AUDIT REPORT

NATIONAL CITY MORTGAGE COMPANY
NON-SUPERVISED MORTGAGEE
BUFFALO, NEW YORK

2001-NY-1004

AUGUST 23, 2001

OFFICE OF AUDIT
NEW YORK/NEW JERSEY

Issue Date	August 23, 2001
Audit Case Number	2001-NY-1004

TO: Engram Lloyd, Director, Homeownership Center
Philadelphia, Pennsylvania, 3AHH

Alexander C. Malloy

FROM: Alexander C. Malloy, District Inspector General for Audit, 2AGA

SUBJECT: National City Mortgage Company
Non-Supervised Mortgagee
Buffalo, New York

We completed an audit of the books and records of National City Mortgage Company, (National) a non-supervised mortgagee. The objective of the audit was to determine whether National originated loans in accordance with the requirements of the U.S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices. The review covered the period between December 1, 1998 and November 30, 2000.

Our review concluded that for seven of the 33 loans we reviewed, National did not adhere to prudent lending practices during the underwriting process. In addition, we found that National did not properly account for prepaid items paid on behalf of the borrower and did not have adequate controls to ensure that appraisals were completed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

Within 60 days, please provide us for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this audit.

Should you or your staff have any questions, please contact William H. Rooney, Assistant District Inspector General for Audit, on (212) 264-8000, extension 3976.

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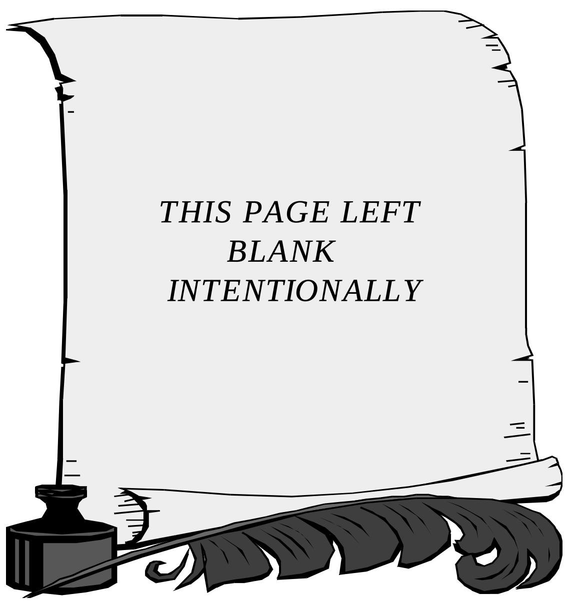
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Executive Summary

We completed an audit of the books and records of the Buffalo Branch Office of National City Mortgage Company, (National) a non-supervised mortgagee. The objective of the audit was to determine whether National originated loans in accordance with regulations and requirements of the U.S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices. The review covered the period between December 1, 1998 and November 30, 2000, and consisted of a review of 33 HUD/FHA insured loans. A summary of the results of our review is provided below.

Four loans in default

Our review concluded that for seven of the 33 loans we reviewed, National did not adhere to prudent lending practices during the underwriting process. Our review disclosed that each of the seven loans had at least one significant processing deficiency and that four were in default. The specific processing deficiencies were: earnest money was not verified, minimum investments were not provided, income was overstated, sources of gift funds were not verified, loan ratios exceeded HUD/FHA standards, and funds from an unsecured loan was used as an earnest money deposit. We believe these deficiencies occurred because National's personnel did not assure that those loans were processed in accordance with HUD/FHA requirements. Consequently, mortgages were approved for unqualified borrowers causing HUD/FHA to assume an unnecessary insurance risk.

Prepaid items not properly accounted

Our review also disclosed that National did not properly accounted for prepaid items that were paid on behalf of the borrowers. In this regard, National failed to identify the premium pricing credits and the seller contributions on both the Good Faith Estimate and the HUD-1 Settlement Statement. For 21 of the 33 loans we reviewed, we found that National or the sellers paid prepaid items on behalf of the borrowers, but the amounts paid were not itemized on neither the Good Faith Estimate nor the HUD-1 Settlement Statement. Also, for 18 of those loans, National provided a premium pricing credit to the borrowers, however, the amount was only shown as a lump sum on the HUD-1 Settlement Statement. We believe these deficiencies occurred because National did not adequately review loan closing documents to ensure that all requirements were met. As a result, we found four loans where the borrowers did not meet the minimum required cash investment.

Appraisals not properly completed

Additionally, our review disclosed that for six of the 33 loans reviewed the appraisal did not indicate that there was a prior sale of the property. This occurred because National did not have adequate controls to ensure that appraisals were completed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). As a result, HUD/FHA based its decision to insure the loans on incomplete and/or inaccurate information.

Recommendations

Regarding the first finding (inadequate loan origination practices), we recommend that you indemnify HUD/FHA against future losses on five of the seven loans in question. Regarding the second and third findings, we made specific recommendations for your action.

Exit Conference

The results of the audit were discussed with representatives of National during the course of the audit and at an exit conference held on July 10, 2001, at National's Buffalo Branch Office. National provided documentation, which supported that the minimum cash investment had been met by the borrower in one of the cases in our review. Therefore, we revised Finding 1 to reflect the correction supported by the documentation provided. National indicated that they would provide a written response to the findings upon request from the Philadelphia Homeownership Center.

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Abbreviations

FHA	Federal Housing Administration
HUD	U.S. Department of Housing and Urban Development
OIG	Office of Inspector General
USPAP	Uniform Standards of Professional Appraisal Practice

Introduction

National City Mortgage Company (National) is a non-supervised mortgagee with its headquarters located in Miamisburg, Ohio. The Buffalo Branch Office originates loans in the western area of the State of New York and is located at 5500 Main Street, Suite 210, Williamsville, New York, 14221. National's Regional Office for underwriting and closings loans is located at 60 Hickory Drive, Waltham, Massachusetts.

During our audit period, from December 1, 1998 to November 30, 2000, National's Buffalo Branch Office originated 238 HUD/FHA loans under the Direct Endorsement Program. At May 1, 2001, the mortgages for 15 of the 238 loans were in default. National originates and services HUD/FHA insured loans, Veterans Administration insured loans, and conventional loans.

Audit Objectives

Our audit objectives were to determine whether National originated its HUD/FHA mortgages in accordance with HUD requirements, which required adherence to prudent lending practices, and to determine whether National's quality control plan, as implemented, meets HUD requirements.

Audit Scope and Methodology

The purpose of our examinations were to confirm the accuracy of all material information used as a basis for originating and closing the loans. We obtained background information by:

- Reviewing relevant HUD regulations, requirements and Mortgagee Letters.
- Examining records and reports maintained on HUD's Single Family Insurance System, Neighborhood Watch Early Warning System, Single Family Acquired Asset Management System and Computerized Home Underwriting Management System.
- Interviewing HUD's Philadelphia Homeownership Center Staff.

To accomplish our audit objectives, we performed an examination of 33 loans. We review the files of 12 loans that had gone into default. The remaining 21 loans consisted of 17 loans that were randomly selected using Audit Command Language (ACL) software and four loans that involved the same seller who sold the properties after holding them for less than a year.

Our audit procedures included: (a) a reconfirmation of the borrowers' income and assets, (b) a verification of selected data on the settlement statements; and (c) interviews with the borrowers, members of HUD and National staff, Appraisers, and Closing Agents.

Audit Period

We performed the audit field work between March 2001 and June, 2001. Our audit pertained to loans generally originated between December 1, 1998, and November 30, 2000. However, as necessary, we reviewed loan activity prior and subsequent to our audit period. Our audit work was performed at National's Buffalo, New York and Waltham, Massachusetts Offices, in accordance with generally accepted governmental auditing standards.

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A copy of this report was provided to National.

Inadequate Loan Origination Practices Resulted in Approval of HUD/FHA Insured Loans for Unqualified Borrowers

Our review disclosed that National did not adhere to prudent lending practices when processing seven of the 33 loans that we examined during our audit. We noted that processing deficiencies occurred because National personnel did not assure that the loans were processed in accordance with HUD/FHA requirements. As a result, mortgages were approved for unqualified borrowers causing HUD/FHA to assume an unnecessary insurance risk.

Section 2-1 of HUD Handbook 4000.4 REV-1, Single Family Direct Endorsement Program requires mortgagees to develop HUD/FHA insured loans in accordance with accepted sound mortgage lending practices. Also, HUD Handbook 4000.4 REV-l, Chapter 2, Section 2-5, provides that the mortgagee must obtain and verify information with at least the same care that would be exercised in originating the loan in which the mortgagee would be entirely dependent on the property as security to protect its investment.

In our opinion, National did not adhere to the above requirements, as discussed below, when it underwrote seven of the 33 loans we reviewed.

Examined 33 loans

Our examination of 33 loans originated by National between May 1, 1998, and November 30, 2000, disclosed that in seven cases National either did not follow HUD requirements or did not exercise the care expected of a prudent lender in underwriting the loans. Consequently, we found significant origination deficiencies in seven cases, as shown below:

Deficiency	Number of Loans
Earnest Money Not Verified	2 of the 7 loans
Minimum Investment Not Provided	6 of the 7 loans
Overstated Income and Understated Ratio	1 of the 7 loans
Source of Gift Not Verified	2 of the 7 loans
Ratios Exceeded HUD/FHA Standards	1 of the 7 loans
Unsecured Loan Used for Earnest Money	1 of the 7 loans

Additionally, the mortgages of four of the seven cases were in default as of May 1, 2001 (See Appendix A).

Appendix A to this report provides a summary of the loan origination deficiencies noted during our review, while Appendixes B-1 through B-7 provide an individual description of the origination deficiencies for each of the seven loans[1] that National did not adhere to prudent lending practices. The deficiencies occurred because National representatives did not adhere to HUD/FHA requirements, nor comply with prudent lending practices. In our opinion, the deficiencies resulted in the approval of mortgages for unqualified borrowers, which have caused HUD/FHA to assume an unnecessary risk.

Recommendations

We recommend that the you require National to:

1A. Indemnify HUD/FHA against future losses on five of the seven loans in question (FHA Case Nos. 372-2942863, 372-2800182, 372-2840385, 372-2864510 and 372-2889830).

1B. Provide your office with an explanation and a corrective action plan to assure that all HUD/FHA guidelines regarding origination and underwriting are followed by its loan processing, underwriting and closing employees.

[1] When we provided draft copies to the HUD Philadelphia Homeownership Center for comment, we were advised that if a deficiency is less than $500, the deficiency would not warrant indemnification but would require corrective action regarding future cases. Because two of our seven cases involved deficiencies that were less than $500, we recommended that five of the seven cases be indemnified.

National Did Not Comply With Requirements Pertaining to Prepaid Items

National did not properly accounted for prepaid items paid on behalf of the borrowers. National failed to identify the premium pricing credits and seller contributions on both the Good Faith Estimate and the HUD-1 Settlement Statement. We attribute this to National's failure to adequately review loan closing documents to ensure that all requirements were met. As a result, we found four[1] loans where the borrowers did not meet the minimum required cash investment.

Criteria

According to Handbook 4155.1 Rev-4, CHG-1, Paragraph 1-9, the Good Faith Estimate and the HUD-1 must provide an itemized statement indicating which items are being paid on the borrowers' behalf. The disclosure of only a lump sum amount is not acceptable. Also, Mortgagee Letter 98-29, Single Family Loan Production - Mortgage Calculation Simplification, provides that the National Housing Act requires the minimum cash investment to be 3 percent of the estimated cost of the property's acquisition. HUD/FHA has determined that the minimum cash investment should be based on the property's sales price without considering loan closing costs.

Reviewed 33 Loans

We conducted a review of prepaid items for all 33 loans in our sample. We reviewed the Mortgage Credit Analysis Worksheet to determine whether any premium pricing credits or seller contributions were identified. Also, we examined the HUD-1's to determine if any prepaid items existed that were not identified on the Mortgage Credit Analysis Worksheet. For those loans in which we identified prepaid items, we reviewed the Good Faith Estimate and the HUD-1 Settlement Statement to determine if the items paid on behalf of the borrowers were itemized.

21 loans where prepaid amounts were not itemized

There were 25 loans in which National or the seller paid prepaid items on behalf of the borrowers. In 21 of those loans, the amounts paid were not itemized on neither the

[1]In Finding 1, we mentioned six loans did not meet the minimum cash investment requirement. As addressed in this Finding; four of the six loans did not meet the minimum cash investment requirement because of premium pricing credits and seller contributions. The four cases were HUD/FHA case numbers 372-2800182,372-2707963,371-2805940 and 372-2864510.

Good Faith Estimate nor the HUD-1 Settlement Statement. There were 18 loans that National provided a premium pricing credit to the borrower. In all of these loans, the amount was shown as a lump sum on the HUD-1 Settlement Statement.

We discussed this situation with National's Regional Underwriting Manager. The Underwriting Manager examined 11 of the loans to determine if they were in fact loans containing premium pricing credits. After consulting several other National staff, the Underwriting Manager concluded that any time National pays any of the borrowers' costs it should be considered premium pricing credits.

Borrowers did not meet the minimum cash requirement

Next, we explained that for four of the loans that National paid costs on behalf of the borrowers, the borrowers did not meet the minimum cash investment requirement. The Underwriting Manager explained that the underwriters calculate the minimum investment requirement on the Mortgage Credit Analysis Worksheet. However, it is the responsibility of the Closing Department to make the underwriters aware of any items recorded on the HUD-1 that would affect the minimum cash investment.

When we spoke with the Regional Operations Manager, who is responsible for the Closing Department, the Manager explained that the underwriters generally verify the minimum cash investment requirement. We asked the Operations Manager about items that occur at closings such as funds returned to the borrower. The Operations Manager was unsure of whether the post closing review that is performed at National's headquarters would check to determine if the minimum cash investment had been met.

Closing Department responsible for ensuring minimum cash investment is met

Subsequent to our conversation with the Operations Manager, we followed-up with the Underwriting Manager and were told that the Operations Manager agreed that it is the responsibility of the Closing Department to ensure that the minimum cash investment requirement is met.

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Closing instructions did not include procedures on costs paid on borrowers behalf

In addition, during our review we determined that the Closing Department provided the closing attorneys with loan closing instructions. The instructions included procedures regarding the sellers contribution. However, the instructions did not include procedures regarding the costs National pays on behalf of the borrowers. Furthermore, the loan closing instructions for the four loans where the borrowers did not meet the minimum cash investment did not include any instructions regarding the required minimum cash investment.

We explained to the Underwriting Manager that it is National's responsibility to ensure that items paid on behalf of borrowers are itemized on the Good Faith Estimate and the HUD-1 Settlement Statement. Also, National must ensure that each borrower meets the minimum cash investment. The Underwriting Manager claimed that National was aware of this, but after talking to the loan closing staff it became apparent that the closing staff was not paying as much attention to these items as they should have been.

Recommendations

We recommend that you require National to:

2A. Ensure that all items prepaid by either National or the sellers on behalf of borrowers are itemized on both the Good Faith Estimate and the HUD-1 Settlement Statement.

2B. Include minimum cash investment instructions as part of the loan closing instructions to the closing attorneys and ensure that each borrower has met the minimum cash requirement.

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National Did Not Ensure That Appraisals Were Properly Completed

Our review disclosed six cases that the appraisal did not indicate that a prior sale of the property occurred less than a year before the appraisal. National has not developed adequate controls to ensure that appraisals are completed in accordance with Uniform Standards of Professional Appraisal Practice (USPAP). As a result, HUD/FHA based its decisions to insure the loans on incomplete and /or inaccurate information. Mortgagee Letter 94-54 states that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal.

Criteria

Mortgagee Letter 96-26 provides that each appraisal shall conform to the USPAP and further states that each appraisal shall analyze and report in reasonable detail all prior sales of the property being appraised that occurred within one year preceding the date when the appraisal is prepared.

Standard Rule 1-5(b) of the USPAP states that when developing a real property appraisal, an appraiser must analyze any prior sale of the property that occurred within one year for the one to four-family residential property. Further, under the comments to Standard rule 2-2 (a) (xi), it states that when the purpose of the assignment is to develop an opinion of market value, a summary of the results of the information required by Standards Rule 1-5 is required. If such information was unobtainable, a statement of the efforts undertaken by the appraiser to obtain the information is required.

Appraisals Failed to Disclose Prior Sales

Prior sales not disclosed

Our review disclosed that appraisals for six loans in our sample did not disclose that a prior sale had occurred less than a year before the appraisal. In each case, the property had been purchased and then resold within a short period of time at a higher price with a FHA/HUD insured borrower as shown below:

Case Number	Date of Prior Sale	Prior Sale Purchase Price	Date of HUD/FHA Mortgage Sale	HUD/FHA Mortgage Purchase Price
371-2805940	12/7/99	$44,000	2/2/00	$61,064
372-2800182	5/4/98	$21,500	7/31/98	$44,500
372-2811728	5/15/98	$23,500	8/28/98	$48,000
372-2839341	8/14/98	$18,000	11/5/98	$42,900
372-2885477	10/30/98	$23,250	4/9/99	$48,900
372-2889830	10/16/98	$22,000	4/26/99	$46,000

For five of the six properties, the same entity originally purchased the properties and then resold the properties within 6 months. In fact the sales contract for 372-2800182 was dated April 30, 1998, which was four days prior to the entity purchasing the property. None of the appraisals disclosed the prior sale and the date that the prior sale occurred.

National did not Adequately Review Appraisals

Appraisals not adequately reviewed

National's staff indicated that if they had been aware of the prior sale they would have based the loan amount on the prior sales price. Our review disclosed that the same loan officer processed all five cases where the entity referred to above was the seller. The loan officer, who is no longer employed by National, stated that the entity selling the properties was in the business of purchasing and reselling properties and that National's staff knew that these properties had been involved in prior sales.

Mortgagee Letter 94-54 states that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. Further. Section 3-3 G of HUD Handbook 4000.4, Single Family Direct Endorsement Program requires the mortgagee's underwriter to review the appraisal to determine whether or not the appraiser's conclusions are acceptable. In our opinion, National did not use due diligence when reviewing the appraisals to ensure that appraisers were complying with USPAP requirements, especially since a member of its staff was aware that the seller was involved in properties being resold in short periods of time. As a result, the appraisals did not provide complete information; thus, this may have prevented an accurate valuation of the properties, which would have affected the maximum insurable mortgage amounts.

Recommendations

We recommend that National be instructed to:

3A. Implement adequate controls to ensure that appraisal are in compliance with all USPAP Standards.

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Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure its goals are met. Management controls include the processes for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance.

Relevant Management Controls

We determined the following management controls were relevant to our audit objective:

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

We assessed all of the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe that significant weaknesses exist in the following management controls. These weaknesses are described in the findings section of this report.

- National did not develop adequate procedures regarding origination of HUD/FHA loans and conducting underwriter reviews of loans proposed for HUD/FHA mortgage insurance, Finding 1 (Program Operations).

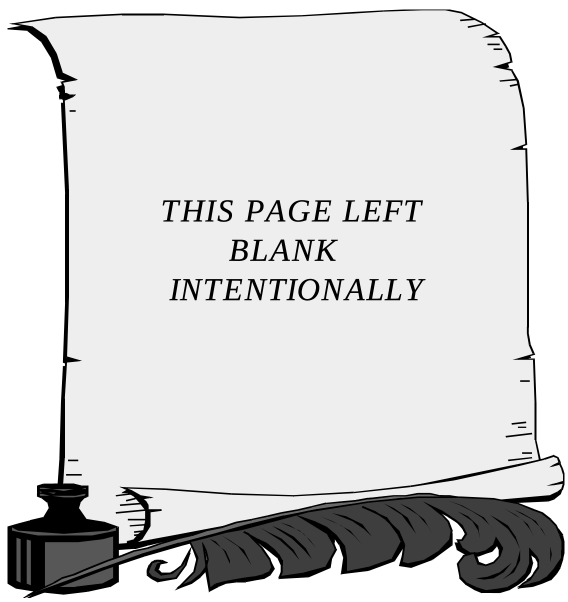
- National did not develop adequate closing policies, Finding 2 (Compliance with Laws and Regulations).

- National did not implement adequate procedures to ensure accurate mortgage information, Finding 1 (Validity and Reliability of Data), (Compliance with Laws and Regulations).

- National did not implement adequate controls regarding appraisers, Finding 3 (Validity and Reliability of Data).

Follow Up On Prior Audits

Ernst & Young LLP, Certified Public Accountant, audited National City Mortgage Company for the Year ended December 31, 1999. The accounting firm's audit report on National did not contain any findings related to the Buffalo Office.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Summary of Loan Origination Deficiencies

NATIONAL CITY MORTGAGE COMPANY
Buffalo, New York

SUMMARY OF LOAN ORIGINATION DEFICIENCIES

HUD/FHA Case Number	Mortgage Amount	Settlement Date	Earnest money Not Verified	Minimum Investment Not Provided	Overstated Income & Understated Ratios	Source of Gift Not Verified	Ratios exceeded HUD/FHA standards	Unsecured Loan used for Earnest Money	Loan status as of 10/1/97	Appendix Reference
372-2942863	$90,286	12/22/99	X	X					In Default	B-1
372-2800182	$44,928	7/31/98		X	X				Loan is current.	B-2
371-2707963	$84,918	6/3/99		X					Loan is current.	B-3
371-2805940	$60,634	2/28/00		X					In Default	B-4
372-2840385	$64,969	1/21/99				X	X		In Default	B-5
372-2864510	$43,143	12/31/98		X		X		X	In Default	B-6
372-2889830	$46,447	4/26/99	X	X					Loan is current.	B-7
Totals	$435,325		2	6	1	2	1	1		

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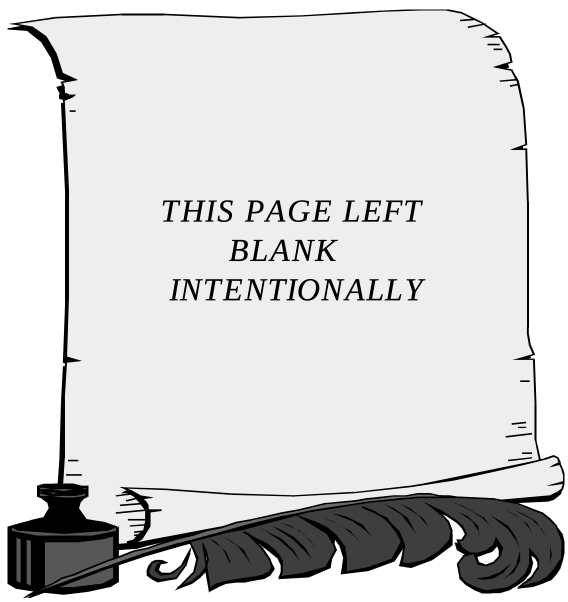
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Narrative Case Presentations

FHA Case Number:	372-2942863
Loan Amount:	$90,286
Settlement Date:	12/22/99
Status:	Default - last payment made 2/1/00

Summary

National approved the mortgage without resolving a significant discrepancy that existed between the amount of earnest money held by the broker and the amount reported on the HUD-1. Without the earnest money the borrower would not have had sufficient funds to meet the minimum cash investment requirement. Therefore, HUD/FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD/FHA requirements.

Pertinent Details

A. Source of Earnest Money Deposit Funds Not Verified
B. Borrower Did Not Provide the Minimum Required Cash Investment

National did not resolve a significant discrepancy regarding the amount of earnest money on deposit. On the application, earnest money was listed as $650 and the seller/builder provided verification in the form of a check from the borrower that $650 in earnest money was being held as a deposit. The Mortgage Credit Analysis Worksheet did not list any earnest money; however, the HUD-1, Settlement Statement listed $3,000 as the amount of earnest money that was on deposit. In this regard, there was no documentation in the file to verify that the borrower provided the $3,000, in earnest money. During an interview, the borrower stated that only $650 was provided as earnest money, not the $3,000, as stated on the HUD-1. In addition, the HUD-1 listed $203.40 as cash due from the borrower at the loan closing. Pertaining to this, the borrower stated that no additional funds were provided at the closing. Neither National nor its closing agent verified that the $3,000 of earnest money existed or that the borrower provided the $203.40 due at the loan closing. As a result, the borrower did not provide the minimum required cash investment.

FHA Case Number: 372-2800182

Loan Amount: $44,928

Settlement Date: 7/31/98

Status: Current

Summary

National approved the mortgage although the borrower did not meet the minimum cash investment requirement. Our review disclosed that the borrower invested $497.67 less than the required minimum cash investment. Also, National incorrectly calculated the borrower's income regarding a bonus. As a result of this miscalculation, the total fixed payment to determine the income ratio was 47.61 percent, not 44.65 percent as indicated on the Mortgage Credit Analysis Worksheet. Therefore, HUD/FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD/FHA requirements.

Pertinent Details

A. Borrower Did Not Provide the Minimum Required Cash Investment

The borrower made a deposit of $1,300 and paid $255 for a credit and appraisal report. At the loan closing National returned $499.43 to the borrower; thus, the borrower's total cash investment was $1,055.57. The $1,055.57 is $497.67 less than the required minimum cash investment of $1,553.24 The National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the cost of the acquisition of the property. HUD/FHA determined that the minimum cash investment was to be based on the property's sales price without considering loan closing costs (Mortgagee Letter 98-29, October 22, 1998). A review of the loan closing file did not disclose any documentation indicating that National identified or instructed the Closing Attorney as to the amount of minimum cash investment that was to be made by the borrower.

B. Overstated Income and Understated Credit Ratios

National indicated on the Mortgage Credit Analysis Worksheet that the borrower's monthly bonus wages were $759. Handbook 4155.1 REV-4 CHG 1, Paragraph 2-7A, allows for the use of bonus income, if the borrower has received such income during the past two years and there are reasonable prospects of its continuance.

In such cases the mortgagee must develop an average estimate of the bonus amount or overtime income for the past two years. Based on the information on the Verification of Employment form, the borrower averaged $7,258.43 in bonuses each year. This would amount to $604.87 per month, not $759 per month as computed by National. As a result, National approved the loan using inaccurate income amounts, which understated the fixed payment used to determine the income ratio. The correct ratio amount was 47.61 percent not the 44.65 percent as indicated on the Mortgage Credit Analysis Worksheet. More importantly, the total fixed payment to the effective income ratio had already exceeded the 41 percent standard that was in effect at the time the loan was approved.

FHA Case Number: 371-2707963

Loan Amount: $84,918

Settlement Date: 6/3/99

Status: Current

Summary

National approved the mortgage although the borrower did not meet the minimum cash investment requirement. Our review disclosed that the borrower invested $447.29 less than the minimum required cash investment. Therefore, HUD/ FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD/FHA requirements.

Pertinent Details

A. Borrower Did Not Provide the Minimum Required Cash Investment

The borrower's earnest money deposit of $500, plus the $1,602.71 paid at the loan closing totaled $2,102.71 as the borrower's investment. The $2,102.71 is $447.29 less than the minimum required cash investment of $2,550. The National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the cost of acquisition of the property. HUD/ FHA determined that the minimum required cash investment was to be based on the property's sales price without considering loan closing costs. (Mortgagee Letter 98-29, October 22, 1998)

FHA Case Number: 371-2805940

Loan Amount: $60,634

Settlement Date: 2/28/00

Status: Default – Last payment made 7/1/00

Summary

National approved the mortgage although the borrower did not meet the minimum cash investment requirement. Our audit disclosed that the borrower invested $30.84 less than the required minimum cash investment. Therefore, HUD/ FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD requirements.

Pertinent Details

A. Borrower Did Not Provide the Minimum Required Cash Investment

The borrower's earnest money deposit of $2,000, less the $198.92 returned to the borrower at loan closing, left a total of $1,801.08. The $1,801.08 is $30.84 less than the required minimum cash investment of $1,831.92 . The National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the cost of acquisition of the property. HUD/FHA determined that the minimum cash investment was to be based on the property's sales price without considering loan closing costs. (Mortgagee Letter 98-29, October 22, 1998)

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FHA Case Number: 372-2840385

Loan Amount: $64,969

Settlement Date: 1/21/99

Status: Default – Last payment made 11/1/99

Summary

National approved the mortgage without verifying the source of gift funds deposited into the borrower’s account. Furthermore, the borrower's 35.26 percent ratio of mortgage payment to effective income exceeded HUD/FHA's standard of 29 percent. Therefore, HUD/FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD requirements.

Pertinent Details

A. Source of Gift Not Verified

National did not verify the source of gift funds as required by Handbook 4155.1 Rev-4, Paragraph 2-10C. The file contains a gift letter form, copies of a official bank check for $1,150, and a money order for $400, totaling $1,550, along with a letter from the borrower's bank statements identifying $1,150 as being deposited into the borrower’s bank account. The file did not contain documentation showing the donor's source of the funds. National's gift letter form requests information as to the donor's source of funds, such as the depository name and address, and the account number, however, that information was not provided. Without the $1,550 gift, the borrower would not have had sufficient assets to close the loan and would not have been eligible for the $5,000 Home Buyer Equity Funds Grant that the borrower received.

B. Credit Analysis Ratio Exceeded HUD/FHA Standard

National approved the loan despite the fact that the Mortgage Credit Analysis Worksheet showed an excessive 35.26 percent ratio of mortgage payment to effective income. The HUD/FHA standard in effect at the time specified a 29 percent limit on the mortgage payment to effective income ratio (Handbook 4155.1 REV-4 CHG 1, Paragraph 2-12).

The compensating factors used by National to justify using the higher ratio were that the net housing payment decreased and the borrower had little debt. Our review indicated that the borrower's housing payments would increase from $595 to $670.89. In addition, the level of debt does not effect the mortgage payment to effective income ratio. In our opinion, the compensating factors did not provide adequate justification for approving a loan that exceeded the HUD/FHA standard.

FHA Case Number: 372-2864510

Loan Amount: $43,143

Settlement Date: 12/31/98

Status: Default – Last payment made 2/1/00

Summary

National approved the mortgage without properly verifying the source of gift funds deposited into the borrower's account. Furthermore, the borrower used funds from an unsecured loan as the earnest money deposit. Thus, the borrower did not meet the minimum cash investment requirement. Consequently, HUD/FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD requirements.

Pertinent Details

A. Source of Gift Not Verified

National did not verify the source of gift funds as required by Handbook 4155.1 Rev-4, Paragraph 2-10C. The file contains a gift letter, a copy of an official check, and the borrower's bank deposit slip showing $1,700 as going into the borrower's account. The file did not contain documentation showing the source of the funds. National's gift letter form requests information as to the donor's source of funds, such as depository name and address, and the account number, however, that information was not provided. Without the $1,700 gift, the borrower would not have had sufficient assets to close the loan.

B. Unsecured Loan Funds Used For Earnest Money

The borrower's earnest money of $500 was obtained from the proceeds of a $2,500 unsecured loan. National should have been aware of this since the file contained a copy of the borrower's bank statement showing that the earnest money had been paid with a check from the borrower's account on 10/5/98, at which time the only funds in the account were from the $2,500 unsecured loan. In addition, on the loan application the borrower checked that no part of the downpayment was borrowed. The Mortgage Credit Analysis Worksheet did not list any earnest money deposit;

however, the $500 was listed on the HUD-1. National approved this loan with knowledge that the borrower had not met the earnest money requirements.

C. Borrower Did Not Provide the Minimum Required Cash Investment

The borrower's earnest money deposit of $500, plus the $470 paid by the borrower at loan closing totaled $ 970 as the borrower's investment. The $970 is $317 less than the required minimum investment of $1,287. The National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the cost of acquisition of the property. HUD/ FHA determined that the minimum cash investment was to be based on the property's sales price without considering loan closing costs (Mortgagee Letter 98-29, October 22, 1998) .

FHA Case Number: 372-2889830

Loan Amount: $46,447

Settlement Date: 4/26/99

Status: Current

Summary

National approved the mortgage without resolving a significant discrepancy that existed with the source of the earnest money deposit. Without the earnest money the borrower did not have sufficient funds to meet the minimum cash investment requirement. Therefore, HUD/FHA's decision to insure the loan was based on National's inaccurate representation that the borrower met HUD/FHA requirements.

Pertinent Details

A. Source of Earnest Money Deposit Funds Not Verified
B. Borrower Did Not Provide the Minimum Required Cash Investment

The HUD-1 Settlement Statement showed that the earnest money deposit was $1,250, which is 2.7 percent of the sales price. If the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the mortgagee must verify the amount deposited and the source of funds (HUD Handbook 4155.1 REV-4 CHG 1, paragraph 2-10A). The borrower did not have a history of savings based on the information contained in the file. The file contained a note signed by the borrower stating that the borrower planned to give $300 a week from the borrower's paychecks to the seller as the earnest money deposit. The support for the earnest money deposit was four money orders. The money orders had dates of issuance of 2/5/99, 2/12/99, 2/26/99, and 3/11/99 and totaled $1,200. However, our review disclosed that the money orders were in consecutive numeric order between 02464551 and 02464554. It is apparent that the money orders were obtained all at one time. In addition, the information submitted to HUD pertaining to the earnest money deposit had discrepancies. The HUD-1 Settlement Statement indicated the amount was $1,250. The sales contract indicated that it was $1,500. Lastly, the Loan Application showed $1,200. National did not adequately verify the source of funds for the earnest money deposit. Without the $1,200 of earnest money funds the borrower would not have had sufficient assets to close, and would not have met the minimum cash investment requirement.

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