of this report. Due to the voluminous nature of Suburban's exhibits in their response, we will make them available upon request.

¹ Three of these loans are included with the 38 loans which were overinsured as a result of appraisal overvaluations.

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BACKGROUND AND OBJECTIVES

The National Housing Act 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, purchase, holds, or sells Federal Housing Administration (FHA)-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 sanctions.

Suburban Mortgage, Inc. (Suburban) is headquartered in Phoenix, Arizona, and was approved as a nonsupervised direct endorsement lender in 1988. It is locally owned and is one of the largest privately owned mortgage companies in Arizona. Suburban has four approved branch offices, including its Phoenix headquarters office. It originates mortgage loans primarily in the Phoenix metropolitan area. Suburban originated 1,020 FHA loans from March 1, 2004, through February 28, 2006.

Our primary audit objective was to determine whether Suburban originated HUD-insured loans in accordance with prudent lending practices and HUD requirements.

RESULTS OF AUDIT

Finding 1: Suburban's Appraisal Review Process Was Inadequate to Ensure That Condominium Units' Appraised Values Were Reasonable and That the Units Had Obtained Required Occupancy Authorizations

Suburban did not follow HUD requirements or its own quality control plan when reviewing appraisals submitted as part of loan packages for units sold in two condominium projects.² Suburban's failure to use due diligence during its underwriting appraisal review process resulted in HUD insuring 38³ condominium units that were overvalued by approximately 40 percent and which did not have authorization for occupancy from the City of Phoenix. The property overvaluations resulted in a corresponding overinsurance on the \$3.1 million of FHA-insured mortgages obtained on the properties and an increased risk to HUD. We attribute the problems to a disregard of HUD-required appraisal requirements by the two Suburban-selected appraisers, combined with Suburban's inadequate internal control environment, which allowed obvious appraisal errors and omissions to go undetected during the underwriting and quality control review processes.

HUD Requirements

Regulations at 24 CFR [*Code of Federal Regulations*] 202.5(j)(4) require HUD-approved lenders, officers, directors, and employees to conform to generally accepted, prudent, and responsible lending practices. Section 202.5(h) requires lenders to implement written quality control plans that assure compliance with HUD regulations and other issuances regarding loan origination. The specific requirements for HUD-insured loan originations, including appraisal requirements, are principally set out in HUD Handbooks 4150.2, 4155.1, 4000.2, and 4000.4 and various mortgagee letters. HUD Mortgagee Letter 2005-06 specifically reminds lenders that they are jointly responsible with the appraisers for the quality of appraisals for properties that will be security for FHA-insured mortgages.

² Both projects involved the same seller who offered the units to prospective buyers for no money down and no closing costs; i.e., downpayments and closing costs were absorbed by the seller.

³ We reviewed the appraisal reports for 19 of these 38 condominium units located in two complexes. The units in these two complexes are essentially the same without any differences that would affect their valuations. Basically, they are the same in size, design, construction, remodeling, and sales price. Accordingly, all the units, by size, respectively in the two complexes would have the same market values. Thus, the 19 units we did not review would be overvalued by a similar amount, i.e. approximately 40 percent.

Appraisal Deficiencies Resulted in Overvaluation of the Subject Condominium Units

The two appraisers⁴ selected by Suburban to appraise the subject condominium units did not follow HUD appraisal requirements, including the Uniform Standards of Professional Appraisal Practice, when appraising the units in the two condominium projects. Specifically, the appraisers did not accurately describe the units being appraised and did not identify and use appropriate comparable properties when using the sales comparison approach to value the condominium units (see Appendix C-1). These errors resulted in the creation of artificial, inflated values for the units in the two condominium projects and a corresponding unwarranted increase of approximately 40 percent for the 38 FHA-insured mortgages underwritten by Suburban for units in the projects.

The Condominiums Were Inaccurately Described

The appraisals did not accurately reflect the subject condominiums' condition and characteristics. The subject projects (see below) are two- and three-story walk-up apartment complexes that were converted to one- and two-bedroom condominium units.

| Project address | Units | Bedrooms/baths | Quantity/size | Year built | Age ⁵ |
|--------------------------------------|-------|--------------------------------------|------------------------|------------|------------------|
| 3010 W. Camelback Rd. Phoenix, AZ | 72 | 1 bedroom/1 bath 2 bedroom/2 bath | 26 – 684' 46 – 968' | 1973 | 31 |
| 2537 W. Georgia Ave. Phoenix, AZ | 28 | 2 bedroom/1 bath | 28 – 792' | 1982 | 23 |

⁴ The two appraisers involved with these two projects were also involved with the same seller in at least 10 other condominium conversion projects involving FHA-insured loans originated by Suburban.

⁵ Age represents the age of the units at the date of the appraisals used for FHA insurance purposes.

Exterior Views of the Two Condominium Complexes

3010 W. Camelback Rd., Phoenix



2537 W. Georgia Ave., Phoenix



We reviewed 19 of the 38⁶ appraisals related to the FHA-insured mortgages approved by Suburban in the two projects and noted numerous descriptive errors made by the appraisers that contributed to an inflated value for the units. For instance, in FHA case 023-1892486-7, the appraiser completed the appraisal as if the unit had been a two-bedroom, two-bath, 948-square-foot unit. However, this is a one-bedroom, one-bath, 684-square-foot unit. Additionally, the appraiser selected a comparable unit (#132) from the same complex as the subject unit and inaccurately described and evaluated it as a three-bedroom, 1,298-square-foot unit when it is a two-bedroom, 968-square-foot unit. There are no three-bedroom units in the entire project. (Three months later, as part of a different appraisal, the same appraiser correctly listed the unit's square footage and number of bedrooms). The other two comparables used to establish the appraised value for this unit were also two-bedroom units, not one-bedroom units (also see our discussion of inappropriate comparables below). Based upon this information, it appears that the appraiser purposely appraised the subject property as a larger unit to establish a higher value for one-bedroom units in the condominium complex. This was the first sale in the project, and the inflated value of the unit was used to support the sales price of later sales, for this project.

In addition to the above misrepresentations on this and other appraisals, the appraisers embellished and/or falsely added other characteristics and amenities to add value to the units where none existed, such as

- Covered porch - The condominium projects do not have covered porches; the only cover is a roof overhang on the top floor and an upper floor walkway that overhangs the first floor (see photos above).

⁶ This includes 34 active FHA-insured loans and four foreclosed loans in which a claim was submitted to HUD. Additionally, we reviewed the appraisals related to four other loans that were originally FHA-insured but have since been terminated.

- Foyer - One appraiser listed the units in the Camelback project as having foyers; the second appraiser did not list this amenity.
- Energy-efficient windows - The appraisals show that the units in the 2537 Georgia Avenue complex had dual pane energy-efficient windows installed as part of the remodeling/conversion work. However, only one unit out of 28 had new dual pane windows installed. The remaining 27 units appear to have the same single pane windows that were installed when the building was constructed 25 years ago.
- Appraisal form - One of the appraisers used the Uniform Residential Appraisal Report (FNMA Form 1004), primarily used for appraising single-family properties, rather than the Individual Condominium Unit Appraisal Report (Fannie Mae Form 1073). Although this form was acceptable to HUD at the time the appraisals were submitted, it does not provide the detailed information provided by Form 1073 that could be used to analyze the characteristics of the complex, including owner occupancy percentage. The owner occupancy information detailed on a condominium appraisal form can be used to assess the 51 percent owner/occupancy requirement. Only 7 of the 23 units we reviewed met HUD's 51 percent owner occupancy requirement at the time they were submitted for insurance endorsement.

The appraisers also made other errors on their appraisals of the subject condominium units that appear to indicate either sloppiness or intentional misrepresentation, including

- Using the same comparable units on different appraisals but providing different property descriptions (of the comparables) on the separate appraisals,
- Incorrectly listing comparable units' financing as FHA when conventional financing was used and vice versa, and
- Incorrectly listing the Camelback project as having 64 total units when it has 72 units.

The above misrepresentations and errors in the description of unit and project characteristics and amenities, combined with the use of inappropriate comparable units discussed below, contributed to significant overvaluation of the individual units in the two projects and corresponding overinsured FHA mortgages.

Inappropriate Comparable Units and Invalid Adjustments Were Used to Establish Values

The comparable units used to establish values for the condominium units were not valid or appropriate. Suburban used two appraisers to conduct all of the appraisal work for the FHA-insured loans they underwrote for the two condominium projects reviewed. Our analysis of those appraisals indicated that the appraisers inappropriately used questionable appraisal techniques and inappropriate comparables to inflate the value of the initial units sold in the projects. The overvaluation of those units created an artificial market that allowed the appraiser to then use them as comparable units for later

condominium sales in the two complexes reviewed, resulting in the overvaluation of those units as well (individual appraisal deficiencies noted are more fully discussed in appendix D). In the opinion of the Office of Inspector General's (OIG) appraiser/analyst, there were significant deficiencies in the analyses used by the appraisers that resulted in the units being overvalued by approximately 40 percent, such as

- Use of comparable units that had a preferable design and were better constructed and models that were originally built as condominium units, not converted to condominiums as were the subject projects;
- Making excessive, unsupported adjustments to value;
- Frequently selecting comparable units that were outside the neighborhood boundaries detailed in the appraisal report without a valid reason, although valid comparables, similar in age, design, and construction, were available within the neighborhood.

Comparable units used were not similar

The appraisal reports clearly show that the appraisers frequently selected comparable properties that were not of the same type, design, and construction as the subject units. In one extreme case, the comparable unit chosen was half the age of the subject property; a single-level townhome, compared to a three-story apartment type complex; and in a low-traffic residential neighborhood surrounded by single-family homes, compared to a high-traffic mixed community of businesses, apartments, and single-family homes. This comparable unit, shown below, is a two-bedroom, two-bath, 975-square-foot condominium. This unit was inappropriately used as a comparable unit for the first FHA appraisal in the Camelback project that falsely portrayed a one-bedroom unit as a two-bedroom unit (discussed above). Additionally, other units from this complex were frequently used to initially establish the project's one-bedroom property values (although all units in this project are two-bedroom). The appraiser failed to make appropriate adjustments for the neighborhood, location, style, design, age (16 years compared to 30), and construction. In addition, the units in this complex were only used to establish the values for one-bedroom units and not the two-bedroom units that would have better matched the number of bedrooms and square footage in the Camelback project. By using these units to value one-bedroom units rather than two-bedroom units and not making the appropriate adjustments, the appraisers appear to have purposely inflated the value of the one-bedroom units.

Dissimilar Condominium Units Often Used as Comparables



Similar problems were noted with other comparable units used by the appraisers. Suburban failed to adequately review the photos and other information in the appraisal reports that clearly indicated the appraisers' frequent use of comparable properties that were not of the same type, design, and construction as the subject units.

Valuation adjustments were not valid or supported

Large valuation adjustments were made by the appraisers without reasonable support to validate the legitimacy of the adjustments. For example, one of the comparable properties used is part of a planned gated community that has a mixture of single-story and two-story condominiums, town homes, and single-family homes. The appraiser claimed that the selected comparable unit in this planned community was similar in design, size, remodel condition, and appeal to the unit being appraised. We verified that the comparable unit was in a more economically stable community and better location and was not similar in design, size, and appeal (as shown in the photo below). The appraiser made a value adjustment (increase) of \$12,000 or 21 percent of the gross selling price of the comparable unit. The appraiser's \$12,000 added value was based on the "totally remodeled" condition of the subject property. We found that this "remodeling" of the subject project was incomplete and poorly done and did not meet city code (see our discussion of the subject unit's remodeling status below). Such a large adjustment to a clearly superior property should have alerted Suburban to potential appraisal problems. However, Suburban did not question the large valuation adjustments made by the appraiser without reasonable support nor the obvious differences between the comparable unit and the subject unit.

Clearly Superior Condominium Unit Comparable for Which Inappropriate Value Adjustment was Made



Noncomparable units were selected when suitable comparable units were available

The appraiser frequently selected comparable units that were outside the subject units' neighborhood, in economically stable, better kept communities, and in locations where properties normally sold for much higher prices. Our analysis of the appraisals found that the appraiser often went outside the recommended one-mile radius, often going as far as five miles away, to locate comparable units. In one case, a comparable unit was selected that was two blocks away from a prestigious community known to cater to the wealthy. In another case, the comparable unit was within walking distance of an entertainment district where, historically, properties commanded a much higher price than properties in the economically distressed area where the subject condominium units were located. Suburban did not question why the appraiser went outside the neighborhood boundaries listed on the appraisal report to obtain comparable sales or determine whether other condominium projects in the subject properties' market area had recent comparable sales.

The appraisers frequently stated on the appraisal reports that a lack of recent sales in the subject property's market forced them to go outside of the neighborhood to select suitable comparable units. However, based upon a review of the Arizona Multiple Listing Service and the Maricopa County Tax Assessor's databases, there were numerous condominium sales within the relevant periods that matched the subject projects' characteristics of size, age, design, and construction. Some of these comparables are detailed below.

| Sale price | Year built | Sale date | Address | Zip code | Beds/baths | Sq. ft. | Stories | Garage/carport |
|------------|------------|----------------|------------------------|----------|------------|---------|---------|----------------|
| \$45,300 | 1974 | June 15, 2003 | 6810 N. 35th Ave. | 85017 | 2/1 | 728 | 1 | 2 |
| \$58,770 | 1974 | Aug. 22, 2003 | 6818 N. 35th Ave. | 85017 | 2/2 | 987 | 1 | 2 |
| \$51,360 | 1984 | Sept. 26, 2003 | 2928 W. Colter St. | 85017 | 2/2 | 806 | 1 | 1 |
| \$45,900 | 1974 | Dec. 26, 2003 | 6820 N. 35th Ave. | 85017 | 2/1 | 728 | 1 | 2 |
| \$50,000 | 1971 | Feb. 10, 2004 | 3008 W. Bethany Home | 85017 | 2/1 | 994 | 2 | 2 |
| \$45,000 | 1981 | Mar. 30, 2004 | 2724 W. McLellan Blvd. | 85017 | 2/1.5 | 986 | 2 | 1 |
| \$63,000 | 1981 | May 15, 2004 | 2740 W. McLellan Blvd. | 85017 | 2/1.5 | 986 | 2 | 1 |
| \$42,500 | 1973 | Aug. 20, 2004 | 3232 W. Vermont Ave. | 85017 | 2/1.5 | 992 | 1 | 1 |
| \$55,000 | 1973 | Dec. 27, 2004 | 3243 W. Denton Ln. | 85017 | 2/1 | 992 | 1 | 1 |
| \$59,000 | 1974 | Nov. 3, 2004 | 6818 N. 35th Ave. | 85017 | 2/1 | 728 | 1 | 2 |
| \$59,900 | 1974 | Apr. 11, 2005 | 2132 W. Glenrosa Ave. | 85015 | 2/1.5 | 960 | 1 | 1 |
| \$51,500 | 1973 | Jan. 21, 2005 | 3321 W. Vermont Ave. | 85017 | 2/1 | 960 | 2 | 1 |
| \$69,900 | 1973 | May 18, 2005 | 3314 W. Denton Ln. | 85017 | 2/1.5 | 960 | 2 | 1 |

Suburban's appraisers apparently ignored these more suitable comparable units and went outside the subject condominium's market area to selectively choose higher valued units to support the inflated sales prices of the units being appraised. In the opinion of OIG's appraiser/analyst, sales within the market area/neighborhood of the two subject condominiums supported a maximum value of \$50,000 for the one-bedroom condominium units, not the \$71,200 average value provided by Suburban's selected appraisers; and the larger two-bedroom units should have appraised at approximately \$59,000, not the \$89,000 average value provided by Suburban's selected appraisers.

Unit Remodeling Was Inadequate

The seller of the condominiums did not obtain completion certificates and related occupancy authorization from the city for the conversion/rehabilitation work done. According to the City of Phoenix Development Service Department, both complexes

required construction permits to rehabilitate the infrastructure of the buildings to accommodate the condominium upgrades. Some of the specific upgrades were electrical wiring, plumbing, roofing, and installation of security gates. Online City of Phoenix records (available to the public), show that only 4 of 72 units have passed inspection for the 3010 W. Camelback Road project, and only 22 of 28 units have passed inspection for the 2537 W. Georgia Avenue project. The remaining units still have open building permits and, therefore, should not have been sold and occupied until the work was complete and certified by city inspectors. According to the City of Phoenix' Assistant Director for Development, final inspections of these units will be made by the city, and the current owners will be held responsible for bringing their units up to code if deficiencies are noted.

Further, based upon interviews with the condominium owners and inspections of the properties, the seller did not suitably remodel the units and did not install items that, according to the condominium sales brochures, were to be part of the remodeling work. According to the property owners, the remodeling work was so poor that two owners were temporarily displaced so that major reconstruction of the interior rooms could be accomplished. These two units, are still vacant. The majority of owners stated that they had to replace, repair, or finish aesthetic items on their own because the seller often promised to do the work but did not follow through with the repairs. Overall, the owners were very dissatisfied with their units, and many commented that they planned on selling their units as soon as possible.

We also noted many problems during our inspections of the properties, including

- Plumbing leaks and drainage problems – Several owners we interviewed stated that they continue to have plumbing problems, and some units we inspected showed evidence of internal leaks that caused deterioration of the units' interior walls.
- Electrical problems - In one project, power outages affected the exterior lighting and took several days to repair. Some units in the same project had faulty wiring to electrical outlets and telephone jacks that the owners stated had never worked.
- Unfinished remodeling work – At least three units had flooring defects such as rotted floorboards and holes that were purposely covered over (not repaired) with carpeting and linoleum. Several owners complained that painting and molding work was superficial and was only done where it was visible. Energy-efficient windows that were listed as part of the remodeling work at one of the projects had not been installed in 27 of the 28 units.

The need to close out open city building permits and obtain occupancy authorizations should have been noted during the property appraisal process but was either not identified or ignored by the appraisers. Suburban's inadequate review of the appraisal reports allowed this problem to go undetected and has resulted in HUD assuming excessive risk for mortgages on properties that do not meet city building codes and financially

jeopardized the current owners, who may be required to pay for expensive repairs to bring their units up to city building code standards.

Suburban Did Not Adequately Review the Appraisal Reports

Suburban's underwriting review of the appraisals related to units in these two condominium projects did not meet HUD requirements or the standards of a prudent lender. Further, Suburban failed to include appraisal reviews as part of its (implemented) quality control process, although such reviews are required by its written quality control plan and HUD requirements. Consequently, Suburban failed to identify and act on the obvious appraisal problems related to the two condominium projects. Had it carried out its responsibilities, it would have identified the appraisal problems before it submitted 38 overvalued mortgages to HUD for insurance endorsement.

As discussed above and in Appendices D-1 to D-19, there were numerous indicators of problems with the appraisal reports, related to the two condominium complexes that should have led Suburban to question the validity of the appraisers' factual information and the plausibility and consistency of their conclusions. These indicators included use of the Uniform Residential Appraisal Report form (although acceptable by HUD at the time of submission) instead of the Individual Condominium Unit Appraisal Report, which resulted in a limitation on the information available related to the condominium units; violations of the 51 percent owner occupancy clearly discernable from file information; not noting errors in property descriptions or questioning why the appraisers always had to go outside the neighborhood to find comparable sales; not questioning why the appraised values of the subject condominium units significantly exceeded the predominant neighborhood values; not questioning design and construction differences clearly identifiable through review of property photos; not questioning the use of unsupported adjustments to comparable sales prices; not questioning the significantly different neighborhoods of the comparable properties versus the subject condominium units; and the failure to question whether rehabilitation/renovation of the units had been completed in accordance with outstanding city building permits (available to the public online).

Additionally, Suburban's written quality control plan (and HUD requirements) calls for a compliance review of approximately 10 percent of its processed loans and a review of loans related to any borrower that defaulted within the first six months of loan closing. This includes a review of the appraisal report of the selected loans. The appraisal review should entail a desk review of the appraisal data to determine the validity of the comparable units, the value conclusion, any changes made by the underwriter, and overall quality of the report. In addition, a field review is required for a sample of the 10 percent and for all loans that went into default. However, Suburban's reviews did not include desk reviews and, when applicable, field reviews of appraisal reports. Suburban's quality control reviews did not include any reverification of loan

information as called for in its written quality control plan. For example, the following document represents Suburban's entire quality control review file related to a defaulted loan selected from our audit period.

FHA case file 023-220924-0

REVIEW OF EARLY PAYMENT DEFAULTS AS OF 9/30/05

40021868

Purchase -- closed 2-3-05
Loan Officer: [REDACTED]
Underwriter: [REDACTED] - manual underwrite
Realtor: [REDACTED]
Housing: \$485 to \$623
Ratios: 41/43.4
Assets: Ameridream (no other funds verified)
Credit: Rent rating for 5 months
Small account rated for 3 months
No other credit obtained
Employment: Present employer for 1 month
Previous employer for 2 months
Previous employer 6 months at Job Corps
Insufficient comp factors listed on MCAW
of payments made before default: 1
Currently in default: Yes

Suburban officials stated that during this period, they had changed their quality control procedures but failed to implement a document review process as required by their quality control plan and HUD requirements. They claimed that beginning in June 2006, they changed their procedures and are now reordering and analyzing the required loan documents, including obtaining new appraisals. However, the failure to previously review appraisal reports during the quality control process contributed to Suburban's failure to identify the problems with the appraisals related to these condominium units.

Conclusion

Suburban did not follow HUD requirements or its own quality control plan when reviewing appraisals related to condominium units in two converted apartment projects. Consequently, it failed to identify significant problems with the appraisals, which resulted in the creation of an artificial market value and an overvaluation of all the units in the two projects appraised for Suburban by approximately 40 percent. Further, it failed to note that the conversions from apartments to condominiums were not completed in accordance with local city requirements, and as a result, the majority of the units in the projects were not authorized for occupancy. As a result, HUD has been placed at increased risk on 38 insured mortgages totaling \$3.1 million that were overinsured

because of the inflated values of the units serving as security for the mortgages. Additionally, the failure to ensure that the units obtained completion certificates from the city for the conversion/rehabilitation work not only increases HUD's risk, but also could result in financial harm to the purchasers of the units who will be held responsible for correction of any code violations found when the city performs its final inspection of the units.

The seriousness of the appraisal problems related to these two condominium conversion projects, and Suburban's inadequate appraisal reviews, raises concerns about other similar projects involving the same two appraisers and seller. In this regard, we identified 10 other conversion projects involving these appraisers and seller where some of the units in the properties were purchased using FHA-insured mortgages originated by Suburban. The validity of the appraisals related to these units should be evaluated to determine whether appraised values and the resultant FHA-insured mortgages are supported.

Recommendations

We recommend that HUD's assistant secretary for housing – federal housing commissioner

1A. Initiate settlement negotiations with Suburban, requesting reimbursement and/or indemnification for HUD's actual and potential losses on the 38 loans detailed in appendix C-1 totaling more than \$3.1 million.

1B. Require Suburban to obtain new appraisals on all active FHA-insured loans it originated that involved the two appraisers and the seller of the condominium complexes described in this report. If similar property overvaluations are found, require Suburban to indemnify HUD on any overinsured mortgages identified.

1C. Require Suburban to implement procedures that will ensure appropriate review of appraisals during its quality control review process.

1D. Take appropriate administrative action against the two identified appraisers, including removing them from the roster of approved FHA appraisers, for their failure to adhere to HUD appraisal requirements.

Finding 2: Suburban Did Not Follow HUD Requirements When Originating and Underwriting FHA-Insured Mortgages

Suburban did not follow prudent lending practices and HUD requirements in the origination and underwriting of 7 of the 48⁷ loans we reviewed. As a result, loans were approved, which contained origination deficiencies that subjected HUD to an unacceptable insurance risk. These underwriting deficiencies included inadequate borrower credit analysis, inadequate analysis of borrower employment and income, lack of compensating factors to support high loan ratios, and ineligible contributions by property sellers. (Also, see finding 1 relating to Suburban's inadequate review of appraisals during the underwriting and quality control review processes). Consequently, HUD paid insurance claims on four loans totaling \$394,303 and continues to be at risk for three loans totaling \$360,633, which did not meet HUD approval requirements. In addition, in 24 of the 48 loans reviewed, Suburban allowed interested third-party involvement in the document verification process. Although we did not note any negative effects resulting from this inappropriate involvement, it represents a significant processing weakness that should have been identified and addressed by Suburban during its underwriting and quality control review processes.

HUD Requirements

Regulations at 24 CFR [*Code of Federal Regulations*] 202.5(j)(4) require HUD-approved lenders, officers, directors, and employees to conform to generally accepted, prudent, and responsible lending practices. Section 202.5(h) requires lenders to implement written quality control plans that assure compliance with HUD regulations and other issuances regarding loan origination. The specific requirements for HUD-insured loan originations are principally set out in HUD Handbooks 4155.1, 4000.2, and 4000.4 and various mortgagee letters.

Suburban Did Not Have Adequate Controls over Loan Origination and Control Processes

Suburban did not follow HUD requirements in the origination of 7 of 48 loans reviewed, resulting in an increased risk to the FHA insurance fund. These underwriting deficiencies occurred because Suburban employees did not follow or did not understand HUD requirements relating to loan processing and quality control. Problems noted in Suburban's loan origination and control processes included

⁷ Eighteen of these mortgages were also analyzed during our appraisal review process discussed in finding 1.

- Not properly analyzing borrower’s credit history,
- Not properly analyzing borrower’s employment history and income,
- Not ensuring that appropriate compensating factors existed when debt-to-income standards (ratios) were exceeded,
- Improper use of alternative financing programs for borrowers who did not meet requirements for the programs,
- Allowing sellers to make ineligible or excessive contributions on the borrower’s behalf,
- Allowing interested third parties to handle critical verification documents, and
- Not adequately reviewing a sample of all loans it originated and those loans that defaulted within six months of origination as part of the quality control process.

Credit Histories Were Questionable, and Liabilities Went Unreported

Suburban improperly analyzed the borrower’s credit history for six of the seven questioned mortgages. In two instances, Suburban failed to pursue nontraditional/alternate credit when the credit-reporting agency was unable to rate the borrower’s credit. HUD regulations require the lender to develop an alternative credit history for those borrowers who have not established credit or choose not to use credit.⁸

In five instances, Suburban did not obtain a credible explanation for delinquent accounts as required by HUD.⁹ For example, in FHA case 023-203364-5, the borrower’s credit report showed nine collection accounts. The borrower’s explanation of these credit problems was that she used credit cards to support herself while in school. However, the delinquent accounts were incurred before and extended beyond the documented period that the borrower was attending school. Suburban failed to demonstrate that the borrower’s excessive delinquent accounts were beyond her control.

In two instances, Suburban failed to use all of the borrower’s and/or the nonpurchasing spouse’s liabilities to calculate debt-to-income ratios.¹⁰ In one case, FHA case 023-199965-1, the lender did not obtain the spouse’s credit report and failed to update the borrower’s report that exceeded the maximum 120 days and, therefore, was outdated for loan analysis and approval purposes. Although the borrower minimally exceeded HUD’s debt-to-income standard, the actual excess is unknown because Suburban used an outdated credit report for the borrower and did not obtain a credit report for his spouse.

⁸ HUD Handbook 4155.1, REV-5, paragraph 2-3.

⁹ Same as eight: “Explanation must make sense and be consistent with other credit information in file.”

¹⁰ HUD Handbook 4155.1, REV-5, paragraph 2-11/2-2D.

Employment Was Questionable, and Income Was Unsupported

For three of the seven questioned loans, Suburban did not substantiate the borrowers' effective income and/or stability of employment. HUD requires the lender to verify the borrowers' most recent two full years of employment or obtain evidence supporting other endeavors. Any gaps in employment longer than 30 days require an explanation. Additionally, the income of each borrower must be analyzed to determine whether the borrower(s) has the capacity to repay the mortgage debt.¹¹ In one case, FHA case 023-220924-0, the borrower had been employed at his current job for only one month. Suburban loosely substantiated an additional year of employment through another verification of employment and borrower statements. However, actual employment history was verified for only the five months before the loan application. During this period, the borrower had two different jobs and was unemployed for one month between the two jobs. This limited and unstable job history did not meet HUD's requirements for both two years' verified employment and a stable income history.

Mortgages Had High Debt-to-Income Ratios without Valid Compensating Factors

For six of the seven mortgages, HUD's recommended debt-to-income ratios were exceeded without documented, valid compensating factors.¹² HUD guidelines require the lender to obtain and document on the mortgage credit analysis worksheet "remarks" section the compensating factors that justify exceeding the benchmark guidelines.¹³ In one case, FHA case 023-203364-5, the borrower exceeded the front-end ratio by 8 percent and the back-end ratio by 10 percent. Suburban listed some claimed compensating factors that were not supported by verifiable documents or did not pertain to the qualifying ratios. In another instance, Suburban did not list compensating factors in the "remarks" section when the recommended qualifying ratios were exceeded.

Use of the Interest Rate Buy-Down Program Was Inappropriate

For three of four loans reviewed, in which the borrowers used a 2-1 interest rate buy-down program to assist in qualifying for their mortgages, Suburban failed to provide adequate compensating factors to offset the increased risk resulting from future mortgage payment increases. As required by HUD, the lender must establish that the eventual

¹¹ HUD Handbook 4155.1, REV-5, paragraph 2-6/2-7.

¹² HUD Handbook 4155.1, REV-5, paragraph 2-12A.

¹³ HUD Handbook 4155.1, REV-5, paragraph 2-13.

increase in mortgage payments in such cases will not affect the borrower adversely and likely lead to default.¹⁴ In these three instances, Suburban did not demonstrate that the borrowers had the capacity to increase income or manage financial obligations or had substantial assets to cushion the increase in mortgage payments, which could assist the borrowers in meeting their increasing mortgage payments. In one instance, even after taking into consideration the lowered payment resulting from the interest rate buy-down, the borrowers' debt-to-income ratios exceeded HUD standards.

Contributions Were Ineligible

In four instances, Suburban allowed an interested third party to contribute funds on the borrowers' behalf in excess of HUD's standards or to provide funds to pay off borrowers' delinquent debts at closing.¹⁵ Suburban's failure to properly analyze the borrowers' assets, gifts, and the closing statements allowed these ineligible contributions to go undetected. For example, for FHA case 023-221521-7, the lender did not verify source of funds used to pay off \$653 in delinquent accounts at closing. Information from the loan file indicated that the borrower consistently had overdrafts on his account and would not have been able to pay \$520 in closing costs and the \$653 for delinquent accounts. In this regard, the borrower stated that he did not make the \$653 payment but believed it was paid by the seller. This would result in overinsurance as interested third parties are not allowed to pay delinquent borrower accounts, and if they do so, the FHA-insured mortgage must be reduced by a like amount.

¹⁴ HUD Handbook 4155.1, REV-5, paragraph 2-14B2.

¹⁵ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Inappropriate Interested Third Parties Were Involved

In 24 of the 48 loan files reviewed, interested third parties (sellers) were involved in the verification or transmittal of borrower loan documents (income, employment, credit, and/or explanation letters). The supporting loan documents were transmitted to Suburban through the seller's fax machine, clearly indicating seller control over the documents. In accordance with HUD guidelines, lenders cannot accept or use documents relating to credit, employment, or income that are handled by or transmitted by or through interested third parties.¹⁶ Although we identified no adverse consequences resulting from this practice, it is a significant control weakness that Suburban should have identified and corrected during its underwriting and quality control review processes. Allowing interested third-party involvement in the processing of borrower loan documents increases the risk of fraud in the origination process, thereby increasing HUD's insurance risk.

¹⁶ HUD Handbook 4155.1, REV-5, paragraph 3-1.

The Quality Control Review Process Was Inadequate

Suburban's quality control review process, as implemented, did not meet HUD requirements and serve as a tool for identifying and correcting problems in its loan origination and underwriting process. Suburban's written quality control review plan and HUD requirements¹⁷ called for the reverification of assets, employment, gifts, credit, and appraisals of approximately 10 percent of loan originations (and all insured loans defaulting within six months). However, there was no documentation in its files indicating that these reverifications were done. In one instance, the total quality control review file consisted of one piece of paper with no documented analysis of the loan or any reverifications (see finding 1). Without detailed quality control reviews, including reverification of critical loan documents, problems in the loan origination and underwriting processes (such as those problems set out in findings 1 and 2 of this report) will not be identified and corrected. Suburban officials stated that beginning in June 2006, it started obtaining and analyzing reverification documents as required by HUD.

Conclusion

Suburban did not comply with HUD requirements in processing and underwriting seven FHA-insured loans reviewed. Deficiencies in its analysis of borrowers' credit, employment history, and income; a failure to ensure there were adequate compensating factors to support high debt-to-income ratios; and its failure to consider the future effects on mortgage risk related to borrowers' use of 2-1 interest rate buy-down mortgages have placed HUD's FHA insurance program at increased risk. Deficiencies related to these seven loans were significant enough to warrant indemnification. Accordingly, we recommend that Suburban indemnify HUD for actual losses incurred on four loans totaling \$394,303, on which HUD has paid insurance claims, and for potential losses on three loans totaling \$360,633 (see appendix C-2).

¹⁷ HUD Handbook 4060.1, REV-1, paragraph 6-6.

Recommendations

We recommend that HUD's assistant secretary for housing – federal housing commissioner

2A. Initiate settlement negotiations with Suburban, requesting reimbursement and/or indemnification for HUD's actual and potential losses on the seven loans detailed in appendix C-2 totaling \$754,936.

2B. Require Suburban to implement controls to ensure that its quality control plan is fully implemented and that reverifications required by the plan are obtained and analyzed.

SCOPE AND METHODOLOGY

Suburban was selected for review due to its higher than average default-to-claim ratio for FHA-insured loans originated under the Phoenix, Arizona, HUD field office jurisdiction. We performed our audit fieldwork at the office of Suburban and at several title companies in Phoenix, Arizona.

To accomplish our audit objectives, we

- Reviewed applicable HUD handbooks and mortgagee letters, the Uniform Standard of Professional Appraisal Practice (USPAP) standards, and the International Building Code regulations.
- Reviewed 48 insured loans originated by Suburban during the period March 1, 2004, through February 28, 2006, and reviewed the appraisals (only) for an additional 8 loans.
- Conducted interviews with officials and employees of Suburban, title companies, and the seller of the two condominium projects included in our review.
- Contacted and interviewed borrowers as deemed appropriate.
- Conducted field visits to inspect the two condominium projects included in our review and the comparable units used by the appraisers to establish the subject condominium units' values.
- Used information obtained from HUD's Neighborhood Watch and Single Family Data Warehouse systems; Real Quest; and the Maricopa County Tax Assessor's and City of Phoenix, Development Service Department's online databases.

The audit generally covered the period March 1, 2004, through February 28, 2006. The period was expanded to cover the review of the first 10 appraisal reports, obtained by Suburban for one of the condominium projects, that were completed beginning in September 2003. 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:

- Suburban's controls over the underwriting of FHA loans.
- Suburban's controls over its quality control review 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 items are significant weaknesses:

- Suburban did not have adequate controls over its loan origination process to reasonably ensure that loan originations, including appraisals, complied with HUD requirements and prudent lending practices (see findings 1 and 2).
- Suburban's controls were inadequate to ensure that its quality control review process was fully implemented (see findings 1 and 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE¹⁸

| Recommendation number | Ineligible <u>1/</u> | Unsupported <u>2/</u> | Funds to be put to better use <u>3/</u> |
|-----------------------|----------------------|-----------------------|---|
| 1A | \$35,624 | \$19,463 | \$789,092 |
| 2A | 7,135 | | 101,747 |
| Total | \$42,759 | \$19,463 | \$890,839 |

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 polices or regulations. In this instance, the amount represents actual losses incurred on HUD's resale of four properties on which claims were paid.

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. In this instance, the amount represents 29 percent of the claim amount paid by HUD for one property, which has not yet been resold (see Note 3/ below).

3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings 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. In this instance, the amount represents 29 percent of the outstanding mortgage balances on the 39 properties on which OIG is recommending indemnification, which were still active as of February 16, 2007. The percentage reflects that, based upon statistics provided by HUD, upon sale of the mortgaged property FHA's average loss experience is about 29 percent of the claim amount.

¹⁸ See Appendix A-1 for detailed information relating to the computation of these amounts.

Appendix A-1

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

| FHA case no. | Outstanding mortgage balance | Loss on resale (ineligible cost) | | Claims paid property not resold (unsupported cost) | Indemnification amount (funds put to better use) 29% of outstanding mortgage balance |
|--------------|------------------------------|----------------------------------|--|--|--|
| | | | | | |
| 023-1892486 | \$64,601 | \$ - | | \$ - | \$18,734 |
| 023-1966202 | 65,114 | | | | 18,883 |
| 023-1971458 | 65,532 | | | | 19,004 |
| 023-1984859 | 86,806 | | | | 25,174 |
| 023-2033645 | Claim | 16,257 | | | |
| 023-2099918 | Claim | 6,371 | | | |
| 023-2171644 | 69,355 | | | | 20,113 |
| 023-2196544 | 68,752 | | | | 19,938 |
| 023-2209240 | Claim | 12,996 | | | |
| 023-2159234 | 95,051 | | | | 27,565 |
| 023-2157852 | 77,988 | | | | 22,616 |
| 023-2238326 | 78,755 | | | | 22,839 |
| 023-2273203 | 81,433 | | | | 23,616 |
| 023-2300236 | 81,938 | | | | 23,762 |
| 023-2300111 | 81,460 | | | | 23,623 |
| 023-2290180 | 83,516 | | | | 24,220 |
| 023-2307257 | 81,598 | | | | 23,663 |
| 023-2265939 | 80,567 | | | | 23,364 |
| 023-2309786 | 81,998 | | | | 23,779 |
| 023-2291729 | 94,727 | | | | 27,471 |
| 023-2097141 | 67,290 | | | | 19,514 |
| 023-2159196 | 91,127 | | | | 26,427 |
| 023-2074656 | 85,674 | | | | 24,846 |
| 023-2130610 | 89,362 | | | | 25,915 |
| 023-2238723 | 91,928 | | | | 26,659 |
| 023-2146128 | 68,981 | | | | 20,004 |
| 023-2283275 | 92,664 | | | | 26,872 |
| 023-2041273 | 67,025 | | | | 19,437 |
| 023-2210987 | 74,541 | | | | 21,617 |
| 023-2053735 | 85,858 | | | | 24,899 |
| 023-2023149 | 66,935 | | | | 19,411 |
| 023-2007589 | 88,536 | | | | 25,675 |
| 023-2229773 | 90,215 | | | | 26,162 |
| 023-2134868 | 87,482 | | | | 25,370 |

| FHA case no. | Outstanding mortgage balance | Loss on resale (ineligible cost) | Claims paid property not resold (unsupported cost) | Indemnification amount (funds put to better use) 29% of outstanding mortgage balance |
|---------------------|-------------------------------------|---|---|---|
| 023-2024394 | 67,114 | | 19,463 ¹⁹ | |
| 023-2229767 | 78,660 | | | 22,811 |
| 023-2138042 | 76,974 | | | 22,323 |
| 023-2214184 | 78,562 | | | 22,783 |
| 022-1826177 | 136,176 | | | 39,491 |
| 023-1999651 | 103,672 | | | 30,065 |
| 023-2094536 | Claim ²⁰ | 7,135 | | |
| 023-2215217 | 111,004 | | | 32,191 |
| Total | \$3,071,858 | \$42,759 | \$19,463 | \$890,839 |

¹⁹ The Property was conveyed to HUD and has not been resold, the claim is 29% of the loan amount.


²⁰ This mortgage was terminated (not foreclosed), but prior to termination HUD paid a partial claim on it.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

 Suburban Mortgage, Inc.

April 3, 2007

VIA ELECTRONIC MAIL AND FEDERAL EXPRESS

Ms. Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing
and Urban Development
Office of the Inspector General
Region IX, 9DGA
611 West Sixth Street
Suite 1160
Los Angeles, California 90017-3101

**RE: Suburban Mortgage, Inc.
HUD OIG Draft Audit Report**

Dear Ms. Hobbs:

Suburban Mortgage, Inc. ("Suburban" or "Company") is in receipt of the Draft Audit Report ("Report"), dated March 12, 2007, 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 48 loans the Company originated in the Phoenix, Arizona field office jurisdiction between March 1, 2004, and February 28, 2006, as well as an additional review of 10 appraisal reports completed between September 2003 and February 2004.

The Report states that its primary objective was to determine whether Suburban originated Federal Housing Administration ("FHA") insured loans in accordance with prudent lending practices and HUD requirements. The Report contains two findings, alleging appraisal review deficiencies in 38 loans and underwriting deficiencies in 9 cases. Based on these findings, the Report recommends that HUD require Suburban to: (1) indemnify it in connection with the 44 total loans¹ involved in the appraisal review and underwriting findings; (2) obtain new appraisals on other FHA-insured mortgages that it originated involving two appraisers and the seller involved in two condominium

¹ We understand that three of the loans identified in the underwriting finding are also included in the 38 loans involved in the Report's appraisal finding, which brings the total number of loans at issue in the Report to 44 cases.

DC-899689 v2 0307734-0100

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projects, as well as require indemnification in these cases if deficiencies similar to those identified in the Report are found; and (3) implement procedures that will ensure appropriate review of appraisals and reverification of loan documentation during its Quality Control process.²

The OIG provided Suburban with an opportunity to submit written comments for inclusion in the final report. This response summarizes Suburban's history and operations, including several improvements the Company has made to its Quality Control procedures, and addresses the individual findings in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations. That being said, we understand that final audit reports routinely include auditors' comments about the audited lender's written response, but the company is not provided an opportunity to respond to these additional comments. Often, these comments include substantive allegations or statements that were not a part of the draft audit report provided to the company. To the extent that the OIG makes such additional substantive comments in this instance, we respectfully request an opportunity to respond to these additional statements to ensure that a full picture of the audited issues is presented in the final Report.

I. **BACKGROUND**

Headquartered in Phoenix, Arizona, Suburban was incorporated in September 1988, received approval to participate in the Department's FHA mortgage insurance programs as a non-supervised mortgagee in December 1988, and received Direct Endorsement authority on June 2, 1992. Suburban offers a wide variety of loan products to assist consumers in identifying and obtaining the type of financing that best suits their individual or family needs. Loan officers receive ongoing training and guidance concerning the over 250 loan programs offered by Suburban, and the Company works closely with individual borrowers in an effort to make the loan application, underwriting, and closing processes as smooth and simple as possible. Suburban does not service FHA loans, but sells all FHA loans that it originates in the secondary market on a servicing-released basis. Its primary investors currently include EMC Mortgage, Wells Fargo Home Mortgage, Inc., Countrywide Home Loans, Inc., U.S. Bank, and Ohio Savings Bank. The Company enjoys excellent relationships with both consumers and its investors, and Suburban's employees consistently strive to produce high quality loans in compliance with HUD/FHA standards.

² Although not directed at the Company, the Report also recommends that the Department take appropriate administrative action against the two appraisers referenced in the Report.

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For the past 19 years, Suburban has endeavored to provide quality service to FHA borrowers. FHA lending constituted approximately 27% of the Company's overall business operations over the past five years, and the Company takes its relationship with the Department and its responsibilities under the FHA program seriously. Until the fourth quarter ending December 31, 2006, Suburban had been the largest FHA lender in HUD's Phoenix, Arizona region, with Countrywide Home Loans, Inc., Assurity Financial Services, LLC, Wells Fargo Bank, NA, and CTX Mortgage Company, LLC rounding out the top five producers. Suburban, therefore, is dedicated to working with HUD to extend credit to qualified FHA borrowers, and we would never knowingly violate FHA requirements nor endanger the reputation of the Company or its employees. Throughout our existence, we have endeavored to provide dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA program.

II. RESPONSE TO THE FINDINGS

The Report contains two findings, including several sub-findings, in which it alleges that Suburban did not properly review property appraisals in 38 cases or originate 9 loans in accordance with HUD requirements or prudent lending practices. Upon receipt of the draft Report, Suburban conducted a thorough review of the findings and loan files, as well as examined applicable HUD/FHA guidelines and internal Company procedures at the time these loans were originated in an effort to provide pertinent information and documentation with this response. Our review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD's requirements. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate Suburban's general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report, evidence our adherence to FHA requirements in connection with the findings and cited loans, and set forth our opposition to the manner in which the recommendations are presented in the Report.

A. FINDING 1 – SUBURBAN COMPLIED WITH HUD REQUIREMENTS REGARDING APPRAISAL REVIEWS

In Finding 1, the Report alleges that the underwriters in the cited cases did not adequately review appraisals or obtain explanations of appraisal deficiencies that would

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indicate lower property values in certain appraisals performed by two appraisers on units of two condominium projects. Specifically, Finding 1, Appendix C-1, and Appendix D allege that, in 38 appraisals of condominium units secured by loans originated by Suburban, the lender and appraiser overvalued the properties by approximately 40 percent. The Report arrives at this conclusion by relying on assertions in several sub-findings that: (1) the appraisers inaccurately described the condominiums being appraised; (2) the appraisers selected inappropriate comparables and made invalid adjustments to the comparables to establish the subject properties' values; (3) the condominium sellers did not obtain certain certifications from the city and both the appraisers' reports and the Company's reviews of the appraisals ignored or did not detect inadequate remodeling of the condominium units at issue; and (4) the Company's underwriters and Quality Control process did not adequately review the appraisal reports. As discussed in detail below, Suburban respectfully disagrees with the vast majority of the allegations in Finding 1 and maintains that its underwriters adequately examined the appraisals in the cases reviewed by the OIG in compliance with HUD guidelines.

Comment 1

At the outset, Suburban takes strong exception to the auditing procedures implemented by the OIG in connection with 19 of the appraisals cited in Finding 1. Although the text and "Highlights" of the Report allege deficiencies in 38 appraisals performed on condominium units, the footnotes in Appendix C-1 of the Report indicate that the appraisals performed on 19 of the 38 loans cited in the Report "were not specifically included in [the OIG's] appraisal review." Rather than conduct an independent review of the appraisals in these 19 cases, the auditors assert that property values in all units in the two apartment complexes securing the loans at issue in the Report were overvalued, which caused these 19 units and the related HUD-insured mortgages originated by Suburban also to be overvalued. The Report buries this important fact in an appendix footnote and, in the text and "Highlights" of the Report, alleges that all 38 appraisals, whether or not actually examined by the auditors, contain material deficiencies that warrant indemnification by the Company. Inflating the number of appraisals with speculation that additional appraisals may involve the alleged deficiencies without examining the Uniform Residential Appraisal Reports ("URAR") in those cases distorts the Report's findings, and we question whether basing a harsh indemnification recommendation in these 19 loans on such conjecture constitutes prudent auditing procedures. For these reasons, we strongly believe that these 19 loans, as well as any recommendations regarding appraisals that were not specifically reviewed by the auditors in this case, should be removed from the Report. At the very least, in order to put the findings in the Report in the proper context, the reader should be informed up front that the OIG in fact reviewed only 23 appraisals, and that it is

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extrapolating its findings and recommendations to additional appraisals of similar condominium units. We address each of the matters raised in Finding 1 in turn below.

1. Suburban Generally Complied with HUD Guidelines Regarding Reviewing Appraisals

As part of Company policy and practice, Suburban diligently undertakes to obtain and verify all information, including the property appraisal, as if it were entirely dependent on the property as security to protect the Company's investment. HUD Handbook 4000.4, REV-1, CHG-2, ¶ 2-5. The Company understands and appreciates that its underwriters must assume the responsibility of reviewing appraisal reports to ensure reasonable conclusions, sound reports and compliance with HUD requirements, as well as the decisions relating to the acceptability of appraisals. HUD Handbook 4000.4, REV-1, CHG-2, 2-4(C); Mortgagee Letter 97-45; see also HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-3. It is our policy and procedure to require that each underwriter review the appraisal in accordance with HUD valuation policy to determine whether the appraiser's conclusions are acceptable and, in the event that an appraisal report's findings are inconsistent or otherwise unacceptable, we require our underwriters to obtain additional information or explanation from the appraiser or return the case to the appraiser for reconsideration. See HUD Handbook 4000.2, REV-2, ¶ 2-15.

In each of the cases cited in Finding 1, Suburban obtained an appraisal from an independent, third party appraiser. None of the appraisers were employees of the Company.³ In each of the loans at issue, Suburban's underwriters reviewed the URAR and were satisfied with the overall value conclusions of the appraiser based on the information provided. A lender does not physically visit the subject property when it contracts with an independent third party appraiser and, therefore, must be able to rely on the appraiser's observations noted in the appraisal report. The underwriters in the loans at issue reasonably relied on the appraisers' expertise and experience in appraising properties, and accepted the appraisers' conclusions based on this reliance

³ We note that several of the Report's allegations regarding the cited appraisals involve actions taken by the individual appraisers, and one of the recommendations in Finding 1, which advises HUD to institute administrative action against the individual appraisers, does not involve or affect the Company. As the two individual appraisers at issue in the Report are independent, third party contractors and not employees of the Company, Suburban is not in a position to respond to the assertions or recommendations specific to the individual appraisers in these cases. Thus, to the extent that the Report's assertions identify alleged deficiencies on the part of the individual appraisers, we believe that the Report should be revised to clarify that these assertions do not involve Suburban and that the OIG should direct its concerns regarding the third party appraisers to those individuals.

Comment 2

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and the explanations provided on the face of the URARs. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e). HUD recently visited the issue of lender responsibility for appraisal review, and determined that holding lenders strictly liable for the quality of appraisals performed by independent third-parties was not appropriate. See 69 Fed. Reg. 43,504 (July 20, 2004). In amending its regulations, the Department reiterated that, provided the underwriter reviews the appraisal report and determines that the appraiser's conclusions were reasonable and supported by the analysis contained in the URAR, the lender would be in compliance with HUD guidelines. Id. Thus, while Mortgagee Letter 05-06, which is cited in the Report, indicates that lenders and appraisers are equally responsible for the integrity of the appraisal, this Letter was published to convey the passage of HUD's amended regulations regarding appraisals, which clarifies that the standard for lender review of appraisals is one of "knowing (actual knowledge) or reason to know." See Mortgagee Letter 2005-06.

Comment 2

Here, Suburban reasonably relied on the appraiser's observations and representations, as indicated in the appraisal reports. Suburban recognizes that some of the appraisal reports in the cases cited in Finding 1 contain certain information that the appraisers should have explained in greater detail, primarily with respect to comparables selected or adjustments made. While the appraiser's explanations in a given case may not have been as thorough as possible, the appraisers did explain their reasons for selecting the comparables and making the adjustments to value indicated on each URAR. Moreover, any deficiencies that occurred in this regard were isolated and do not reflect the Company's overall standards for appraisal review. While a few oversights may have occurred in some of the appraisals at issue, the underwriter reasonably determined that the appraiser's conclusions were acceptable in these cases. These appraisal reports appeared to meet applicable HUD/FHA guidelines and appraisal standards, and Suburban reasonably relied on the appraiser's representations with respect to the properties' condition and value.

Thus, as demonstrated in the individual responses below, in each case, the value reached by the appraiser was supported. Each borrower cited in Finding 1 received good title to the property and the Department's lien position was not affected. Below we address each of the Report's specific issues with regard to the appraisals in these cases.

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2. Reappraisals Conducted by Independent HUD Appraisers Confirm that the Subject Properties Were Properly Valued

In Finding 1 and throughout the summary, text and attached appendices, the Report asserts that the properties at issue were overvalued by thirty to forty percent. In fact, the Report goes so far as to assert that, based on issues identified in the first appraisal of the condominium properties, the appraiser intentionally established a higher value to support the sales price of later sales. Suburban strongly disagrees with these repetitive allegations and maintains that the properties at issue in the Report were properly valued based on the reasonable and supportable appraisals conducted prior to closing.

While this response addresses the Report's individual concerns with the appraisals in detail below, we would like to take this opportunity to demonstrate that re-appraisals of a sample of the 38 properties at issue support the values determined by the original appraisals and confirm that Suburban complied with HUD requirements in reviewing and accepting the appraisals used to obtain FHA insurance in these cases. In response to the Report's allegations, Suburban obtained appraisals on several of the properties at issue in the Report. These appraisals were conducted by independent, third party appraisers who are not employed by the Company and are not affiliated with the two appraisers cited in the Report who conducted the initial appraisals on the 38 properties at issue. These appraisals demonstrate that the appraisal reports submitted to Suburban and to HUD in these cases were complete, accurate, and reflected valuations that were supported by the subject properties and a reasonable selection and review of available comparables.

For example, Appendix D of the Report alleges that the property securing the [REDACTED] loan, **FHA Case No. 023-2033645**, should have appraised at \$59,000 rather than the \$95,000 reflected on the appraisal report and used by the Company to establish the maximum insurable FHA mortgage in this case. In response to this assertion, Suburban obtained a review of the appraisal of the property in the [REDACTED] case on March 26, 2007. The review appraiser indicated in this report that, as of the effective date of the original appraisal, the opinion of market value in the URAR under review was accurate (**Exhibit A-1**). The review appraiser also stated that he did not disagree with the value of the initial appraisal report (**Exhibit A-1**). In fact, in response to Question 6 regarding comparables, the review appraiser suggested that two additional comparables, which sold for significantly more than the comparables used in the original appraisal, would have been more appropriate (**Exhibits A-1, A-2**). This statement suggests that available comparables may have indicated an even higher value than the \$95,000 reflected on the original URAR and used to support the FHA

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Names have been redacted for privacy reasons.

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mortgage amount in this case. This review appraisal supports the accuracy of both the original URAR and the value utilized by Suburban to underwrite the FHA mortgage in this case.

In another instance, Appendix D of the Report asserts that the property securing the [REDACTED] loan, **FHA Case No. 023-2159234**, should have also appraised at \$59,000, rather than the \$100,000 value reflected on the original URAR. A review appraisal conducted by an independent, third party appraiser, however, determined that the original appraisal was properly conducted, that the comparables selected "provide a good indication of value for the subject property," and that the opinion of market value was accurate as of the effective date of the original URAR (**Exhibit B-1**). Based on this review appraisal, Suburban properly relied on the \$100,000 value set forth in the original URAR (**Exhibit B-2**) to underwrite the loan in this case. Moreover, in reviewing the original URAR in the [REDACTED] loan, **FHA Case No. 023-2171644**, this independent review appraiser came to similar conclusions regarding the original appraisal and determined that the \$73,000 value used by Suburban to underwrite the loan (**Exhibit C-1**) was supported by the comparables and the original appraiser's analysis (**Exhibit C-2**).

The above discussion demonstrates that, in several of the cases cited in the Report, review appraisals confirm that the property values set forth in the original URARs and submitted to HUD were reasonable and supported. For these reasons, Suburban takes strong exception to both the individual allegations regarding the value at which these properties "should have" appraised, as well as the repetitive assertions that the properties cited in the Report are overvalued. Suburban maintains that the appraisals used in these cases were completed in compliance with HUD requirements, and that its underwriters properly reviewed the appraisal reports and reasonably relied on the values reflected. As a result, the allegations regarding overvaluation should be removed from the final Report.

3. Suburban Complied with HUD Requirements in Reviewing the Condominium Requirements in the Appraisal Reports at Issue

In sub-finding 1, the Report alleges that certain of the appraisals reviewed did not accurately reflect the subject properties' satisfaction of certain condominium-specific HUD requirements. Specifically, sub-finding 1 asserts that: (1) one appraiser incorrectly used the URAR, FNMA Form 1004, rather than the Individual Condominium Unit Appraisal Report, Fannie Mae Form 1073 ("Condo Form") required for appraisal of condominium units; (2) only 7 of the 23 units reviewed by the auditors met HUD's fifty-one percent owner occupancy requirement at the time of submission for insurance endorsement; and (3) 12 of the condominium units at issue, which were located in the

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Camelback project, were sold and submitted for FHA insurance prior to the expiration of the one-year waiting period required by HUD for condominium developments.

Comment 4

a. Appraisal Form

Concerning the assertions regarding the use of an incorrect appraisal form, Suburban respectfully disagrees with the allegations in this sub-finding. Prior to January 1, 2006, HUD required that appraisals of properties secured by FHA-insured loans be reflected on the URAR, FNMA Form 1004. See HUD Handbook 4000.2 REV-3, ¶2-4(A); see also Mortgagee Letter 96-26. While HUD guidelines indicated that the Condo Form, Fannie Mae Form 1073, was also acceptable, the Department did not require use of this form under guidelines in place during the times the appraisals at issue were completed. It was not until HUD issued Mortgagee Letter 2005-34 that the Department required HUD-approved appraisers to use the Condo Form to report appraisals of condominium units secured by FHA loans. See Mortgagee Letter 2005-34; see also HUD Notice H 2005-17. In that Mortgagee Letter, HUD instructed FHA Roster Appraisers to continue using existing appraisal forms until the January 1, 2006 implementation date. As all of the properties at issue in the Report were appraised prior to January 1, 2006, under HUD guidelines in place at the time of these appraisals, the appraisers were permitted to use either the URAR or the Condo Form. All 38 of the cited appraisals were reported on one of these two forms. The appraisers complied with HUD requirements in conducting these appraisals, and Suburban conformed to HUD guidelines in reviewing the appraisal reports submitted to the Company. Therefore, we believe that this allegation should be removed from the final Report.

Comment 5

b. Owner Occupancy Requirement

With regard to the allegation concerning the fifty-one percent owner occupancy requirement, the Company understands and appreciates that at least 51% of the units of a project must be occupied by the owners or sold to owners who intend to occupy the units to meet HUD's project approval for condominium mortgages. See HUD Handbook 4150.1 REV-1, ¶ 11-3(B). To ensure that this requirement was satisfied in the cases cited in the Report, Suburban obtained certifications signed by the President of the management company prior to closing indicating that the condominium units were at least 51% owner-occupied. We have attached two such certifications, in the [REDACTED] loan, FHA Case No. 023-2099918, and the [REDACTED] loan, FHA Case No. 023-2209240 as Exhibit D-1. Moreover, as indicated by the URARs in these two example cases, the appraisal reports in these loans did not indicate that the 51% owner occupancy requirement had not been met (Exhibits D-2, D-3). While the Company appreciates that, had the appraiser used the Condo Form, this information may have been available on the face of the appraisal report, as discussed above, this form was

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not required by HUD at the time the appraisals at issue were conducted. Thus, Suburban obtained all required documentation regarding the 51% owner occupancy requirement in these cases and was satisfied based on the certifications made by the seller and the information contained in the URARs that this requirement was satisfied. The Company properly relied on these documents with regard to this issue and complied with HUD guidelines in this regard. Thus, we respectfully request that this assertion be removed from the final Report.

c. One Year Cooling-Off Period

Finally, regarding the assertion that 12 of the units in the Camelback condominium project did not meet the one-year cooling off period, Suburban respectfully disagrees. The Company understands and appreciates that HUD guidelines dictate that condominium units in any project converted from rental housing to condominium ownership, such as those in the Camelback project, are not eligible for insurance and HUD will not process the project unless the conversion occurred more than one year before the application for mortgagor approval. See HUD Handbook 4150.1 REV-1, ¶ 11-3(D)(1); see also HUD Handbook 4150.1 REV-1, ¶ 11-9. To determine whether HUD has processed the project, and, therefore, whether it is eligible for FHA financing, it is Suburban's policy and practice to consult either HUD's website or the Department's FHA Connection system regarding condominium approvals. With regard to the Camelback project, the HUD website regarding condominium project approvals indicates that this particular project was "Approved" on August 11, 2003 (Exhibit E-1). The "Condominium Detail – Field Descriptions" page defines the status term "Approved" to mean that the "[c]ondominium is eligible for FHA insurance endorsement" (Exhibit E-2). Based on this definition, and HUD's guideline indicating that HUD will not process a condominium project unless the conversion occurred more than one year prior to approval, Suburban consistently has relied on the information on HUD's website and FHA Connection system regarding condominium project approval dates to determine whether the one-year cooling off requirement has been met.

Thus, in the 12 cases at issue in the Report, Suburban properly relied on information it obtained from the Department's FHA Connection system regarding the HUD approval status of the Camelback project. As indicated above, HUD's system indicates that the Camelback project was approved on August 11, 2003 (Exhibit E-1), which the Company understood to convey that the property had met the one-year cooling off period and that individual units were eligible for insurance as of that date (Exhibit E-2). All loans originated by Suburban that were secured by Camelback project units were closed subsequent to this date. Moreover, in each of these cases, the Company verified HUD's approval of the Camelback project prior to loan closing and

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included evidence of this information in the loan file. Examples of such documentation in three of the loans are attached as **Exhibit E-3**. These loans are: (1) ██████ – **FHA Case No. 023-1984859**; (2) ██████ – **FHA Case No. 023-1966391**; and ██████ – **FHA Case No. 023-1952906**. These approvals make clear that the condominium documents relied upon by HUD to approve this project were first recorded in August of 1979 (**Exhibit E-3**). This discussion and the attached documentation evidence that Suburban complied with HUD requirements regarding the one-year cooling off period by reasonably relying on HUD's systems regarding condominium project approvals to determine that, as of the date of closing in all 12 of the loans at issue, the Department had approved the condominium project for FHA financing. Therefore, allegations regarding the one-year cooling off period should be removed from the Report.

4. Suburban Property Analyzed the Appraisers' Comparable Property Selections

As discussed above, sub-finding 2 of the Report asserts that, in every case cited in Finding 1, the appraisers used comparable properties that were: (1) not similar to the subject property in type, design and/or construction; (2) inappropriately adjusted; or (3) not the most suitable comparable units available. Suburban respectfully disagrees with these assertions in many of the cases, and believes that it fully complied with HUD guidelines in reviewing the appraisals cited in the Report. As discussed above and in response to these specific allegations below, review appraisals the Company obtained in preparation of this response confirm that the comparables used and valuations made were appropriate. We address each of the specific allegations regarding the comparables in sub-finding 2 below.

a. Similarity of Comparables to Subject Property

First, sub-finding 2 asserts that, in the 23 cases reviewed, the subject property is not sufficiently similar to the comparable properties to allow for a reasonable evaluation of the sales prices. The Report also uses this information to support the allegation that the appraiser overvalued the subject property.

When reviewing the appraisal, the Company appreciates that HUD guidelines indicate that its underwriters must ensure that the comparables are "reasonably equal to the subject in size, age and design." See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). FHA requirements regarding such analysis, however, acknowledge that "it is not always possible to find three comparables very close in similarity to the subject" and instructs lenders to ensure that the appraiser makes necessary adjustments under such circumstances. *Id.* Moreover, HUD guidelines regarding appraisals of condominium units dictate that such appraisals

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"should include comparables from competing projects and value should not be based solely on sales by the developer." Id. ¶ 11-7(F).

Notwithstanding the HUD requirements cited in connection with sub-finding 2, the Report alleges that comparable properties are not similar enough as a result of differences in type, design, or construction. For instance, in the ██████ loan, **FHA Case No. 023-2159234**, the Report asserts that one of the comparables was not similar to the subject property because it was superior in gross living area, age, exterior construction, location and amenities. Here, although the comparable had additional amenities and approximately 150 square feet more than the subject, the appraiser clearly stated that the "comparable sales selected are the most recent and similar to the subject property and are representative of the current market trends for the general neighborhood market area" (**Exhibit B-2**). The appraiser also indicated that this comparable was "considered a good indicator of value based on similar design, condition and appeal" (**Exhibit B-2**). Based on these statements, the underwriter adhered to HUD requirements by determining that the differences reflected on the appraisal were within HUD guidelines and by examining the URAR and ensuring that the appraiser made the necessary value adjustments to compensate for the differences (**Exhibit B-2**). In this case and several others cited in this section of sub-finding 2, Suburban's underwriter reviewed the appraisal reports and was satisfied with the overall value conclusions of the appraisers based on the information provided. The review appraisals obtained by Suburban in preparation of this response confirms that the underwriter's reliance on the original appraiser's comparable selection was appropriate. The review appraisal indicates that the comparable sales at issue in the ██████ loan have "comparable floor plans from competing developments that provide a good indication of value for the subject property" (**Exhibit B-1**). The reviewer also points out that HUD requires appraisers of condominium units to select comparables from competing projects (**Exhibit B-1**), which the original appraiser did in selecting this particular comparable property (**Exhibit B-2**).

Lenders like Suburban must be able to rely on the appraiser's decisions regarding comparable sales and observations noted in the appraisal report. In the cases cited in the Report, Suburban reasonably relied on the appraiser's observations and representation that the comparables were the most similar recently sold properties available, even though some of the comparables were slightly bigger or smaller in size or had more or less amenities than the subject properties. As a result, we respectfully request that the allegations and recommendations regarding the similarities of comparable sales be removed from the final Report.

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b. Adjustments to Comparable Values

Second, the Report alleges that, in the 23 cases reviewed, the appraiser made inappropriate adjustments to the comparable properties reflected on the URARs.

With regard to adjustments, Suburban understands and appreciates that its underwriters must analyze the reasonableness of the adjustments made to comparable properties and ensure consistency in such adjustments. See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). In the majority of the cases cited in sub-finding 2, the Company maintains that it complied with these requirements in reviewing the URARs contained in the loan files. For example, in the [REDACTED] loan, **FHA Case No. 023-2159234**, the Report asserts that the appraiser improperly characterized the subject building's design, which uses the upper level walkways that extend over the lower floor's entry points, as a covered porch and the lack of a covered porch on the subject should have been considered when adjusting the comparable properties that in fact had covered porches. Contrary to this assertion, the URAR's pictures clearly indicated that the subject property had a porch that was covered (**Exhibit B-2**). While the covering may have been provided by the upper level's walkway or the roof overhang, the property clearly had a porch area that was indeed covered and protected from the elements. As the subject property had a covering on the porch similar to those in comparables 1 and 2, the appraiser reasonably determined that an adjustment to these comparables for this feature was unnecessary. For the third comparable, where no covering over the porch area was indicated, the appraiser properly made a \$1,000 adjustment (**Exhibit B-2**). The review appraiser agreed with these adjustments in the review appraisal obtained by Suburban in preparation of this response, and noted that the adjustment for this feature was minimal (**Exhibit B-1**).

In compliance with HUD guidelines, in this case and several others cited in this section of sub-finding 2, the underwriter reviewed the URAR in this case, determined that the adjustments made were reasonable based on the differences in property condition, and properly determined that the URAR supported the valuation analysis provided by the appraiser in this case. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e). As Suburban complied with its obligations under FHA requirements, indemnification would not be appropriate. Therefore, we respectfully request that the allegations and recommendations regarding adjustments be removed from the final Report.

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c. Selection of Comparables

Finally, sub-finding 2 of the Report alleges that, in several cases, the appraiser selected comparables that were outside of the subject property's neighborhood and often went outside the recommended one-mile radius to locate comparable units.

When reviewing the appraisal, Suburban appreciates that its underwriters must examine the distance between the subject property and comparables, and that the comparables should be located in the same or similar neighborhoods and environments as the subject property. See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). In the majority of cases cited in the Report, Suburban's underwriters properly reviewed the appraisals and determined that this requirement was satisfied.

For instance, in the [REDACTED] loan, **FHA Case No. 023-2033645**, although the comparables were a few miles from the subject property, the appraiser expressly stated on the URAR that, "due to a lack of more recent and similar comparative sales in the immediate subject area, it was necessary to expand the search beyond the recommended 1 mile parameter to a competing project that included Comps 3 and 4" (**Exhibit A-2**). Similarly, in the [REDACTED] loan, **FHA Case No. 023-2099918**, while the comparables were approximately 3.5 miles away from the subject property, the appraiser expressly stated on the URAR that "the closest comparable condos similar to subject are located 3.73 miles away. No other apartment style or condo comparables similar to subject were available within the recommended parameters at time of inspection" (**Exhibit D-2**). In these two cases and several others cited in this section of sub-finding 2, the underwriter reasonably relied on the appraisers' expertise and experience in appraising properties, and accepted the appraisers' conclusions, notwithstanding the distance of the comparables. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e).

Notwithstanding this express direction by HUD, the Report suggests that, even though the appraisers expressly indicated that the comparables chosen were the best available properties, the Company should have conducted a review of the Arizona Multiple Listing Service (as the auditors did) and determined that more suitable comparable sales were available. Suburban is not aware of any HUD requirement that an underwriter, in addition to examining the URAR, conduct an independent search of real estate records to confirm the selection of an appraiser's comparable sales. Rather, as discussed above, HUD holds lenders to a standard of "known or should have known." See Mortgagee Letter 2005-06. In both of these cases, as well as in several

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additional cases cited in the Report, there was nothing in the appraisal reports to suggest that the comparables selected were not the most appropriate comparables available to the appraiser at the time the URAR was prepared. Suburban's underwriters reviewed these documents and properly determined based on the appraisers' express statements that the comparables selected were the most suitable under the circumstances.

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Moreover, the review appraisals obtained by Suburban confirm the reasonableness of the underwriters' reliance on the original appraisers' statements in these cases. For instance, in the [REDACTED] loan, the review appraiser indicated that the comparable sales "provide a good indication of value for the subject property" (**Exhibit A-1**). As discussed above, where the review appraiser determined that more appropriate comparables were available, he indicated that the more suitable comparables had sales prices that were much higher than the comparables used by the original appraiser and questioned by the auditors (**Exhibit A-1**). This analysis demonstrates that the original appraiser's selection and resulting valuation was more conservative than necessary based on the available comparable sales. Similarly, in the [REDACTED] loan, the review appraiser drew similar conclusions regarding the reasonableness of the valuation set forth in the original appraisal, as well as the conservative use of comparables when higher-priced sales were available (**Exhibit F**).

In summary, as Suburban complied with its obligations under FHA requirements in reviewing the original appraisers' selection of comparables in the cases cited in the Report, indemnification in these loans would not be appropriate. Therefore, we respectfully request that the allegations and recommendations regarding neighborhood analysis be removed from the final Report.

5. Unit Remodeling

In sub-finding 3, in all but one of the 23 appraisals reviewed by the auditors, the Report asserts that: (1) both the appraisers' reports and the Company's reviews of the appraisals ignored or did not detect inadequate remodeling of the condominium units at issue; and (2) the seller did not obtain completion certificates and related occupancy authorizations from the City of Phoenix for the conversion work done.

Comment 9

With regard to the remodeling work, the individual loan allegations set forth in Appendix D assert that the appraisers arbitrarily assigned value adjustments to the subject property for remodeling work without providing any supporting documents or discussion to justify the value. Suburban respectfully disagrees with this assertion. For example, in the [REDACTED] loan, **FHA Case No. 023-2033645**, the Report makes this assertion with regard to a \$3,000 value adjustment made to the subject for remodeling

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work. The appraisal in this case, however, clearly states that the "complete remodel" of the subject "include[d] new ceiling fans, appliances, interior paint, carpet, vinyl floors throughout, light and bathroom fixtures, wood blinds, kitchen cabinets and counters" (Exhibit A-2). Based on this description, the appraiser reasonably determined that a \$3,000 value adjustment to the subject was necessary to account for the remodeling work. As the value adjustment was supported by the appraiser's comments regarding the remodeling work, the underwriter reasonably determined that the adjustment was appropriate in this case. Moreover, the review appraiser in this instance agreed with the necessity of the \$3,000 adjustment. The review appraisal indicates in response to Question #5 that the description of the remodeling work was detailed and, with regard to the adjustment, expressly stated that "due to the extensive updating and new upgrades throughout the subject property ... the condition adjustment appears to be reasonable and well justified" (Exhibit A-1). The review appraisal report confirms that the underwriter reasonably reviewed the URAR in this case and had no reason to question the adjustment for the remodeling work or require additional discussion of the remodeling. As indicated above, lenders need to rely on the appraiser's expertise and judgment regarding the extent of remodeling and the valuation of such renovations. Suburban properly did so in this case and others cited in the Report.

Comment 9

With regard to the allegation concerning the property certifications, the individual loan allegations set forth in Appendix D assert that had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that the project met the city's building code standards. The Report also alleges that city records demonstrate that certain building permits remain open, final inspections were not completed, and certificates of completion were never issued for the condominium units. As a result, the Report asserts the units should not have been sold and occupied until the work was completed and certified to by city inspectors. Suburban disagrees with these assertions. First, FHA guidelines and appraisal standards do not require appraisers to "research the extent and cost" of remodeling work in condominium projects. Instead, HUD requires that "the appraiser must make a complete visual inspection of the subject property." HUD Handbook 4150.2, CHG-1, ¶3-1. The Department also has stated that "the appraiser, in performing the appraisal of the property, does not act as a home inspector. . . . Rather an appraiser is required to make reasonable observations about the property and site." See Mortgagee Letter 99-32. Thus, in accordance with HUD's requirements, the appraisers in the cases at issue performed the necessary on-site visual inspections and were not required to research the extent of the condominiums' remodeling.

Second, contrary to the Report's assertions, further inspection of the remodeling would not have led the appraisers to discover construction permits in these cases.

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Notably, in the [REDACTED] case, the review appraiser confirmed that the original appraiser would have never reviewed or retrieved building permits from the City of Phoenix because the remodeling did not require significant restructuring of the units (**Exhibit A-1**). Instead, as discussed in the review appraisal, neither certificates of completion nor construction permits for remodeling were ever issued for any unit in the Camelback property, and the city will not be required to make additional inspections of the condominium units (**Exhibit A-1**). Moreover, appraisers are retained for their knowledge and expertise in valuing real estate. As FHA guidelines permit lenders to rely on an appraiser's conclusions absent deficiencies on the face of the appraisal, nothing on the face of the appraisals in the subject cases suggested the underwriters should have further investigated the property certifications or building permits in these cases. It is Suburban's responsibility to review the appraisals in accordance with HUD valuation policy to determine whether the appraiser's conclusions are acceptable, and the Company fulfilled its obligation in each of these cases.

Finally, even if the appraiser had researched the property certifications, in ten of these cases, the appraisals were performed and the loans were closed before construction permits were issued on October 12, 2004 for the Camelback properties (**Exhibit G**). These cases include: (1) [REDACTED] - FHA Case No. 023-1892486; (2) [REDACTED] - FHA Case No. 023-1952906; (3) [REDACTED] - FHA Case No. 023-1966391; (4) [REDACTED] - FHA Case No. 023-1971458; (5) [REDACTED] - FHA Case No. 023-1966202; (6) [REDACTED] - FHA Case No. 023-1978990; (7) [REDACTED] - FHA Case No. 023-1984859; (8) [REDACTED] - FHA Case No. 023-1989669; (9) [REDACTED] - FHA Case No. 023-2033645; and (10) [REDACTED] - FHA Case No. 023-209918. Thus, although HUD required the appraisers to perform no more than an on-site inspection of the units, had the appraisers "researched the extent and cost" of the remodeling, as alleged in the Report, no building permits (much less open building permits) existed for the appraisers to discover. In fact, all that the appraisers would have uncovered are the occupancy certificates that were originally issued for the Camelback property in the 1970s (**Exhibit H**).

Ultimately, Suburban complied with its obligations under FHA requirements in reviewing the original appraisers' review of unit remodeling in the cases cited in the Report, and indemnification in these loans would not be appropriate. Therefore, we respectfully request that the allegations and recommendations regarding remodeling and property certifications be removed from the final Report.

6. Adequate review

Finally, sub-finding 4 asserts that the Company's underwriters and Quality Control process did not adequately review the appraisal reports. Specifically, the Report alleges that upon Suburban's review of the appraisal reports, it should have

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questioned the validity of the appraisers' factual information and the plausibility and consistency of their conclusions. The Report claims these indicators included: (1) use of the incorrect appraisal form; (2) failure to adhere to the 51% owner occupancy and one-year conversion requirements; (3) errors in property descriptions or non-neighborhood comparables; (4) appraised values in excess of predominant neighborhood values; (5) design and construction differences in comparable properties; (6) the use of unsupported adjustments; and (7) unit remodeling in accordance with building permits and certifications.

As discussed above, the Company understands and appreciates that its underwriters must assume the responsibility of reviewing appraisal reports to ensure reasonable conclusions, sound reports and compliance with HUD requirements, as well as the decisions relating to the acceptability of appraisals. HUD Handbook 4000.4, REV-1, CHG-2, 2-4(C); Mortgagee Letter 97-45; see also HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-3. It is our policy and procedure to require that each underwriter review the appraisal in accordance with HUD valuation policy to determine whether the appraiser's conclusions are acceptable and, in the event that an appraisal report's findings are inconsistent or otherwise unacceptable, we require our underwriters to obtain additional information or explanation from the appraiser or return the case to the appraiser for reconsideration. See HUD Handbook 4000.2, REV-2, ¶ 2-15.

Here, Suburban ordered an appraisal in each of the cases at issue, and the Company's underwriters reviewed the URAR and were satisfied with the overall value conclusions of the appraiser based on the information provided. The underwriters in the loans at issue reasonably relied on the appraisers' expertise and experience in appraising properties, and accepted the appraisers' conclusions based on this reliance and the appraisers' explanations provided on the face of the URARs. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e).

Moreover, with regard to the alleged use of an incorrect appraisal form, all of the properties at issue in the Report were appraised prior to January 1, 2006. Under HUD guidelines in place at the time of these appraisals, the appraisers were permitted to use either the URAR or the Condo Form. As all 38 of the cited appraisals were reported on one of these two forms, Suburban properly met its obligation with regard to the review of the final appraisal. The Company also understands and appreciates that at least 51% of the units of a project must be occupied by the owners or sold to owners who intend to occupy the units to meet HUD's project approval for condominium mortgages. See HUD Handbook 4150.1 REV-1, ¶ 11-3(B). To ensure that this requirement was satisfied

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in the cases cited in the Report, Suburban obtained certifications signed by the President of the management company prior to closing indicating that the condominium units were at least 51% owner-occupied. Suburban, therefore, was comfortable based on these certifications and the information contained in the URARs that this requirement was satisfied. In addition, Suburban verified that the Camelback project was approved on August 11, 2003 (**Exhibit E-1**), which the Company understood to convey that the property had met the one-year cooling off period and that individual units were eligible for insurance as of that date (**Exhibit E-2**). All loans originated by Suburban that were secured by Camelback project units were closed subsequent to this date.

With regard to comparable sales, lenders like Suburban must be able to rely on the appraiser's decisions regarding comparable sales and observations noted in the appraisal report. In the cases cited in the Report, Suburban reasonably relied on the appraiser's observations and representation that the comparables were the most similar recently sold properties available, even though some of the comparables were slightly bigger or smaller in size or had more or less amenities than the subject properties. The Company's underwriters also reviewed construction differences in comparable properties and properly determined, based on the appraisers' express statements, that the comparables selected were the most suitable under the circumstances.

Finally, with regard to unit remodeling, Suburban's underwriters reasonably reviewed the URARs at issue and had no reason to question the adjustment for the remodeling work or require additional discussion of the remodeling. As HUD's requirements require an appraiser to conduct no further research or investigation of property certifications beyond the on-site review, nothing on the face of the appraisals in these cases suggested the underwriters should have requested additional information.

These assertions in sub-finding 4 are exact repetitions of the allegations made elsewhere in the Report. In each circumstance, the Report makes detailed claims, and the Company has responded to each item accordingly. Thus, the inclusion of these allegations in yet another sub-finding in the Report is excessive and prejudicial. As discussed throughout this response, it is Suburban's responsibility to review the appraisals in accordance with HUD valuation policy to determine whether the appraiser's conclusions are acceptable, and the Company fulfilled its obligation in each of these cases. Indemnification, therefore, is not appropriate, and we respectfully request that these repeat allegations be removed from the final Report.

With regard to the Report's Quality Control allegations, sub-finding 4 suggests that Suburban's Quality Control review of a sample of loans and early payment defaults did not include a desk review of the appraisal and, when applicable, field reviews of appraisal reports. While we acknowledge that the Company did not consistently re-

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verify appraisals in its past Quality Control reviews, it is now Suburban's policy to perform a desk review of appraisals and obtain new appraisals, when required, in connection with each Quality Control review performed. Suburban is committed to the stringent Quality Control of the FHA-insured loans it originates, and we have reminded Company employees of the importance of re-verifying and documenting appraisal information for all Quality Control reviews. It is always Suburban's intention to implement its Quality Control plan to comply with HUD requirements, and we believe any oversight with regard to the desk appraisals and re-verifications in the loans cited in the Report did not contribute to any of the Report's concerns regarding the subject appraisals. As discussed at length herein, the Company complied with HUD requirements regarding its review of appraisals in FHA transactions, and we are confident that any problems that the Company may have experienced in the past with regard to the Quality Control issues raised in the Report have been resolved. We, therefore, respectfully request that these allegations be removed from the Report.

B. FINDING 2 – SUBURBAN COMPLIED WITH HUD's UNDERWRITING REQUIREMENTS

Finding 2 of the Report asserts, in seven sub-findings, that the Company did not originate 9 of the 48 loans reviewed in compliance with HUD requirements. Specifically, the Report asserts that these loans involved deficiencies in: (1) credit analysis; (2) income documentation; (3) debt assessment; (4) interest rate buy-down assessments; (5) seller contributions; (6) interested third-party document handling; and (7) reverification of loan documentation during the Quality Control process. We address each of these individual allegations in turn below.

1. Credit Analysis

In eight cases, the Report takes issue with the Company's evaluation of the borrowers' creditworthiness. Specifically, the Report asserts that the Company did not properly pursue nontraditional/alternate credit, obtain a credible explanation for delinquent accounts, or use all of a non-purchasing spouse's liabilities to calculate debt-to-income ratios.

Suburban respects the importance of analyzing a borrower's credit performance and examining his or her attitude towards credit obligations. It is Suburban's policy and practice, with respect to every FHA applicant, to scrutinize the applicant's credit record and reasonably determine the potential borrower's creditworthiness. Given the potential risks not only to the Department, but to the Company, of making a poor credit decision, the Company's management endeavors to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis. Suburban's

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employees take their underwriting responsibilities seriously and understand that they will face severe consequences for unsatisfactory analysis of borrower credit. Suburban never would knowingly jeopardize the Company's stability or its relationship with the Department.

That being said, we note that HUD delegated to FHA lenders the responsibility for analyzing a borrower's credit and determining an individual's creditworthiness. See HUD Handbook 4155.1 REV-5, ¶ 2-3. While HUD has established specific guidelines, credit analysis remains largely subjective. For example, where derogatory credit items are present, lenders have discretion to consider the borrower's unique circumstances and determine whether financing is appropriate. As the Department has recognized that underwriting is more of an art than a science and requires the careful weighing of the circumstances in each individual case, it is Suburban's policy to carefully scrutinize a borrower's credit history to obtain any documentation or explanation necessary to assess a borrower's credit risk. See Mortgage Letters 00-24 and 95-07; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. While two underwriters may make different decisions about a borrower's credit in the same case, both underwriters may have complied with FHA requirements and made reasonable underwriting decisions. Suburban takes its underwriting responsibility seriously and would never knowingly approve a loan to an unqualified borrower.

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In the cases cited in the Report, Suburban complied with FHA guidelines by examining the borrowers' overall pattern of credit behavior and reasonably determining that the borrowers qualified for FHA financing. The Company properly considered each borrower's previous housing obligations, recent and/or undisclosed debts, collections, judgments, and bankruptcies, and Suburban underwriters reasonably determined that past derogatory items did not reflect a current disregard for financial obligations. The loan files contain required documentation and Suburban prudently exercised the discretion granted to it by the FHA. As discussed below, the borrowers in these cases generally were hard-working individuals who took responsibility for their financial obligations. As a result, Suburban adhered to FHA requirements by reasonably determining that the borrowers were creditworthy and qualified for FHA loans. We address a representative sample of the cited loans below.

a. [REDACTED] – FHA Case No. 022-1826177

In the [REDACTED] case, the Report alleges that the borrower's credit report did not reflect sufficient information to rate and evaluate the borrower's credit history, and Suburban did not pursue alternative credit such as utility payments, rental payments, insurance, or other means to establish the borrower's credit. In addition, the Report asserts the borrower's limited credit history indicated a tendency to disregard liabilities,

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and the primary credit history was composed of several collection accounts that appeared to have been paid off just before the borrower applied for the mortgage.

Suburban understands and appreciates HUD's requirement that for borrowers without an established credit history, a lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. See HUD Handbook 4155.1, REV-5, ¶ 2-3. However, HUD provides that "neither the lack of credit history nor the borrower's decision not to use credit may be used as a basis for rejecting the loan application." *Id.* In accordance with these guidelines, Suburban properly analyzed the borrower's credit and made a prudent decision to approve the borrower for FHA financing. First, despite the lack of traditional credit accounts reflected on the borrower's credit report (**Exhibit I-1**), in an effort to obtain alternative sources of credit, the underwriter in this case obtained a Verification of Rent directly from the borrower's landlord, which documented nearly a year in timely rental payments (**Exhibit I-2**). As HUD considers an individual with no late housing payments to be considered as having an acceptable credit history, the underwriter reasonably deemed the borrower's rental history a positive indication of the borrower's attitude to his financial obligations. See HUD Handbook 4155.1, REV-5, ¶ 2-3.

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Moreover, in accordance with FHA guidelines, the underwriter obtained a written statement from the borrowers, which explained that the [REDACTED] maintained no other credit accounts, opting instead to pay all recurring obligations in cash (**Exhibit I-3**). As the borrower maintained over \$1,100 in cash reserves at the time of closing (**Exhibit I-4**) and maintained a fixed-payment-to-income ratio well under HUD's 41% threshold (**Exhibit I-4**), the underwriter had no reason to question the borrower's means to satisfy his household credit obligations. The borrowers also explained the few collection accounts appearing on the credit report (**Exhibit I-1**), which were incurred nearly two years prior to closing. Although FHA guidelines do not require a borrower to satisfy his or her collection accounts in order to be eligible for FHA financing, the borrower, in this case, satisfied each of the collection accounts prior to closing (**Exhibits I-1 and I-5**). The underwriter considered these efforts to be a positive indication of the borrower's attitude to re-establishing his credit and honoring his financial obligations.

Ultimately, as the borrower satisfied all outstanding obligations and made a conscious decision to incur no additional recurring credit obligations, the underwriter prudently deemed the borrower to be responsible. HUD recognizes that the lack of traditional credit is no reason to reject a loan application, and we believe the borrower was eligible for FHA financing. Indemnification, therefore, is not warranted in this case, and we respectfully request that the findings be removed from the final audit report.

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b. [REDACTED] – FHA Case No. 023-2215217

In this case, the Report alleges that Suburban did not adequately analyze the borrower's credit history. Specifically, it asserts that the majority of the borrower's credit history was composed of collection and charge-off accounts, several of which were paid off at closing. In addition, one of the two non-collection accounts shown on the credit report reflected no activity on the account, and the other account was for the apartment complex where the borrower was renting. Although the credit report reflected a good rental history, the Report claims the report also showed a court judgment obtained by the same complex against the borrower. The Report claims that Suburban did not resolve this apparent conflict or otherwise document that the borrower had any acceptable credit history.

As HUD grants underwriters the discretion to evaluate a borrower's creditworthiness, given the borrower's credit explanations and excellent rental history, Suburban believes the underwriter reasonably determined the borrower posed a low credit risk in this case. The Company understands that FHA guidelines consider collections and judgments to indicate a borrower's regard for credit obligations and require lenders to consider these items in their analysis of creditworthiness. See HUD Handbook 4155.1, REV-5, ¶2-3(C). HUD also requires the borrower to explain in writing all collections and judgments. *Id.* Thus, in compliance with FHA guidelines, the underwriter obtained a detailed written statement to explain the borrower's financial circumstances (**Exhibit J-1**). Notably, the borrower explained that he suffered a physical injury while on the job for [REDACTED] which placed a significant strain on the borrower's financial resources. Despite the fact that these accounts resulted from factors beyond the borrower's control, the borrower explained that he was taking the necessary steps to satisfy any outstanding accounts, and, in fact, satisfied some of these accounts at closing (**Exhibit J-2**). Given the borrower's explanation and the significant amount of time that had passed since the accounts were incurred, the underwriter was justified in assigning less weight to these accounts.

Moreover, contrary to the allegations in the Report, the borrower's credit report reflected two positive credit references with activity on both accounts (**Exhibit J-3**). Although the borrower had satisfied his [REDACTED] account by the date of the credit report, the borrower made 15 months of timely payments. The credit report also reflected 11 months of timely rental payments to [REDACTED] (**Exhibit J-3**). While the Company acknowledges that the borrower paid a previous judgment to the same [REDACTED] in 2002, the underwriter obtained a copy of the borrower's current rental agreement to document the borrower's separate and current housing obligation (**Exhibit J-4**). As reflected in both this agreement and the credit report, the

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borrower paid \$539 in monthly housing expenses, which had been timely since March 2004 (**Exhibits J-3 and J-4**).

The underwriter also documented nearly \$2,000 in cash reserves (**Exhibit J-5**), and the borrower had been employed at his current job for over four years (**Exhibit J-6**), which demonstrated the borrower's consistent means to satisfy a monthly mortgage obligation. Thus, as HUD has recognized that timely housing payments indicate a good credit history, when coupled with the borrower's credit explanations, the unforeseen cause of the borrower's financial difficulties, and the efforts made to satisfy his accounts, the Company believes the underwriter prudently deemed the borrower to be creditworthy in this case.

2. Income Documentation

In three cases, the Report alleges that Suburban did not substantiate the borrowers' effective income and/or stability of employment. Specifically, the Report emphasizes that HUD requires a lender to verify a borrower's most recent two years of employment history and obtain evidence to document gaps of employment lasting longer than 30 days. Additionally, the Report notes that a lender must analyze the income of each borrower to determine whether the borrower(s) has the capacity to repay the mortgage debt.

It is Suburban's policy and practice to document a full two-year employment history for every FHA borrower and to analyze the borrower's financial capacity to repay the loan. See HUD Handbook 4155.1, REV-5, ¶ 2-6. In those cases where a borrower has been employed at his or her current job for less than two years, the Company obtains the necessary documentation to verify the borrower's previous employment and/or gaps in employment. See id. It is also Company policy to analyze a borrower's income to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. Id. ¶ 2-7. In accordance with these guidelines, Suburban properly documented and verified the borrowers' income and employment in the three cases cited in the Report.

For example, in the [REDACTED] case, **FHA Case No. 022-1826177**, the Report alleges that Suburban did not substantiate the borrower's employment history, as the borrower had four different employers and job positions in 16 months. In addition, the Report asserts that the borrower maintained a ten-month gap in employment, during which time the borrower claimed to have held miscellaneous day jobs that paid cash. Contrary to the allegations in this case, HUD requires a lender to document a two-year employment history to verify stability of income without dictating a limit to the number of jobs a borrower can work during the two-year period. See HUD Handbook 4155.1, REV-5, ¶

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2-6. In fact, FHA guidelines state that "we do not impose a minimum length of time a borrower must have held a position of employment to be eligible. . . . A borrower who changes jobs frequently within the same line of work, but continues to advance in income or benefits, should be considered favorably." Id.

In this case, in accordance with FHA guidelines, Suburban documented the borrower's employment history for the previous 35 months. Prior to the date of closing (**Exhibit K-1**), the borrower had been employed at his current job for 11 months, which the Company verified with a Verification of Employment ("VOE"), the borrower's most-recent pay stub, and a 2004 W-2 form from his current employer (**Exhibit K-2**). Before beginning his current job on April 7, 2004, the borrower had been employed for another construction company from December 10, 2003 until March 19, 2004, mere days before beginning his current employment. The underwriter obtained a VOE for this employer, as well as a 2003 and 2004 W-2 form to document the borrower's time on the job (**Exhibit K-3**). Suburban also obtained a VOE and 2003 W-2 form to verify the borrower's prior employment from October 16, 2003 until December 9, 2003 as a construction plumber (**Exhibit K-4**). Despite three jobs over the course of 16 months prior to closing, the borrower worked in the same line of work, maintained consistent earnings, and the underwriter understood it to be common for construction workers to frequently change jobs, particularly in geographic areas, like Arizona, where extreme weather conditions drive construction schedules. The underwriter, therefore, obtained sufficient documentation of the borrower's income stability.

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Moreover, prior to the borrower's employment with [REDACTED], the borrower worked odd construction jobs from December 2002 until October 2003. Although the borrower was not a payroll employee during this time, the borrower provided a written explanation to explain the gap in documented income (**Exhibit K-5**). Notably, the borrower worked different construction day jobs and was paid in cash once the work was complete. As HUD requires lenders to explain gaps in employment spanning one month or more, the borrower's explanation was sufficient documentation to complete the borrower's two-year employment history. Furthermore, although no additional documentation was required, the Company obtained evidence of the borrower's prior construction employment. As reflected on the borrower's loan application, [REDACTED] worked for [REDACTED] from April 2002 until December 2002 (**Exhibit K-6**), which Suburban documented with a VOE (**Exhibit K-7**). The borrower also certified on his loan application to his Community College attendance during the duration of this employment history (**Exhibit K-6**). Although additional explanation of the borrower's college attendance was unnecessary to document a full two-year work history, the underwriter considered this a significant factor in analyzing the borrower's capacity to pay a mortgage obligation.

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Ultimately, Suburban obtained more than sufficient documentation to substantiate the borrower's two-year employment history. As the Company complied with FHA guidelines in this case, indemnification is not appropriate, and we respectfully request that this finding be removed from the final audit report.

3. Debt Assessment

In eight cases, the Report asserts that the borrowers exceeded HUD's recommended debt-to-income ratios without documented, valid compensating factors. Specifically, the Report claims that Suburban listed some compensating factors that were not supported by verifiable documents or did not pertain to the qualifying ratios. Moreover, it also alleges that Suburban did not list compensating factors in the "Remarks" section when the recommended qualifying ratios were exceeded.

As discussed above, the Department has acknowledged that "[u]nderwriting is more of an art than a science and requires the careful weighing of circumstances that affect the borrower's ability and willingness to make timely mortgage payments." Mortgagee Letter 00-24; see also Mortgagee Letter 95-07. Underwriting requires the subjective evaluation of information based on experience in determining whether a potential borrower is creditworthy. An underwriter must carefully weigh all aspects of an individual's case, and were two underwriters to review the same file, one might approve a loan where the other would deny a loan. Significantly, each underwriter may have made a reasonable and prudent underwriting decision.

Furthermore, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines of 29% and 41% where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, REV-5, ¶¶ 2-12, 2-13. The Department has professed that the "FHA does not set an arbitrary percent by which ratios may be exceeded but rather FHA relies on the underwriter to judge the overall merits of the loan application and to determine what compensating factors apply and the extent to which those factors justify exceeding the ratios." Mortgagee Letter 00-24 (emphasis added). Thus, where a potential borrower's qualifying ratios are high, an underwriter has to consider all relevant circumstances and exercise discretion in deciding whether to approve or reject a loan. This discretion is particularly important when the same loans underwritten manually could be submitted through an automated underwriting system and approved with much higher qualifying ratios. With different standards for varying types of underwriting, the Department must rely on underwriters to adequately analyze a borrower's financial circumstances and take into account all relevant factors, including the range of acceptable levels in qualifying ratios.

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It is Suburban's policy to carefully consider each borrower's circumstances and document significant compensating factors in the "Remarks" section of the MCAW in compliance with HUD guidelines. This policy has been in place since the Company's inception, and we regularly remind our employees of the importance of ensuring that debt-to-income ratios in excess of HUD's guidelines are justified by significant compensating factors. Contrary to the allegations in this sub-finding, when compensating factors or other justifications were required, Suburban obtained the necessary documentation and properly noted these factors in the "Remarks" section of the MCAW. We address a representative sample of the cited loans below.

a. [REDACTED] – FHA Case No. 022-1826177

In the [REDACTED] case, the Report alleges that Suburban did not document valid factors to compensate for the borrower's excessive front-end debt-to-income ratio of 37.44% (versus HUD's maximum standard ratio of 31%) and the substantial increase in housing cost. The Report asserts that the Company's claimed compensating factors of overtime income and ability to save were not supported by the verifications of employment and bank balances.

Contrary to the allegations in this case, documentation in the loan file supported the significant compensating factors recorded on the MCAW in this case (**Exhibit I-4**). First, as you know, FHA guidelines provide that for borrowers with limited recurring expense, greater latitude is permissible on the borrower's front-end ratio than on the total fixed payment ratio. See HUD Handbook 4155.1, REV-5, ¶ 2-12(A). Thus, as the borrower's 37.44% ratio only slightly exceeded HUD's benchmark guidelines, and the borrower maintained no other monthly recurring obligations (**Exhibit I-4**), the underwriter was justified in assigning less weight to this figure. Second, the borrower's pay stubs in the loan file substantiated the receipt of additional overtime income that was not used to qualify the borrower for the loan (**Exhibit K-2**). The borrower's bank statements also documented his assets as of March 14 (**Exhibit L**). While this amount did not equal the amount of cash reserves shown on the MCAW as of March 29, the borrower would have received an additional two weeks of pay (\$1,200 total) by March 29, which would have exceeded the documented amount of cash reserves (**Exhibit K-2**).

Finally, the borrower in this case maintained nearly a year in timely rental payments (**Exhibit I-2**), and he had been employed in the same line of work for three years (**Exhibit K-6**). As HUD has recognized a conservative attitude towards the use of credit, the receipt of additional documented income, the maintenance of cash reserves, the timely payment of housing expenses, and the potential for increased earnings as significant compensating factors to justify the approval of a loan with higher-than-

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recommended qualifying ratios, we believe the underwriter more than justified the 37.44% front-end ratio in this case. See HUD Handbook 4155.1, REV-5, ¶ 2-13. The borrower, therefore, qualified for FHA financing, and indemnification is not warranted. We respectfully request these findings be removed from the final Report.

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b. [REDACTED] – FHA Case No. 023-2094536

The Report alleges, in the [REDACTED] case, that Suburban approved this mortgage although the borrower's front-end qualifying ratio of 38% exceeded HUD's maximum 31% ratio. The Report asserts that the only compensating factor provided was an undocumented possibility of future child support, even though the loan file did not include a child support decree, divorce decree, or voluntary payment agreement as required by HUD. Additionally, the Report claims the ratios used by the Company were computed based on a short-term interest rate buydown.

Contrary to the allegations in this case, HUD requires a lender to document child support income with a child support decree, divorce decree, or voluntary payment agreement if such income is to be used to qualify the borrower for the loan. See HUD Handbook 4155.1, REV-5, ¶ 2-7(F). If, however, the income is not used in the calculation of effective income, HUD requires all compensating factors to be supported by mere documentation, without specifying how such factors, including additional income, must be verified. See id. ¶ 2-13(E). In accordance with these requirements, Suburban obtained a copy of the borrower's child support worksheet (**Exhibit M-1**), which verified the June 1, 2004 effective date of the child support, the \$523.19 monthly amount, and the borrower's case number (DR1995-094860). Moreover, the borrower provided written statements, which further substantiated her "newly-awarded" child support (**Exhibit M-2**). FHA guidelines specifically recognize additional documented compensation or income as a significant compensating factor, and HUD requires an underwriter to record compensating factors in the "Remarks" section of the MCAW. See id. ¶ 2-13. The Department also has stated that greater latitude is permissible on a borrower's front-end qualifying ratio. Id. Thus, as the Company properly noted (**Exhibit M-3**) and documented the future child support income as a compensating factor in this case, we believe this factor is more than sufficient to justify approval of the loan with a 38% mortgage-payment-to-income ratio. Furthermore, as FHA guidelines in effect at the time of closing (**Exhibit M-4**) allowed the Company to qualify the borrower using the reduced buydown interest rate (see Mortgagee Letter 04-28), indemnification in this case is unwarranted, and Suburban respectfully requests that these findings be removed from the final audit report.

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c. ██████ – FHA Case No. 023-2182913

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In this case, the Report alleges that Suburban did not provide any compensating factors to justify approval of the loan with a front-end qualifying ratio of 34.8%, which exceeded HUD's 31% maximum ratio.

As discussed above, FHA guidelines provide that greater latitude is permissible on a borrower's front-end qualifying ratio, than on the back-end, fixed-payment-to-income ratio. See HUD Handbook 4155.1, REV-5, ¶ 2-12. Thus, as the 34.8% front-end ratio in this case only slightly exceeded HUD's benchmark threshold, and the underwriter documented significant compensating factors, Suburban properly approved the borrower for the FHA loan. Notably, in accordance with FHA guidelines, the underwriter noted in the "Remarks" section of the MCAW that the borrower received periodic additional income ██████ based on a return on the borrower's share of gaming revenues (Exhibit N-1). The underwriter also documented this income with a copy of a check to the borrower from the casino (Exhibit N-2), a written statement from the borrower explaining large deposits (Exhibit N-3), and a memo to the file that verified the borrower's additional \$2,500 - \$4,000 in quarterly income (Exhibit N-4). HUD has recognized the receipt of additional documented income as a significant compensating factor that directly affects the borrower's ability to repay the mortgage, and we believe this factor alone justified approval of the loan with a 34.8% front-end qualifying ratio. See HUD Handbook 4155.1, REV-5, ¶ 2-13(E).

That being said, the underwriter documented three additional factors that justified approval of the loan. First, the borrower enjoyed substantial job stability, as she had been employed at her current job for nine years (Exhibit N-5). Second, the borrower's bank statements verified consistent cash reserves of nearly \$2,000 (Exhibit N-6), and, third, the borrower maintained no recurring monthly debt (Exhibit N-1). As HUD has recognized the potential for increased earnings, the ability to accumulate savings, the conservative use of credit, and substantial cash reserves as significant compensating factors, we believe these items further supported the borrower's approval in this case. See *id.* ¶¶ 2-13(C), (G), and (I). The borrower undisputedly qualified for FHA financing, and the findings in this case should be removed from the final Report.

d. ██████ – FHA Case No. 023-2181591

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In the ██████ case, the Report alleges that Suburban ordered the credit report of the non-purchasing spouse, but did not use her liabilities to calculate the borrower's debt-to-income ratio. The Report asserts that with the non-purchasing spouse's monthly debt payments of \$145, the borrower's back-end ratio increased to 49%. The

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Report claims the borrower should not have been eligible for FHA financing without significant compensating factors, which Suburban did not provide.

Contrary to the allegations in this case, Suburban properly verified that the borrower was not responsible for his non-purchasing spouse's monthly liabilities and no compensating factors were required to justify approval of the loan. Notably, the Company understands and appreciates HUD's requirement that the debts of a non-purchasing spouse must be included in the borrower's qualifying ratios if the borrower resides in a community property state or the property to be insured is located in a community property state. See HUD Handbook 4155.1, REV-5, ¶ 2-2(D). Here, however, the non-purchasing spouse incurred her monthly obligations prior to marriage, which, in a community property state, means the borrower could not be held responsible. As shown on the spouse's credit report, she incurred four student loans in 2001 (**Exhibit O-1**), which were transferred to a different lender, and these debts occurred prior to her September 28, 2003 marriage to the borrower (**Exhibit O-2**). Suburban, therefore, properly excluded these debts from the borrower's qualifying ratios.

Moreover, had compensating factors been required in this case, the underwriter documented significant items that justified approval of the loan. Specifically, the "Remarks" section of the MCAW reflects the following compensating factors (**Exhibit O-3**): (1) the borrower's minimal use of credit, with only \$270 in recurring expenses (**Exhibit O-3**); (2) the timely payment of rent, which is verified for 18 months by the borrower's credit report (**Exhibit O-4**); (3) a minimal increase in the borrower's housing expense from \$550 to \$603.98 per month (**Exhibit O-3**); and (4) excellent job stability, with two years at the borrower's current job (**Exhibit O-3**). As HUD recognizes each of these items as significant compensating factors, even if the borrower's back-end ratio had equaled 49%, the borrower in this case would have qualified for FHA financing. Indemnification, therefore, is not warranted, and these findings should be removed from the final Report.

4. Interest Rate Buy-Downs

In three loans involving temporary interest rate buy-downs, the Report contends that Suburban did not provide adequate compensating factors to offset the increased risk resulting from future mortgage payment increases. Specifically, the Report alleges that the loan files did not contain evidence that the borrower met at least one of the four buy-down criteria to demonstrate that the scheduled mortgage payment increase would not adversely affect the borrowers' risk of default. Suburban respectfully disagrees with these allegations.

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As you know, at the time the three loans at issue were originated, interest rate buy-downs were permissible in connection with FHA-insured loans provided that, among other factors, the lender established that the eventual increase in mortgage payments would not affect the borrower and likely lead to default.⁴ See HUD Handbooks 4155.1 REV-5, ¶ 2-14(B)(2). Specifically, HUD guidelines required that the underwriter document that the borrower met one of the following criteria: (1) potential for increased income that would offset the scheduled payment increases, as indicated by job training or education in the borrower's profession or by a history of advancement in the borrower's career with attendant increases in earnings; (2) a demonstrated ability to manage financial obligations in such a way that a great portion of income may be devoted to housing expense, or in cases where long-term debt will not extend beyond the term of the buy-down agreement; (3) the borrowers have substantial assets available to cushion the effect of the increased payments; or (4) the cash investment made by the borrower substantially exceeds the minimum required. See *id.* (emphasis added).

As demonstrated below, in each of the three cases listed in the Report, the loan file contained documentation to support the borrowers' ability to sustain the eventual increase in mortgage payments without an increased likelihood of default. While the underwriter may not have noted each of these criteria on the MCAW in every loan, in each instance Suburban took into account the criteria in determining the borrower's eligibility for the buy-down interest rate, and included evidence of such criteria in the loan file. The Company properly used a mortgage payment amount that reflected the buy-down rate to underwrite these loans, and reasonably determined that the borrowers qualified for FHA financing in each of these cases. Therefore, Suburban respectfully maintains that the Report's recommendation of indemnification would be inappropriate in these three loans and requests that the allegations regarding buy-downs be removed from the Report. We address each loan in turn below.

a. ██████████ – FHA Case No. 023-2033645

In the ██████████ case, the Report alleges that Suburban approved this mortgage using a 2-1 interest rate buy down program without providing compensating factors to

⁴ As you know, in August of 2004, HUD issued Mortgagee Letter 04-28, in which it changed its guidelines to require lenders to consider the interest rate reflected on the note when determining whether an individual was qualified for FHA financing, even if the borrower would receive a buy-down interest rate. Upon notice of this change, Suburban amended its policies and procedures to ensure compliance with the revised guidance. Nevertheless, as discussed herein, the Company complied with the provisions in place at the time the three loans cited in this sub-finding were underwritten.

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establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to repay the loan. Without the buydown (and an adjustment for additional debt), the Report claims the borrower's qualifying ratios would have equaled 44% and 59%, which exceeds HUD's maximum thresholds.

Contrary to the allegations in the Report, the loan file contained evidence indicating that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. In fact, both the MCAW in this case (**Exhibit P-1**) and loan file documents supported the borrower's potential for increased income that would offset the scheduled payment increases, one of the express criteria set forth by the Department. See HUD Handbook 4155.1 REV-5, ¶ 2-14(B)(2). Specifically, the borrower's income documentation indicated that she was likely to earn both overtime and bonus income (**Exhibit P-2**). The borrower's employer also indicated that the borrower was scheduled to receive an increase in pay within months of loan closing (**Exhibit P-2**). As neither the borrower's overtime or bonus income, nor scheduled pay increase, were included in the borrowers' effective income (**Exhibit P-1**), this income demonstrated the potential for increased income that would be adequate to offset the borrowers' scheduled payment increases. Suburban complied with HUD requirements in this case and this loan should be removed from consideration in this sub-finding.

b. ██████ – FHA Case No. 023-2094536

In this case, the Report asserts that Suburban approved this mortgage based on a 2-1 interest rate buydown without providing any compensating factors to establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to repay the loan. Without the buydown, the Report alleges the borrower's front-end and back-end qualifying ratios would have equaled 45%, which is in excess of HUD's recommended maximums of 29% and 41%. It alleges that such an increase would have adversely affected the borrower's ability to meet her monthly mortgage obligation.

Here, contrary to the assertions in the Report, the loan file evidenced that the borrower had the potential to earn additional income that could be used to offset the increased mortgage payments. Importantly, the loan file documented \$523.19 in monthly child support income the borrower was due to receive beginning mere weeks after closing (**Exhibit M-1**). In fact, Suburban obtained a copy of the borrower's child support worksheet (**Exhibit M-1**), which verified the June 1, 2004 effective date of the child support, the \$523.19 monthly amount, and the borrower's case number (DR1995-094860). Moreover, the borrower provided written statements, which further substantiated her "newly-awarded" child support (**Exhibit M-2**). As this child support income was not used to qualify the borrower for the loan, it could have been used to

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offset the additional future mortgage payments. At the time this loan was approved, the underwriter reasonably determined that the borrower met at least one of the buy-down criteria and properly approved this borrower for FHA financing based on the buy-down rate. Thus, this allegation should be removed from the final Report.

c. [REDACTED] – FHA Case No. 023-2099918

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In the [REDACTED] case, the Report alleges that Suburban approved this mortgage using a 2-1 interest rate buy down program without providing compensating factors to establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to repay the loan. Without the buydown, the Report claims the borrower's qualifying ratios would have equaled 37% and 50%, which exceeds HUD's maximum thresholds of 29% and 41%. Moreover, the Report asserts that the borrower had minimal savings and had no housing expenses before the purchase of the home.

Despite the allegations of low savings and no housing expenses in this case, the loan file contained evidence indicating that the scheduled mortgage payment increase would not adversely affect the borrower, as the file supported the borrower's potential for increased income that would offset the scheduled payment increases. See HUD Handbook 4155.1 REV-5, ¶ 2-14(B)(2). Specifically, the borrower's income documentation indicated that the borrower's annual income had increased over the previous two years, and the borrower was likely to earn overtime income (**Exhibit Q-1**). Moreover, the VOE verified that the borrower was scheduled to receive a 3% increase in her pay within three months of closing (**Exhibit Q-2**). Suburban did not use the borrower's overtime income, or the borrower's scheduled pay increase, to calculate the borrowers' effective income. Thus, this income demonstrated the potential for increased income that would be adequate to offset the borrowers' scheduled payment increases in this case. At the time this loan was approved, the underwriter reasonably determined that the borrower met at least one of the buy-down criteria and properly approved this borrower for FHA financing based on the buy-down rate. This allegation, therefore, should be removed from the final Report.

5. Seller Contributions

In four cases, the Report asserts that Suburban allowed an interested third party to contribute funds on the borrowers' behalf in excess of HUD's standards or to provide funds to pay off borrowers' delinquent debts at closing. The Report claims that Suburban's failure to analyze the borrowers' assets, gifts, and the closing statements allowed these ineligible contributions to go undetected. Suburban respectfully disagrees with these allegations.

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As you know, FHA guidelines permit sellers to contribute up to 6% of the property's sales price toward the buyer's actual closing costs, prepaid expenses, discount points, and other financing concessions. See HUD Handbook 4155.1 REV-5, ¶ 1-7. While a seller's payment of more than 6% of the borrower's closings costs normally requires a dollar-for-dollar reduction to the sales price prior to calculating the maximum mortgage amount, HUD requirements expressly state that only those "closing costs normally paid by the borrower are considered contributions if paid by the seller." Id. Moreover, FHA guidelines state that "items typically paid by the seller, under local or state law or custom, such as real estate commissions, charges for pest inspections, fees paid for trustees to release a deed of trust, etc. are not considered contributions." Id. (emphasis added). Finally, with regard to downpayment assistance and other gift funds, HUD guidelines indicate that the Department requires a dollar-for-dollar reduction only when the gift funds do not meet HUD guidelines regarding permissible gifts. See id. Contrary to the assertions in this sub-finding, Suburban maintains that it complied with all of the above-cited requirements in underwriting several of the cases cited in the Report. Below we provide examples of individual cases in which the Company satisfied HUD requirements.

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First, in the ██████ case (FHA Case No. 023-2033645), Suburban takes issue with the Report's assertion that the seller contributed an unidentified deposit on behalf of the borrower totaling \$427, which was used to pay off several of the borrower's delinquent accounts at closing. Instead, contrary to this allegation, both the Company's escrow ledger (Exhibit R-1) and the HUD-1 Settlement Statement (Exhibit R-2) verified the receipt of \$427.56 in funds from the borrower. Moreover, the Company instructed the settlement agent that three borrower debts would be paid through escrow (Exhibit R-3), and the settlement agent reflected the borrower's deposit and subsequent payment of the debts on the HUD-1 Settlement Statement (Exhibit R-2). Based on this documentation, the Company had no reason to believe the seller contributed the alleged \$427 deposit.

Comment 16

Similarly, in the ██████ case (FHA Case No. 023-2099918), the Company takes issue with the Report's claim that \$702 was provided on behalf of the borrower at closing to pay off her collection accounts, which should have resulted in a dollar-for-dollar reduction in the sales price of the property. Instead, like the documentation in the ██████ case, both the Company's escrow ledger and the HUD-1 Settlement Statement verified the receipt of \$543.66 in funds from the borrower, as well as a \$25 earnest money deposit (Exhibit S). As the borrower required only \$462 to pay off the four accounts shown on the HUD-1 (Exhibit Q-2), Suburban received more than sufficient funds from the borrower to satisfy these obligations. The Company, therefore, was not required to reduce the purchase price of the property, and the loan was not overinsured.

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Suburban believes indemnification is not appropriate in both the [REDACTED] and [REDACTED] cases, and these findings should be removed from the final Report.

Finally, the Report alleges, in the [REDACTED] case (FHA Case No. 023-2215217), that the borrower informed the OIG that he did not supply the \$653 provided at closing to pay off his collection accounts, and he believes these funds were provided by either the seller or the lender. As HUD considers such payments inducements to purchase and requires a dollar-for-dollar reduction in the sales price and maximum insurable mortgage amount, the Report asserts that the Company did not verify the source of the funds used to pay off these debts. It claims that a review of information in the loan file indicates that the borrower historically had little money available to meet other expenses, as the borrower often overdrafted his account for minor purchases.

Contrary to the allegations in this case, Suburban had no reason to believe that the \$653 used to pay off borrower debts at the time of closing came from anyone other than the borrower. In fact, the Company obtained copies of the borrower's bank statements prior to closing, which, despite few overdrafts, showed a \$2,132.73 balance as of February 21, 2005 (Exhibit T-1). As this balance was more than sufficient to pay off the \$653 in outstanding accounts at the March 8, 2005 closing (Exhibit J-2), Suburban properly verified the borrower's source of funds in this case. Moreover, the Company instructed the settlement agent to verify payoff amounts to satisfy two borrower debts through escrow (Exhibit T-2). Thus, when the HUD-1 Settlement Statement reflected the receipt of \$653 in closing funds from the borrower and showed no debit for the same amount on the seller's side (Exhibit J-2), without evidence to the contrary, Suburban properly understood the borrower to have paid these funds. The Company certainly did not pay the \$653 on behalf of the borrower, and we are unaware of any arrangement between the borrower and the seller to cover the payment of the borrower's debts. As the borrower had sufficient documented assets to pay these debts, and the HUD-1 Settlement Statement reflects the receipt of funds from the borrower, we believe Suburban properly verified the source of funds. Without documentation to suggest the \$653 was paid by the seller or another third party, indemnification in this case is not appropriate. Suburban respectfully requests that this finding be removed from the final Report.

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6. Third Party Involvement

In this sub-finding, the Report alleges, in 24 loans,⁵ that the Company permitted interested third parties to be involved in the verification or transmittal of borrower loan documents, including income, employment, and credit documentation. Specifically, the Report asserts that borrowers' supporting loan documents were transmitted to Suburban through the sellers' fax machines. Although the Report acknowledges that no adverse consequences resulted from this alleged practice, the Report claims that the Company should have identified and corrected the practice during its underwriting and quality control review processes. For the five specific loans cited in this sub-finding, the Report does not contain details about which documentation was received from the seller in each case. However, based on the few specific assertions in Appendix E of the Report, we generally understand that the concerns involve borrower income and asset documentation, as well as borrower credit reports.

It is Suburban's policy and practice in all FHA transactions to obtain verifications, alternate income and asset documentation, and credit reports directly from the providers without accepting any verifications or alternate documents that are transmitted through, or by using the equipment of, a real estate agent, builder, or home seller. See HUD Handbook 4155.1 REV-5, ¶ 3-1. The Company, therefore, has restricted all employees from accepting any income or asset document that has been delivered via a real estate agent's or home seller's fax machine. Moreover, it is the Company's policy and practice to obtain credit reports directly from the credit reporting companies. Even if the real estate agent or seller in a transaction provides Suburban with a copy of a credit report it ordered for a borrower, the Company has instructed all employees to ensure they replace the seller's copy with a credit report ordered directly from the source. Based on these policies, in certain of the five cases cited herein, Suburban acknowledges that it received some income and asset documents faxed from the real estate agent's or seller's equipment. This is strictly against Company policy, and we have reminded Suburban employees about the importance of properly verifying the facsimile headers and footers of all documentation. Although we are confident, as acknowledged in the Report, that no adverse consequences resulted from the faxed documentation in these cases, Suburban has taken the necessary and appropriate steps to ensure any deficiencies do not recur.

Moreover, in many of the loans referenced in the Report, the loan files contained additional documentation verifying the information contained in the documents faxed

⁵ Although the Report refers to 24 cases where interested third parties were allegedly involved, the Report makes substantive allegations in connection with this sub-finding in five cases.

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from the real estate agent or seller. For instance, in the [REDACTED] loan, **FHA Case No. 022-1826177**, while the copy of the earnest money deposit check appears to have been faxed by the real estate agent, the Company obtained a summary of the co-borrower's bank transactions, which reflected payment of the \$500 earnest money deposit on February 25, 2005 by the same check number 1108 (**Exhibits L and U**). In addition, in the [REDACTED] case, **FHA Case No. 023-2215217**, after the seller faxed a copy of the borrower's bank statements to the Company, Suburban obtained a separate account transaction summary, which reflected the same 40503 account number (**Exhibit T-1**).

The Company also obtained credit reports directly from the credit reporting companies in each of the five cases cited herein. The credit reports in the [REDACTED] case (**FHA Case No. 022-1826177**), the [REDACTED] case (**FHA Case No. 023-2033645**), the [REDACTED] case (**FHA Case No. 023-2099918**), the [REDACTED] case (**FHA Case No. 023-2209240**), and the [REDACTED] case (**FHA Case No. 023-2215217**) are attached as **Exhibits I-1, V-1, V-2, V-3, and J-3**.

In summary, it is Suburban's policy and practice to obtain income, asset, and credit verifications and documents directly from the provider of the information. It is always the Company's intent to fully comply with FHA guidelines, and we believe that any identified deficiencies with regard to faxed documentation in the five referenced loans will not recur. Thus, based on this policy and the compliant documentation discussed above, we respectfully request that this allegation be removed from the final Report.

Comment 18

7. Quality Control Reverification

In this sub-finding, the Report alleges that Suburban's Quality Control review process, as implemented, did not meet HUD requirements and serve as a tool for identifying and correcting problems in its loan origination and underwriting process. Although Suburban's written Quality Control plan and HUD requirements called for the reverification of assets, employment, gifts, credit, and appraisals of approximately 10% of loan originations and all early payment default loans, the Report asserts that the loan files contained no documentation to verify that these re-verifications were completed. The Report claims that without these Quality Control reviews and re-verifications, problems in the loan origination and underwriting processes will not be identified and corrected.

Suburban takes its Quality Control responsibilities seriously and actively ensures that the Company implements all components of its Quality Control plan. As acknowledged in the Report, it is the Company's policy to review 10% of all FHA-insured loans originated by the Company within 90 days from the end of the month in

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which the loans closed. See HUD Handbook 4060.1, REV-1, ¶¶ 6-6(A), (C); HUD Handbook 4060.1, REV-2, ¶¶ 7-6(A), (C). In addition to 10% of the loans selected for a routine quality control review, it is the Company's policy to review all loans that go into default within the first six payments. Id. ¶¶ 6-6(D); 7-6(D). In both instances, it is Suburban's policy to timely complete Quality Control reviews, and the Company ensures the Quality Control reviews re-verify certain documentation and information, including the borrowers' credit report, employment and asset documentation, and appraisals. Id. ¶¶ 6-6(E); 7-6(E).

Comment 18

Although it is not clear from the face of the allegations, Suburban understands the Report to be primarily concerned with the Company's re-verification of borrower information and appraisals in connection with early payment default loans. Thus, with regard to early payment default loans, Suburban completes a timely Quality Control review of those early payment default loans that it is aware have gone into default. The Company, however, does not service any of the loans it closes, but rather sells all loans in the secondary market on a servicing-released basis. Accordingly, Suburban's ability to monitor the default status of a loan it originates largely depends on whether the loan's purchaser timely notifies Suburban that the loan has gone into default or foreclosure and/or timely reports the default to HUD so that it is reflected in FHA Connection. Unfortunately, many servicers often fail to keep the Company and/or HUD apprised of borrowers' payment histories, a problem that is not unique to Suburban. Nevertheless, it is Suburban's policy to actively monitor Neighborhood Watch and the default status of the loans the Company originates.

Moreover, while Suburban acknowledges that it began to obtain re-verification documentation in June 2006, it is now Company policy to re-verify a borrower's employment, obtain a new credit report from a different credit bureau, re-verify a borrower's assets or other sources of funds, and perform a desk review of the appraisal in connection with each Quality Control review performed, including the Company's Quality Control reviews of early payment default loans. Suburban is committed to the stringent Quality Control of the FHA-insured loans it originates, and we have reminded Company employees of the importance of re-verifying and documenting borrower information for all Quality Control reviews. It is always Suburban's intention to implement its Quality Control plan to comply with HUD requirements, and we believe any oversight with regard to the re-verifications in the loans cited in the Report will not recur.

Suburban has always engaged in stringent Quality Control. We consistently review and analyze Company practices and procedures, and take responsibility to ensure that FHA requirements are met. We have implemented a written Quality Control

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plan that complies with HUD/FHA requirements, and it is our policy and practice to conduct timely Quality Control reviews and re-verify all required items. We are confident that any problems that the Company may have experienced in the past with regard to the issues raised in the Report have been resolved, and we respectfully request that these allegations be removed from the Report.

Comment 19

C. RECOMMENDATIONS – SUBURBAN OPPOSES THE WAY IN WHICH THE REPORT PRESENTS ITS RECOMMENDATIONS

In addition to opposing several of the individual allegations contained in the Report, Suburban disagrees with certain aspects of the recommendations made in connection with the loans referenced in Findings 1 and 2. As you know, the Schedule of Questioned Costs and Funds Put to Better Use ("Schedule"), which is attached as Appendix A to the Report, categorizes the potential losses to HUD in connection with: (1) actual losses incurred on HUD's resale of four properties securing loans on which claims were made; (2) loans in which HUD will ultimately pay on claim-terminated loans once the underlying properties have been sold; and (3) potential losses in connection with current, active loans on which no claim has been made. The Schedule lists these potential losses as "ineligible costs", "unsupported costs", and "funds put to better use," respectively, and identifies the loans in each category in Appendix A-1. To derive the estimated losses in connection with the 38 active loans and the one unfinalized claim, the Report indicates that it included 29% of the unpaid principal balance in the 38 active cases and 29% of the claim amount in the remaining unfinalized claim. According to Appendix A, this multiplier was selected based on information provided by HUD showing that its losses on sales average 29 percent of the claim paid.

As indicated above, Suburban does not take issue with the OIG's inclusion of the Department's actual losses in connection with loans for which claims have been made, and acknowledges that using the 29% multiplier represents a fair potential loss in loans in which claims have been made, but actual losses are unknown at the time of the Report's issuance. The Company does, however, take strong exception to the calculation of \$922,232 in estimated losses in the 38 remaining loans. First, we note that the \$922,232 figure does not represent a payment that the Report recommends Suburban pay to HUD, but rather reflects a mere estimate of the losses the Department could incur if these 38 loans ultimately result in claims to HUD. All 38 of the loans, however, remain active. In most cases, these loans are performing and the borrowers are consistently making payments. Suburban appreciates that these 38 loans may have entered default at some point; however, none of these 38 loans have been foreclosed, terminated, or resulted in insurance claims to the Department. To date, HUD has not incurred any loss in connection with these cases and there is no reason to

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believe that the Department will incur losses in these cases. Moreover, in the event that HUD does pay a claim in any of these loans, there is no guarantee that the Department will sustain monetary loss, as HUD may be able to recoup the claim amount in the sale of the underlying property.

Notwithstanding these facts, the Report suggests that the Department will experience losses in the amount of 29% of the unpaid principal balance of each one of these 38 loans, and lists the financial risk to the Department, which it defines as "funds to be put to better use," as \$922,232. This calculation assumes that every one of the 38 active loans will go into foreclosure and result in a claim to HUD. Such an assumption would be supportable if 100% of the loans that enter default resulted in claims to HUD; however, that percentage is significantly lower. There is no reason to believe that any of these loans, let alone all 38 of them, will result in a claim or financial loss to the Department. HUD has collected its insurance premium in each of these cases, which continue to perform as active FHA loans. Based on these facts, absent evidence that the 38 loans at issue will result in an actual claim to the Department, the over \$900,000 potential loss figure is greatly inflated and does not paint an accurate picture of the risks associated with this matter. As with the Report's citation to the total mortgage amounts in the recommendations sections, it appears that inclusion of such an inflammatory figure in the final Report serves only as an attempt to justify the costs of the audit of this Company, rather than portray the precise amount of the potential losses that HUD may incur in connection with these 38 loans.

Moreover, this arbitrary monetary figure and the citations to mortgage amount totals are included with mere recommendations to the Department to require the Company to indemnify it in connection with certain loans. Upon receiving the final Report, the Department will have an opportunity to independently review the audit findings and make an independent determination of whether indemnification is warranted in any of these cases. As discussed at length earlier in this response, Suburban disagrees that the vast majority of the findings set forth in the Report warrant indemnification. HUD may also disagree with the Report's assertions and decide not to pursue indemnification in some or all of the cited cases. Notwithstanding the fact that the Report's findings are preliminary, the OIG's recommendations assume that HUD will accept each allegation and pursue indemnification in each case.

In addition, while the audit process is still ongoing at the time the OIG issues its "final" report, the Report and the OIG's recommendations are made public on the OIG website. As a result, a lender's investors and peers are able to access the preliminary recommendations of the OIG before a final assessment as to their merit can be made by the Department. These entities often misinterpret the OIG's recommendations to be

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final actions by the Department, and also frequently misunderstand the total mortgage amounts or potential losses cited to be the actual financial penalties assessed by HUD on the audited FHA lender. Under these circumstances, making these preliminary recommendations public and including an inflammatory figure based on total mortgage amounts or arbitrary potential loss figures that are based on the unsupported assumption that every single loan at issue will result in a claim to HUD will have a material, adverse effect on the business of the audited FHA lender. If the OIG's goal is to present the reader with a full and accurate disclosure of the audit and its implications to the audited lender, the Report should include the following disclosure on the first page in bold, capitalized lettering:

THE REPORT FINDINGS REFLECT THE VIEWS OF THE OFFICE OF INSPECTOR GENERAL AND DO NOT CONSTITUTE A FINAL DETERMINATION OF THE MATTERS RAISED HEREIN BY THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. THE FINAL DETERMINATION IN THIS MATTER WILL BE MADE BY THE REPORT'S ADDRESSEE, THE HUD ASSISTANT SECRETARY FOR HOUSING – FEDERAL HOUSING COMMISSIONER, WHO WILL ULTIMATELY DECIDE WHETHER TO ACCEPT THE REPORT'S RECOMMENDATIONS IN WHOLE OR IN PART OR REJECT THEM.

Comment 19

The above discussion demonstrates that millions of dollars in total mortgage amounts cited and the over \$900,000 estimated loss figure is unrepresentative of the Department's actual loss risk in connection with the cases cited in the Report. Inclusion of these overstated figures in the Report unfairly represents the loss exposure to HUD, and ultimately the Company, as a result of this audit. Therefore, Suburban strongly opposes the inclusion of these figures in the final Report and requests that they be removed or amended to portray a more accurate picture of the potential losses in the FHA loans cited in the Report. As the recommendation regarding these loans is that the Company indemnify HUD, the Report should merely state this recommendation without including total mortgage amounts or estimated losses that are difficult, if not impossible, to predict accurately in these loans. At the very least, if the final Report continues to include the average claim loss paid for the 38 active loans as the potential financial risk to HUD and the Company, the Report should also clarify the percentage of defaulted loans that result in a claim to HUD and include the potential losses based on this significantly reduced number of loans. This figure would present readers with a more accurate and fair picture of the financial risks associated with the loans identified in the Report.

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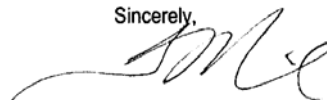
III. CONCLUSION

Suburban takes the matters raised in the draft Report seriously. Because FHA lending comprises a significant portion of Suburban's overall business operations, the Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, Suburban substantially complied with FHA appraisal review and underwriting requirements and made loans to qualified FHA borrowers. Suburban's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of Suburban, or do not affect the underlying loans' insurability. Suburban at no time misrepresented information it submitted to the Department. Moreover, since the loans cited in the Report were originated, the Company has made several improvements to its Quality Control procedures and has continued to enhance its underwriting practices. The Company identified and responded to operational and underwriting concerns, and it has exercised responsible management supervision.

We believe that this response and accompanying exhibits demonstrate that certain of the Report's recommendations in connection with the cited loans are unwarranted. We respectfully request that the OIG revise its recommendations to fit the facts of this case and remove allegations from the Report in those instances in which Suburban has demonstrated its compliance with HUD requirements.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip L. Schulman, at (202) 778-9027. Thank you for your kind consideration.

Sincerely,



Thomas Reid
President

cc: Phillip L. Schulman, Esq.

OIG Evaluation of Auditee Comments

Comment 1 We disagree with Suburban's claim that the results of OIG's review of 23 appraisals should not be extrapolated to the 19 other cases set out in the report where specific appraisal reviews were not made, but indemnification is recommended. In this instance such a conclusion is appropriate, fully supported, and logical. The appraisals in question relate to condominium units in two complexes. The units in the two complexes were (for all practical purposes) identical units in their respective complexes that had the same remodeling/conversion work completed and had no special features that would differentiate them from any other units in the complexes. They were all sold within a relatively short period of time for comparable prices. Accordingly, all units in the two complexes, depending upon the number of bedrooms, had comparable values at the time of sale. In this regard, sales of units in the two properties were used interchangeably, without adjustments, by the two appraisers when establishing values for other units in the two complexes, reflecting their belief that the units in the respective complexes had equal values. Thus, based upon actual property characteristics and actual sales prices, all units in the two complexes, not just the 23 we re-evaluated, were overvalued by approximately 40 percent. This would include the 19 units included in the report whose appraisals were not re-evaluated. These overvaluations were reflected in the FHA-insured mortgages used to purchase the properties by the borrowers and thus the mortgages are significantly overinsured.

We do concur with Suburban's comment that OIG's recommendation for indemnification of the 19 cases that are based upon extrapolation should be more fully disclosed. To address this concern, we have added a footnote to the lead paragraph of finding 1 disclosing this condition.

Comment 2 Suburban contends that it relied on the appraisers' expertise and experience in appraising the properties and, unless their underwriters had a reason to know or had doubts about the appraisal report, they had no reason to contest the reports' validity or their adherence to HUD FHA guidelines. However, as set out in the report, our review of 23 appraisal reports identified obvious documentation errors, omissions, and other questionable data such as photographs showing the dissimilarity of the comparable units versus the subject units; consistently long distances of the comparables from the subject units (different neighborhoods); values outside of the neighborhood norms; owner occupant percentages that did not meet HUD requirements; unsupported adjustments, etc. These inconsistencies and inaccuracies should have been identified during the underwriting and quality control processes and alerted Suburban to potential problems with the plausibility and consistency of the appraisers' conclusions, and led to a follow-up to resolve the problems identified.

Had the underwriters followed-up on these obvious inconsistencies and errors early on, they would have determined that the appraisals did not provide

reasonable property valuations. For example, the very first appraisal received for a unit in these two complexes (related to FHA Case Number 023-1892486) contained numerous inconsistencies that should have led the underwriter to question its plausibility. This included obviously dissimilar comparable properties clearly discernable from the accompanying photographs; comparables from outside the subject unit's neighborhood; an appraised value significantly outside the predominate values of the neighborhood; the appraiser's claim that the unit had a covered patio when the photographs clearly showed it did not; documentation indicating that "61+/-" of the 72 units in the complex were rented, thus indicating that the complex did not meet HUD's required 51 percent owner occupant level, etc. Had the underwriter followed up on these indicators, it would have become clear that the unit was a one bedroom one bath 684 square foot unit, not a two bedroom two bath 948 square foot unit as claimed by the appraiser; the neighborhood of three of the comparable units was clearly superior to that of the appraised unit; and these three comparables were clearly superior in design and construction than the appraised unit.

Further, it would have been determined that the other comparable used, a pending sale from the same complex as the appraised unit, was not a three bedroom 1,298 square foot unit as claimed by the appraiser, but actually a two bedroom 968 square foot unit (It should be noted that an FHA insured loan for this unit was being processed by Suburban at the same time, thus the pending sale). A prudent examination of this and other concurrent appraisals, at the start of the sales process for the units in these two complexes, would have alerted Suburban to the significant overvaluation of the units in these two complexes. In addition, a secondary opportunity to evaluate the accuracy of the appraisals presented itself when some of the loans in the complexes defaulted within 90 days of loan closing. Had Suburban followed its quality control plan and obtained new appraisals of the properties supporting these defaulted loans, the initial appraisal overvaluation would have been identified. These prudent actions were not taken by Suburban and as a result, HUD insured mortgages on 38 properties that were overvalued by approximately 40 percent.

Comment 3 We disagree with Suburban's claim that four "desk reviews" by an independent fee appraiser it hired confirmed that the subject properties were properly valued. Our analysis of these limited independent desk reviews raised serious concerns relating to the review appraiser's conclusions and accordingly, in our opinion, there is no justification for reconsideration of any of the appraisal conclusions resulting from our audit.

The fee review appraiser's conclusions were based upon the use of the same comparable properties used by the original appraiser. The desk reviews of the four appraisals involved the use of twelve comparable property sales – seven were units within the two subject complexes and the other five claimed comparable properties were located in four other condominium complexes (one of the review appraisals is not discussed separately as it is an exact duplicate of one of the others, using the

same comparables and adjustments and arriving at the same appraised value). As documented in our re-evaluations, the initial appraisals of the units (initial sales) in the two complexes resulted in a significant overvaluation of the units in the complexes (and artificial market values for all the units in the complexes). Accordingly, the use of these sales as comparables in subsequent appraisals would result in similar overvaluations, in this instance approximately 40 percent. Because of this, any valid reappraisal would not include properties in these two complexes. However, the fee review appraiser did not take this into consideration and accepted these as comparables. Further, as set out in the audit report, the other five claimed comparable properties, which the fee review appraiser also used in his **desk** reviews, were not at all similar to the units in the two condominium complexes. They were located in much more desirable and expensive neighborhoods than the subject properties, and were not even close to being physically comparable. The use of these more expensive, dissimilar comparables contributed to the significant overvaluations, which was not recognized by Suburban's fee review appraiser.

Additionally, for two of his four reviews, Suburban's fee review appraiser provided two other more recent and "more appropriate comparable sales" which sold for significantly more than the comparable sales used in the original appraisal. Suburban felt that these sales may have indicated an even higher value for the subject properties. However, an inspection of these "comparable" properties again found that they were located in completely different, more expensive neighborhoods, and were not at all comparable to the subject units. The fee review appraiser's claim that these were more appropriate sales, when in fact they are obviously dissimilar, further brings into question the adequateness of the **desk** review appraisals he conducted.

We also question Suburban's assertion that its independent review appraiser did not work for them. A review of HUD's database noted that the contracted appraiser had conducted at least 19 FHA appraisals for Suburban over the past three years. Second, during the exit conference, Suburban professed that its fee reviewer had completed field reviews of the original appraisal work. This would require the appraiser to personally view and inspect the properties. However, per the exhibits provided by Suburban, the reviewer performed only **desk** reviews not the more comprehensive field reviews that Suburban had claimed. In both of these instances, Suburban's incorrect assertions, whether intentional or not, places doubt on the validity and accuracy of the reviewer's work. Other concerns relating to the validity of Suburban's and its fee reviewer's comments relating to OIG's evaluation of the original appraisals are set out in the response to Comments 7 and 9 below.

Comment 4 Suburban states that up until January 1, 2006, HUD required appraisals of properties secured by FHA-insured loans be reflected on the URAR, FNMA Form 1004, but that the Condominium Unit Appraisal Report Form, Fannie Mae Form 1073 was also acceptable (this statement is contradictory). In our opinion, the required use of the condominium appraisal report prior to January 2006 (Form 1073) is ambiguous (see Mortgagee Letter 97-22). However, its use for evaluating condominiums would

have been prudent as it provides additional information necessary to properly determine the plausibility and consistency of the appraisers' conclusions that are not available on FNMA Form 1004 (which was designed primarily for single family homes). In this regard, the appraiser who provided the first nine appraisals on the first of the two subject condominiums did use FNMA Form 1073 (the second appraiser chose to use FNMA Form 1004). A close review of the information provided on these initial nine appraisals would have brought into question the units' appraised values when compared to the predominant values of the area; the owner occupancy percentage in the complex; individualized information relating to common elements, etc. In that the other appraiser did all Suburban's appraisals for the second condominium complex using FNMA Form 1004 rather than FNMA Form 1073, this type of information was not available. However, due to the ambiguousness of the rules relating to required use of the Condominium Unit Appraisal Report, our report has been changed to reflect that FNMA Form 1073 was not required to be used for appraisals of condominium units.

Comment 5 Suburban claimed that obtaining certifications from the seller (interested third party) stating that the condominium complexes met the 51 percent owner occupancy level required by HUD demonstrated its compliance with this requirement. However, this certification was contradicted by other information in the files which indicated that this owner occupancy level was not met. For example, the first nine appraisal reports Suburban received for these complexes (which were completed on FNMA Form 1073) clearly showed that this requirement was not met (the first appraisal showed that 61+/- of the 72 units were rented). This demonstrates Suburban's lack of due diligence in reviewing available information to confirm the required owner occupant level was met.

Comment 6 Suburban stated that it relied on HUD's website to determine whether the first of the two condominium complexes had been approved by HUD for FHA insurance, and assumed that if the complex was listed on the website then the one year cooling off period had been met. HUD staff at the Santa Ana Home Ownership Center informed us that review of the website is the preferred method for lenders to ensure the condominiums are a HUD approved project and meet all requirements. However, the condominium approval dates for converted apartments listed on the website sets out the start of the one year cooling off period, not the date units in the complexes are eligible for FHA insurance. HUD staff went on to state that information listed on the website for the complex in question was not complete and did not provide the additional information normally supplied that would provide the date that the complex actually would have met the one year requirement. HUD staff stated that they would not fault the lender for relying on the information listed on HUD's website. Nevertheless, Suburban had information in its origination files that clearly showed that the "apartment complex" was purchased by the developer in March 2003. If the developer had all the information and application forms ready for submittal to HUD in the month they purchased the property (not the norm) then at the earliest, February 2004 would have been the end of the waiting period, not August 2003 as

shown on HUD's website. A prudent lender would have followed up on this contradictory information and would have determined that the waiting period had not been met.

Comment 7-1 In almost every case, the original appraiser selected comparable units that were outside of the subject's area, overvalued units in the subject complexes or units that were developed and sold by the same developer/seller. In our opinion, the selection of units outside of the subject's neighborhood could occur in a few of the cases. But when it is the norm, as in these appraisals, Suburban should have been alerted to the possibility that the comparable units were not appropriate. Action could then have been taken to determine whether there were comparable units within the neighborhood. As detailed in the report, there were many comparable sales within the neighborhood which could have been used, and which would have provided more valid estimates of value. Further, had Suburban verified the validity of the appraisers' assertion that the units were "good indicators of value based on similar design, size, remodel condition and appeal," easily determinable through examination of the submitted photos, they would have found that the comparable units used were completely dissimilar properties. It would have been clear that the properties were not of the same type, design, style or appeal, and were in much more expensive and exclusive neighborhoods than the subject properties which were located in high traffic, high crime areas. This obvious information also should have alerted Suburban's fee review appraiser to the fact that the selected comparable units were not comparable (including the two substitute comparable properties he identified). Had the fee review appraiser inspected the properties he would have realized that the units were not valid comparables and accordingly should not have been used to establish values for the units being appraised.

Comment 7-2 Our assessment of the valuation adjustments found that the appraisers were inconsistent in valuing amenities often increasing or decreasing the dollar amount on different appraisals for the same amenity. These actions lead us to believe the adjustments were used to support a predetermined value. One small value amenity which we identified was the appraisers' inconsistent claims that the units in the complexes had porches when in fact the porches were simply covered walkways which should not have been compared equally to comparable units which had true porches. Suburban's fee reviewer asserted that one of the appraised units he examined required an upward valuation adjustment for a porch (covered walkway) as the comparable property had no porch. However, in our opinion the overhang/walkway is not considered a covered porch, let alone a covered patio as claimed by one of the appraisers. This is clearly evident from the photographs in the appraisal reports. But of even more concern is the lack of consistency and validity of claimed property conditions, features and amenities provided by the appraisers. For example, in the case cited by Suburban fee review appraiser (FHA Case No. 023-2159234) the appraiser made a \$1,000 upward adjustment to one of the comparables (which was from the second of the two subject complexes) saying it did not have a covered porch whereas the property being appraised (and the two other comparables from the first complex) were identified as having covered porches.

However, the same appraiser had performed previous appraisals at the second complex and in those appraisals he stated the units had covered porches, which resulted in an increased appraised value for the units.

These types of inconsistencies, although the individual value may be small, raises concerns about the quality of the appraisals and indicates the appraisers were manipulating claimed amenities and price to reach a predetermined unit value. Suburban's lack of due diligence failed to identify the conflicting information provided by its selected appraisers related to the existence or non-existence of porches and covered patios in the subject units. These discrepancies should have been identified through a brief examination of the appraisal photos which clearly showed that the units in the two projects had no visible differences in regards to purported porches. This is just one of many inconsistencies in value adjustments made by the two appraisers. Other claimed amenities affecting value that were listed on the appraisal reports but which did not exist included claimed foyers in some of the units; covered patios in the first complex; a community swimming pool in the second complex; and a greenbelt which was simply crushed rock. Suburban failed to identify these obvious errors during its underwriting and quality review processes.

Comment 8 See Comments 3 and 7-1

Comment 9 Suburban contends that the appraisers' value adjustments related to the remodeling work done to the condominium units were supported and justified. In this regard, all the units in the two condominium complexes were supposedly remodeled and provided with additional amenities; however the appraisers' valuation adjustments for this work was not consistent, fluctuating excessively, from appraisal to appraisal with no documented explanation for the fluctuations. Adjustments to reflect this claimed remodeling ranged from \$0 to \$12,000. The \$12,000 adjustment, which was twice HUD's guideline for the maximum line item adjustment, had no support, simply a statement saying the comparable unit's condition was inferior. Such a major unsupported adjustment should have alerted Suburban to potential problems with the appraisal. However, Suburban simply accepted the appraiser's weak explanation that the subject unit was completely remodeled and the comparable was inferior. Had Suburban followed up, it would have noted that not only was the adjustment not supported, but that the comparable unit was clearly superior to the subject (a photograph of this comparable unit is provided on page 11 of the report – FHA Case No. 023-2171644).

In another earlier appraisal, the appraiser provided an unsupported adjustment for the total remodeling work for the subject unit of \$3,000 as the comparable unit's condition was only "good" (FHA Case No. 023-2033645). Suburban's review appraiser claimed this was supported as the appraiser had provided a general listing of the remodeling work on page 1 of the appraisal. However, simply listing claimed remodeling work does not show how the work relates to the comparable unit (which was again clearly superior to the subject) nor support the value. In this regard, on other appraisals the appraiser had made no adjustment when he listed the

comparable units' condition as good. This conflicts with the previous case discussed, where a \$3,000 adjustment was made for a unit listed in good condition. These wide ranges in condition adjustments for the appraisals - \$0 to \$12,000 – raises serious concerns relating to the appraisers' use of the condition adjustments. However, these inconsistencies in adjustments were not identified and addressed by Suburban.

Had Suburban conducted reasonable due diligence reviews or followed their quality assurance plan and obtained reappraisals for loans in default, they would have discovered that not only were the condition adjustments made for the remodeling work not supported, but that the remodeling work was not completed properly and many of the remodeling items listed on the appraisal report were not done at all. For example, in one complex dual pane energy efficient windows were supposed to be part of the remodeling job; we found only one unit had the work completed, none of the other units' windows were replaced. In other instances, the appraiser lists the bathroom fixtures as new, but the units we inspected did not have “brand new fixtures.” It appears the remodeling company tried to refurbish some of the bathroom fixtures by painting over them. It is hard to conceive how the appraiser determined a painted tub to be a new bathroom fixture.

In regards to open construction permits for the complexes, the units were not permitted individually because it would not have been cost effective (100 units X \$200 [approximate permit cost] = \$20,000). In such cases, where several units are being renovated in one building, the accepted method, according to City of Phoenix officials, is to apply for a building permit that covers the entire complex. In this case, each building (seven total) were issued a permit that listed the units under each building that required each discipline (mechanical, structural, electrical and plumbing) to be inspected and certified complete by a city inspector. Accordingly, Suburban's claim that remodeling permits were never issued for any “unit” in the Camelback property is technically correct as the permits were for the buildings in which the units were located. However, each unit within each building has to pass inspection to close out the permit. Thus, Suburban's statement, provided by its review appraiser, relating to individual unit permits has no validity. Additionally, Suburban's review appraiser's claim that “the city will not be required to make additional inspections of the condominium units” also is not true. During our audit, supervisory inspectors from the City of Phoenix, Development Department provided us with city completion certification requirements and specifically verified which units in the two complexes were not complete and still required a final inspection to receive a Certificate of Completion at the time of our audit. There has been no change and all the Camelback units listed in our draft audit report as being subject to final inspection by the city have still not received final completion certifications and will require final inspections prior to close out of the construction permits. Accordingly, Suburban's fee review appraisers claim that there currently are no open permits for the Camelback project is not true. As discussed in the report, this open permit information is easily accessible to the public on the city's website.

Additionally, construction permits for the Camelback projects were not issued until October 12, 2004, and then only because the city forced the developer to obtain them when it was discovered that significant rehabilitation work was being done without the required permits. The appraiser should have been aware of problems with the permit process as the work would have been ongoing when he performed his initial appraisals. Because of the type of work being done (plumbing, electrical, structural, and mechanical), it would have been apparent that permits should have been obtained and posted on the site. Once the city forced the developer to obtain the permits, the permits would have been posted on the site and would have been clearly visible when the appraiser conducted his inspections of the units.

Comment 10 Suburban claimed that its underwriters reviewed the appraisals in accordance with HUD valuation policy and determined the appraisers' conclusions were acceptable. However, as discussed in OIG's responses to comments 3 through 9 above, and in the report, Suburban's underwriters did not use due diligence when reviewing the 38 appraisals related to the two condominium projects discussed in the report. Had they done so, the obvious errors, misstatements and inconsistencies in the appraisals would have been identified early on and timely action could have been taken to correct the identified inaccuracies and avoid future problems. This was not done and HUD has been placed at risk for 38 FHA-insured mortgages supported by properties that were overvalued by approximately 40 percent.

Comment 11 Although Suburban addresses the concerns set-out in the report by type of deficiency, the deficiencies should be addressed in total as they relate to each of the individual loans. This is necessary because of risk layering, i.e. one deficiency affecting a loan by itself may not affect loan approval, whereas if combined with other deficiencies it could affect final loan approval. We have provided such an analysis in Appendix E of the report for each of the loans in question.

Comment 12 FHA Case No. 022-1826177 - HUD regulations require that the lender establish an overall pattern of credit behavior. Basing the borrowers' overall credit history on a single, limited (11 months) instance of on-time rental payments does not constitute prudent lending practices. This is especially true in this instance where one of the borrower's past collection accounts was related to apartment rental. Furthermore, the borrowers did not have any cash reserves as claimed by Suburban. The reserve balance of \$1,100 is simply a snapshot at one point in time right after the borrower received a paycheck. An analysis of the borrowers' savings history and earning and debt payment patterns show that the borrowers were only earning enough to meet daily expenses, not accumulate any reserves or cope with a 40 percent increase in their housing expense. Finally, we disagree with Suburban's claim that the borrowers' debt payments show a positive attitude towards satisfying debts. The payments were made primarily during the loan origination process and appear to be made out of necessity and appearance rather than a positive effort to honor financial obligations.

FHA Case No. 023-2215217 - Suburban's claim that the borrower's rental history is "positive" is not supported by information in the loan origination file. The borrower's apartment rental history of only 11 months and a court ordered judgment from the same apartment complex contradicts Suburban's claim. The borrower's explanation of this judgment does not provide any details of what occurred, only that the apartment manager will provide a satisfactory history of payment. Suburban's claim that the borrower also made 15 months of timely payments on another account is not supported by the credit report which shows an opening and a date of last activity on the same date indicating there was no activity on the account. Additionally, the borrower's eight remaining accounts, five collections, two court claims, and only one current account, shows a significant problem regarding the borrower's attitude towards meeting financial obligations. His explanation that he was hurt on the job may have affected the current accounts, but his credit problems started well before the accident. Suburban's claim that the borrower had cash reserves of \$2,000 is not accurate. This balance represents cash available on one day right after a deposit into the borrower's checking account, but just three days earlier the borrower had less than \$6.00 in this same account. Thus, in reality, the borrower had no reserves and was earning only enough to meet his daily living expenses.

Comment 13 FHA Case No. 022-1826177 - The basis for verifying the borrower's income is to establish the amount and the likelihood of its continuance to determine the borrower's capacity to repay the mortgage debt. The borrower's frequent employment changes coupled with a 10 month gap in employment during the 26 months prior to loan origination contradicts Suburban's claim that the borrower had income stability. Further, the borrower, although his four jobs during this period of time were in construction, had no advance in income and the jobs did not involve the same line of work (i.e operator, construction operator, plumbing). This combined with the 10 month gap in employment (during which time the borrower claimed to have held odd jobs to pay his bills) did not establish the income stability required for loan approval.

Comment 14 FHA Case No. 022-1826177- Suburban claimed that although the borrowers' front-end debt-to-income ratio exceeded HUD's guidelines by 6.44 percent, there were adequate factors, such as overtime income, no other monthly recurring obligations, and ability to save, to compensate for this. However, contrary to these statements, analysis of the borrowers' bank account shows the borrowers had no cash reserves (a one day balance of \$1,100 on payday is not cash reserves) and were earning only enough income to meet monthly living expenses; the borrower's employment verification did not show that there would be any overtime income; and their monthly housing expense would be increasing by 40 percent. Thus, there were no valid, documented compensating factors to justify exceeding HUD's debt-to-income ratios.

FHA Case No. 023-2094536 - Suburban did not provide any credible compensating factors to support exceeding HUD debt-to-income ratio guidelines or to compensate

for expected future increases in the mortgagor's monthly mortgage payment resulting from the use of the 2 - 1 interest rate buy-down program. Suburban claimed that a worksheet in the loan file claiming to show required future child support payments is sufficient to meet the documentation requirements for compensating factors. However, the worksheet has nothing to support its validity or the probability that any child support will ever be received (i.e. there is no history). Accordingly, the child support worksheet does not meet the documentation requirements set out in HUD Handbook 4155.1 REV-5 paragraph 2-13.

FHA Case No. 023-2182913 - Suburban's response satisfied our concerns and we have removed this loan from our report.

FHA Case No. 023-2181591- Suburban's response satisfied our concerns and we have removed this loan from our report.

Comment 15 FHA Case No. 023-2033645 - Suburban did not establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to pay. Suburban states that the borrower will likely earn overtime and bonus income to cover the increased housing payments; however, the verification of employment is specifically marked "no" in relation to whether it is likely that overtime and bonuses will continue. The possibility of a small increase in pay mentioned by Suburban would not offset the substantial increase in mortgage payments that would occur when the interest rate buy-down expires. The borrower had no additional training or education that would lead to increased pay or a history of increased pay through advancement. Accordingly, there were no documented factors that would mitigate the effects of the expiration of the interest rate buy-down and the increased mortgage payment.

FHA Case No. 023-2094536 - Suburban's claim that a copy of a child support worksheet in the file (not an official document) relating to the possibility of future child support payments is insufficient to demonstrate the potential for additional income to support the eventual increase in mortgage payments resulting from the expiration of the 2-1 interest rate buy-down (also see comment 14). Such nebulous information does not document in any manner as to whether the order was finalized and if so whether such payments will ever be received by the borrower.

FHA Case No. 023-2099918 - Suburban claimed that the borrower's verification of employment showed a history of increasing annual income, a likelihood of earning overtime income and a projected pay increase of three percent within three months of closing. Suburban felt that this demonstrated the potential for increased income that would offset the scheduled mortgage payment increases. However, when the underwriter approved the loan these claimed compensating factors were not addressed in the remarks section of the Mortgage Credit Analysis worksheet as required. Further, in our opinion, file information relating to these claims did not meet HUD requirements for documenting the potential for increased income, i.e., job training, education, or a history of advancement in the borrower's career with

consequent increases in pay. In this regard, the amount of potential overtime income was not documented and pay increases appeared to be simply cost of living increases, not the result of the borrower's advancement in her profession. There were no other documented factors that would have compensated for the mortgage payment increases, which, after inclusion of outstanding debt not considered by Suburban, would have resulted in total debt to income ratios of approximately 50 percent. This is significantly above HUD's standard of 41 percent.

Comment 16 FHA Case No. 023-2033645 - The information provided by Suburban does not confirm that the borrower paid the \$427.56 at escrow closing. The HUD-1 and escrow ledger only show that this money was provided at closing on behalf of the buyer. There is no copy of the escrow receipt or check to show who actually provided the funds. This is especially critical because at April 12, 2004, one month before closing, the borrower had only \$19.47 in her bank accounts. Thus, Suburban did not properly verify that the funds were available, and used to make the \$427.56 payment received by the title company at loan closing.

FHA Case No. 023-2099918 - Suburban states that the HUD-1 and the title company's escrow ledger verified receipt of \$543.66 in funds from the borrower at closing (\$480 and \$63.66) and an additional \$25 in earnest money. However, these documents only verify that funds were provided on behalf of the borrower. Documents in Suburban's file only verify that the borrower made the initial \$25 earnest money payment. Further, a review of the sales contract and amendments show that the seller was to pay \$480 at closing on behalf of the borrower for the appraisal fee and two months HOA fees. This indicates that the borrower did not make the \$480 payment shown on the HUD-1. Additionally, the HUD-1 shows that \$727 was due at escrow to satisfy the borrower's four delinquent accounts, not \$462 as Suburban claims. In summary, Suburban documented only \$25 in borrower payments to meet closing requirements and satisfy the \$727 in debts to be paid off at closing.

FHA Case No. 023-2215217 - Suburban claimed that it had no reason to question the source of the \$653 used to pay off the borrower's debts at closing since he had sufficient documented assets (a bank balance of \$2,132.73) to cover payment of the debts. However, the document that Suburban claimed to be a bank statement was actually just a computer-generated cash flow statement that did not have the borrower's account number or the identity of the financial institution. HUD does not recognize such a document as a legitimate form of fund verification. Further, even if this document was to be used, it did not demonstrate that the borrower would have sufficient funds available to payoff these debts at closing. The \$2,132.73 balance shown on this document represents cash available on one day right after a deposit into the borrower's checking account. But this document showed that just three days earlier the borrower had less than \$6.00 in this same account and that he was often overdrawn on the account. Thus, in reality the borrower had no reserves and was earning only enough to meet his daily living expenses. Thus, it is questionable as to whether he would have funds available to

meet closing requirements two weeks later. As set out in the report, the borrower stated he did not provide the funds used to pay off the \$653 of debt at closing. Suburban also claimed that it instructed the settlement agent to verify source and payoff of the \$653 and that when the HUD-1 Settlement Statement reflected receipt of funds from the borrower it assumed this had been done. However, the HUD-1 only shows receipt of funds not the source of the funds and HUD looks to the lender, not the settlement agent, to ensure that the borrower has provided the required funds.

Comment 17 Suburban acknowledged that it received some verification documents from interested third parties, that it has reminded employees of the importance of properly verifying all faxed documents, and that the identified deficiencies with faxed documents will not reoccur. However, Suburban went on to state that in many of the instances where there was third party involvement with verification documents, other additional information was obtained which verified the information faxed by the third parties. We do not concur with Suburban's opinion that the other documentation it cited, untitled and unidentifiable summary banking printouts and credit reports, serve to replace/verify the type of information that was faxed to it by third parties, i.e. earnest money payment documentation, W-2s, pay stubs, other employment information, explanations for poor credit, rental verifications, divorce settlements, schooling, etc. Such documentation is susceptible to falsification and thus must be provided to the lender without passing through the hands of an interested third party.

Comment 18 We commend Suburban for taking quick corrective action after deficiencies in the implementation of its quality control plan were brought to its attention during our audit.

Comment 19 Suburban's concerns relating to OIG's reporting process are not matters to be addressed in this report, but matters which should be raised in a different forum.

APPENDIXES

SCHEDULE OF APPRAISAL DEFICIENCIES

| FHA case no./notes | Original Mortgage amount | A | B | C | D | E | F | G |
|--------------------|-----------------------------|---|---|---|---|---|---|---|
| 023-1892486 1 | \$ 65,927 | X | X | X | X | X | X | X |
| 023-1966202 1 | \$ 68,021 | X | X | X | X | X | X | |
| 023-1971458 1 | \$ 67,890 | X | X | X | X | X | X | |
| 023-1984859 1 | \$ 90,560 | X | X | X | X | X | X | |
| 023-2033645 1 * | \$ 92,140 | | | X | X | X | X | |
| 023-2099918 1 * | \$ 92,140 | | | X | X | X | X | |
| 023-2171644 1 | \$ 71,274 | | | X | X | X | X | |
| 023-2196544 1 | \$ 70,800 | | | X | X | X | X | |
| 023-2209240 1 * | \$ 95,050 | | | X | X | X | X | |
| 023-2159234 1 | \$ 97,290 | | | X | X | X | X | |
| 023-2157852 1 | \$ 80,500 | X | | X | X | X | X | |
| 023-2238326 1 | \$ 80,500 | X | | X | X | X | X | |
| 023-2273203 1 | \$ 83,022 | X | | X | X | X | X | |
| 023-2300236 1 | \$ 83,225 | X | | X | X | X | X | |
| 023-2300111 1 | \$ 82,740 | X | | X | X | X | X | |
| 023-2290180 1 | \$ 84,680 | X | | | X | X | X | |
| 023-2307257 1 | \$ 82,682 | X | | X | X | X | X | |
| 023-2265939 1 | \$ 82,352 | X | | X | X | X | X | |
| 023-2309786 1 | \$ 82,925 | X | | X | X | X | X | X |
| 023-1952906 2 | \$ - | | X | X | X | X | X | |
| 023-1966391 2 | \$ - | X | X | X | X | X | X | |
| 023-1978990 2 | \$ - | X | X | X | X | X | X | |
| 023-1989669 2 | \$ - | X | X | X | X | X | X | |
| 023-2291729 3 | \$ 96,320 | | | | | | | |
| 023-2097141 3 | \$ 69,830 | | | | | | | |
| 023-2159196 3 | \$ 94,080 | | | | | | | |
| 023-2074656 3 | \$ 90,200 | | | | | | | |
| 023-2130610 3 | \$ 92,140 | | | | | | | |
| 023-2238723 3 | \$ 94,080 | | | | | | | |
| 023-2146128 3 | \$ 71,125 | | | | | | | |
| 023-2283275 3 | \$ 94,405 | | | | | | | |
| 023-2041273 3 | \$ 69,830 | | | | | | | |

| FHA case no./notes | Original Mortgage amount | A | B | C | D | E | F | G |
|---------------------------|---------------------------------|-----------|----------|-----------|-----------|-----------|-----------|----------|
| 023-2210987 3 | \$ 76,665 | | | | | | | |
| 023-2053735 3 | \$ 90,200 | | | | | | | |
| 023-2023149 3 | \$ 69,830 | | | | | | | |
| 023-2007589 3 | \$ 92,364 | | | | | | | |
| 023-2229773 3 | \$ 92,440 | | | | | | | |
| 023-2134868 3 | \$ 90,839 | | | | | | | |
| 023-2024394 3 ** | \$ 69,830 | | | | | | | |
| 023-2229767 3 | \$ 80,800 | | | | | | | |
| 023-2138042 3 | \$ 79,530 | | | | | | | |
| 023-2214184 3 | \$ 80,800 | | | | | | | |
| Total | \$ 3,149,026 | 16 | 8 | 22 | 23 | 23 | 23 | 2 |

- A. The subject unit did not meet the 51 percent owner occupancy requirement.
- B. The subject unit was sold before completion of the one-year cooling-off period.
- C. The claimed remodeling work was not supported and/or not certified complete by the City of Phoenix.
- D. One or more comparable unit(s) was not similar in design or location or was identified by OIG as being overvalued by the subject appraiser(s) in a previous appraisal.
- E. There was an unsubstantiated adjustment or lack of value adjustment for one or more comparable unit(s).
- F. The appraised value is far below or far exceeds the predominate value for the area with no explanation.
- G. The subject property's characteristics were incorrectly identified.

1 – These 19 mortgages were included in our appraisal review and either had claims paid on them by HUD or remain HUD insured.

2 – These four mortgages were included in our appraisal reviews to assist us in establishing values for the two condominium projects but have been terminated and are no longer HUD insured.

3 – Appraisals related to these 19 active HUD-insured mortgages originated by Suburban were not specifically included in our appraisal review. However, as discussed in finding 1, property values for all units in the two subject apartment complexes were overvalued by approximately 40 percent because of actions taken in establishing initial unit values in these two projects. Accordingly, these 19 units and the related HUD-insured mortgages are also overvalued by approximately 40 percent.

* HUD has paid claims on these three mortgages and resold the properties.

** Claim has been paid and the property conveyed to HUD

. APPENDIXES

Appendix C-2

SCHEDULE OF LOAN DEFICIENCIES

| FHA case number | Original Mortgage amount | A | B | C | D | E | F | G |
|------------------|--------------------------|----------|----------|----------|----------|----------|----------|----------|
| 022-182617-7 | \$139,707 | X | X | X | | | X | X |
| 023-199965-1 | \$107,043 | X | | X | | | | X |
| 023-203364-5* | \$92,140 | X | X | X | X | X | X | |
| 023-209453-6**** | \$114,973 | | | X | X | X | | X |
| 023-209991-8* | \$92,140 | X | | | X | X | X | X |
| 023-220924-0* | \$95,050 | X | X | X | | | X | X |
| 023-221521-7 | \$113,883 | X | | X | | X | X | |
| Total | \$754,936 | 6 | 3 | 6 | 3 | 4 | 5 | 5 |

- A. Unacceptable credit history, inadequate analysis of credit
- B. Unstable employment, income stability not established
- C. Inaccurate/excessive debt-to-income ratios without valid compensating factors
- D. Inappropriate use of the buy-down rate
- E. Excess and/or ineligible seller contributions
- F. Interested third party handled loan documents
- G. Did not reverify loan documents during quality control review process

* Problems with the appraisal and the appraisal review also noted – see finding 1 and schedule C-1. HUD has paid claims on these three mortgages and resold the properties.

** Claim has been paid and property conveyed to HUD and resold.

*** Loan has been terminated. However, HUD paid a partial claim of \$7,135 prior to termination.

APPENDIXES

Appendix D

NARRATIVE CASE SUMMARIES – APPRAISALS

D-01

HUD case number: 023-1892486 refinanced as 023-2299109
Loan amount: \$65,927
Settlement date: October 26, 2005
Status: Current

The appraisal misrepresented the subject unit's size and did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$50,000, not the \$70,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, excessive values in relation to predominant values in the neighborhood, and the project's failure to meet the 51 percent owner occupancy, excessive distance from comparables to the subject unit, etc.

The Subject Property's Characteristics Were Not Correctly Identified

Uniform Standards of Professional Appraisal Practice (USPAP) standard 1. The appraiser erroneously appraised the unit as a two-bedroom, two-bath, 968-square-foot unit. The unit is actually a one-bedroom, one-bath, 684-square-foot unit.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1 paragraph 4-6A2. The OIG appraiser/analyst noted that the comparable units used to establish value for the subject unit (in addition to being two-bedroom, two-bath, not one-bedroom, one-bath units) were superior to the subject unit in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of comparables from outside the area.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$1,500 value adjustment for the remodeling work without providing any supporting documents to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit Was Valued in Excess of the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$70,000 and the predominant value for the area of \$55,000. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The seller's representative certified that the condominium project was 51 percent owner occupied at the time of the sale. However, as indicated in part II, "Valuation Condition 13," of the appraisal report, the condominium project did not meet the 51 percent owner occupancy requirement, or it could not be determined. Further, the appraiser noted in the "Project Improvements" section of the appraisal that 61 (84.72 percent) of the 72 total units in the condominium project were being rented. Thus, the owner occupancy level did not meet the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-1966202
Loan amount \$68,021
Settlement date: January 15, 2004
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$50,000, not the \$70,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, excessive values in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of comparables from outside the area. Additionally, the other comparable unit used is from the same complex and earlier the same appraiser wrongly appraised it as a two bedroom unit when it was actually a one bedroom unit (see Appendix D-01). Thus, the overvalued unit was used as a comparable to overvalue this and other one bedroom units in the complex.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG 1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$3,000 value adjustment for the remodeling work without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open

permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The appraiser arbitrarily assigned a \$2,000 adjustment for inferior interior work without providing any supporting documents or discussion to justify the value. Additionally, the building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit Was Valued in Excess of the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$70,000 and the predominant value for the area of \$55,000. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The seller's representative certified that the condominium project was 51 percent owner occupied at the time of the sale. However, as indicated in part II, "Valuation Condition 13," of the appraisal report, the condominium project did not meet the 51 percent owner occupancy requirement, or it could not be determined. Further, the appraiser noted in the "Project Improvements" section of the appraisal that 61 (84.72 percent) of the 72 total units in the condominium project were being rented. Thus, the owner occupancy level did not meet the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-1971458 refinanced as 023-2416998
Loan amount \$67,890
Settlement date: December 27, 2006
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$50,000, not the \$70,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, excessive values in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy, excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of comparables from outside the area.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG 1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$3,000 value adjustment for the remodeling work without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open Permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The appraiser assigned a \$2,000 adjustment to the date/time because “[a]ccording to the sales agent, comparable #1 was sold as a ‘Pre-Grand Opening’ sale. Since that time, there has been a \$2,000 price increase on the subject’s model”; however, there is no market support provided for the adjustment. Additionally, the building’s design uses the upper level walkways and roof that extend over the lower floor’s entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit’s appraised value.

The Unit Was Valued in Excess of the Neighborhood’s Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject’s appraised value of \$70,000 and the predominant value for the area of \$55,000. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD’s 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The seller’s representative certified that the condominium project was 51 percent owner occupied at the time of the sale. However, as indicated in part II, “Valuation Condition 13,” of the appraisal report, the condominium project did not meet the 51 percent owner occupancy requirement, or it could not be determined. Further, the appraiser noted in the “Project Improvements” section of the appraisal that 61 (84.72 percent) of the 72 total units in the condominium project were being rented. Thus, the owner occupancy level did not meet the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-1984859
Loan amount: \$90,560
Settlement date: February 12, 2004
Status: Delinquent

The appraiser did not use appropriate comparable units when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$93,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, excessive values in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy, excessive distance from a comparable to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that the comparable unit used to establish value for the subject unit was superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select a larger, superior unit in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of a comparable from outside the area. The other two comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to these two sales indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current

owner of the unit will be responsible for completing the work. An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The appraiser arbitrarily assigned a \$2,000 adjustment for inferior interior without providing any supporting documents or discussions to justify the value. Additionally, the building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable unit had, should have been taken into consideration in establishing the unit's appraised value.

The Unit Was Valued in Excess of the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$93,000 and the predominant value for the area of \$55,000. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3 B. The appraiser indicates in the "Project Improvements" section of the appraisal that of the 72 total units in the condominium projects, about 62 (86.11 percent) had been sold. However, the appraiser negates this by indicating in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project does not meet the 51 percent owner occupancy requirement. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2033645
Loan amount: \$92,140
Settlement date: May 19, 2004
Status: Conveyed

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$95,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of comparables from outside the area. The other two comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to these two sales indicated that the units were overvalued by approximately 30 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$3,000 value adjustment for the remodeling work of the subject unit without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit;

therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$95,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2099918
 Loan amount: \$92,140
 Settlement date: May 12, 2005
 Status: Conveyed

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$95,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. The other two comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to these two sales indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations. Suburban should have questioned the use of comparables from outside the area.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$3,000 value adjustment for the remodeling work without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not

have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$95,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2171644
Loan amount: \$71,274
Settlement date: November 5, 2004
Status: Reinstated by mortgagor

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$50,000, not the \$73,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and necessary occupancy permits issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The other two comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to previous sales indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. Suburban should have questioned the use of comparables from outside the area, especially since the appraiser continually went outside of the area for appraisals related to this project and used comparable properties from distinctly different areas.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's

building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The appraiser made a line item adjustment to a comparable in excess of 10 percent and gross adjustments exceeding the 25 percent guideline without providing a detailed explanation "including reasons for not using more similar comparable sales." The adjustment made by the appraiser did not reflect actual condition and characteristics of two comparables. These two comparables were superior to the subject property, yet their sales prices were adjusted upward, not downward as would be expected. Additionally, the building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$73,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2196544
Loan amount: \$70,800
Settlement date: December 14, 2004
Status: Reinstated by mortgagor

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$50,500, not the \$73,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparables to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select larger, superior units in an attempt to validate the sales price of the subject unit. The other two comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to sales in this project indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations. Suburban should have questioned the use of comparables from outside the area.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional

inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The appraiser made a line item adjustment to a comparable in excess of 10 percent and gross adjustments exceeding the 25 percent guideline without providing a detailed explanation "including reasons for not using more similar comparable sales." Additionally, the building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$73,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2209240
Loan amount: \$95,050
Settlement date: 2/2/05
Status: Conveyed

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$98,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the cost of remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and necessary occupancy permits issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparable to the subject unit, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that the comparable unit used to establish value for the subject unit was superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select a larger, superior unit in an attempt to validate the sales price of the subject unit. Three other comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related to sales in this project indicated that the units were overvalued by approximately 40 percent. Thus, use of such sales as comparables in subsequent appraisals resulted in similar overvaluations. Suburban should have questioned the use of a comparable from outside the area.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$3,000 value adjustment for remodeling work without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable unit had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$98,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2159234
Loan amount: \$97,290
Settlement date: April 13, 2005
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$100,000 used by Suburban in establishing the maximum insurable mortgage.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, undervaluation in relation to predominant values in the neighborhood, excessive distance from comparable to the subject unit, arbitrary value for remodeling, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that one comparable unit used to establish value for the subject unit was superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The appraiser apparently went outside the area to select a larger, superior unit in an attempt to validate the sales price of the subject unit. Two other comparables used were previous sales from the same condominium project as the subject. Our review of the appraisals related sales in this project indicated that its units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations. Suburban should have questioned the use of a comparable from outside the area.

Remodeling Work Had No Support for Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$5,000 value adjustment for remodeling work without providing any supporting documents or discussion to justify the value.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable unit had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$100,000 and the predominant value for the area of \$140,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

HUD case number: 023-2157852
Loan amount: \$80,500
Settlement date: September 15, 2004
Status: Reinstated by mortgagor

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$83,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.²¹ Additionally, the only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that two of the comparable units used to establish value for the subject unit were superior to the subject in gross living area, age, exterior construction, upkeep, and location and had better amenities, green belt landscaping, and ample parking for residents and guests. The other comparable used was a previous sale from the same condominium project as the subject. Our review of the appraisals related to this project indicated that the units were overvalued by approximately 40 percent. Thus, use of such sales as comparables in subsequent appraisals resulted in similar overvaluations. The appraiser apparently selected larger, superior units in an attempt to validate the sales price of the subject unit.

²¹ The unit inspection and building permits were completed in Novemebr 2006 after our field work was complete.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. The appraiser arbitrarily assigned a \$7,000 value adjustment for the remodeling work without providing any supporting documents or discussion to justify the value. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.²² Additionally, based upon interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. We confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$83,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 70 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, in other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with effective dates postdating the loan in question, the "PUD" section of the appraisal states that of the 28 total units in the condominium project, only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have met the 51

²² The unit inspection and subsequent building permit and certificate of completion were completed in November 2006, after we finished our audit field work.

percent owner occupancy requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2238326
Loan amount: \$80,500
Settlement date: June 30, 2005
Status: Reinstated by mortgagor

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$84,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the City makes its final inspection of the unit.²³ Additionally, the only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that a comparable unit used to establish value for the subject unit was superior to the subject in gross living area, exterior construction, upkeep, and location and had better amenities and green belt landscaping. Additionally, it was noted that this comparable unit was superior in age and had ample parking for residents and guests. The other comparables used were from a previous sale from the same condominium project as the subject and the other condominium project included in our review. Our analysis of the appraisals related to these projects indicated that the units were overvalued by approximately 40 percent. Thus, use of such sales as comparable in subsequent appraisals resulted in similar overvaluations. The appraiser apparently selected a larger, superior comparable unit in an attempt to validate the sales price of the subject unit.

²³ The unit inspection and building permit were completed in Novemebr 2006 after our field work was complete.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.²⁴ Additionally, based upon interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. We confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable unit had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$84,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the wrong appraisal form had been used and the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with effective dates postdating the loan in question, state in the "PUD" section of the appraisals that of the 28 total units in the condominium project only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have met the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

²⁴ The unit inspection and subsequent building permit and certificate of completion were completed in November 2006, after we concluded our audit field work.

HUD case number: 023-2273203
Loan amount: \$83,022
Settlement date: July 29, 2005
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$86,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.²⁵ Additionally, the only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that a comparable unit used to establish value for the subject unit was superior to the subject in gross living area, exterior construction, upkeep, and location and had better amenities and green belt landscaping. Additionally, it was noted that the comparable unit was superior in age and had ample parking for residents and guests. The appraiser apparently selected a larger, superior unit in an attempt to validate the sales price of the subject unit. The other two comparables used were a previous sale; one from the same condominium project as the subject and the second sale from the other condominium project included in our review. Our review of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables in subsequent appraisals resulted in similar overvaluations.

²⁵ The unit inspection and building permit were completed in Novemebr 2006 after our field work was complete.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.²⁶ Additionally, based on interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. We confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable unit had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$86,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with effective dates postdating the loan in question, state in the "PUD" section of the appraisal that of the 28 total units in the condominium project, only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have met the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

²⁶ The unit inspection and subsequent building permit and certificate of completion were completed in November 2006, after we concluded our audit field work.

HUD case number: 023-2300236
Loan amount: \$83,225
Settlement date: November 3, 2005
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$86,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was consistent with that listed on the appraisal. The only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Resulted in Significant Overvaluations

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. Two of the comparables used were previous sales from the same condominium project as the subject, and the other was a sale from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work was not consistent with that listed in his appraisal. Based on interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. Additionally, we confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to support values in this project had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$86,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with effective dates postdating the loan in question, state in the "PUD" section of the appraisal that of the 28 total units in the condominium project, only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have met the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2300111
Loan amount: \$82,740
Settlement date: November 3, 2005
Status: Delinquent

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$86,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was consistent with that listed on the appraisal. The only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Resulted in Significant Overvaluations

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. Two of the comparables used were previous sales from the same condominium project as the subject, and the other was a sale from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 30 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work was not consistent with that listed in his appraisal. Based on interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. Additionally, we confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to establish value in this project had, should have been taken into consideration in establishing the subject unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$86,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. Also, the appraiser indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, in other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with effective dates postdating the loan in question, the "PUD" section of the appraisal states that of the 28 total units in the condominium project, only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have been met the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2290180
 Loan amount: \$84,680
 Settlement date: November 23, 2005
 Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$87,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was consistent with that listed on the appraisal. The only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Resulted in Significant Overvaluations

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. Two of the comparables used were previous sales from the same condominium project as the subject, and the other was a sale from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to support values in this project had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$87,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by

the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser also indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, the "Project Improvements" section of the appraisal states that of the 28 total units in the condominium project, only eight (28.57 percent) have been sold. Thus, the owner occupancy level did not meet the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2307257
Loan amount: \$82,682
Settlement date: November 23, 2005
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$87,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was consistent with that listed on the appraisal. The only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Resulted in a Significant Overvaluation

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. Two of the comparables used were previous sales from the same condominium project as the subject, and the other was a sale from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work was not consistent with that listed in his appraisal. Based upon interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. Additionally, we confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to support values in this project had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$87,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser also indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, the "Project Improvements" section of the appraisal states that of the 28 total units in the condominium project, only eight (28.57 percent) have been sold. Thus, the owner occupancy level did not meet the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

HUD case number: 023-2265939
Loan amount: \$82,352
Settlement date: June 30, 2005
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$85,000 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was completed in accordance with outstanding city building permits and that necessary occupancy permits were issued. The permits remain open, no occupancy authorization was obtained, and the new homebuyer will be held responsible if any deficiencies are noted when the city makes its final inspection of the unit.²⁷ Additionally, the only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Were Not Similar in Design or Location

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. The OIG appraiser/analyst noted that a comparable unit used to establish value for the subject unit was superior to the subject in gross living area, exterior construction, upkeep, and location and had better amenities and green belt landscaping. Additionally, this comparable unit was newer and had ample parking for residents and guests. The other two comparables used were previous sales from the same condominium project as the subject and from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units in the projects were overvalued by approximately 40 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation. The appraiser apparently selected a larger, superior unit and overvalued units from the subject condominiums as comparables in an attempt to validate the sales price of the subject unit.

²⁷ The unit inspection and building permit were completed in Novemebr 2006 after our field work was complete.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work required city construction permits to ensure that it met the city's building code standards. Records show that the final inspections were not completed (open). According to the City of Phoenix, certificates of completion were never issued for the unit; therefore, it did not have occupancy authorization. The city will need to make additional inspections to close open permits, and if defects in the rehabilitation work are noted, the current owner of the unit will be responsible for completing the work.²⁸ Additionally, based on interviews with owners, who purchased the units from the same seller, the only unit that contained all of the remodeling work described in the appraisal was one of the model units. We confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floor's entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to support values in this project had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$85,000 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the wrong appraisal form had been used and the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. The FHA case file contains a 51 percent owner occupancy certification provided by a representative of the home owners association or management company. The appraiser also indicates in part II, "Comprehensive Valuation Package under Valuation Condition 13," that the condominium project meets the 51 percent owner occupancy requirement. However, in other appraisals by the same appraiser (FHA case numbers 023-2290180 and 023-2307257), with the same effective date, the appraiser states in the "PUD" section of the appraisal that of the 28 total units in the condominium project, only eight units (28.57 percent) had been sold. Thus, the owner occupancy level could not have been met the 51 percent requirement as certified. This matter should have been addressed by Suburban during the underwriting process.

²⁸ The unit inspection and subsequent building permit and certificate of completion were completed in November 2006, after we concluded our audit field work.

HUD case number: 023-2309786
Loan amount: \$82,925
Settlement date: January 25, 2006
Status: Current

The appraiser did not use appropriate comparable units and valid adjustments when establishing the unit's appraised value. The appraiser's misrepresentation of the subject and comparable units led to a significant overvaluation of the subject property and a corresponding excessive FHA-insured mortgage. In the opinion of the OIG appraiser/analyst, this unit should have appraised at approximately \$59,000, not the \$87,500 used by Suburban in establishing the maximum insurable mortgage.

In addition, the appraiser did not document the extent or cost of the remodeling work done and failed to ensure that the rehabilitation work was consistent with that listed on the appraisal. The only unit identified as having remodeling work completed that was consistent with that described on the appraisal was a model unit.

Based upon information in the appraisal report and loan origination file, Suburban should have become aware of potential problems with this appraisal during the underwriting process. The deficiencies included failure of the appraiser to address seller concessions, overvaluation in relation to predominant values in the neighborhood, the project's failure to meet the 51 percent owner occupancy requirement, etc.

Comparables Used Resulted in a Significant Overvaluation

HUD Handbook 4150.2, CHG-1, paragraph 4-6A2. Two of the comparables used were previous sales from the same condominium project as the subject, and the other was a sale from the other condominium project included in our review. Our analysis of the appraisals/sales related to these two projects indicated that the units were overvalued by approximately 40 percent. Thus, use of them as comparables for this appraisal resulted in a similar overvaluation.

Remodeling Work Was Incomplete with No Assigned Value

HUD Handbook 4150.2, CHG-1, paragraph 3-1, and HUD Handbook 4150.1, REV-1, paragraph 11-7A9. Had the appraiser researched the extent and cost of the work completed, he would have found that the remodeling work was not consistent with that listed in his appraisal. Interviews with owners, who purchased the units from the same seller, informed us that the only unit that contained all of the remodeling work described in the appraisal was one of the model units. Additionally, we confirmed that the remodeling work described in the appraisals was not consistent with the visual characteristics of the condominium units.

An Adjustment Was Needed to Reflect Comparable Units' Amenities

HUD Handbook 4150.2, appendix D-3, section 9. The building's design uses the upper level walkways and roof that extend over the lower floors' entry points, which the appraiser inappropriately characterized as a covered porch. This lack of a covered porch, which the comparable units originally used to support values in this project had, should have been taken into consideration in establishing the unit's appraised value.

The Unit's Value Conflicted with the Neighborhood's Predominant Value

HUD Handbook 4150.2, paragraph 4-1A. The appraiser failed to explain why there was such a large gap between the subject's appraised value of \$87,500 and the predominant value for the area of \$125,000. Had Suburban questioned the unexplained difference, it would have found that the predominant value for the area was based on single-family homes rather than condominiums. Further, the appraiser did not identify the significant concessions being paid by the seller that affected the sales price of the subject unit; i.e., all downpayment and closing costs were essentially paid by the seller.

The Project Did Not Meet HUD's 51 Percent Owner Occupancy Requirement

HUD Handbook 4150.1, REV-1, paragraph 11-3B. There were no documents in the FHA case file, including the comprehensive valuation packet or a 51 percent owner occupancy certification, to indicate that the 51 percent owner occupancy requirement had been met. Further, the appraiser also indicates in the "PUD" section in the appraisal that of the 28 total units in the condominium projects, about eight (28.57 percent) of the condominium units had been sold. Thus, the owner occupancy level did not meet the 51 percent requirement. This matter should have been addressed by Suburban during the underwriting process.

The Subject Property's Characteristics Were Not Identified

The appraiser failed to identify the specific unit being appraised, bringing into question the quality of care put into preparing the appraisal as a whole. In this regard, the appraiser had at least four other appraisals using the same three comparables within less than a four-week period with three different final values and no discussion as to why the values were different.

Appendix E

NARRATIVE CASE SUMMARIES – MORTGAGE CREDIT

E-01

HUD case number: 022-182617-7
Loan amount: \$139,707
Settlement date: March 31, 2005
Status: Active/delinquent
Indemnification: \$40,515

Suburban underwrote and approved this loan although the borrowers had an unacceptable credit history and unstable employment and no valid compensating factors needed to support their excessive debt-to-income ratio. As a result, HUD insured the loan based on Suburban's inaccurate representation that the borrowers met HUD qualifying guidelines. In addition, the lender allowed interested third parties to handle vital loan documents and did not ensure the validity of the bank account documentation submitted on behalf of the borrowers.

Unacceptable Credit History

HUD Handbook 4155.1, REV-5, paragraph 2-3. The borrower's credit report did not have sufficient information to rate and evaluate his credit history. Therefore, Suburban was responsible for establishing the borrower's credit through alternative methods, which it failed to do. Suburban did not pursue alternate credit such as utility payments, insurance, or other means through direct access from the credit provider. In addition, the borrower's limited credit history indicated a tendency to disregard liabilities; the primary credit history was composed of several collection accounts that appeared to have been paid off just before the borrower applied for the mortgage.

Unstable Employment

HUD Handbook 4155.1, REV-5, paragraph 2-6. Suburban failed to substantiate the borrower's employment stability. The borrower had four different employers and job positions in 16 months. In addition, a 10-month continuous gap in employment occurred, during which time the borrower claimed to have held miscellaneous day jobs that paid cash.

Excessive Debt-to-Income Ratio

HUD Handbook 4155.1, REV-5, paragraph 2-12A. Suburban failed to document valid factors to compensate for the borrower's excessive front-end debt-to-income ratio of 37.44 percent (versus HUD's maximum standard of 31 percent) and the substantial increase (over 40 percent) in housing cost. Suburban's claimed compensating factors of overtime income and ability to save were not supported by the verifications of employment and bank balances.

Interested Third-Party Handling and Validity of Loan Documents

HUD Handbook 4155.1, REV-5, paragraph 3-1. Suburban failed to obtain proper documentation to validate the borrower's source and amount of funds available. According to HUD policy, the lender is required to elicit a full financial picture of the borrower. However, a copy of the borrower's claimed earnest money check appears to have been faxed by the realtor (interested third party), and the bank statement used to validate the borrower's assets has no identifying logo to verify it as being from an authentic financial institution.

Recommendation

Indemnify HUD for the \$139,707 mortgage.

HUD case number: 023-199965-1
Loan amount: \$107,043
Settlement date: May 28, 2004
Status: Active/reinstated
Indemnification: \$31,042

Suburban underwrote and approved this loan without fully analyzing the borrower's credit. The lender did not obtain valid explanations of the borrower's poor credit history, update of the primary borrower's credit report that had exceeded the 120-day maximum timeframe allowed by HUD, or obtain a credit report for the primary borrower's nonpurchasing spouse to determine whether she had any outstanding debt that could have affected loan approval. Accordingly, the lender did not have the information necessary to determine whether the borrowers met HUD-required qualifying guidelines, including debt-to-income ratios.

Inadequate Evaluation of Credit/Debts

HUD Handbook 4155.1, REV-5, paragraphs 2-2D, 3-1, and 2-3. Suburban did not properly analyze the borrower's credit worthiness as it failed to obtain a credit report for the primary borrower's spouse. The lender is required to factor a nonpurchasing spouse's debts into the qualifying ratios in community property states. Suburban did not update the borrower's credit report that exceeded the maximum 120 days and, therefore, was outdated and not valid for loan analysis and approval. Suburban did not provide adequate compensating factors to justify the borrower's poor credit history, which showed an overall pattern of disregarding liabilities and a penchant for overspending.

Debt-to-Income Ratios Not Determined

HUD Handbook 4155.1, REV-5, paragraph 2-12B. Although the borrower minimally exceeded HUD's debt-to-income standard, the actual excess is unknown because Suburban used an outdated credit report for the borrower and did not obtain a credit report for the borrower's spouse.

Recommendation

Indemnify HUD for the \$107,043 mortgage.

HUD case number: 023-203364-5
Loan amount: \$92,140
Settlement date: May 19, 2004
Status: Conveyed
Loss to HUD: \$16,257

Suburban underwrote and approved the loan even though the borrower did not have an adequate employment history, had excessive delinquent credit accounts, and had excessive debt-to-income ratios without adequate compensating factors. Further, Suburban used the 2-1 interest rate buy-down program to qualify the borrower without documenting any compensating factors that would help her meet the increased mortgage payments when the buy-down terminated. HUD insured the loan based on Suburban's inaccurate representation that the borrower met HUD qualifying guidelines. Additionally, the seller contributed \$1,383 above the maximum contribution allowed by HUD, of which at least \$427 was used at closing to pay off some of the borrower's delinquent accounts. Therefore, a dollar-for-dollar reduction in the sale price of the home is required for the \$1,383 in excessive seller contributions.

Employment Stability Not Established

HUD Handbook 4155.1, REV-5, paragraph 2-6. Suburban could verify only 11 months of employment history for the borrower, far short of the 24 months expected by HUD guidelines. Suburban attempted to use training and education as a compensating factor for the lack of employment history. However, documentation in the loan file only supported two months of training that had taken place three and one-half years earlier.

Inappropriate Use of Buy-Down Rate

HUD Handbook 4155.1, REV-5, paragraphs 2-14B2 and 2-10C. Suburban approved this mortgage using a 2-1 interest rate buy-down program without providing compensating factors to establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to pay. Without the buy-down, the borrower's debt-to-income ratios (after adjustment for additional debt discussed below) would have been 44 percent (front) and 59 percent (back) ratios versus HUD's recommended maximums of 29 and 41 percent.

Failure to Properly Analyze Credit History

HUD Handbook 4155.1, REV-5, paragraphs 2-11A and 2-3. Suburban did not include a debt with monthly payments of \$231 (which had approximately 10 months of payments left) although the debt would have significantly affected the borrower's ability to make mortgage payments during the months immediately after loan closing. Further, Suburban did not obtain a valid and reasonable explanation of the circumstances relating to the borrower's nine delinquent accounts. The borrower's explanation that she used credit cards to support herself confirms that she was unable to properly manage her personal finances.

Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-5, paragraph 2-12. Suburban did not provide any factors to compensate for the borrower's exceeding the HUD qualifying ratios of 29 and 41 percent. The borrower's front ratio was 36.7 percent, and her back ratio was 51.7 percent (after taking into account the excluded debt discussed above).

Excess Seller Contribution

HUD Handbook 4155.1, REV-5, paragraphs 1-7A and B. Suburban did not reduce the maximum mortgage for the amount of seller contributions (\$1,383) that exceeded HUD's maximum allowable limit of 6 percent of sales price. This amount includes an unidentified deposit on behalf of the borrower totaling \$427, which was used to pay off several of the borrower's delinquent accounts at closing.

Interested Third Party Handled Documents

HUD Handbook 4155.1, REV-5, paragraph 3-1. Suburban improperly accepted documents relating to the borrower's credit, employment, and income that were handled by/transmitted from or through the interested third party's (seller's) equipment (fax machine).

Recommendation

Indemnify HUD for the loss \$16,257

HUD case number: 023-209453-6
Loan amount: \$114,973
Settlement date: May 26, 2004
Status: Terminated
Indemnification: \$7,135 Partial Claim

Suburban underwrote and approved the loan although the borrower had excessive debt-to-income ratios without adequate compensating factors. Further, Suburban used the 2-1 interest rate buy-down program to qualify the borrower without documenting any compensating factors that would help her meet the increased mortgage payments when the buy-down terminated. HUD insured the loan based on Suburban's inaccurate representation that the borrower met HUD qualifying guidelines. Additionally, Suburban allowed the seller to pay off borrower collection accounts totaling \$272 in violation of HUD policy, resulting in an overinsured mortgage.

Excessive Debt-to-Income Ratio

HUD Handbook 4155.1, REV-5, paragraphs 2-12A, 2-13E, Suburban approved this mortgage although the borrower's mortgage payment-to-income ratio of 38 percent exceeded HUD's maximum of 31 percent. In accordance with HUD requirements, if this maximum ratio is exceeded, valid compensating factors must be present. The only compensating factor provided by Suburban was an undocumented possibility of future child support. The information documented in the file did not document the potential that the borrower would receive child support income as required by HUD. Additionally, the ratios used by the lender were computed based upon a short-term interest rate buy-down (see below).

Inappropriate Use of Buy-Down Rate

HUD Handbook 4155.1, REV-5, paragraphs 2-14B2 and 2-10 C. Suburban approved this mortgage based upon a 2-1 interest rate buy-down program without providing any compensating factors to establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to pay. Without the buy-down, the borrower's debt to income ratios would have been 45 percent (both front and back), significantly exceeding HUD's recommended maximums of 29 and 41 percent. Such an increase would have adversely affected the borrower's ability to meet her monthly mortgage obligation.

Ineligible Contribution

HUD Handbook 4155.1, REV-5, paragraph 2-10C. The lender violated HUD's policy by allowing the seller to pay off the borrower's debt (\$272), which is an inducement to purchase requiring a dollar for-dollar-reduction in the selling price.

Recommendation

Indemnify HUD for the \$7,135 partial claim paid.

HUD case number: 023-209991-8
Loan amount: \$92,140
Settlement date: May 25, 2004
Status: Conveyed
Loss to HUD: \$6,371

Suburban used the 2-1 interest rate buy-down program to qualify the borrower for the mortgage without documenting any compensating factors that would help her meet the increased mortgage payments when the buy-down terminated. In addition, the lender did not reduce the maximum insurable mortgage for \$1,147 in excessive seller contributions used to meet closing costs and to pay off borrower collection accounts. Also, Suburban did not properly analyze the borrower's credit history and allowed the seller to handle critical loan documents in violation of HUD policy.

Inappropriate Use of Buy-Down Rate

HUD Handbook 4155.1, REV-5, paragraph 2-14B2. Suburban approved this mortgage using a 2-1 interest rate buy-down program without providing compensating factors to establish that the eventual increase in mortgage payments would not adversely affect the borrower's ability to pay. Without the buy-down, the borrower's debt-to-income ratios would have been 32 percent (front) and 50 percent (back) versus HUD's recommended maximums of 29 and 41 percent. Interest buy-down programs are designed to reduce the borrower's payment during the early years of the mortgage. However, the lender must establish that the eventual increase in mortgage payments would not adversely affect the borrower and lead to default. This can be done by 1) establishing that the borrower has the ability to increase earnings/income, 2) demonstrating the borrower's ability to manage financial obligations in a way so that more income can go to housing, or 3) documenting that the borrower has substantial assets to cushion the increase or that the cash investment substantially exceeded the minimum required. However, in this instance, the borrower had minimal savings and had no housing expenses before the purchase of the home.

Excessive and Ineligible Seller Contributions

HUD Handbook 4155.1, REV-5, paragraphs 1-7A and 2-10C. The seller paid \$6,144 of the borrower's closing costs (including the loan discount and the buy-down fee), which is \$445 more than the 6 percent of purchase cost (\$5,699) maximum allowed by HUD. Additionally, \$702 was provided on behalf of the borrower at closing to pay off her collection accounts. The excessive payment for borrower closing costs (\$445) and the payment of the borrower's collection accounts (\$702) are considered unallowable purchase inducements, which should have resulted in a dollar-for-dollar reduction in the sale price of the property. Since Suburban failed to take these inducements into account, the mortgage is overinsured by \$1,147.

Inadequate Analysis of Borrower's Credit

HUD Handbook 4155.1, REV-5, paragraph 2-4A2. The lender did not reconcile or explain discrepancies in the loan file related to two outstanding debts with monthly payments of \$116 listed on the borrower's credit report. The report indicated that the borrower, although an authorized user on the account, was not responsible for the debt. Accordingly, Suburban did not include these as borrower debts when determining the borrower's debt-to-income ratios. However, borrower bank statements in the loan file show that the borrower is making the monthly payments on these accounts. The lender should have resolved this discrepancy and determined who was responsible for and was paying these debts. By paying the debt, the borrower took responsibility for the debt, and the liabilities should have been factored into her qualifying ratios. If this had been done, the borrower's total debt-to-income ratio would have been 45.4 percent (taking into consideration the 2-1 interest rate buy-down discussed above the debt-to-income ratio would have been 56.9), which exceeded HUD's standard of 41 percent.

Interested Third Party Handled Documents

HUD Handbook 4155.1, REV-5, paragraph 3-1. Suburban improperly accepted documents relating to the borrower's credit, employment, and income that were handled by/transmitted from or through the interested third party's (seller's) equipment (fax machine).

Recommendation

Indemnify HUD for the \$6,371 loss resulting from the foreclosure and resale of the property.

HUD case number: 023-2209240
Loan amount: \$92,050
Settlement date: February 2, 2005
Status: Conveyed
Loss to HUD: \$12,996

Suburban underwrote and approved this loan although the borrower had only a limited and unstable employment history and a limited credit history (including an unexplained collection account) and had no compensating factors that would justify significantly exceeding HUD's debt- to- income ratio standards. In addition, Suburban allowed an interested third party to handle vital loan documents in violation of HUD requirements.

Inadequate Employment and Income History

HUD Handbook 4155.1, REV-5, paragraph 2-6. Suburban failed to demonstrate that the borrower had a stable income and employment history. The borrower had been employed at his current job for only one month. Suburban loosely substantiated an additional year of employment through another verification of employment and borrower statements. However, actual employment history was verified for only the five months before the loan application. During this period, the borrower had two different jobs and was unemployed for one month between the two jobs. This limited and unstable employment history did not meet HUD's requirements for two years' verified employment and a stable employment and income history.

Excessive Debt-to-Income Ratio

HUD Handbook 4155.1, REV-5, paragraph 2-12A. The borrower's mortgage payment- to-debt ratio (front) of 41 percent significantly exceeded HUD's standard of 29 percent. However, Suburban failed to identify any compensating factors to justify approval of this high-ratio loan. In this regard, the borrower's housing expense was going up more than 75 percent; and he had "\$0" confirmed reserves, unstable employment, and no real credit history. Accordingly, there were no factors, which would have justified the approval of this high-ratio loan.

Inadequate Credit Analysis

HUD Handbook 4155.1, REV-5, paragraph 2-3. The borrower had a very limited credit history (less than one year). This limited credit history included a collection account. However, Suburban did not obtain a written explanation from the borrower describing the circumstances related to this account as required by HUD.

Interested Third Party Handled Documents

HUD Handbook 4155.1, REV-5, paragraph 3-1. Suburban improperly accepted documents relating to the borrower's credit, employment, and income that were handled by/transmitted from or through the interested third party's (seller's) equipment (fax machine).

Recommendation

Indemnify HUD for the \$12,996 loss resulting from the foreclosure and resale of the property.

HUD case number: 023-221521-7
Loan amount: \$113,883
Settlement date: March 8, 2005
Status: Active
Indemnification: \$33,026

Suburban failed to document any compensating factors to justify its approval of this high-ratio loan; the mortgage payment-to-income ratio was 41.4 percent versus HUD's 29 percent standard. Additionally, the seller apparently provided \$653 at closing to pay off two borrower collection accounts. HUD considers such payments inducements to purchase and requires a dollar-for-dollar reduction in the sales price and, in this instance, the maximum insurable mortgage. Further, the lender used documents that did not meet HUD standards to verify the borrower's assets used to pay closing costs. A bank statement and a cash flow ledger did not have identifying institutional logos required if used to verify sources of funds. Suburban did not adequately analyze the borrower's credit history including not resolving contradictory credit information and not identifying any acceptable credit history for the borrower. Finally, Suburban allowed an interested third party to handle vital loan documents in violation of HUD requirements. The combined problems associated with this loan resulted in an unacceptable insurance risk to HUD.

Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-5, paragraph 2-12A. Suburban failed to provide any compensating factors that justified approval of this high-ratio loan. The borrower's mortgage-to-income ratio (front) was 41.4 percent versus HUD's standard of 29 percent. HUD requirements allow for approval of loans involving high debt-to-income ratios only if significant compensating factors are present. In this case, not only were there no identified compensating factors, but the borrower also had no reserves, his housing expense was going up almost 50 percent, and he had a poor credit history.

Borrower's Assets Not Properly Verified

HUD Handbook 4155.1, REV-5, paragraph 3-1. Documents used to verify the borrower's deposits in a financial institution can be used only if they clearly identify their source (financial institution's name, address). The lender used a computer-generated cash flow statement that did not have the borrower's account number or the identity of the financial institution. Additionally, the lender used bank statements that were more than five months old to verify one account. Accordingly, the funds the borrower needed for loan closing were not adequately verified.

Ineligible Third Party Contribution

HUD Handbook 4155.1, REV-5, paragraphs 2-10C. The borrower informed us that he did not provide the \$653 provided at closing to pay off his collection accounts and he believes these funds were provided by either the seller or the lender. HUD considers such payments inducements to purchase and requires a dollar-for-dollar reduction in the sales price and, in this instance, the maximum insurable mortgage. The lender did not verify the source of the funds used to pay off these debts. In this regard, a review of information in the file indicates that the borrower historically had little money available to meet other than normal living expenses as he consistently had bank overdrafts, often resulting from minor purchases.

Inadequate Analysis of Borrower's Credit History

HUD Handbook 4155.1, REV-5, paragraph, 2-3. Suburban did not adequately analyze the borrower's credit history. The majority of the borrower's credit history was composed of collection and charge-off accounts, several of which were paid off at closing (see above). One of the two noncollection accounts listed on the credit report showed that there had never been any activity on the account. The other account listed was for the apartment complex where the borrower was renting. However, although the credit report showed a good rental history, the report also showed a court judgment obtained by the same complex against the borrower. The lender did not resolve this apparent conflicting information. Thus, the lender did not document that the borrower had any acceptable credit history.

Interested Third-Party Handling of Documents

HUD Handbook 4155.1 REV-5, paragraph 3-1. Lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment. However, Suburban accepted income and asset documents relating to this mortgage that were sent from the seller's fax machine.

Recommendation

Indemnify HUD for the \$113,883 mortgage.