
AUDIT REPORT



CHAPEL MORTGAGE CORPORATION NON-SUPERVISED MORTGAGEE RANCOCAS, NEW JERSEY

2003-NY-1002

MARCH 11, 2003

OFFICE OF AUDIT
NEW YORK/NEW JERSEY REGION



Issue Date	March 11, 2003
Audit Case Number	2003-NY-1002

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

Alexander C. Malloy

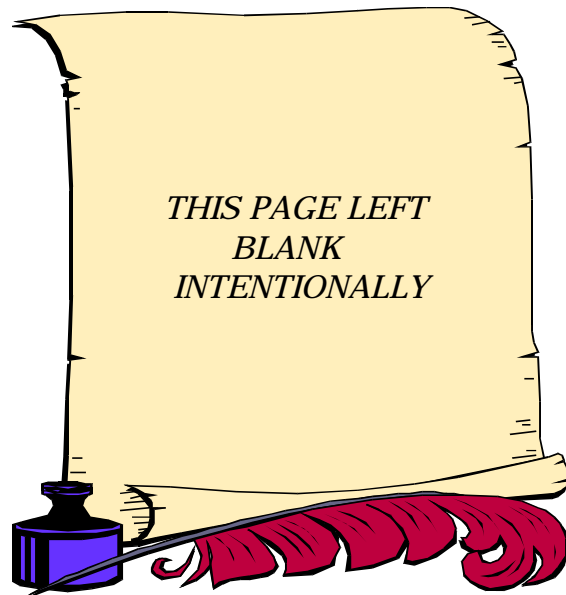
FROM: Alexander C. Malloy, Regional Inspector General for Audit, 2AGA

SUBJECT: Chapel Mortgage Corporation
Non-Supervised Mortgagee
Rancocas, New Jersey

We completed an audit of Chapel Mortgage Corporation (Chapel), a non-supervised mortgagee. The objective of the audit was to determine whether Chapel approved 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, 1999 and November 30, 2001. Our review concluded that Chapel did not always adhere to prudent lending practices during the approval process of the 25 loans that we examined during our audit.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us for each recommendation without management decisions, 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 considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendations without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

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



Executive Summary

We completed an audit of Chapel Mortgage Corporation (Chapel), a non-supervised mortgagee. The objective of the audit was to determine whether Chapel approved 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, 1999 and November 30, 2001, and consisted of a review of 25 HUD/FHA insured loans that totaled \$2,937,120. A summary of the results of our review is provided below.

25 loans in default

We concluded that Chapel did not always adhere to prudent lending practices during its approval process of the 25 HUD/FHA insured loans that we reviewed. More specifically, our review disclosed that each of the 25 loans had at least one significant underwriting deficiency. Some of the underwriting deficiencies are as follows:

Underwriting processing deficiencies

- Inaccurate/Excessive Debt to Income Ratios.
- Unsupported Employment Income.
- Unsupported Rental Income.
- Understated Liabilities.
- Insufficient Payroll Data.
- Insufficient Verification of Employment (VOE).
- Insufficient Banking Data.
- Insufficient Cash Gift Information.
- Unexplained Derogatory Credit.
- Unexplained Deposits & Recently Opened Accounts.
- Ineligible Commitment Fee.
- Discrepancies with Appraisal.

We believe that the underwriting deficiencies occurred because Chapel personnel did not assure that the loans were approved in accordance with HUD/FHA requirements. As a result, mortgages were approved for unqualified borrowers causing HUD/FHA to assume an unnecessary risk.

We recommend that your office take appropriate action against Chapel for not adhering to HUD's underwriting requirements, and require Chapel to indemnify HUD/FHA against future losses on all 25 loans identified in Appendix A of this report. We further recommend that Chapel provide your office with a corrective action plan containing assurances that all HUD/FHA guidelines regarding

Exit conference

underwriting HUD/FHA insured loan are followed by its underwriting staff.

The results of the audit were forwarded to Chapel on November 22, 2002, and an exit conference was held on January 9, 2003 attended by the following:

Office of Inspector General (OIG)

Alexander C. Malloy, Regional Inspector General for Audit
William H. Rooney, Assistant Regional Inspector General
for Audit
Michael Zaccaria, Senior Auditor
Diego Ramos, Auditor.

Chapel

Richard J. Arbogast, President, Chief Executive Officer,
Thomas J. Burke, Vice President, Chief Financial Officer,
Gerald H. Nolan, Vice President, Chief Operations Officer.

We received a draft copy of Chapel's comments at the exit conference and an email copy on January 14, 2003 from Chapel's attorney. The comments are included in Appendix C of this report.

Chapel disagrees with our determination that it did not adhere to prudent lending practices. As explained in our evaluation of Chapel's comments, Chapel did not follow all applicable HUD/FHA underwriting requirements. As a result, HUD/FHA assumed an unnecessary insurance risk for the loans in question.

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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

Chapel Mortgage Corporation (Chapel) is a non-supervised mortgagee located at 315 Main Street, Rancocas, New Jersey. Chapel Mortgage Shareholders and Executive Management include James J. Burke, Sr. (Chairman), Richard J. Arbogast (President and Chief Executive Officer), and Thomas. Burke (Senior Vice President and Chief Financial Officer).

During our audit period, from December 1, 1999 to November 30, 2001, Chapel Mortgage Corporation underwrote, under its Direct Endorsement Program, approximately 600 HUD/FHA loans amounting to over \$70,000,000 within the State of New Jersey. Chapel Mortgage Corporation underwrites both HUD/FHA insured loans and conventional loans.

Audit Scope and Methodology

Our audit objective was to determine whether Chapel approved its HUD/FHA mortgages in accordance with HUD requirements, which required adherence to prudent lending practices.

The purpose of our review was to confirm the accuracy of all material information used as the basis for underwriting and closing the loans. We obtained background information by:

- Reviewing relevant HUD regulations, requirements, and Mortgage Letters.
- Examining records and reports maintained on HUD's Neighborhood Watch Early Warning System.
- Interviewing officials of Chapel and holding discussions with HUD's Philadelphia Homeownership Center Staff.

To accomplish our audit objectives, we initially selected a sample of 33 loans from HUD's Neighborhood Watch database. From the Neighborhood Watch database, we identified loans originated by loan correspondents and subsequently underwritten by Chapel. Our sample of HUD/FHA insured loans were originated by loan correspondents, had three or more defaults, and had borrowers who only made six or less payments on their mortgages before they went into default. We subsequently found out that eight loans were under review by our office of investigation; therefore, we eliminated them from our sample, thus, reducing our sample and file review to 25

cases. The 25 loans in our sample had insured mortgages that totaled \$2,937,120.

Our file review and audit procedures included verification of: (a) the borrowers' income, assets, and liabilities, and (b) selected data on the settlement statements and appraisals. They also included inquiries with members of HUD's and Chapel's staff.

Audit Period

We performed the audit fieldwork between January 2002 and October, 2002. Our audit pertained to loans underwritten between December 1, 1999, and November 30, 2001. Our audit work was performed at Chapel's Rancocos, New Jersey Office. The audit was conducted in accordance with generally accepted government auditing standards.

A copy of this report was provided to Chapel.

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

Our review disclosed that Chapel did not adhere to prudent lending practices when approving 25 loans that we examined during our audit. We noted that underwriting deficiencies occurred because Chapel personnel did not assure that the loans were processed in accordance with all applicable 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-1, 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, Chapel did not always adhere to the above requirements, as discussed below, when it underwrote the 25 loans we reviewed .

Examined 25 loans

Our examination of 25 loans approved by Chapel between December 1, 1999 and November 30, 2001, disclosed that in all 25 cases Chapel either did not follow all applicable HUD requirements or did not exercise the care expected of a prudent lender in approving the loans. Consequently, we found significant underwriting deficiencies in all 25 cases, as shown below:

<u>Deficiencies</u>	<u>Number of Loans</u>
Inaccurate/Excessive Debt to Income Ratios	20 of 25 loans
Unsupported Employment Income	6 of 25 loans
Unsupported Rental Income	7 of 25 loans
Understated Liabilities	3 of 25 loans
Unsupported Verification of Deposit	1 of 25 loans
Insufficient Payroll Data	4 of 25 loans
Insufficient VOE	4 of 25 loans
Insufficient Banking Data	3 of 25 loans

Finding

<u>Deficiencies Continued</u>	<u>Number of Loans</u>
Insufficient Cash Gift Information	15 of 25 loans
Unexplained Derogatory Credit	4 of 25 loans
Unexplained Deposits & Recently Opened Accounts	5 of 25 loans
Ineligible Commitment Fee	23 of 25 loans
Not Enough Funds to Close	1 of 25 loans
Discrepancies with Appraisal	13 of 25 loans
Ineligible Fees and Charges	1 of 25 loans
Earnest Money Not Documented	1 of 25 loans

Additionally, the mortgages of all 25 cases were in default as of November 30, 2001. These HUD/FHA insured mortgages amounted to \$2,937,120 (See Appendix A). Appendix A to this report provides a summary of the loan underwriting deficiencies noted during our review, while Appendixes A-1 through A-25 provide an individual description of the underwriting deficiencies for each of the 25 loans. The deficiencies occurred because Chapel 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.

Chapel's comments

Chapel disagrees with our determination that it did not adhere to prudent lending practices and did not process loans in accordance with applicable HUD/FHA requirements.

OIG's evaluation of Chapel's comments

Our evaluation of Chapel's response is included for each loan identified on Appendixes A-1 through A-25. As explained in our evaluations, Chapel simply did not follow all of HUD/FHA's underwriting requirements. As a result, HUD/FHA assumed an unnecessary risk and insured unqualified borrowers.

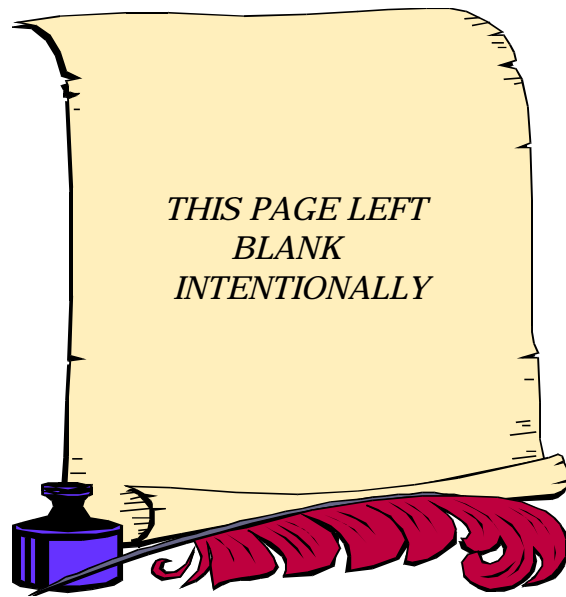
Recommendations

We recommend that you:

- 1A. Take appropriate action against Chapel for not adhering to HUD's requirements regarding

underwriting, and indemnify HUD/FHA against future losses on all 25 loans identified in Appendix A of this report.

- 1B. Require Chapel to provide your office with a corrective action plan to assure that all HUD/FHA guidelines regarding the underwriting of HUD/FHA insured loans are followed by its underwriting staff.



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

We assessed 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.

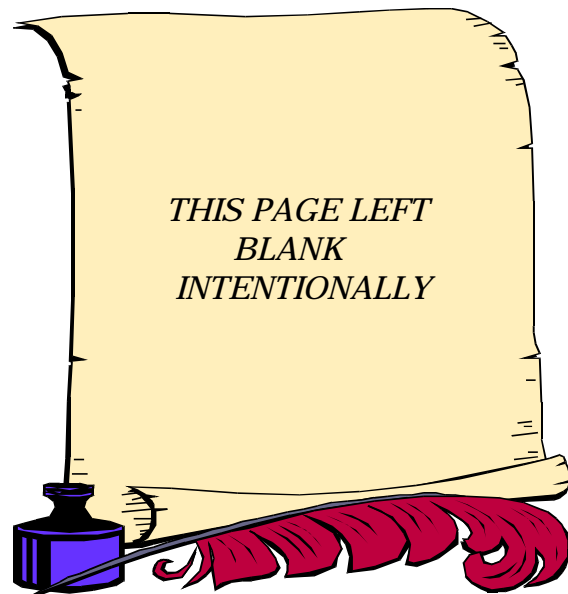
Significant Weaknesses

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.

- Chapel did not underwrite loans in accordance with all applicable HUD/FHA requirements, Finding 1 (Program Operations).
- Chapel did not implement adequate procedures to ensure that all loan processing information was accurate, Finding 1 (Validity and Reliability of Data), (Compliance with Laws and Regulations).
- Chapel did not implement adequate controls over appraisers, Finding 1 (Validity and Reliability of data).

Follow Up On Prior Audits

There are no prior OIG audit reports on Chapel Mortgage Corporation of Rancocas, New Jersey.



CHAPEL MORTGAGE CORPORATION
Rancocas, New Jersey

Summary of Loan Origination Delinquencies

HUD/FHA Case Number	Mortgage Amount	Settlement Date	Inaccurate & Excessive Income Ratios	Unreported/Erroneous Income	Unreported Rental Income	Undersated Latencies	Unreported Verification of Deposit	Insufficient Payroll Data	Insufficient VDE	Insufficient Banking Data	Insufficient Cash Gift Information	Unexplained Discrepancy Credit	Unexplained Deposits & Creditworthy Accounts	Intelligible Current Fee	No Enough Funds to Close	Discrepancies With Appraisal	Intelligible Fees and Charges	Earned Money Documented	Agency Reference
352-4072914	\$104,141	08/07/00	X	X		X					X	X	X	X		X			A-01
352-3989898	\$104,141	01/21/00	X	X	X						X			X	X				A-02
352-3982878	\$155,400	01/07/00	X	X		X		X			X	X	X	X					A-03
352-4026835	\$148,798	05/29/00	X							X	X			X					A-04
352-4087422	\$123,978	08/29/00	X						X		X		X	X		X			A-05
352-4018879	\$157,822	07/31/00	X	X							X	X	X	X					A-06
352-39828180	\$155,420	04/28/00	X	X	X		X							X				X	A-07
351-37291341	\$76,886	03/24/00	X					X	X		X			X					A-08
352-4058116	\$114,059	08/29/00	X		X				X		X		X	X		X			A-09
352-4026805	\$128,457	05/31/00	X	X							X			X		X	X		A-10
351-3842154	\$125,287	07/20/00	X			X		X			X			X		X			A-11
352-4072849	\$89,845	07/18/00	X		X						X		X	X					A-12
352-39898129	\$168,676	04/17/00	X		X							X		X					A-13
352-4026857	\$121,339	08/21/00	X		X						X			X					A-14
352-4110795	\$149,900	09/22/00	X		X						X			X					A-15
352-4026891	\$114,059	05/12/00	X								X	X		X					A-16
351-3803849	\$88,966	04/28/00	X					X						X		X			A-17
352-4139381	\$94,223	10/27/00	X							X				X		X			A-18
352-4128505	\$109,100	11/29/00	X								X			X		X			A-19

CHAPEL MORTGAGE CORPORATION
Rancocas, New Jersey

Summary of Loan Origination Deficiencies

HU/ETH/Loan Number	Mortgage Amount	Settlement Date	Inaccurate & Excessive Deal to Income Ratios	Unsupported Employment Income	Unsupported Rental Income	Understated Liabilities	Unsupervised Verification of Request	Insufficient Payroll Data	Insufficient YOE	Insufficient Banking Data	Insufficient Loan SMI Information	Unexplained Derogatory Credit	Unexplained Deposits & Reported Accounts	Ineligible Commitment Fee	Not Enough Funds to Close	Discrepancies With Appraisal	Ineligible Fees and Charges	Earned Money Not Documented	Appendix Reference
392-3971484	\$94,223	03/02/00									X			X		X			A-20
392-3995283	\$128,900	03/19/00						X						X		X			A-21
391-3728532	\$77,198	04/17/00								X	X								A-22
392-4017271	\$98,284	04/19/00											X	X					A-23
392-3924410	\$104,141	03/10/00	X											X		X			A-24
392-4077939	\$128,987	07/14/00												X		X			A-25
Totals	\$2,507,120		20	6	7	3	1	4	4	3	15	4	5	23	1	13	1	1	

Narrative Case Presentation

FHA Case Number: 352-4077614

Loan Amount: \$104,141

Settlement Date: 08/07/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Employment Income

C. Understated Liabilities

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 19 and 40 percent respectively. However, we believe that the ratios calculated by Chapel are incorrect, as discussed in the following paragraphs.

On the Mortgage Credit Analysis Worksheet, Chapel included part-time and commission income of \$400, and \$500, respectively. Per Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7B, part-time (second job) income, including employment in seasonal work, may be used as qualifying income, if the borrower has worked the part time job uninterrupted for the past two years and will continue to do so. In addition, Handbook 4155.1 REV-4 CHG 1, Paragraph 2-7D, provides that commission income must be averaged over the previous two years and that the borrower must provide his or her last two years tax returns along with a recent pay stub. The borrower's file did not include the necessary documentation required by the aforementioned criteria that would allow part-time and commission income to be included as income for the borrower.

Additionally, Chapel understated the borrower's monthly liabilities by \$58, and underestimated the borrower's monthly child support payments by \$333. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-11A states that the mortgagee must include the monthly housing expense, and all other additional recurring charges including child support, installment accounts and revolving accounts when computing debt ratios.

Narrative Case Presentation

After considering the above deficiencies and other income and liabilities omitted by Chapel, we calculated the debt ratios to be 20.3 and 66.5 percent respectively.

D. Insufficient Cash Gift Information

The borrower's file did not contain evidence that a \$6,300, cash gift was withdrawn from the donor's bank account, nor evidence that the gift was deposited into the borrower's bank account. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing that the amount of the gift was deposited in the borrower's bank account.

E. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on August 7, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on July 28, 2000. Mortgagee Letter 94-7, Section IV: provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

F. Unexplained Deposits & Recently Opened Accounts

Handbook 4155, 1 REV-4 CHG 1, Paragraph 2-10B, provides that if there is a large increase in a bank account amount or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained various bank account statements that indicated numerous "non payroll" deposits without a written explanation from the borrower as to the source of the funds.

G. Unexplained Derogatory Credit

The file contained copies of a bank statement that indicated that the borrower was charged numerous Non Sufficient Fund fees. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-3, provides that major indications of derogatory credit problems, requires a sufficient written explanation from the borrower. Chapel did not obtain a required explanation for the stated matter from the borrower.

Narrative Case Presentation

H. Discrepancies With Appraisals

The file contained an appraisal dated July 11, 2000, that did not have the required information regarding the prior sale of the subject property. More importantly, information was in Chapel's files that indicated a sale occurred prior to the appraisal report date. Chapel's underwriting staff did not resolve this discrepancy. Our analysis of information in the file showed that the property was sold five months prior to the August 7, 2000, closing date. The previous owner purchased the home on March 16, 2000 for \$35,000, and subsequently sold it five months later on August 7, 2000 for \$105,000.

Standards Rule 1-5(b) of the Uniform Standards of Professional Appraisal Practice (USPAP) provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G, of HUD Handbook 4000.4, Single Family Direct Endorsement, requires the mortgagee's underwriter to review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Chapel's comments

352-4077614

1. HUD OIG stated that the debt to income ratios were not calculated correctly. Chapel included part-time and commission income which was not adequately documented. In calculating the ratios, Chapel used rental income from Schedule E of Form 1040. The borrower's base income was \$3904 per month, the net rental income was \$1128 per month, for a total monthly income of \$5032. Using this income, the debt to income ratios are 23.6 percent and 42.1 percent, which are acceptable.
2. HUD OIG also stated that Chapel underestimated the borrower's monthly child support payments. The borrower has child support payments deducted directly from his paycheck. Consequently, the payment was already calculated in.
3. The "unexplained" deposits HUD OIG refers to are the funds from the gift letter.
4. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
5. HUD OIG noted that the borrower had derogatory credit information, specifically numerous non-sufficient fund fees, which were not adequately explained. Chapel agrees that the file does not contain an explanation for this derogatory information.

Narrative Case Presentation

OIG's Evaluation of Chapel's comments

1. In its response, Chapel recalculated different debt to income ratios from those stated on the borrower's Mortgage Credit Analysis Worksheet that were in the HUD/FHA file. We observed that in Chapel's recalculation of the debt to income ratios, Chapel did not include a mortgage payment of \$1,093 for another rental property owed by the borrower. HUD/FHA requires that such mortgage payments be included in the calculations. OIG included the mortgage payment in our calculation and concluded that the fixed payment to total income ratio was significantly higher than that calculated by Chapel.
2. HUD/FHA requires that Chapel use the borrower's monthly gross income to calculate the debt to income ratios as required by Handbook 4155.1, REV-4 CHG-1, Paragraph 2-11A. Payroll deductions such as child support payments are included as part of the borrower's debt calculation. Chapel did not include all of the child support payments when calculating the borrower's debt.
3. OIG's review of the bank statements indicated that the "non payroll" deposits in question does not appear to be the funds of the gift because the deposits consisted of numerous amounts that did not equal the gift amount.
4. Chapel concurs with issue.
5. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-3966898

Loan Amount: \$104,141

Settlement Date: 01/21/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Employment Income

C. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Although the debt to income ratios that Chapel computed (28.73 and 34.03 percent respectively) were within the HUD/FHA guidelines, we believe that these ratios are incorrect.

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7, provides that the income of each borrower must be analyzed to determine whether it can be reasonably expected to continue through at least the first three years of the mortgage loan. From the documents in the file, we could not determine how Chapel calculated the borrower's \$3,581, estimated monthly income. Our calculation indicate \$2,175, as the estimated monthly income.

Per Handbook Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7M(2), if a property was acquired since the borrower's last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or another rental agreement for the property being rented. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the \$595 of monthly rental income used by Chapel to compute the debt ratios.

When taking in account our calculation of monthly income, which amounted to \$2,175, and excluding the \$595 of monthly rental revenue, the debt ratios are 55.1 percent and 65 percent respectively.

Narrative Case Presentation

D. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. Our review of the file indicated that the donor provided a check, but the copy in the file was not a cancelled check. The borrower's file did not contain evidence of a \$3,500, cash gift withdrawn from the donor's bank account or evidence that the gift funds were deposited into the borrower's bank account.

Also, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. The borrower's file contained a gift letter that did not list the donor's address.

E. Ineligible Commitment Fee

The HUD 1 included a \$450 commitment fee that was paid by the borrower on January 21, 2000 (closing date). The mortgage interest lock-in date shown on the lock-in confirmation sheet was listed as January 19, 2000. Mortgagee Letter 94-7, Section IV: states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

F. Not Enough Funds to Close

Chapel indicated on the Mortgage Credit Analysis Worksheet that the borrower would be using money from the borrower's stock plan to close the loan on the property. The stock plan had a value of \$26,633.18 on September 30, 1999. However, the file did not contain evidence indicating that the borrower actually received money from the stock plan. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-10(L), states that when the borrower claims assets through the sale of stocks and bonds, the value of these securities must be verified from the stockbroker or by photocopies of the stock certificates along with a dated newspaper that identified the price of the stock. In addition, the actual receipt of the funds must be verified. Chapel did not comply with these requirements.

Narrative Case Presentation

G. Discrepancies With Appraisals

The file contained an appraisal dated November 23, 1999, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel's files that indicated a sale occurred prior to the appraisal report date. Chapel's underwriting staff did not resolve this discrepancy. Our analysis of the information in the file showed that the property was sold four months prior to the January 21, 2000 closing date. The previous owner purchased the property on September 29, 1999, for \$52,000, and subsequently sold it four months later on January 21, 2000 for \$105,000.

Standards Rule 1-5(b) of the USPAP states that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G, of HUD Handbook 4000.4, Single Family Direct Endorsement, requires the mortgagee's underwriter to reviewer the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Chapel's comments

1. Chapel did not provide any comments for this HUD/FHA case number.

Narrative Case Presentation

FHA Case Number: 352-3928276

Loan Amount: \$155,400

Settlement Date: 01/07/2000

Status: Non-Current

Pertinent Details

- A. Inaccurate/Excessive Debt to Income Ratios
- B. Unsupported Employment Income
- C. Understated Liabilities
- D. Unexplained Derogatory Credit
- E. Insufficient Payroll Data

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 30 and 39 percent respectively. However, we believe that the ratios calculated by Chapel are incorrect, as discussed in the following paragraphs.

From the documents in the file, we could not determine how Chapel calculated the borrower's estimated monthly overtime income of \$126.66, as required by Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7A. In addition, Chapel understated the borrower's monthly liabilities by \$569, because it did not use the most current credit report in the file. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-3B, provides that the mortgagee must ascertain the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment for the property being purchased. Chapel used an old credit report in the file to calculate the borrower's debt to income ratios and the liabilities identified on the old credit report were \$569 less per month than the more current credit report in the file.

Also, our review of the file indicated that the borrower may be paying child support. Chapel's files did not indicate whether child support payments were being paid. This is important because in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-11A, child support payments must be included as part of the debt ratios calculations. In addition, the most current credit report indicated that the borrower was delinquent on the mortgage payments for one of the borrower's rental properties. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-3, provides that major indications of derogatory credit problems, requires a sufficient written explanation from the borrower. Chapel did not obtain an explanation from the borrower.

Narrative Case Presentation

We believe that the borrower's debt to income ratios are 21 and 61.1 percent respectively after considering the discrepancies with the borrowers monthly liabilities, monthly overtime income and other omissions of income and liabilities. These ratios would be higher if the borrower was making child support payments.

We noted that Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1(E), provides that pay stubs must show the borrower's name, social security number, and year to date earnings. The pay stubs in file did not identify the borrower's name or social security number.

F. Insufficient Cash Gift Information

The borrower's file did not contain evidence of a \$15,000, cash gift withdrawn from the donor's bank account. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the funds were deposited in the borrower's bank account. Also, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. The gift letter in borrower's file did not list the donor's telephone number.

G. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on January 7, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on January 5, 2000. Mortgagee Letter 94-7, Section IV: provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Chapel's comments

352-3928276

1. Regarding the debt to income ratios, Chapel noted that the borrower had a nine year job. As of 1/4/00 the borrower changed jobs with the City and received a salary of \$32000/year. This equals \$2667/month. Rental income is \$4237 @ 75 percent equals \$3178/month. Total debt is equal to \$2636.50/month. Per the appraiser, the new property being acquired will give a net rental income of \$1029/month. Using the new leases for acquired property, the net rental income is \$1125/month. Using the other properties, net rental @ 75 percent of gross rental minus PITI payment as income, the ratios are 26 percent and 44 percent, which are acceptable under HUD OIG guidelines.

Narrative Case Presentation

Consequently the overtime income did not need to be included. The child support payments were included in the calculations.

2. In addition, the file shows that Chapel received a credit update showing that the purported delinquency was incorrect.
3. HUD OIG also stated that the pay stubs in the file did not provide the borrower's name or social security number as well as the year-to-date earnings. Although the pay stub did not have a social security number disclosed, it did show the borrower's name and the year-to-date income.
4. The file allegedly did not contain evidence of a \$15,000 cash gift and the gift letter did not list the donor's telephone number. Chapel disagrees with this statement; the file, in fact, does show proof of transfer and proof of donor's ability to provide the funds, as well as a valid gift letter.
5. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

OIG's Evaluation of Chapel's comments

1. In its response, Chapel recalculated different debt to income ratios from those stated on the borrower's Mortgage Credit Analysis Worksheet that were in the HUD/FHA file. We observed that in Chapel's recalculation of the debt to income ratios, Chapel did not include mortgage payments of \$1,243 and \$686 for other rental properties owed by the borrower. HUD/FHA requires that such mortgage payments be included in the calculations. OIG included the mortgage payment in its calculation and concluded that the fixed payment to total income ratio was significantly higher than that calculated by Chapel.
2. Our analysis of Chapel's file indicated that Chapel did not use the most recent credit report, dated December 31, 1999. Instead, Chapel used the older credit report on file dated October 12, 1999. The December 31, 1999 credit report indicated that the borrower had additional debt of \$569 that Chapel did not include as part of its debt to income ratios calculations.
3. Our analysis of Chapel's file indicated that the borrower's pay stubs did not identify the borrower's name and social security number. Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1 (E), requires the borrower's name and social security number on pay stubs.
4. The Chapel file did not provide documentation indicating that the \$15,000 cash gift was withdrawn from the donor's bank account. Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, states that the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank.
5. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-4026635

Loan Amount: \$145,798

Settlement Date: 05/25/00

Status: Non-Current

Pertinent Details Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 35 and 35 percent respectively. Chapel's justification for a higher mortgage payment to effective income ratio was a compensating factor, "job stability".

B. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must contain a gift letter that specifies the dollar amount, signed by the borrower and donor, and state that no repayment is required. In addition, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. Our review disclosed that the gift letter did not list the donor's address.

C. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on May 25, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on May 19, 2000. Mortgagee Letter 94-7, Section IV: provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

D. Insufficient Banking Data

Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1F, provides that as an alternative to obtaining a verification of deposit, the mortgagee may choose to obtain the borrower's original bank statements for the most recent three month period. Our review disclosed that the file only contained a bank statement for a one month period and the statement was dated four months prior to the closing of the property.

Chapel's comments

352-4026635

1. HUD stated that the borrower's debt to income ratio was not supported by the borrower's job stability because the pay stub did not identify the borrower's year-to-date earnings. In fact, the pay stubs in the file do show a year-to-date figure. In addition, the file contains copies of the borrower's W-2's, and a verification of employment form contains supporting information.
2. The gift letter failed to list the donor's address; however, the file adequately documents that the gift was given and received. The omission of an address on the letter is a technical omission which does not impair the quality of the loan.
3. The gift funds were adequately documented. A treasurer's check from the donor bank was made out to the closing agent. The amount is the same as stated in the gift letter. The file shows the same amount withdrawn from the donor's account. Based on the gift received by the closing agent, as well as the \$4734 the borrower had, there was no shortage of funds to close.
4. Chapel agrees the file contained only one month's bank statement.
5. Chapel agrees that the commitment fee should not have been changed as the interest lock-in date was less than 15 days.

OIG's Evaluation of Chapel's comments

1. Chapel provided documentation that identified the borrower's year to date earnings. As a result, we eliminated the deficiency regarding insufficient payroll data.
2. The gift letter did not identify the donor's address as required by Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10C.
3. Chapel provided documentation that indicated the borrower had sufficient funds to close the loan. As a result, we eliminated the deficiency regarding not enough funds to close loan.
4. Chapel concurs with issue.
5. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-4057422

Loan Amount: \$123,978

Settlement Date: 06/20/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio should not exceed 29 percent, unless the mortgagee addresses compensating factors that could justify exceeding these ratios. Chapel computed a 35.05 percent mortgage payment to effective income ratio and did not include any compensating factors that justified using the excessive ratio.

B. Insufficient Cash Gift information

The borrower's file did not contain evidence that a \$9,000, cash gift was withdrawn from the donor's bank account. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank.

In addition, Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10C, provides that the mortgagee must obtain a gift letter from the borrower specifying the dollar amount. Also, the gift letter must be signed by the donor and the borrower stating that no repayment is required. The gift letter must show the donor's name, address, telephone number, and relationship to the borrower. The borrower's file contained a gift letter that did not list the donor's address.

C. Insufficient Verification Of Employment

Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1E, provides that as an alternative to obtaining a Verification of Employment, (VOE) the mortgagee may chose to obtain the borrower's most recent 30 day period pay stub; and the mortgagee must also verify the borrower's employment by contacting all current employers through the telephone. Our review of the file provides that Chapel did not contact all of the borrower's current employers by telephone to verify employment.

Narrative Case Presentation

D. Ineligible Commitment Fee

A commitment fee of \$450 was on the HUD-1, which was paid by the borrower on June 20, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on June 19, 2000. Mortgage Letter 94-7, Section IV: provides that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

E. Unexplained Deposits & Recently Opened Accounts

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10B, provides that if there is a large increase in a bank account amount, or the account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a copy of a bank statement indicating that a bank account was opened on April 6, 2000, and a \$500 deposit was made on June 14, 2000, without a written explanation from the borrower as to the source of funds (the borrower’s closing date was June 20, 2000).

F. Discrepancies With Appraisals

The file contained an appraisal dated March 9, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel’s files that indicated a sale occurred prior to the appraisal report date. Chapel’s underwriting staff did not resolve this discrepancy. Our analysis of the information in the file showed that the property was sold four months prior to the June 20, 2000 closing date. The previous owner purchased the property on February 15, 2000, for \$17,000, and subsequently sold it four months later on June 20, 2000 for \$125,000.

Standards Rule 1-5(b) of the USPAP provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G, of HUD Handbook 4000.4, Single Family Direct Endorsement, requires the mortgagee’s underwriter to reviewer the appraisal to determine whether or not the appraiser’s conclusions are acceptable.

Narrative Case Presentation

Chapel's comments

352-4057422

1. In this case, HUD determined that the debt to income ratio of 35.05 percent exceeded the guidelines of 29 percent. Having recalculated the numbers, Chapel agrees with HUD on this point.
2. HUD OIG noted that the gift letter did not contain the donor's address. Although that is correct, this technical violation did not impair the quality of the loan.
3. HUD OIG stated that Chapel did not adequately verify employment. As we advised HUD previously in the Shaffer Letter, the employment gap was adequately explained. As noted, the CMC file contains 1040 forms for the years 1998 and 1999, and pay stubs for the weeks of April 2, 7 and 21, 2000. The file shows that the borrower collected unemployment benefits in 1999. Copies of these documents were provided.
4. Chapel agrees that the commitment fee should not have been changed as the interest lock-in date was less than 15 days.
5. HUD OIG stated that Chapel should have questioned a new deposit of \$500 which was made within a week of closing. This information was not needed to qualify the borrower, and therefore was immaterial.
6. HUD OIG stated that its investigation showed a prior sale of the property that was not disclosed on the appraisal. HUD OIG alleged that other information in the file should have alerted Chapel's underwriter to this fact. The additional information was not available at the time the loan was approved. Chapel did not have reason to doubt the appraisal at the time of approval. Chapel relied on the appraisal. The appraiser was selected by the correspondent from among FHA-approved appraisers. It is Chapel's contention that the appraiser and correspondent were involved in a fraudulent transaction, and Chapel was an unwitting victim of such fraud. Had Chapel known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

OIG's Evaluation of Chapel's comments

1. Chapel concurs with issue.
2. The gift letter did not identify the donor's address as required by Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10C.
3. Our review of the file indicated that Chapel did not contact all of the borrower's current employers by telephone to verify employment as required by Handbook 4155.1, REV-4 CHG 1 Paragraph 3-1E.
4. Chapel concurs with issue

Narrative Case Presentation

5. Chapel's file contained a copy of a bank statement indicating that a bank account was opened April 6 2000 and a \$500 deposit was made on June 14, 2000. Chapel did not obtain a written explanation from the borrower as to the source of funds, as required by Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10B.
6. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-4018379

Loan Amount: \$157,822

Settlement Date: 07/31/00

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Employment Income

C. Unexplained Derogatory Credit

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 33 and 44 percent respectively without listing the required compensating factors. We believe that the ratios calculated by Chapel are incorrect. From the documents in the file, we could not determine how Chapel calculated the borrower's estimated monthly overtime income of \$928, as required by Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7A. Without the overtime, we calculated the debt to income ratios to be 40.4 and 53.6 percent.

Furthermore, copies of the bank statement and credit reports included in the file indicated that the borrower was charged numerous Non Sufficient Funds fees. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-3, provides major indications of derogatory credit problems, which requires a sufficient written explanation from the borrower. Chapel's files did not contain an explanation from the borrower.

D. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on July 31, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on July 21, 2000. Mortgagee Letter 94-7, Section IV: provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

E. Unexplained Deposits & Recently Opened Accounts

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10B, provides that if there is a large increase in a bank account amount, or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a bank account statement indicating a \$1,798.72, increase without an explanation from the borrower as to the source of the funds.

Chapel's comments

352-4018379

1. According to the HUD OIG report, the debt to income ratio was excessive, as HUD OIG could not determine how the income was calculated. As we advised HUD in the Shaffer Letter, the Chapel's file contains pay stubs dated 5/13/00, 5/27/00, 6/10/00, 6/24/00, 7/1/00, 7/8/00 and 7/15/00 to document current income. The file also contains a VOE dated 5/08/00. Copies of these documents were provided to HUD OIG.
2. HUD OIG also noted that the borrower had derogatory credit information, specifically numerous non-sufficient funds fees, which were not adequately explained. Chapel agrees that the file does not contain an explanation for this derogatory information, but asserts that this is a technical violation which does not impair the quality of the loan.
3. The commitment fee should not have been charged as the interest lock-in date was less than 15 days.
4. HUD OIG stated that a large deposit was not explained. The file shows that the deposits came from the redemption of a savings plan.

OIG's Evaluation of Chapel's comments

1. OIG recognizes that some overtime occurred. However, the total amount of the borrower's 1999 base pay subtracted from the amount of the borrower's 1999 W-2 does not equal \$11,136 per year of overtime (\$928 a month times 12 month) as stated in the Verification of Employment.
2. Chapel concurs with issue.
3. Chapel concurs with issue.
4. In accordance with Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10B, Chapel must verify the source of large increases in the borrower's funds. This was not done by Chapel.

Narrative Case Presentation

FHA Case Number: 352-3928180
Loan Amount: \$155,420
Settlement Date: 04/28/2000
Status: Non-Current

Pertinent Details

- A. Inaccurate/Excessive Debt to Income Ratios
- B. Unsupported Verification of Deposit
- C. Unsupported Employment Income
- D. Unsupported Rental Income

Per Handbook 4155.1 REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 39 and 48.1 percent respectively. Although Chapel provided compensation factors, we do not believe that the factors Chapel identified justified the approval of the loan, as discussed in the following paragraphs.

The compensating factors that Chapel used to justify the loan were that the borrower had "great reserves" and "putting money down". Chapel indicated that the borrower possessed reserves of \$83,326. The file indicated that the borrower received the majority of this money (\$80,000) on June 18, 1999, as a result of a lawsuit. However, the borrower's bank statements did not indicate the receipt of these funds, as required by Handbook 4155.1 REV-1, Chg-1, Paragraph 3-1 and 3-1F. In short, there was no evidence in the file that indicated that the borrower received the funds. In our opinion, the compensating factors did not provide adequate justification for approving a loan that exceeded the HUD/FHA standard ratios.

Also, we believe that the debt ratios are higher. Specifically, we could not determine how Chapel calculated the borrower's estimated monthly overtime income of \$600, as required Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7A. Thus, it is questionable as to whether the \$600 should be included in the ratio calculations.

Narrative Case Presentation

Also, according to Handbook 4155.1 REV-4 CHG-1, Paragraph 2-7M(2), if property is acquired since the last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or other rental agreement. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the \$600 of monthly rental income used by Chapel to compute its debt ratios.

Without the monthly income resulting from overtime and rental of the property, we believe that the debt-to-income ratios would be 55 and 68 percent respectively.

E. Earnest Deposit Not Documented

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10A, provides that 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 of deposit and the source of funds. The HUD-1, which was located in the borrower's file, listed a \$5,000 earnest money deposit. This amount exceeded 2 percent of the property's \$160,000 sales price. The borrower's file did not contain any evidence that Chapel verified the deposit or the source of the funds.

F. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on April 28, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on April 27, 2000. Mortgage Letter 94-7, Section IV: states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Chapel's comments

352-3928180

1. The borrower relied on a settlement of \$80,000 as a down payment. Chapel believes that this amount was an adequate compensating factor to justify the higher debt to income ratio. HUD OIG stated that the file does not provide evidence that the funds were received. As stated in the Shaffer Letter, Chapel contacted the attorney who handled the settlement to verify that the funds were received.
2. HUD OIG stated that a copy of a signed lease was not included. However, the rental property was the property being acquired in conjunction with the loan transaction. Consequently, the appraiser's estimate of anticipated rent was properly relied upon.

Narrative Case Presentation

3. The file did not provide evidence of the earnest deposit funds of \$5,000. We agree that the source of the funds was not documented appropriately. This technical violation, however, does not impair the quality of the loan.
4. The commitment fee should not have been charged as the interest lock-in date was less than 15 days.

OIG's Evaluation of Chapel's comments

1. Handbook 4155.1, REV-1 CHG-1, Paragraph 3-1 and 3-1F requires that the receipt of the funds resulting from the lawsuit must be verified by obtaining the borrower's bank statements. Chapel did not obtain the borrower's bank statements as required.
2. In accordance with Handbook 4155.1, REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower's Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.
3. Chapel concurs with issue.
4. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 351-3791341

Loan Amount: \$76,866

Settlement Date: 03/24/00

Status: Non-Current

Pertinent Details

- A. Inaccurate/Excessive Debt to Income Ratios
- B. Insufficient Verification of Employment
- C. Insufficient Payroll Data

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 31.21 and 48.79 percent respectively. Chapel justified the high debt to income ratios by listing compensating factors, such as, "minimum credit user" and "now working full time". We believe that the ratios calculated by Chapel are incorrect, as discussed in the following paragraph.

Chapel overstated monthly income by \$1,319. Handbook 4155.1, REV-4 CHG-1, Paragraph 3-1E, provides that the mortgagee must obtain a Verification of Employment (VOE) and most recent pay stub(s). The file did not contain these required documents regarding the borrower's second job. When the monthly income of \$1,319 is not included, the borrower's debt to income ratios increase to 64 and 100 percent respectively.

D. Insufficient Cash Gift Information

In accordance with Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. The borrower's file did not contain a bank withdrawal slip or canceled check from the donor regarding a \$2,500 gift.

Narrative Case Presentation

E. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on March 24, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on March 20, 2000. Mortgagee Letter 94-7, Section IV: provides that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Chapel's comments

351-3791341

1. HUD OIG stated that the debt to income ratio is too high because Chapel did not obtain verification of the borrower's second job. However, Chapel has a Verification of Employment form which showed an acceptable income of \$3467 per month. In addition, the new housing payment increased only by 46 percent making the loan acceptable.
2. According to HUD OIG, the file did not sufficiently document the cash gift. The file, however, includes a deposit ticket showing the funds deposited to the borrower's account, and the check refers to the donor.
3. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

OIG's Evaluation of Chapel's comments

1. The debt to income ratios on Chapel's Mortgage Credit Analysis Worksheet forwarded to HUD/FHA indicated income of \$1,319 from a second job. As stated above, Chapel's file did not contain a Verification of Employment for this second job. In Chapel's response to this issue, Chapel computed new debt to income ratios using projected income from the borrower's first job. Regarding the first job, the borrower went from working part time to full time. Because the borrower went from part time to full time employment, we believe that Chapel should have verified the borrower's employment record for the most recent two years as required by Handbook 4155.1, REV-4 CHG-1, Paragraph 2-6. This was not done by Chapel.
2. The documentation in Chapel's file did not indicate that the gift funds came from the donor's banking institution as required by Handbook 4155.1, REV-4 CHG-1, Paragraph 3-1E.

Narrative Case Presentation

3. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-4058116

Loan Amount: \$114,059

Settlement Date: 06/29/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel approved the borrower's mortgage despite the fact that the Mortgage Credit Analysis Worksheet included a 36.28 percent mortgage payment to income ratio and a 48.67 percent total fixed payment to income ratio and did not include any compensating factors that justified using the excessive ratios

In addition, we believe that Chapel overstated the borrower's monthly income, which would result in a higher debt to income ratios than the ratios mentioned above. Per Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7M(2), if property was acquired since the borrower's last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or other rental agreement. Our review disclosed that there was a lease in the file amounting to \$800 per month, but the lease did not contain the name of the renter or a signature. Because the name and signature was not provided, we believe that the amount on the lease should not have been considered and included in the calculation of the ratios. Without this income, the ratios are raised to 42.9 percent and 58.0 percent respectively.

C. Insufficient Cash Gift Information

The borrower's file neither contained evidence that a \$5,000 cash gift was withdrawn from the donor's bank account, nor that \$5,000 was deposited into the borrower's bank account. In accordance with Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's withdrawal slip or canceled check from the gift donor's bank, along with the borrower's bank deposit slip or bank statement showing that the amount was deposited in the borrower's bank account.

Narrative Case Presentation

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a gift letter that specifies the dollar amount, signed by the borrower and donor, and stating that no repayment is required. In addition, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. Our review disclosed that the gift letter did not list the donor's address.

D. Insufficient Verification Of Employment

The file contained a Verbal Verification of Employment that was provided by the borrower. Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1(E), provides that as an alternative to obtaining a verification of employment, the mortgagee must verify the borrower's employment by contacting all current employers through the telephone. Our review of the file indicated that the mortgagee did not comply with this requirement.

E. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on June 29, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on June 26, 2000. Mortgagee Letter 94-7, Section IV: states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

F. Discrepancies With Appraisals

Information in the file indicated that the seller of the property who is identified on the appraisal, purchased the property subsequent to the date of the appraisal report. Chapel's underwriting staff did not resolve this discrepancy. The appraisal report dated June 16, 2000, identified the seller's name; however, according to information in Chapel's file, the property was sold to the seller on June 22, 2000, six days subsequent to the date of the appraisal report.

Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. 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.

Narrative Case Presentation

Chapel's comments

352-4058116

1. HUD OIG determined that the debt to income ratio was excessive, and no compensating factors were present. Having reviewed the file, Chapel agrees with this determination.
2. A renter's signature was not on a rental agreement. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser's estimate of rental income was used.
3. Chapel agrees that the file did not contain appropriate documentation for the cash gift.
4. A verification of employment form was obtained, contradicting HUD OIG's statement that income was not verified.
5. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.
6. According to HUD OIG, information showed that the seller of the property did not own the property on the date of the appraisal. At the time Chapel reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and Chapel would not have made the loan if it knew of any problems. The appraiser was on HUD OIG's approved appraisal list. It has subsequently appeared that the FHA-approved appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD OIG's fraud unit.

OIG's Evaluation of Chapel's comments

1. Chapel concurs with issue.
2. In accordance with Handbook 4155.1 REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower's Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.
3. Chapel concurs with issue.
4. Documentation in Chapel's file indicated that the borrower verified the employment. Employment must be independently verified; therefore, we disagree with Chapel that employment was verified.

Narrative Case Presentation

5. Chapel concurs with issue.
6. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-4032805

Loan Amount: \$126,457

Settlement Date: 05/31/00

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Employment Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 38.69 and 47.80. percent respectively without stating compensating factors. For the reason provided below, we believe that the ratios calculated by Chapel are incorrect.

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7, provides that the borrower's income must be analyzed to determine whether it can reasonably be expected to continue through the first three years of the mortgage. Chapel showed the borrower's monthly income as being \$2,327. Our calculation determined that the monthly income was \$2,100. Using \$2,100, as the monthly income, the debt ratios are increase to 41.44 and 51.20 percent respectively.

C. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing that the amount was deposited in the borrower's bank account. The borrower's file contained a gift letter for \$6,000, whereas the borrower's Mortgage Credit Analysis Worksheet showed a \$9,000 gift. Furthermore, the file did not contain evidence that \$6,000 of the \$9,000 was withdrawn from the donor's bank account.

Narrative Case Presentation

D. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on May 31, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on May 25, 2000. Mortgagee Letter 94-7, Section IV: states that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

E. Ineligible Fees and Charges

Handbook 4000.4, Paragraph 1-11, provides that that no extra fees and charges may be collected from the borrower on the basis of Direct Endorsement processing. Only those fees normally charged the borrower in HUD/FHA transactions such as lock-in fees, origination fees, appraisal fees, inspection fees, costs of a credit report, any charges for verifying deposits, and discount points may be charged the borrower in a Direct Endorsement Case. The HUD-1, shows a \$474.21 discount fee (broker premium) that was paid by the borrower when it should have been paid by Chapel to its loan correspondent.

F. Discrepancies With Appraisals

The file contained an appraisal dated May 3, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel’s files that indicated a sale occurred prior to the appraisal report date. Chapel’s underwriting staff did not resolve this discrepancy. Our analysis of the information in the file showed that the property was sold three months prior to the May 31, 2000 closing date. The previous owner purchased the property on March 13, 2000, and subsequently sold it three months later on May 31, 2000.

Standards Rule 1-5(b) of the USPAP provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G of HUD Handbook 4000.4, Single Family Direct Endorsement, requires the mortgagee’s underwriter to reviewer the appraisal to determine whether or not the appraiser’s conclusions are acceptable.

Narrative Case Presentation

Chapel's comments

352-4032805

1. Chapel agrees with HUD's determination that the debt to income ratio was excessive.
2. In our letter of November 15, we advised HUD OIG of the circumstances concerning the gift check. The file shows a gift letter from the borrower's mother. Since the closing agent would not accept a personal check, a bank check in the amount of the gift was obtained.
3. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.
4. HUD OIG stated that an ineligible broker fee of \$474.21 was charged. According to Chapel's records, the fee was not a broker fee but a permitted discount fee to Chapel.
5. According to HUD OIG, information in the file showed that the property had been sold during the year. At the time Chapel reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and Chapel would not have made the loan if it knew of any problems. We note that the appraiser was on HUD's approved list. It has subsequently appeared that the appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD's fraud unit.

OIG's Evaluation of Chapel's comments

1. Chapel concurs with issue.
2. Documentation in Chapel's file included a treasury check for \$6,000 that did not identify the donor as the remitter. According to Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the donor's bank withdrawal statement or canceled check from the donor's bank.
3. Chapel concurs with issue.
4. Handbook 4000.4, Paragraph 1-11 states that only those fees normally charged the borrower in HUD/FHA transactions are allowable. Furthermore, Handbook 4000.4, Paragraph 1-11 identifies discount points as an allowable fee, but excludes underwriting fees or mortgage credit fees. In addition, information in Chapel's file indicated that the borrower already paid

Narrative Case Presentation

2.5 discount points (\$2,436). Therefore, we believe that the \$474.21 discount fee charged the borrower by Chapel is ineligible.

5. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 351-3842154

Loan Amount: \$125,267

Settlement Date: 07/20/00

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Understated Liabilities

C. Insufficient Payroll Data

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt ratios of 30.30 and 37.61 percent respectively. Chapel's justification for the high front ratio was compensating factors, such as "post credit problems resolved", and "acceptable explanation". However, we believe that the total fixed payment to income ratio calculated by Chapel is incorrect, as discussed in the following paragraphs.

Chapel understated the borrower's monthly liabilities by \$837, because it did not include a monthly mortgage payment for a property already owned by the borrower. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-11(A) provides that the mortgagee must include the monthly housing expense, and all other additional recurring charges including child support, installment accounts and revolving accounts when computing debt ratios. As a result, we believe that the borrower's total fixed payment to income ratio should have been 49 percent.

We should also mention that Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1(E), provides that pay stubs must show the borrower's name, social security number and year to date earnings. The pay stubs in the file did not identify the borrower's social security number, as well as the hour worked and wage rate.

D. Insufficient Cash Gift Information

In accordance with Handbook 4155.1 REV-4 CHG 1, paragraph 2-10C, the mortgagee must contain a gift letter that specifies the dollar amount, signed by the borrower and donor, states that

Narrative Case Presentation

no repayment is required, and show the donor's name, address, telephone number, and relationship to the borrower. The borrower's file contained a gift letter for \$3,800 that did not identify the donor's address.

E. Ineligible Commitment Fee

A commitment fee of \$450 is included on the HUD0-1, which was paid by the borrower on July 20, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on July 13, 2000. Mortgagee Letter 94-7 Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

F. Discrepancies With Appraisals

Information in the file indicated that the property listed on the appraisal was previously sold without listing the date of the sale. Chapel's underwriting staff did not resolve this discrepancy.

Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. 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.

Chapel's comments

351-3842154

1. HUD OIG stated that the debt to income ratio as calculated by Chapel was excessive, and that Chapel did not include a monthly mortgage payment. Chapel, however, had a copy of the lease agreement; including the rental income. This rental income, according to Chapel's calculations, provides an acceptable debt to income ratio of 30-43 percent
2. HUD OIG further stated that the pay stub did not include the borrower's social security number. That information, however, was on the W-2's and the verification of employment form in the file. The fact that the employer did not have the employee's social security number printed on the pay stub does not impair the quality of the loan.

Narrative Case Presentation

3. The gift letter did not contain the donor's address. The gift, however, was documented. This technical violation does not impair the quality of the loan.
4. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.
5. According to HUD OIG, information showed that the property had been previously sold. At the time Chapel reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and Chapel would not have made the loan if it knew of any problems. We note that the appraiser was listed on HUD's approved list. It has subsequently appeared that the appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD's fraud unit.

OIG's Evaluation of Chapel's comments

1. Chapel understated the borrower's liabilities by \$837, because it did not include a mortgage payment for a property already owned by the borrower. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-11(A) requires that amount of real estate loans repayments must be included as part of the borrower's liabilities.
2. The pay stub in the file did not identify the borrower's social security, as well as the hours worked and wage rate as required by Handbook 4155.1, REV-4 CHG 1 paragraph 3-1(E).
3. The gift letter did not contain the donor's address as required by Handbook 4155.1, REV-4 CHG 1, paragraph 2-10C.
4. Chapel concurs with issue.
5. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property but did not give a date. It may or may not have been during the previous year. Chapel should have resolved the issued, in accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, which provides that the mortgagee must review the appraisal to determine whether or not the appraiser's conclusions are acceptable

Narrative Case Presentation

FHA Case Number: 352-4072249
Loan Amount: \$83,845
Settlement Date: 07/18/2000
Status: Non-Current

Pertinent Details

- A. Inaccurate/Excessive Debt to Income Ratios
- B. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee addresses compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 30 and 41 percent respectively. However, we believe that the ratios calculated by Chapel are incorrect as discussed in the following paragraph.

According to Handbook 4155.1, REV-4 CHG-1, Paragraph 2-7M(2), if a property is acquired since the last income tax filing and is not shown on the Internal Revenue Service, Schedule E, a current signed lease or other rental agreement must be provided. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the accuracy of the \$765 of monthly rental income used by Chapel to compute the debt ratios. Without the monthly income from a rental agreement, we believe that the debt ratios would have been 40 and 55 percent respectively.

- C. Insufficient Cash Gift Information

The borrower's file did not contain evidence that a \$5,000 cash gift was withdrawn from the donor's bank account. According to Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank.

Narrative Case Presentation

D. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on July 18, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on July 14, 2000. Mortgagee Letter 94-7, Section IV states that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Chapel’s comments

352-4072249

1. HUD OIG stated that the debt to income ratio was excessive. It indicated that the monthly rental income should not have been included because a signed rental agreement was not in the file. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser’s estimate of rental income was used. In addition, as one unit would be owner-occupied, the numbers used are reasonable.
2. As we informed HUD OIG in the Shaffer Letter, the file shows a gift letter in the amount of \$5,000 from the borrower’s brother dated 7/11/00, with a check in that amount from the donor, also dated 7/11/00. The \$5,000 check was deposited on 7/12/00, as evidenced by the deposit receipt. In addition to the \$5,000 gift, the borrower had \$429.82 in the borrower’s own funds, as evidenced by the bank statement in the file. Copies of these documents were provided to HUD OIG. Consequently, the borrower had sufficient funds to close on 7/18/00.
3. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

OIG’s Evaluation of Chapel’s comments

1. In accordance with Handbook 4155.1 REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower’s Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.
2. The borrower’s file did not contain evidence that a \$5000 cash gift was withdrawn from the donor’s bank account. The copy of the gift check in the file was not a copy of the cancelled check. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor’s bank withdrawal slip or canceled check from the gift donor’s bank.
3. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-3999129

Loan Amount: \$163,676

Settlement Date: 04/17/2000

Status: Non-Current

Pertinent Details

- A. Inaccurate/Excessive Debt to Income Ratios
- B. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 39.8 and 49.9 percent respectively without identifying compensating factors. Furthermore, we believe that the ratios calculated by Chapel are incorrect, as discussed below.

Per Handbook 4155.1 REV-4 CHG 1, Paragraph 2-7M(2), if a property was acquired since the borrower's last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or other rental agreement. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the accuracy of the \$765 of monthly rental income used by Chapel to compute the debt ratios. Without this income the debt to income ratios would have been 48.29 and 60.60 percent respectively.

- C. Ineligible Commitment Fee

A commitment fee was included on the HUD-1 which was paid by the borrower on April 17, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on April 12, 2000. Mortgagee Letter 94-7, Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

D. Unexplained Deposits & Recently Opened Accounts

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10B, provides that if there is a large increase in a bank account amount or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained a copy of a bank statement dated March 3, 2000, indicating an ending balance of \$12,754.01, which increased \$2,887.96 from the prior month's ending balance. The file also contained correspondence indicating that the substantial increase was due to savings originating from payroll checks of the borrowers. However, there was no documentation in the file explaining how the borrowers accumulated the substantial savings from their payroll earnings.

Chapel's comments

352-3999129

1. According to HUD OIG, the debt to income ratio was excessive. It indicated that the rent relied upon was not supported by the file since a lease was not included in the file. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser's estimate of rental income was used.
2. Chapel agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.
3. HUD OIG complained that the file did not have evidence that the borrowers savings were from their payroll accounts. As noted in the file, the borrowers had deposited a portion of their pay checks regularly into their savings account.

OIG's Evaluation of Chapel's comments

1. In accordance with Handbook 4155.1, REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower's Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.
2. Chapel concurs with issue.
3. Documentation in Chapel's file indicated that the combined net amounts of the borrower and co-borrower's monthly payroll earnings did not equal the amount of unexplained deposits in question.

Narrative Case Presentation

FHA Case Number: 352-4039557

Loan Amount: \$121,339

Settlement Date: 06/21/00

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 37.12 and 40.14 percent respectively and did not include any compensating factors that justified using the excessive mortgage payment to effective income ratio. Furthermore, we believe that the ratios calculated by Chapel are incorrect, as discussed below.

Per Handbook 4155.1, REV-4 CHG 1, Paragraph 2-7M(2), if a property was acquired since the borrower's last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or other rental agreement. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the accuracy of the \$722 of monthly rental income used by Chapel to compute the debt ratios. Without this income the debt to income ratios would have been 46 and 50 percent respectively.

C. Ineligible Commitment Fee

A commitment fee was included on the HUD-1, which was paid by the borrower on June 21, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on June 16, 2000. Mortgagee Letter 94-7, Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

Chapel's comments

352-4039557

1. HUD OIG stated that the debt to income ratio was excessive. Since a signed lease agreement was not included in the file, the rental income should not have been included. The property, however, was purchased with the proceeds of the loan transaction; consequently, the rental income used was that provided on the appraisal.
2. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
3. A large deposit into a bank account was not, according to HUD OIG, explained. The \$1900 bank deposit came from a federal income tax refund; documentation is provided.

OIG's Evaluation of Chapel's comments

1. In accordance with Handbook 4155.1, REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower's Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.
2. Chapel concurs with issue.
3. OIG accepted Chapel documentation regarding the unexplained \$1,900 deposit and eliminated the issue regarding unexplained deposits and recently opened accounts.

Narrative Case Presentation

FHA Case Number: 352-4110796

Loan Amount: \$149,900

Settlement Date: 09/22/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Unsupported Rental Income

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee addresses compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 28.97 and 45.58 percent respectively and listed compensating factors, such as, a "limited credit user", had "good reserve assets" and "good employment stability". However, we believe that the ratios Chapel calculated are incorrect as discussed in the following paragraph.

Our review disclosed that the borrower's file did not contain a copy of a current signed lease. Handbook 4155.1 REV-4 CHG 1, Paragraph 2-7M(2), provides that if a property was acquired since the borrower's last income tax filing and is not shown on the borrower's Internal Revenue Service, Schedule E, the borrower must provide a current signed lease or other rental agreement. Our review disclosed that the file did not contain a signed lease or rental agreement to verify the accuracy of the \$1,381 of monthly rental income used by Chapel to compute the debt ratios. Without this income the debt to income ratios would have been 37.99 and 59.78 percent respectively.

C. Insufficient Cash Gift Information

Mortgagee Letter 00-28, provides that the donor must be able to furnish conclusive evidence that the funds given to the borrower came from the donor's own funds and were not provided directly or indirectly by the seller, real estate agent, builder, or any other entity with an interest in the sales transaction. In addition, the mortgagee remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift. The borrower received a \$12,300, gift from the donor on September 18, 2000. The donor provided a \$10,500, cashier check and a \$1,800, personal check to the closing agent at the loan closing. The file did not contain documentation that the \$1,800, personal check came from the donor's bank

Narrative Case Presentation

account or that the closing agent deposited the gift amount of \$12,300 in the borrower's escrow account.

Also, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. The gift letter in the borrower's file did not show the donor's address.

D. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on September 22, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on September 19, 2000. Mortgagee Letter 94-7, Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Chapel's comments

352-4110796

1. HUD OIG stated that the debt to income ratio was excessive. Since a signed lease agreement was not included in the file, the rental income should not have been included. The property, however, was purchased with the proceeds of the loan transaction; consequently, the rental income used was that provided on the appraisal, and the debt to income ratio is acceptable.
2. According to HUD OIG, the gift letter was not documented adequately. As we explained in our letter of November 15, Chapel's file shows that the donor had two documented bank accounts that contained sufficient funds to cover the amount of the \$12,300 gift. Copies of the documents were provided to HUD OIG. HUD OIG also commented that the donor letter did not provide the donor's address. This is a technical violation that did not impair the quality of the loan.
3. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

OIG's Evaluation of Chapel's comments

1. In accordance with Handbook 4155.1, REV-4 CHG-1, Paragraph 2-7M(2), if rental income is not shown on the borrower's Internal Revenue Service, Schedule E, Chapel must obtain a copy of the signed lease or rental agreement. Chapel did not obtain this documentation.

Narrative Case Presentation

2. Chapel's file did not contain documentation indicating that the \$1,800 was withdrawn from the donor's bank account. Mortgagee Letter 00-28, provides that the donor must be able to furnish conclusive evidence that the funds given to the borrower came from the donor's own funds and were not provided directly or indirectly by the seller, real estate agent, builder, or any other entity with an interest in the sales transaction.
3. Chapel concurs with issue.

Narrative Case Presentation

FHA Case Number: 352-4026591

Loan Amount: \$114,059

Settlement Date: 05/12/00

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee identifies compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 36.27 and 42.76 percent respectively without identifying compensating factors.

B. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. The borrower's file did not contain evidence that the amount of the cash gift was withdrawn from the donor's bank account.

C. Unexplained Derogatory Credit

Chapel's file contained copies of a bank statement that indicated that the borrower had two rent payment checks returned due to Non Sufficient Funds. In addition, the borrower failed to make a rent payment for one month. Handbook 4155.1, REV-4 CHG-1, Paragraph 2-3, provides that major indications of derogatory credit problems, requires a sufficient written explanation from the borrower. Chapel did not obtain explanations for the stated problems from the borrower.

Narrative Case Presentation

Chapel's comments

352-4026591

1. HUD OIG determined that the borrower's debt to income ratio exceeded the HUD guidelines. According to HUD OIG, the file did not identify any compensating factors, and the file did not contain evidence that the amount of the cash gift was withdrawn from the donor's bank account. HUD OIG noted that the file contained copies of a bank statement indicating that the borrower had two rent checks returned due to Non Sufficient Funds. HUD OIG stated that major indications of derogatory credit problems must be explained. Chapel has requested and is still waiting for copies of the supporting documentation from the investor.

OIG's Evaluation of Chapel's comments

1. Chapel is awaiting additional documentation to respond to these issues.

Narrative Case Presentation

FHA Case Number: 351-3803949

Loan Amount: \$88,966

Settlement Date: 4/26/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

B. Insufficient Payroll Data

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee addresses compensating factors that could justify exceeding these ratios. Chapel computed debt to income ratios of 33.07 and 44.9 percent respectively; however, Chapel did not include any compensating factors that justified using the excessive ratios. We believe that the debt-ratios were higher, as discussed below.

Handbook 4155.1, REV-4 CHG-1, Paragraph 3-1(E), provides that Chapel must obtain a Verification of Employment (VOE) and most recent pay stub to verify the borrower's employment. Handbook 4155.1, REV-4 CHG-1, Paragraph 3-1(E), also provides that as an alternative to obtaining a VOE, the mortgagee may choose to obtain from the borrower the original pay stub(s) covering the most recent thirty-day period. The pay stub(s) must show the borrower's name, social security number, and year-to-date earnings. Chapel did not obtain pay stubs to support wages of \$1,408, regarding the borrower's second job. If income from the borrower's second job were not included, the debt ratios would be as high as 80 and 107 percent respectively.

C. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on April 26, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on April 24, 2000. Mortgagee Letter 94-7 Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

D. Discrepancies With Appraisals

Information in the file indicated that the property listed on the appraisal was previously sold without listing the date of the sale. Chapel's underwriting staff did not resolve this discrepancy.

Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. 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.

Chapel's comments

351-3803949

1. HUD OIG stated that a verification of employment for the borrower's second job was not provided. If income from the second job is excluded, the debt to income ratios are too high. According to Chapel, the file contains a verification of employment and paychecks evidencing the second job. In addition borrower had an excellent rental history. Chapel believes that the debt to income ratios are not excessive.
2. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
3. According to HUD OIG, information in the file indicates that the property was previously sold without listing the date of the sale. Information that the property was previously sold was not available at the time the loan was approved.

OIG's Evaluation of Chapel's comments

1. The paychecks (pay stubs) in Chapel's files for the second job did not identify the borrower's name and social security number. Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1 (E), provides that pay stubs must show the borrower's name, social security number, and year to date earnings. As a result, we did not include the second job income in our calculation of the debt to income ratios.
2. Chapel concurs with issue.
3. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property but did not give a date. It may or may not have been during the previous year. Chapel should have resolved the issued, in accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement,

Narrative Case Presentation

which provides that the mortgagee must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-4135361

Loan Amount: \$94,223

Settlement Date: 10/27/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee provides compensating factors that justify exceeding these ratios. Chapel computed debt to income ratios of 35.59 and 49.9 percent respectively and did not include any compensating factors that justified using the excessive ratios.

B. Insufficient Banking Data.

Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1F, provides that the mortgagee must obtain a verification of deposit and most recent bank statement. Chapel's file did not contain bank data for a \$6,314.00 verification of deposit, dated October 20, 2000.

C. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on October 27, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on October 18, 2000. Mortgagee Letter 94-7, Section IV provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

D. Discrepancies With Appraisals

The file contained an appraisal, dated October 12, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel's files that indicated a sale occurred prior to the appraisal report date. Chapel's underwriting staff did not resolve this discrepancy. Our analysis of information in the file showed

Narrative Case Presentation

that the property was sold eight months prior to the October 27, 2000 closing date. The previous owner purchased the property on March 3, 2000, for \$35,000 and subsequently sold it eight months later on October 27, 2000 for \$95,000.

Standards Rule 1-5(b) of the USPAP provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G of HUD Handbook 4000.4, Single Family Direct Endorsement requires the mortgagee's underwriter to review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Chapel's comments

352-4135361

1. HUD OIG stated that the debt- to-income ratios are excessive. This loan, however, was approved using HUD's Loan Prospector.
2. According to HUD OIG, the file did not adequately show that funds were verified, and that the bank statement shows a zero balance. HUD OIG's auditors, however, misread the statement; the zero balance refers to activity in the cash reserve account. That is, the borrower had not borrowed against the account and therefore that amount was zero. In fact, the file shows that a verification of deposit, showing sufficient funds, was obtained.
3. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
4. According to HUD OIG, information in the file indicates that the property was previously sold prior to the appraisal date. At the time, Chapel did not believe that the appraisal was inaccurate. The appraiser was on HUD OIG's approved list. Subsequently, Chapel discovered that the appraiser and the correspondent were involved in a fraudulent transaction, and Chapel was an unwitting victim of such fraud. Had Chapel known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

OIG's Evaluation of Chapel's comments

1. The information in Chapel's file and the information submitted to HUD/FHA did not include compensating factors. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee addresses compensating factors that could justify exceeding these ratios. Chapel did not provide any compensating factors.

Narrative Case Presentation

2. Chapel provided us with documentation indicating that a zero balance did not exist. Therefore, we eliminated the deficiency regarding not enough funds to close the loan.. As for the \$6,314 verification of deposit, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1F, states that the mortgagee must obtain a verification of deposit and most recent bank statement. Although Chapel obtained a verification of deposit, Chapel did not obtain the most recent bank statement.
3. Chapel concurs with issue.
4. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the property occurred four months prior to the property's closing date. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-4126006

Loan Amount: \$109,100

Settlement Date: 11/29/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee provides compensating factors that justify exceeding these ratios. Chapel computed debt to income ratios of 25.04 and 36.48 percent respectively. However, we believe that the ratios calculated are incorrect as discussed in the paragraph below.

A review of the Mortgage Credit Analysis Worksheet prepared by Chapel disclosed a mathematical error regarding the ratio calculations. Our calculation disclosed a mortgage payment to effective income ratio of 31 percent and a total fixed payment to income ratio of 46 percent.

B. Insufficient Cash Gift Information

The file did not contain evidence that the \$5,200 cash gift was withdrawn from the donor's bank account. Mortgagee Letter 00-28, provides that the donor must be able to furnish conclusive evidence that the funds given to the borrower came from the donor's own funds and were not provided directly or indirectly by the seller, real estate agent, builder, or any other entity with an interest in the sales transaction.

C. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on November 29, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on November 17, 2000. Mortgagee Letter 94-7, Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

D. Discrepancies With Appraisals

The file contained an appraisal, dated October 20, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel's files that indicated a sale occurred prior to the appraisal report date. Chapel's underwriting staff did not resolve this discrepancy. Our analysis of the information in the files showed that the property was sold two months prior to the November 29, 2000 closing date. The previous owner purchased the property on September 26, 2000, for \$37,000, and subsequently sold it two months later on November 29, 2000 for \$110,000.

Standards Rule 1-5(b) of the USPAP provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G ,of HUD Handbook 4000.4, Single Family Direct Endorsement requires the mortgagee's underwriter to reviewer the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Chapel's comments

352-4126006

1. According to HUD OIG, the debt to income ratios were incorrect because of a mathematical computation error. Having reviewing the file, Chapel believes that it calculated the ratios correctly.
2. HUD OIG stated that the file did not contain evidence supporting the \$5,200 cash gift. Chapel has presented documentation that the gift money was withdrawn and deposited into the borrower's account.
3. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
4. HUD OIG stated that its investigation showed a prior sale of the property that was not disclosed on the appraisal. HUD OIG alleged that other information in the file should have alerted Chapel's underwriter to this fact. The additional information was not available at the time of loan approval and Chapel did not have reason to doubt the appraisal at that time. The appraiser was selected by the correspondent from the FHA-approved list. It is Chapel's contention that the appraiser and correspondent were involved in a fraudulent transaction, and Chapel was an unwitting victim of such fraud. Had Chapel known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

Narrative Case Presentation

OIG's Evaluation of Chapel's comments

1. Debt to income ratios are calculated on HUD's Mortgage Credit Analysis Worksheets. OIG's review of Chapel's files indicated that Chapel eliminated some of the borrower's income but did not exclude this income from the debt to income ratios; thus, a mathematical error occurred.
2. Chapel provided OIG documentation for a \$5,200 check that had check number 5071. However, the gift check that we are questioning was check number 5128.
3. Chapel concurs with issue.
4. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-3971484

Loan Amount: \$94,223

Settlement Date: 03/02/2000

Status: Non-Current

Pertinent Details

A. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. The file did not contain a check or any other form of banking instrument showing that the donor actually withdrew money for the borrower. However, there was documentation in the file that showed that the borrower deposited \$3,500 on February 25, 2000, \$400 more than the actual amount stated on the gift letter.

Also, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the gift letter must show the donor's name, address, telephone number, and relationship to the borrower. The borrower's file contained a gift letter that did not list the donor's address or telephone number.

B. Ineligible Commitment Fee

A \$450, commitment fee was included on the HUD-1, which was paid by the borrower on March 2, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on February 25, 2000. Mortgagee Letter 94-7, Section IV states that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

Narrative Case Presentation

C. Discrepancies With Appraisals

Information in the file indicated that the property listed on the appraisal was previously sold without listing the date of the sale. Chapel's underwriting staff did not resolve this discrepancy.

Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. 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.

Chapel's comments

352-3971484

1. HUD OIG noted several problems with the gift letter. The amount of the deposit was \$3500, not \$3100 as shown on the gift letter. The gift letter failed to list the donor's address or telephone number. According to Chapel, the gift letter should have been made out in the amount of \$3500, which was the intended, and actual, amount of the gift. Although the gift letter should have included the donor's address and telephone number, this technical violation did not impair the quality of the loan.
2. The loan origination points charged to the borrower were, according to HUD OIG, excessive. The mortgagee can charge only one origination point, but the HUD showed two points. According to Chapel the HUD-1 was inadvertently filled out incorrectly. The HUD-1 should have shown an origination fee of 1 percent and a 2 percent discount fee.
3. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
4. HUD OIG stated that information in the file indicated that the property was previously sold without listing the date of the sale. This information was omitted by the appraiser. Chapel had no other knowledge at the time the loan was approved; had Chapel known of the other sale it would not have approved the loan.

OIG's Evaluation of Chapel's comments

1. The Chapel file did not contain a check or any other form of banking instrument indicating that the donor actually withdrew money from a financial institution for the borrower. In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing the deposit in the borrower's bank account. In addition, in accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the donor's address and telephone number must be identified on the gift letter.

Narrative Case Presentation

2. OIG eliminated the issue regarding excessive loan origination points charged to the borrower based upon Chapel's response.
3. Chapel concurs with issue.
4. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property but did not give a date. It may or may not have been during the previous year. Chapel should have resolved the issued, in accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, which provides that the mortgagee must review the appraisal to determine whether or not the appraiser's conclusions are acceptable

Narrative Case Presentation

FHA Case Number: 352-3995083

Loan Amount: \$128,900

Settlement Date: 03/13/2000

Status: Non-Current

Pertinent Details

A. Insufficient Verification of Employment

Handbook 4155.1, REV-4 CHG 1 Paragraph 3-1E provides that as an alternative to obtaining a Verification of Employment, (VOE) the mortgagee may chose to obtain the borrower's most recent 30 day period pay stub, and the mortgagee must also verify the borrower's employment by contacting all current employers through the telephone. Our review of the file disclosed that Chapel did not verify the borrower's employment by contacting all current employers by telephone.

B. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on March 13, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on March 8, 2000. Mortgagee Letter 94-7 Section IV provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

C. Discrepancies With Appraisals

Chapel's files contained an appraisal, dated February 25, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information was in Chapel's files that indicated a sale occurred prior to the appraisal report date. Chapel's underwriting staff did not resolve this discrepancy. Our analysis of the information in the files determined that the property was sold five months prior to the March 13, 2000 closing date. The previous owner purchased the property on October 26, 1999, for \$45,000, and subsequently sold it five months later on March 13, 2000 for \$130,000.

Narrative Case Presentation

Standards Rule 1-5(b) of the USPAP provides that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgage Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G, of HUD Handbook 4000.4, Single Family Direct Endorsement requires the mortgagee's underwriter to review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Chapel's comments

Chapel did not provide any comments for this HUD/FHA case number.

Narrative Case Presentation

FHA Case Number: 351-3783532

Loan Amount: \$77,198

Settlement Date: 4/17/2000

Status: Non-Current

Pertinent Details

A. Insufficient Cash Gift Information

In accordance with Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing that the funds were deposited in the borrower's bank account. According to information in the file, a donor provided the borrower a \$20,000 gift on December 31, 1999. The file contained documentation showing that the borrower made two \$10,000 deposits, totaling \$20,000, on January 7, 2000, and January 10, 2000, respectively. The file did not contain a copy of the check or any other form of banking instrument showing that the donor actually withdrew money for the borrower. Therefore, the source of the \$20,000 deposit could not be determined from the information in the file.

B. Insufficient Banking Data

Handbook 4155.1, REV-4 CHG 1, Paragraph 3-1F, provides that the mortgagee must obtain a verification of deposit and most recent bank statement. Chapel's file did not contain supporting bank data for a \$5,004.00 verification of deposit, dated March 7, 2000.

Chapel's comments

351-3783532

1. HUD OIG stated that the file did not adequately document the source of the \$20,000 deposit. According to Chapel, the borrower's uncle gave a gift of \$10,000 to the borrower and

Narrative Case Presentation

\$10,000 to the borrower's wife. Both amounts were deposited into one account. The deposits were documented.

2. In contrast to HUD OIG's statement, the file shows that the borrowers had sufficient funds to close. An escrow down payment had been made in February. The verification of deposit, dated March, and evidence of an annuity balance, indicated that the borrowers had sufficient funds to cover the remaining amount due.

OIG's Evaluation of Chapel's comments

1. Although the borrower's bank account indicated deposits amounting to \$20,000, Chapel's file did not contain a copy of a cancelled check or any other form of banking instrument indicating that the donor actually withdrew money from a financial institution for the borrower. Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10C, states that the mortgagee must obtain a copy of the gift donor's bank withdrawal slip or canceled check from the gift donor's bank, along with the borrower's deposit slip or bank statement showing that the funds were deposited in the borrower's bank account.
2. OIG accepted Chapel's response regarding the not enough funds to close issue and eliminated this deficiency. As for the \$5,004 Verification of Deposit, Handbook 4115.1, REV-4 CHG1, Paragraph 3-1F states that the mortgagee must obtain a verification of deposit and most recent bank statement. The Verification of Deposit obtained by Chapel was dated March 7, 2000, but the bank statement in the file was dated January 19, 2000. In short, Chapel did not obtain a recent bank statement.

Narrative Case Presentation

FHA Case Number: 352-4017271

Loan Amount: \$89,264

Settlement Date: 04/19/00

Status: Non-Current

Pertinent Details

A. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on April 19, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on April 17, 2000. Mortgagee Letter 94-7, Section IV states that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

B. Unexplained Deposits & Recently Opened Bank Accounts

Handbook 4155.1, REV-4 CHG 1, Paragraph 2-10B, states that if there is a large increase in a bank account amount, or the bank account was opened recently, the mortgagee must obtain an explanation and evidence of the source of funds from the borrower. The file contained copies of two bank account statements indicating deposits of \$4,000, \$2,850, \$3,046, and \$1,350, without a written explanation and documentation from the borrower as to the source of the funds.

Chapel's comments

352-4017271

1. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
2. HUD OIG also stated that the borrower's bank accounts showed recent deposits without indicating the source of the funds. Chapel agrees that the deposits should have been questioned; however, this omission did not impair the quality of the loan. Chapel also notes that the loan was approved by Loan Prospector.

Narrative Case Presentation

OIG's Evaluation of Chapel's comments

1. Chapel concurs with issue.
2. Chapel's file contained copies of two bank account statements indicating deposits of \$4,000, \$2,850, and \$1,350 without a written explanation and documentation from the borrower as to the source of the funds as required by Handbook 4155.1 REV-4 CHG 1, Paragraph 2-10B.

Narrative Case Presentation

FHA Case Number: 352-3994410

Loan Amount: \$104,141

Settlement Date: 03/10/2000

Status: Non-Current

Pertinent Details

A. Inaccurate/Excessive Debt to Income Ratios

Per Handbook 4155.1, REV-4 CHG 1, Paragraphs 2-12 and 2-13, the borrower's mortgage payment to effective income ratio and total fixed payment to income ratio should not exceed 29 and 41 percent respectively, unless the mortgagee provides compensating factors that justify exceeding these ratios. Chapel computed debt to income ratios of 38.2 and 41.5 percent respectively. Chapel did not list any compensating factors to justify the high mortgage payment to effective income ratio.

B. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on March 10, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on March 9, 2000. Mortgagee Letter 94-7, Section IV provides that commitment or "lock-in" fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

C. Discrepancies With Appraisals

Information in the file indicated that the seller of the property, who is identified on the appraisal, purchased the property subsequent to the date of the appraisal report. Chapel's underwriting staff did not resolve this discrepancy. The appraisal report, dated February 25, 2000, identified the seller's name; however, according to information in Chapel's file, the property was sold to the seller on February 28, 2000, three days subsequent to the date of the appraisal report.

Narrative Case Presentation

Mortgagee Letter 94-54, provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser for the integrity, accuracy and thoroughness of the appraisal. 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.

Chapel's comments

352-3994410

1. HUD OIG stated that the debt to income ratios were excessive, and compensating factors were not listed. Chapel argues that a four-year job stability and eight-year residence were compensating factors.
2. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
3. According to HUD OIG, information in the file indicates that the seller of the property purchased the property subsequent to the date of the appraisal report. Chapel did not have reason to doubt the appraisal at that time. The appraiser, who was on HUD's approved list, was selected by the correspondent. It is Chapel's contention that the appraiser and correspondent were involved in a fraudulent transaction, and Chapel was an unwitting victim of such fraud. Had Chapel known that the appraisal was inaccurate, it would not have approved the loan.

OIG's Evaluation of Chapel's comments

1. Handbook 4155.1, REV-4 CHG 1, Paragraph 2-13 lists compensating factors, such as borrower made a large down payment, borrower demonstrated a conservative attitude toward the use of credit etc. Job stability and eight-year residence are not among the compensating factors listed in the Handbook.
2. Chapel concurs with issue.
3. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

Narrative Case Presentation

FHA Case Number: 352-4077593

Loan Amount: \$128,937

Settlement Date: 07/14/2000

Status: Non-Current

Pertinent Details

A. Ineligible Commitment Fee

A commitment fee of \$450 was included on the HUD-1, which was paid by the borrower on July 14, 2000 (closing date). The mortgage interest rate was locked-in, per the lock-in confirmation document on July 10, 2000. Mortgagee Letter 94-7, Section IV states that commitment or “lock-in” fees must be in writing and must guarantee the interest rate and/or discount points for a period of not less than 15 days before the anticipated closing date. Because the interest lock in date was less than 15 days, we believe that the \$450 commitment fee is ineligible.

B. Discrepancies With Appraisals

The file contained an appraisal, dated June 14, 2000, that did not contain the required information regarding the prior sale of the subject property. More importantly, information in Chapel’s files indicated that a sale occurred prior to the appraisal report date. Chapel’s underwriting staff did not resolve this discrepancy. Our analysis of the information in the file showed that the property was sold three weeks prior to the July 14, 2000 closing date. The seller purchased the property on May 24, 2000, and subsequently sold it three weeks later on July 14, 2000.

Standards Rule 1-5(b) of the USPAP states that when developing a real property appraisal, the appraiser must analyze prior sales of the property that occurred within one year. In addition, Mortgagee Letter 94-54 provides that a mortgagee that selects its own appraiser must accept responsibility, equally with the appraiser, for the integrity, accuracy and thoroughness of the appraisal and will be held accountable by HUD for the quality of the appraisal. Lastly, Section 3-3G, of HUD Handbook 4000.4, Single Family Direct Endorsement requires the mortgagee’s underwriter to review the appraisal to determine whether or not the appraiser’s conclusions are acceptable.

Narrative Case Presentation

Chapel's comments

352-4077593

1. Chapel agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.
2. HUD OIG stated that the appraisal did not contain required information regarding the prior sale of the property. According to HUD OIG, information in the file indicates that a sale occurred prior to the date of the appraisal report. Chapel did not have reason to doubt the appraisal at that time. The appraiser was selected by the correspondent from FHA-approved list. It is Chapel's contention that the appraiser and correspondent were involved in a fraudulent transaction, and Chapel was an unwitting victim of such fraud. Had CHAPEL known that the appraisal was inaccurate, it would not have approved the loan.

Chapel believes that the appraiser may have intentionally misrepresented some facts or omitted facts which, if included, would have prevented the loans from being approved. Chapel believes that the appraiser may have been working with the correspondent, and that an investigation of possible fraudulent activities by those parties should be undertaken by HUD OIG.

OIG's Evaluation of Chapel's comments

1. Chapel concurs with issue.
2. The appraisal report in Chapel's file stated no prior sale. However, the Title Report in Chapel's file mentioned a prior sale of the subject property. In accordance with Section 3-3G of HUD Handbook 4000, Single Family Direct Endorsement, Chapel must review the appraisal to determine whether or not the appraiser's conclusions are acceptable.

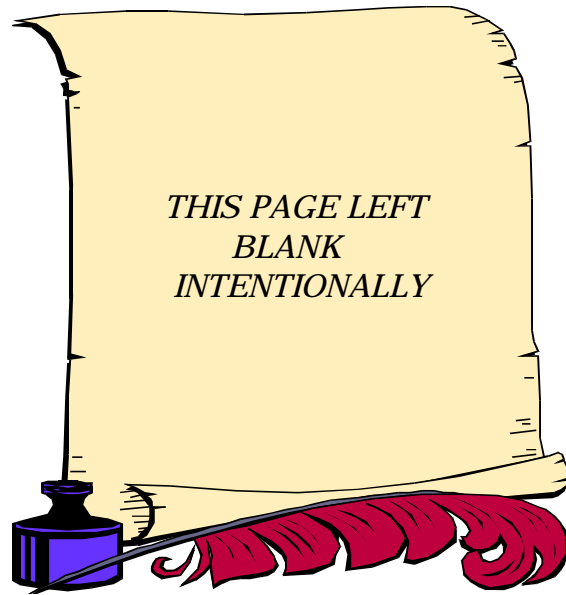
Schedule of Questioned Costs and Funds Put to Better Use

<u>Finding Number</u>	<u>Type of Questioned Costs</u>		<u>Funds Put to Better Use 3/</u>
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	
1	<u>---0---</u>	<u>---0---</u>	<u>\$2,937,120</u>
Total	<u>---0---</u>	<u>---0---</u>	<u>\$2,937,120</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.

2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future 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.

3/ Funds Put to Better Use are costs that will not be expended in the future if our recommendations are implemented, for example, costs not incurred, de-obligation of funds, Withdrawal of Interest, Reductions in Outlays, Avoidance of Unnecessary Expenditures, Loans and Guarantees not Made, and Other Savings.



Chapel's Comments



Robert M. Jaworski • 609.520.6003 • rjaworski@reedsmith.com

January 10, 2003

Mr. Alexander C. Malloy
Regional Inspector General for Audit
New York/New Jersey
U.S. Department of Housing & Urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Re: Audit Report (Draft, December 2002)
File No. 13158
Lender ID No. 74798 00008

Dear Mr. Malloy:

We represent Chapel Mortgage Corporation ("CMC") in connection with the above-referenced matter concerning an on-site audit by the Department of Housing and Urban Development ("HUD") of CMC's former correspondents.

We have reviewed the draft Audit Report prepared by HUD's Office of Audit in connection with the recently completed audit of HUD/FHA insured loans for the period between December 1, 1999, and November 30, 2001. In the Draft Report you directed CMC to indemnify HUD/FHA against future losses on 25 loans identified in Appendix A of the Report, and to provide a corrective action plan containing assurances that all HUD/FHA guidelines regarding underwriting HUD/FHA loans are followed. CMC disagrees with HUD's determination that CMC did not adhere to prudent lending practices, and, in approving the 25 loans examined, did not process the loans in accordance with applicable HUD/FHA requirements.

In the draft Audit Report, HUD also determined that weaknesses exist in the following management controls:

- Loans were not underwritten in accordance with all applicable HUD/FHA requirements.
- Procedures to ensure accurate loan processing information were not adequate.
- Controls over appraisers were not adequate.

Steven J. Ficco
Office Administrative Partner

A Limited Liability Partnership formed in the State of Delaware

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January 13, 2003 12:59 PM

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r e e d s m i t h . c o m

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As we have previously advised HUD, CMC takes very seriously its obligation to comply fully with applicable FHA rules. (See our letter dated November 15, 2002 to Ms. Julie Shaffer, a copy of which is enclosed (the "Shaffer Letter")). It believes that its record as an approved FHA lender over the past 11 years demonstrates its commitment in this regard. If errors are found, CMC is committed to correcting them as quickly as possible and taking immediate steps to prevent any reoccurrence. CMC will review its loan processing procedures and its employee training and improve procedures where advisable.

Nevertheless, CMC believes the majority of the findings referred to in your letter are in error, and the violations that have been found to exist do not impair the quality of the loans. Set forth below are specific information and explanations with respect to the subject loans which we believe should enable you to reach the same conclusion.

The appraisal problems, as noted below and as we previously informed HUD, are the result of an apparent fraud perpetrated on CMC by one of its former correspondents and should be investigated as such by the appropriate fraud investigation unit of HUD. The appraisers involved were on HUD's approved appraiser list, and at the time CMC had no reason to doubt the quality of their work.

352-4077614

HUD stated that the debt to income ratios were not calculated correctly. CMC included part-time and commission income which was not adequately documented. In calculating the ratios, CMC used rental income from Schedule E of Form 1040. The borrower's base income was \$3904 per month, the net rental income was \$1128 per month, for a total monthly income of \$5032. Using this income, the debt to income ratios are 23.6% and 42.1%, which are acceptable.

HUD also stated that CMC underestimated the borrower's monthly child support payments. The borrower has child support payments deducted directly from his paycheck. Consequently, the payment was already calculated in.

The "unexplained" deposits HUD refers to are the funds from the gift letter.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

HUD noted that the borrower had derogatory credit information, specifically numerous non-sufficient fund fees, which were not adequately explained. CMC agrees that the file does not contain an explanation for this derogatory information.

352-3928276

Although the debt to income ratios were satisfactory, HUD alleges that the ratios were calculated incorrectly for the following reasons: Calculation of overtime income not explained; understated liability because credit report not most current; child support payments not documented; most recent credit report indicated delinquency on a mortgage payment (for rental property). According to HUD, these factors would have resulted in debt to income ratios of 22.9% instead of 30% (mortgage payment

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to effective income ratio) and 66.8% instead of 39% (total fixed payment to income ratio), which exceed HUD's ratios of 29% and 41%, without compensating factors.

In regard to the debt to income ratios, CMC noted that the borrower had a nine year job. As of 1/4/00 the borrower changed jobs with the City and received a salary of \$32000/year. This equals \$2667/month. Rental income is \$4237 @ 75% equals \$3178/month. Total debt is equal to \$2636.50/month. Per the appraiser, the new property being acquired will give a net rental income of \$1029/month. Using the new leases for acquired property, the net rental income is \$1125/month. Using the other properties, net rental @ 75% of gross rental minus PITI payment as income, the ratios are 26% and 44%, which are acceptable under HUD's guidelines. Consequently the overtime income did not need to be included. The child support payments were included in the calculations.

In addition, the file shows that CMC received a credit update showing that the purported delinquency was incorrect.

HUD also stated that the pay stubs in the file did not provide the borrower's name or social security number as well as the year-to-date earnings. Although the pay stub did not have a social security number disclosed, it did show the borrower's name and the year-to-date income.

The file allegedly did not contain evidence of a \$15,000 cash gift and the gift letter did not list the donor's telephone number. CMC disagrees with this statement; the file, in fact, does show proof of transfer and proof of donor's ability to provide the funds, as well as a valid gift letter.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

352-4026635

HUD stated that the borrower's debt to income ratio was not supported by the borrower's job stability because the pay stub did not identify the borrower's year-to-date earnings. In fact, the pay stubs in the file do show a year-to-date figure. In addition, the file contains copies of the borrower's W-2's, and a verification of employment form contains supporting information.

The gift letter failed to list the donor's address; however, the file adequately documents that the gift was given and received. The omission of an address on the letter is a technical omission which does not impair the quality of the loan.

The gift funds were adequately documented. A treasurer's check from the donor bank was made out to the closing agent. The amount is the same as stated in the gift letter. The file shows the same amount withdrawn from the donor's account. Based on the gift received by the closing agent, as well as the \$4734 the borrower had, there was no shortage of funds to close.

CMC agrees the file contained only one month's bank statement.

CMC agrees that the commitment fee should not have been changed as the interest lock-in date was less than 15 days.

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352-4057422

In this case, HUD determined that the debt to income ratio of 35.05% exceeded the guidelines of 29%. Having recalculated the numbers, CMC agrees with HUD on this point.

HUD noted that the gift letter did not contain the donor's address. Although that is correct, this technical violation did not impair the quality of the loan.

HUD stated that CMC did not adequately verify employment. As we advised HUD previously in the Shaffer Letter, the employment gap was adequately explained. As noted, the CMC file contains 1040 forms for the years 1998 and 1999, and pay stubs for the weeks of April 2, 7 and 21, 2000. The file shows that the borrower collected unemployment benefits in 1999. Copies of these documents were provided.

CMC agrees that the commitment fee should not have been changed as the interest lock-in date was less than 15 days.

HUD stated that CMC should have questioned a new deposit of \$500 which was made within a week of closing. This information was not needed to qualify the borrower, and therefore was immaterial.

HUD stated that its investigation showed a prior sale of the property that was not disclosed on the appraisal. HUD alleged that other information in the file should have alerted CMC's underwriter to this fact. The additional information was not available at the time the loan was approved. CMC did not have reason to doubt the appraisal at the time of approval. CMC relied on the appraisal. The appraiser was selected by the correspondent from among FHA-approved appraisers. It is CMC's contention that the appraiser and correspondent were involved in a fraudulent transaction, and CMC was an unwitting victim of such fraud. Had CMC known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

352-4018379

According to the HUD report, the debt to income ratio was excessive, as HUD could not determine how the income was calculated. As we advised HUD in the Shaffer Letter, the CMC file contains pay stubs dated 5/13/00, 5/27/00, 6/10/00, 6/24/00, 7/1/00, 7/8/00 and 7/15/00 to document current income. The file also contains a VOE dated 5/08/00. Copies of these documents were provided to HUD.

HUD also noted that the borrower had derogatory credit information, specifically numerous non-sufficient funds fees, which were not adequately explained. CMC agrees that the file does not contain an explanation for this derogatory information, but asserts that this is a technical violation which does not impair the quality of the loan.

The commitment fee should not have been charged as the interest lock-in date was less than 15 days.

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HUD stated that a large deposit was not explained. The file shows that the deposits came from the redemption of a savings plan.

352-3928180

The borrower relied on a settlement of \$80,000 as a down payment. CMC believes that this amount was an adequate compensating factor to justify the higher debt to income ratio. HUD stated that the file does not provide evidence that the funds were received. As stated in the Shaffer Letter, CMC contacted the attorney who handled the settlement to verify that the funds were received.

HUD stated that a copy of a signed lease was not included. However, the rental property was the property being acquired in conjunction with the loan transaction. Consequently, the appraiser's estimate of anticipated rent was properly relied upon.

The file did not provide evidence of the earnest deposit funds of \$5,000. We agree that the source of the funds was not documented appropriately. This technical violation, however, does not impair the quality of the loan.

The commitment fee should not have been charged as the interest lock-in date was less than 15 days.

351-3791341

HUD stated that the debt to income ratio is too high because CMC did not obtain verification of the borrower's second job. However, CMC has a Verification of Employment form which showed an acceptable income of \$3467 per month. In addition, the new housing payment increased only by 46%, making the loan acceptable.

According to HUD, the file did not sufficiently document the cash gift. The file, however, includes a deposit ticket showing the funds deposited to the borrower's account, and the check refers to the donor.

CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

352-4058116

HUD determined that the debt to income ratio was excessive, and no compensating factors were present. Having reviewed the file, CMC agrees with this determination.

A renter's signature was not on a rental agreement. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser's estimate of rental income was used.

CMC agrees that the file did not contain appropriate documentation for the cash gift.

A verification of employment form was obtained, contradicting HUD's statement that income was not verified.

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CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

According to HUD, information showed that the seller of the property did not own the property on the date of the appraisal. At the time CMC reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and CMC would not have made the loan if it knew of any problems. The appraiser was on HUD's approved appraisal list. It has subsequently appeared that the FHA-approved appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD's fraud unit.

352-4032805

CMC agrees with HUD's determination that the debt to income ratio was excessive.

In our letter of November 15, we advised HUD of the circumstances concerning the gift check. The file shows a gift letter from the borrower's mother. Since the closing agent would not accept a personal check, a bank check in the amount of the gift was obtained.

CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

HUD stated that an ineligible broker fee of \$474.21 was charged. According to CMC's records, the fee was not a broker fee but a permitted discount fee to CMC.

According to HUD, information in the file showed that the property had been sold during the year. At the time CMC reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and CMC would not have made the loan if it knew of any problems. We note that the appraiser was on HUD's approved list. It has subsequently appeared that the appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD's fraud unit.

351-3842154

HUD stated that the debt to income ratio as calculated by CMC was excessive, and that CMC did not include a monthly mortgage payment. CMC, however, had a copy of the lease agreement, including the rental income. This rental income, according to CMC's calculations, provides an acceptable debt to income ratio of 30-43%.

HUD further stated that the pay stub did not include the borrower's social security number. That information, however, was on the W-2's and the verification of employment form in the file. The fact that the employer did not have the employee's social security number printed on the pay stub does not impair the quality of the loan.

The gift letter did not contain the donor's address. The gift, however, was documented. This technical violation does not impair the quality of the loan.

CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

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According to HUD, information showed that the property had been previously sold. At the time CMC reviewed the appraisal, it had no reason to believe that there were problems with the appraisal, and CMC would not have made the loan if it knew of any problems. We note that the appraiser was listed on HUD's approved list. It has subsequently appeared that the appraiser and the correspondent were involved in a fraudulent scheme, which should be investigated by HUD's fraud unit.

352-4072249

HUD stated that the debt to income ratio was excessive. It indicated that the monthly rental income should not have been included because a signed rental agreement was not in the file. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser's estimate of rental income was used. In addition, as one unit would be owner-occupied, the numbers used are reasonable.

As we informed HUD in the Shaffer Letter, the file shows a gift letter in the amount of \$5,000 from the borrower's brother dated 7/11/00, with a check in that amount from the donor, also dated 7/11/00. The \$5,000 check was deposited on 7/12/00, as evidenced by the deposit receipt. In addition to the \$5,000 gift, the borrower had \$429.82 in the borrower's own funds, as evidenced by the bank statement in the file. Copies of these documents were provided to HUD. Consequently, the borrower had sufficient funds to close on 7/18/00.

CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

352-3999129

According to HUD, the debt to income ratio was excessive. It indicated that the rent relied upon was not supported by the file since a lease was not included in the file. The rental property, however, was purchased with the proceeds of the loan transaction; consequently, the appraiser's estimate of rental income was used.

CMC agrees that the commitment fee should not have been charged as the interest lock-in date was less than 15 days.

HUD complained that the file did not have evidence that the borrowers savings were from their payroll accounts. As noted in the file, the borrowers had deposited a portion of their pay checks regularly into their savings account.

352-4039557

HUD stated that the debt to income ratio was excessive. Since a signed lease agreement was not included in the file, the rental income should not have been included. The property, however, was purchased with the proceeds of the loan transaction; consequently, the rental income used was that provided on the appraisal.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

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A large deposit into a bank account was not, according to HUD, explained. The \$1900 bank deposit came from a federal income tax refund; documentation is provided.

352-4110796

HUD stated that the debt to income ratio was excessive. Since a signed lease agreement was not included in the file, the rental income should not have been included. The property, however, was purchased with the proceeds of the loan transaction; consequently, the rental income used was that provided on the appraisal, and the debt to income ratio is acceptable.

According to HUD, the gift letter was not documented adequately. As we explained in our letter of November 15, CMC's file shows that the donor had two documented bank accounts which contained sufficient funds to cover the amount of the \$12,300 gift. Copies of the documents were provided to HUD. HUD also commented that the donor letter did not provide the donor's address. This is a technical violation that did not impair the quality of the loan.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

352-4026591

HUD determined that the borrower's debt to income ratio exceeded the HUD guidelines. According to HUD, the file did not identify any compensating factors, and the file did not contain evidence that the amount of the cash gift was withdrawn from the donor's bank account. HUD noted that the file contained copies of a bank statement indicating that the borrower had two rent checks returned due to Non Sufficient Funds. HUD stated that major indications of derogatory credit problems must be explained. CMC has requested and is still waiting for copies of the supporting documentation from the investor.

351-3803949

HUD stated that a verification of employment for the borrower's second job was not provided. If income from the second job is excluded, the debt to income ratios are too high. According to CMC, the file contains a verification of employment and paychecks evidencing the second job. In addition borrower had an excellent rental history. CMC believes that the debt to income ratios are not excessive.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

According to HUD, information in the file indicates that the property was previously sold without listing the date of the sale. Information that the property was previously sold was not available at the time the loan was approved.

352-4135361

HUD stated that the debt to income ratios are excessive. This loan, however, was approved using HUD's Loan Prospector.

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According to HUD, the file did not adequately show that funds were verified, and that the bank statement shows a zero balance. HUD's auditors, however, misread the statement; the zero balance refers to activity in the cash reserve account. That is, the borrower had not borrowed against the account and therefore that amount was zero. In fact, the file shows that a verification of deposit, showing sufficient funds, was obtained.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

According to HUD, information in the file indicates that the property was previously sold prior to the appraisal date. At the time, CMC did not believe that the appraisal was inaccurate. The appraiser was on HUD's approved list. Subsequently, CMC discovered that the appraiser and the correspondent were involved in a fraudulent transaction, and CMC was an unwitting victim of such fraud. Had CMC known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

352-4126006

According to HUD, the debt to income ratios were incorrect because of a mathematical computation error. Having reviewed the file, CMC believes that it calculated the ratios correctly.

HUD stated that the file did not contain evidence supporting the \$5,200 cash gift. CMC has presented documentation that the gift money was withdrawn and deposited into the borrower's account.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

HUD stated that its investigation showed a prior sale of the property that was not disclosed on the appraisal. HUD alleged that other information in the file should have alerted CMC's underwriter to this fact. The additional information was not available at the time of loan approval and CMC did not have reason to doubt the appraisal at that time. The appraiser was selected by the correspondent from the FHA-approved list. It is CMC's contention that the appraiser and correspondent were involved in a fraudulent transaction, and CMC was an unwitting victim of such fraud. Had CMC known of the prior sale or that the appraisal was inaccurate, it would not have approved the loan.

352-3971484

HUD noted several problems with the gift letter. The amount of the deposit was \$3500, not \$3100 as shown on the gift letter. The gift letter failed to list the donor's address or telephone number. According to CMC, the gift letter should have been made out in the amount of \$3500, which was the intended, and actual, amount of the gift. Although the gift letter should have included the donor's address and telephone number, this technical violation did not impair the quality of the loan.

The loan origination points charged to the borrower were, according to HUD, excessive. The mortgagee can charge only one origination point, but the HUD-1 showed two points. According to CMC, the HUD-1 was inadvertently filled out incorrectly. The HUD-1 should have shown an origination fee of 1% and a 2% discount fee.

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CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

HUD stated that information in the file indicated that the property was previously sold without listing the date of the sale. This information was omitted by the appraiser. CMC had no other knowledge at the time the loan was approved; had CMC known of an improper sale it would not have approved the loan.

352-3995083

CMC will respond on this matter separately as it is currently awaiting delivery of the complete file from the investor.

351-3783532

HUD stated that the file did not adequately document the source of the \$20,000 deposit. According to CMC, the borrower's uncle gave a gift of \$10,000 to the borrower and \$10,000 to the borrower's wife. Both amounts were deposited into one account. The deposits were documented.

In contrast to HUD's statement, the file shows that the borrowers had sufficient funds to close. An escrow down payment had been made in February. The verification of deposit, dated March, and evidence of an annuity balance, indicated that the borrowers had sufficient funds to cover the remaining amount due.

352-4017271

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

HUD also stated that the borrower's bank accounts showed recent deposits without indicating the source of the funds. CMC agrees that the deposits should have been questioned; however, this omission did not impair the quality of the loan. CMC also notes that the loan was approved by Loan Prospector.

352-3994410

HUD stated that the debt to income ratios were excessive, and compensating factors were not listed. CMC argues that a four year job stability and eight year residence were compensating factors.

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

According to HUD, information in the file indicates that the seller of the property purchased the property subsequent to the date of the appraisal report. CMC did not have reason to doubt the appraisal at that time. The appraiser, who was on HUD's approved list, was selected by the correspondent. It is CMC's contention that the appraiser and correspondent were involved in a fraudulent transaction, and CMC was an unwitting victim of such fraud. Had CMC known that the appraisal was inaccurate, it would not have approved the loan.

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352-4077593

CMC agrees that the commitment fee is ineligible as the interest lock-in date was less than 15 days.

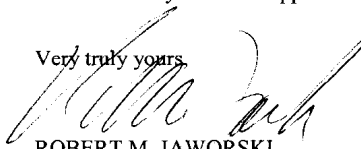
HUD stated that the appraisal did not contain required information regarding the prior sale of the property. According to HUD, information in the file indicates that a sale occurred prior to the date of the appraisal report. CMC did not have reason to doubt the appraisal at that time. The appraiser was selected by the correspondent from FHA-approved list. It is CMC's contention that the appraiser and correspondent were involved in a fraudulent transaction, and CMC was an unwitting victim of such fraud. Had CMC known that the appraisal was inaccurate, it would not have approved the loan.

CMC believes that the appraiser may have intentionally misrepresented some facts or omitted facts which, if included, would have prevented the loans from being approved. CMC believes that the appraiser may have been working with the correspondent, and that an investigation of possible fraudulent activities by those parties should be undertaken by HUD.

We trust that once you have had an opportunity to review the above explanations along with the supporting documentation, you will be in a position to withdraw your indemnification directive with respect to all of the loans mentioned in that directive except for the following files: 352-4032805 (Brown); 352-4057422 (Williams); and 352-4058116 (Coleman).

Thank you for the opportunity to submit this response.

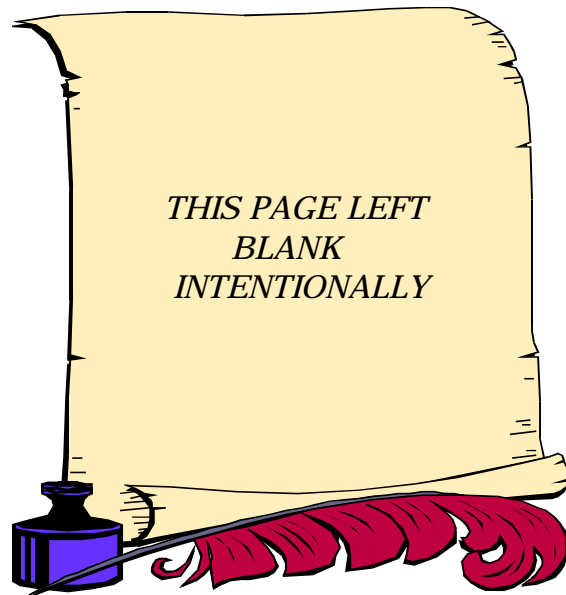
Very truly yours,



ROBERT M. JAWORSKI

RMJ/rf
Encl.

cc: Richard Arbogast
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The Honorable Thomas M. Davis, III, Chairman, Committee on Government Reform

The Honorable Henry A. Waxman, Ranking Member, Committee on Government Reform

Richard J. Arbogast, CEO, Chapel Mortgage Corporation