AUDIT REPORT

HARTFORD FUNDING, LTD.
NON-SUPERVISED MORTGAGEE
RONKONKOMA, NEW YORK

2004-NY-1006

September 28, 2004

OFFICE OF AUDIT
NEW YORK/NEW JERSEY

audit report

Issue Date
September 28, 2004
Audit Case Number
2004-NY-1006

TO: John C. Weicher, Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board, H

Alexander C. Malloy

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

SUBJECT: Hartford Funding, Ltd.
Non-Supervised Mortgagee
Ronkonkoma, New York

We completed an audit of Hartford Funding, Ltd. (Hartford), a non-supervised mortgagee. The objectives of the audit were to determine whether Hartford: (1) approved insured loans in accordance with the requirements of the United States Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices; and (2) implemented and followed a quality control plan that meets HUD/FHA requirements. The review generally covered the period between January 1, 2002, and December 31, 2003.

Although Hartford generally complied with HUD regulations, we found that Hartford did not adhere to prudent lending practices in approving two of the 15 loans that we examined during our audit. Additionally, we found that Hartford's quality control plan was not fully implemented.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us for each recommendation without a management decision, 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 recommendation 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 Edgar Moore, Assistant Regional Inspector General for Audit, at (212) 264-4174.

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Executive Summary

We completed an audit of Hartford Funding, Ltd. (Hartford), a non-supervised mortgagee located in Ronkonkoma, New York. The objectives of the audit were to determine whether Hartford: (1) approved insured loans in accordance with the requirements of the United States Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices; and (2) implemented and followed a quality control plan that meets HUD/FHA requirements. The review generally covered the period between January 1, 2002, and December 31, 2003, and involved a review of 15 HUD/FHA insured loans with mortgage amounts totaling $2,521,500. A summary of the results of our review is provided below.

Two loans with underwriting deficiencies

Although Hartford has adequate procedures in place for the origination of HUD/FHA insured loans and generally complied with HUD regulations, our review disclosed that Hartford did not adhere to prudent lending practices in approving two HUD/FHA insured loans. In particular, we noted that two of the 15 loans that we reviewed had at least one underwriting deficiency. Some of the underwriting deficiencies identified are as follows:

Underwriting processing deficiencies

- Debt-to-income ratio exceeded HUD/FHA standards.
- Inadequate documentation of down-payment.
- Inadequate review of a credit report.
- Minimum cash investment not provided.

We believe that the underwriting deficiencies occurred because Hartford officials did not obtain the proper documentation to support the approval of the loans. As a result, mortgages were approved for unqualified borrowers causing HUD/FHA to assume an unnecessary insurance risk.

Weaknesses in quality control plan implementation

In addition, Hartford has not implemented procedures or established controls to ensure that all loans defaulting within the first six payments undergo a quality control review. This occurred because Hartford did not have procedures in place to ensure that data on defaulted loans was received from the servicer (s) of the HUD/FHA insured loans. Consequently, Hartford is not fully using its quality control plan, which is designed to enhance and maintain accuracy, validity, and completeness in its loan origination process.

Recommendations

Regarding the first finding, we recommend that HUD review the underwriting for the two loans in question and determine whether Hartford should be required to indemnify HUD/FHA against any future losses on these loans as identified in Appendix B of this report. Also, Hartford should provide your office with a corrective action plan containing assurances that proper documentation will be obtained to support the approval of HUD/FHA insured loans. Regarding the second finding, we recommend that Hartford establish: (a) procedures to ensure that all data on defaulted HUD/FHA insured loans is obtained from loan servicers and reviewed, (b) controls and procedures to ensure that all loans that default within the first six payments are properly reviewed in accordance with its quality control plan and HUD requirements.

Although our audit disclosed deficiencies in Hartford's loan underwriting and quality control plan, we noted that Hartford has implemented new procedures to address these deficiencies. Additionally, Hartford officials and their staff fully cooperated throughout the audit and were proactive in addressing the deficiencies identified throughout the audit.

Exit conference

The results of our audit were discussed with Hartford personnel throughout the course of the on-site audit work, and at an exit conference held on September 2, 2004, at Hartford's office. Hartford officials provided written comments to our draft report. Finding one originally discussed deficiencies pertaining to three cases; however, after reviewing Hartford officials' comments we decided to remove case number 374-4034510 from the finding. We included excerpts of the comments with the findings, and provided the complete text in Appendix C of this report.

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Abbreviations

FHA	Federal Housing Administration
HOC	Home Ownership Center
HUD	United States Department of Housing and Urban Development
OIG	Office of the Inspector General

Introduction

Hartford Funding, Ltd. (Hartford), is a non-supervised mortgagee located in Ronkonkoma, New York. Hartford became an authorized direct endorsement mortgagee on June 30, 1983 and currently underwrites HUD/FHA insured and conventional loans. During our audit period between January 1, 2002, and December 31, 2003, Hartford originated 256 HUD/FHA insured loans in the New York Field Office jurisdictional area amounting to $46,795,500. On February 29, 2004, the mortgages for 18 of the 256 loans were in default status.

Audit objectives

The objectives of the audit were to determine whether Hartford: (1) approved insured loans in accordance with the requirements of the United States Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices; and (2) implemented and followed a quality control plan that meets HUD/FHA requirements.

Audit scope and methodology

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

- Reviewing relevant HUD regulations, requirements, and mortgagee letters.
- Examining reports and information maintained on HUD's Neighborhood Watch Early Warning System and Single Family Data Warehouse.
- Reviewing reports from HUD's Quality Assurance Division.

To accomplish our audit objectives, we selected a non-representative sample of 15 loans. The initial sample of 12 loans was from HUD's Neighborhood Watch Early Warning System with beginning amortization dates between January 1, 2002, and January 31, 2004. In selecting this sample, we focused on identifying loans that were currently in default, which had 12 or fewer payments made before the first reported default. The additional three loans were in default as reported by the servicer and had a first reported default within six or fewer payments. These three loans had beginning amortization dates before January 1, 2002. As a result, our sample consisted of 15 loans on which 12 or fewer payments were made before the first default was reported. The 15 loans in our sample were HUD/FHA insured loans that totaled $2,521,000. The results of our detailed testing only apply to the 15 loans selected and cannot be projected over the universe of the 256 loans.

Our file review and audit procedures included: (a) analyses of borrowers' income, assets, and liabilities; (b) verifications of selected data on the settlement statements; (c) confirmations sent to employers, gift donors, and landlords; and (d) inquiries with borrowers, HUD officials, and Hartford's staff.

Audit period

We performed the audit fieldwork between April and July 2004. Our audit pertained to loans originated between January 1, 2002, and December 31, 2003. As necessary, we reviewed loan activity before and after our audit period. Our audit work was performed at Hartford's office in Ronkonkoma, New York. The audit was conducted in accordance with Generally Accepted Government Auditing Standards.

Weaknesses in the Underwriting Process Resulted in the Approval of HUD/FHA Insured Loans for Unqualified Borrowers

Although Hartford has adequate procedures in place for the origination of HUD/FHA insured loans, our review disclosed that Hartford did not adhere to prudent lending practices in approving two of the HUD/FHA insured loans we reviewed. Each of those loans had at least one underwriting deficiency. The deficiencies occurred because Hartford officials did not obtain the proper documentation to support the approval of the loans. As a result, mortgages were approved for unqualified borrowers causing HUD/FHA to assume an unnecessary insurance risk.

Chapter 2, Section 2-1 of HUD Handbook 4000.4 REV-1, entitled "Single Family Direct Endorsement Program" requires mortgagees to conduct its business operations in accordance with accepted sound mortgage lending practices. Also, HUD Handbook 4000.4 REV-l, Chapter 2, section 2-5, provides that mortgagees are to obtain and verify information with at least the same care that would be exercised in originating a loan when the mortgagee would be entirely dependent on the property as security to protect its investment.

In our opinion, Hartford did not always adhere to the above requirements, as discussed below, when it underwrote two of the 15 loans we reviewed.

Examined 15 loans

Our examination of 15 loans approved by Hartford disclosed that Hartford did not exercise the care expected of a prudent lender in approving two of the loans. Consequently, we found that deficiencies occurred during the underwriting process of those loans (cases), as shown below:

Deficiencies	Number of Loans
Debt-to-income ratio exceeded HUD/FHA standards	1 of 15 loans
Inadequate documentation of down-payment	1 of 15 loans
Inadequate review of credit report	1 of 15 loans
Minimum cash investment not provided	1 of 15 loans

On May 31, 2004, the mortgages of 11 of the 15 loans were in default, three loans were terminated, and one loan was current. The two HUD/FHA insured loans with the deficiencies had mortgages amounting to $445,150. We

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request that HUD review Hartford's approval of these loans and determine whether Hartford should indemnify HUD against any losses that may result from claims made to HUD (See Appendix A).

Appendix B to this report provides a summary of the loans' underwriting deficiencies noted during our review. An individual description of the underwriting deficiencies for each of the two loans is provided below:

FHA Case No. 374-3997570

The borrower did not provide the minimum required cash investment.

Our review disclosed that the borrower did not provide the minimum cash investment, and the lender did not adequately review the borrower's credit report. The earnest money deposit of $3,000, plus the $425 paid on account for the appraisal and credit report, plus the $2,859.09 paid at closing totals $6,284.09 for the borrower's investment. The minimum required cash investment was $7,140 ($238,000 contract sales price times 3%). This represents a difference of $855.91. Mortgagee Letter 98-29, dated October 22, 1998 states that the National Housing Act requires the minimum cash investment to be 3 percent of the Secretary's estimate of the cost of acquisition. The mortgagee letter further states that FHA has determined that the minimum cash investment be based on sales price without considering closing costs to further Congressional objectives of simplifying the FHA maximum mortgage amount calculation without significantly increasing FHA's risk. The lender did not ensure that the borrower made the statutory minimum cash investment of $7,140.

The lender's review of the credit report was inadequate.

Additionally, our review disclosed indications that the lender's review of the borrower's credit report was inadequate. The credit report containing the borrower's Social Security number as shown on the loan application indicated that credit accounts were opened that predated the date of birth of the borrower. The credit report also listed a Social Security number alert and indicated that the borrower's name was used with additional Social Security numbers. The lender should have identified these discrepancies while analyzing the borrower's credit. In accordance with Paragraph 2-3 of HUD Handbook 4155.1 REV-4, the lender should have obtained a written explanation from the borrower regarding these accounts.

FHA Case No. 374-4127930

The debt-to-income ratio exceeded HUD standards.

We noted that the debt-to-income ratio exceeded HUD/FHA standards, and that the lender did not adequately document the down-payment. Regarding the debt-to-income ratio that exceeded HUD/FHA standards; the borrower's mortgage payment expense to effective income ratio was 35.92%. HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-12(a) states that a ratio exceeding 29% may be acceptable if significant compensating factors are presented. The underwriter's compensating factor was that the borrower displayed a "conservative use of credit". However, we believe that for this borrower, a conservative use of credit by itself is not a significant compensating factor since the borrower's credit report stated that the borrower did not have sufficient credit to be scored.

The lender did not properly document the down-payment.

Regarding the inadequate documentation of the down-payment; the borrower made an earnest money deposit (down-payment) of $6,000. The $6,000 was provided as gift funds from the borrower's mother-in-law. The lender documented the gift in accordance with HUD regulations and the borrower used the $6,000 gift to make the down-payment. The lender's file contains a copy of a check from the borrower to the borrower's attorney; however, it is not the canceled check. HUD Handbook 4155.1 REV-4 Paragraph 2-10A states, "…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 lender must verify the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check. We will also accept a certification from the deposit holder acknowledging receipt of funds and separate evidence of the source of funds…" Although the lender's file contained evidence of the source of funds, there was no certification from the deposit holder acknowledging receipt of funds.

In response to our review, the lender obtained a letter dated December 16, 2002 from the borrower's attorney stating that the down-payment monies in the sum of $6,000 were being held in an escrow account. The letter was faxed to Hartford on July 14, 2004. We believe that the lender should have obtained this information at the time of loan origination, rather than upon our request.

Auditee comments

Regarding FHA Case No. 374-3997570, Hartford officials agree that the borrower did not provide the minimum cash investment; however, Hartford officials contend that the shortage was $455.91 and not the $855.91 because the borrower received a $400 rent credit. Hartford officials further contend that the $455.91 was caused by a $500 credit given to the borrower from the seller at closing, due to a new "New York State" law, which was not mentioned in the contract. Hartford officials stated in their comments, that procedures have already been implemented requiring the credit to be addressed in all contracts. Regarding the credit report, Hartford officials stated that their procedures require written explanations and the removal of credits that do not apply to the borrower by the credit company. However, Hartford officials stated that for this case, the explanation was not in the file or case binder. Hartford officials further stated that if required, they would try to obtain a letter of explanation from the borrower. Hartford requests that the department not consider indemnification for this case.

Regarding FHA Case No. 374-4127930, Hartford officials contends that HUD guidelines allow greater latitude on the mortgage payment expense to effective income ratio for borrowers with limited recurring expense and this borrower had $0 recurring expense. Hartford officials also stated that although it was not written on the MCAW, the compensating factors were: conservative use of credit and the ability to accumulate savings. Also, the borrower's previous credit history shows that the borrower had the ability to devote a greater portion of income to housing expense. Regarding the inadequate documentation of the down payment, Hartford officials believe that the file adequately documented the down payment with a copy of the borrower's bank statement and a copy of the down payment check payable to the deposit holder. Hartford officials stated that although we did not have the escrow letter before closing, it is clear the down payment went to the deposit holder. Hartford requests that the department not consider indemnification for this case.

OIG evaluation of Auditee comments

Regarding FHA Case No. 374-3997570, there was no documentation in the file showing that the $400, for which the borrower received the rent credit, was actually paid. Nevertheless, the borrower did not make the minimum cash investment; therefore, HUD/FHA has assumed an unnecessary risk and indemnification should be considered.

Regarding FHA Case No. 374-4127930, the borrower's conservative use of credit and the ability to accumulate savings were not significant compensating factors to justify approving this loan. Although the lender developed a credit history by examining the borrower's utility payments, we believe that the lender did not adequately document that the borrower had the ability to accumulate savings. Specifically, our review determined that the borrower only opened a bank account with a $10 deposit during the month that the initial application was submitted. Furthermore, the lender did not obtain adequate documentation to support the down-payment at the time this loan was originated.

Recommendation

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board:

1A. Review the underwriting of the two loans in question (374-3997570, and 374-4127930), and determine whether Hartford should indemnify HUD for any losses that may occur as a result of claims made to HUD. The mortgage amounts associated with these loans totaled $445,150, which would be considered funds put to better use if HUD is indemnified (See Appendix A).

1B. Require Hartford to provide your office with a corrective action plan, which provides assurances that proper documentation will be obtained to support the approval of the HUD HUD/FHA insured loans.

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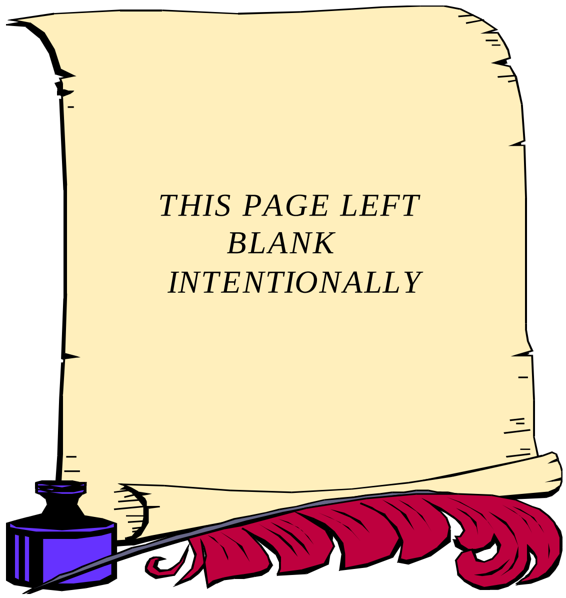
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Hartford Has Not Fully Implemented Its Quality Control Plan

Our review disclosed that Hartford did not always comply with its quality control plan and HUD requirements pertaining to reviews of defaulted loans. Specifically, Hartford has not implemented procedures or established controls to ensure that an analysis is performed on all HUD/FHA insured loans that go into default within the first six payments as required by HUD. This occurred because Hartford did not have procedures in place to ensure that data on loans in default was received from the servicer (s) of the HUD/FHA loans. Consequently, Hartford is not fully using its quality control plan, which is designed to enhance and maintain accuracy, validity, and completeness in its loan origination process.

Hartford's established quality control plan is not fully implemented.

Hartford has established and maintains a quality control plan for the origination of insured mortgages. However, our review showed that Hartford did not fully implement certain provisions of its quality control plan. In particular, procedures have not been implemented, or controls established, to ensure that an analysis is performed on all HUD/FHA insured loans that go into default within the first six payments.

Criteria

Per Paragraph 6-1D(3) of HUD Handbook 4060.1 REV-1, dated September 30, 1993, a mortgagee's Quality Control Plan and review procedures must include an analysis of all loans, which go into default within the first six months.

Paragraph 6-6 D of HUD Handbook 4060.1 REV-1, dated November 24, 2003, which pertains to "Early Payment Defaults", provides that in addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. As defined here, early payment defaults are loans that become 60 days past due.

Hartford's quality control plan calls for reviews of early defaulted loans.

Hartford's quality control plan provides that quality control reviews should be performed within 90 days of the closing of the loan. It also provides that loans, which go into default with six or fewer payments made by the mortgagor, shall also be analyzed. Furthermore, Hartford's quality control plan provides that for HUD-FHA insured mortgages only, there should be an analysis of all loans, which go into default within the first six months.

Early default loans not reviewed for quality control

Despite clearly defined HUD requirements and internally established policies that require performing quality control reviews of loans defaulting within the first six payments, our audit showed that Hartford has not implemented controls or procedures to ensure that early default loans have been adequately reviewed for quality control. Hartford officials state that their FHA loan servicer did not provide them with information on loan defaults because of privacy issues. However, we believe this occurred because Hartford did not have procedures in place to obtain data on the defaulted loans from the servicer (s) of the HUD/FHA loans. Furthermore, only one of the 15 loans selected for our audit testing was reviewed for quality control by Hartford even though 11 of the 15 loans in our sample were in default within the first six payments.

Quality control reviews of early default loans are particularly important since such reviews would provide valuable information to management regarding the causes of defaults, and may disclose underwriting deficiencies associated with the loan. Such reviews may also disclose indicators of fraudulent activities or other significant discrepancies that mortgagees are required to report to HUD.

Recent quality control reviews not completed in a timely manner.

As part of our audit, we reviewed a sample of loans recently reviewed under Hartford's quality control plan. Our review determined that Hartford is performing quality control reviews on a sample of 10% of loans closed on a monthly basis; however, Hartford is not completing these reviews in a timely manner. Specifically, Hartford did not complete the quality control reviews within 90 days of loan closing as required by Paragraph 6-3D of HUD Handbook 4060.1 REV-1 CHG-1. This occurred because Hartford's quality control plan only requires quality control reviews to be performed within 90 days of loan closing and does not include a provision requiring the reviews to be completed within 90 days of loan closing.

Auditee comments

Hartford officials contend that although procedures were in place to obtain information from the servicer, the servicer would not release information on the defaulted loans due to privacy issues. Hartford officials stated that in the spring of this year, they started receiving early payment default reports from the servicer and they started conducting quality control reviews on the loans that show up on the reports.

Regarding recent quality control reviews not being completed timely, Hartford officials stated that HUD changed the guideline in November of 2003 and that the old guideline was for the QC reviews to be performed within 90 days of closing. Hartford officials stated that when they updated their quality control plan with the new guidelines, the change was missed. However, they have corrected their quality control plan and have implemented the 90 days from closing timeframe.

OIG evaluation of Auditee comments

At the time of our audit, Hartford did not have procedures in place to obtain information on defaulted loans from the loan servicer.

In addition, the action conducted by Hartford, to update its quality control plan, is responsive to this audit finding.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board, require Hartford to:

2A. Establish procedures that will ensure that data pertaining to HUD/FHA insured defaulted loans is obtained from the loan servicer (s) and properly reviewed.

2B. Implement controls and procedures to ensure that all loans that go into default within the first six payments are properly reviewed in accordance with its quality control plan and HUD requirements.

2C. Submit its amended quality control plan to HUD for review to ensure that it provides for monthly reviews of a sample of 10% of closed loans to be

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completed within 90 days of loan closing as required by Paragraph 6-3D of HUD Handbook 4060.1 REV-1 CHG-1.

We further recommend that the Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board:

2D. Consider seeking civil monetary penalties against Hartford for early defaulted loans that were not reviewed.

Management Controls

In planning and performing our audit, we considered the management controls of Hartford to determine our auditing procedures, not to provide assurance on the controls. Management controls 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. Management controls include the systems for measuring, reporting, and monitoring program performance.

Relevant management controls

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

- Program Operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- 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.

- 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.

We assessed all the relevant controls identified above.

It is a 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.

Weaknesses

Based on the results of our review, we believe that weaknesses exist in the following management controls: Program Operations, and Compliance with Laws and Regulations. These weaknesses are described in Findings 1 and 2 of this report and summarized below.

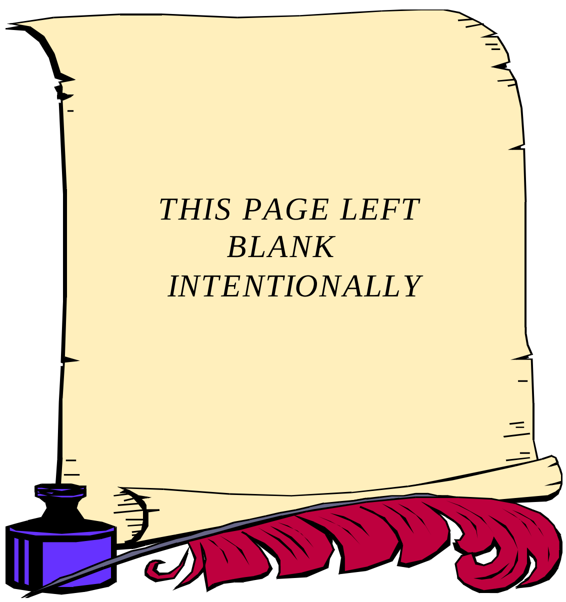
- Hartford did not adhere to prudent lending practices in approving two of the HUD/FHA loans we reviewed (see Finding 1).

- Hartford did not fully implement its quality control plan to ensure that all HUD/FHA insured loans that defaulted within six payments of closing undergo a loan origination quality review, as required by HUD (see Finding 2).

- Hartford did not ensure that recent quality control reviews were completed in a timely manner (see Finding 2).

Follow up on Prior Audits

This is the initial Office of Inspector General audit report on Hartford Funding, Ltd.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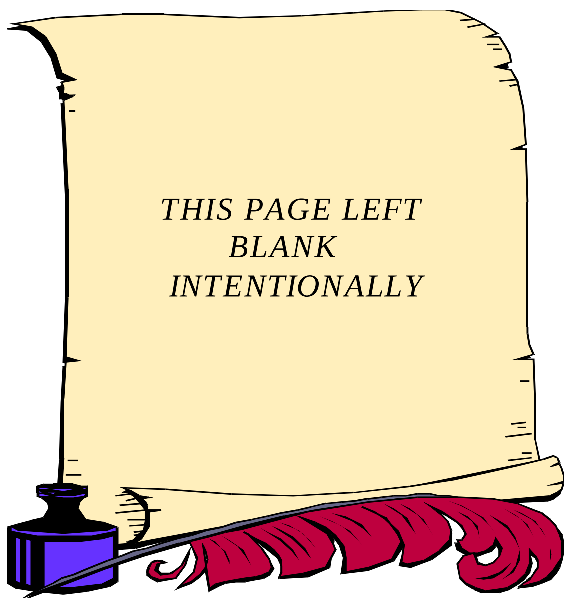
Schedule of Questioned Costs and Funds Put to Better Use

Type of Questioned Costs

Finding Number	Unsupported Costs 1/	Funds Put to Better Use 2/
1	-	$445,150
2	-	-
Total	-	$445,150

1/ Unsupported costs are costs whose eligibility cannot be clearly determined during the audit since such costs were not supported by adequate documentation. A legal opinion or administrative determination may be needed on these costs.

2/ 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.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Summary of Loan Origination Deficiencies

HUD/FHA Case Number	Mortgage Amount	Loan Settlement Date	Payments Before First Default Reported	Ratio(s) Exceeded HUD/FHA Standards	Inadequate Documentation of Down - payment	Inadequate Gift Documentation	Inadequate Review of Credit Report	Minimum Cash Investment Not Provided
374-3997570	$234,300	10/09/02	**0**				**X**	**X**
374-4127930	$210,850	03/11/03	**5**	**X**	**X**			
Totals	**$445,150**			**1**	**1**	**1**	**1**	**1**

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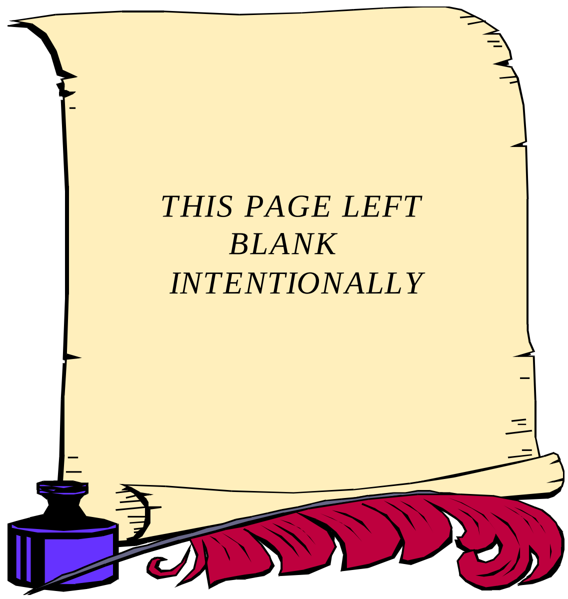
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Auditee Comments

HARTFORD FUNDING LTD.

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Setpember 2, 2004

Mr. Edgar Moore
Assistant Regional Inspector General for Audit
U. S. Department of Housing and Urban Development
26 Federal Plaza, Room 3430
New York, NY 10278-0068

Re: Response to Audit Report dated September 2, 2004

Dear Mr. Moore:

Please consider this letter a response to your Audit Findings dated September 2, 2004.

FINDING #1

FHA Case #374-3997570

This finding was correct, but I disagree with the amount underpaid. As seen by the attached HUD 1, the borrower received a $400 rent credit. This was the borrower's money being refunded to him at closing. This figure should have been included as part of the borrower's minimum required investment. Therefore, $455.91 was the shortage, not $855.91. The shortage was caused by a $500 credit given to the borrower from the seller at closing, due to a new "New York State" law which was not mentioned at all in the contract. This is why the 3% investment shortage was not seen at the time of underwriting.

At the time of this audit, procedures had already been implemented requiring the credit to be addressed in all contracts. We reflect the $500 as a reduction in the sales price on line 11B of the MCAW.

After review of the credit report, the additional social security number looks to be the father's social security number. Hartford Funding's procedures do require written explanations and the credit company to remove the credit which does not apply to the borrower. Apparently, the explanation was not in the file or case binder and the credit company did not remove the non applicable credit. By looking at the report, loans opened before the borrower's birthday (12-30-75) must have belonged to his father. If so, this would have decreased the borrower's bottom ratio. (One debt counted was a $222 monthly payment which was opened in 1968 – this obviously was not the borrowers) If required, we will try to obtain a letter of explanation from the borrower again and research as to which accounts did not apply to the borrower.

We respectfully request the department not to consider indemnification for this particular case.

Visit Our Website.www.hartfordfunding.com

LICENSED MORTGAGE BANKER, NEW YORK STATE BANKING DEPARTMENT

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FHA Case #374-4034510

The FHA guideline states, regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds **ultimately were not provided from an unacceptable source** and were indeed the donor's own funds.

Because of several obvious reasons (large amount of funds or the mother felt more comfortable having the attorney hold the money until closing) the gift money was given directly to the borrower's attorney. This is not an uncommon practice. To document the gift transfer and source of funds, the underwriter accepted a letter from the attorney stating she was in receipt of the funds (**Exhibit 1**) and a copy of a fully executed HUD 1 from the sale of the mother's house showing net proceeds to the seller in an amount exceeding the $85,000 gift. (**Exhibit 2**) Your audit report states these facts.

We feel the HUD 1 was sufficient to prove the gift funds did not come from an unacceptable source. This is a legal document executed by an officer of the court (the closing attorney). HUD allows donors to borrower the gift money and the lender must provide proof that it was not borrowed from an unacceptable source. If the donor took a credit card advance and the lender documented it with a copy of the statement showing the withdrawal, it is apparent it did not come from any unacceptable source. We feel the HUD 1 also shows the same type of proof of where the money came from – the sale of the mother's house – which is not an unacceptable source. I have requested a letter from the borrower's attorney stating who she received the funds from and copies of the checks deposited (although I know this is confidential information between the attorney and their client). I have received deposit slips from the attorney, but am trying to go one step further)

We also disagree with the following comment "The lender did not obtain verification from the closing agent that the purported gift was received from the donor and transferred to the seller". The HUD 1 from the closing clearly shows the borrower received a credit for "Gift held by purchaser's attorney in escrow" in the amount of $85,000. (**Exhibit 3**) Again, the HUD 1 is signed by our bank attorney. Does this not show proof the closing agent (who signed the HUD 1) verified the gift funds were used at the closing and of course ultimately to the seller.

We do not understand why HUD will accept a HUD 1 for proof of sale of a current residence (without showing the money deposited into the borrower's account or actually is used at the closing of the subject property), but not accept a HUD 1 in this case. Also, the same reasoning applies to HUD's acceptance of a "down payment receipt letter" from the deposit holder, but yet will not accept a letter from an attorney (the deposit holder) for the $85,000 gift.

We respectfully request the department not to consider indemnification for this particular case.

FHA Case #374-4127930

According to HUD guidelines, for borrowers with limited recurring expense, greater latitude is permissible on this ratio than on the total fixed payment ratio. The borrower had $0 recurring expense. The total expense ratio was 35.91. Although it was not written on the MCAW, the compensating factors were:

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1. Conservative use of credit and the ability to accumulate savings. The borrower put $3,093.77 of his own funds into the deal. The borrower also chose not to use installment or credit card debt. The underwriter considered this a conservative use of credit.
2. Previous credit history shows borrower has ability to devote a greater portion of income to housing expense. Again, the borrower had no recurring expense therefore he had the ability to devote more of his income to housing expense.

Regarding the alleged inadequate documentation of the down payment, Hartford feels the file was adequately documented as follows: Attached please find a copy of the borrower's bank statement (**Exhibit 4**) and a copy of the down payment check payable to the deposit holder. (**Exhibit 5**) Please note the check # is 0093 (see check) and the bank statement shows a withdrawal of $6,000 – check #93. We realize we did not have a cancelled check, but the statement clearly shows the check being withdrawn. Although, we did not have the escrow letter before closing, it is clear the down payment, in fact, went to the deposit holder. See a copy of the December, 2002 escrow letter (**Exhibit 6**).

We respectfully request the department not to consider indemnification for this case.

FINDING #2

<u>EARLY DEFAULTED LOANS NOT REVIEWED FOR QUALITY CONTROL</u>

The audit report states Hartford did not have procedures in place to obtain data on the defaulted loans. Our procedure, at the time, was to obtain the information from the servicer, Washington Mutual. They would not release this information, due to privacy issues. I have attached a letter from our Account Executive from Washington Mutual confirming this fact. **(Exhibit 7)** In the spring of this year, we finally started receiving the EPD reports. Any loans, of course, which show up on this report are immediately quality controlled.

<u>RECENT QUALITY CONTROL REVIEWS NOT COMPLETED IN A TIMELY MANNER</u>

HUD changed this guideline in November of 2003 (4060.1 rev-1 chg-1). The old guideline was for the QC reviews should be "performed" within 90 days of closing. When the Quality Control Plan was updated with the new guidelines, this change was missed. We have corrected our Plan (**Exhibit 8**) and have implemented the 90 days from closing timeframe.

If you require any further information, please do not hesitate to contact the undersigned.

Sincerely,

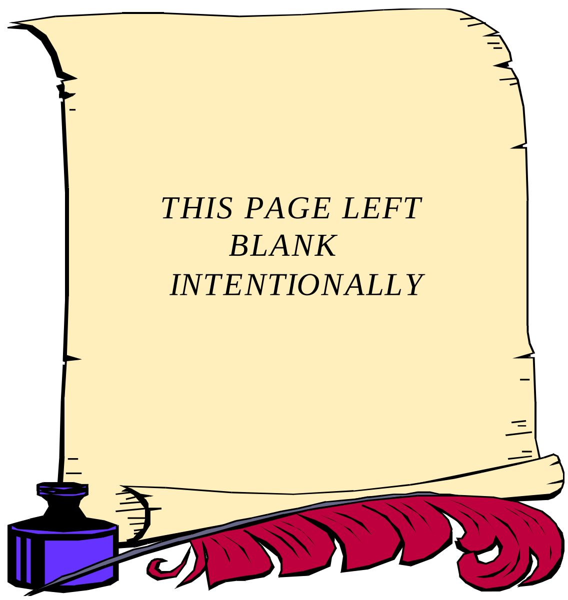
HARTFORD FUNDING LTD.

Peggy Miceli

Peggy Miceli
Vice President

PM:mj

Enc.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