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TO: John C. Weicher, Assistant Secretary for Housing, Federal Housing
Commissioner, H

Joan S. Hobbs

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

SUBJECT: National City Mortgage Company
Direct Endorsement Mortgagee
7500 Dreamy Draw Drive, Ste 245
Phoenix, AZ 85020

We completed a limited review of National City Mortgage Company (National City), a Direct Endorsement mortgagee. The review was performed on one of the mortgagee's branch offices in Phoenix, Arizona. We selected this branch office for review based on the results of a previous OIG audit that identified the use of false credit and employment documents by Keystone Mortgage, a loan correspondent of National City. The review objective was to determine if National City failed to appropriately identify and follow up on indicators of fraudulent credit and employment documents within a sample of nine FHA loans. We conducted the review in accordance with generally accepted government auditing standards.

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 review.

If you have any questions, please contact Charles Johnson, Assistant Regional Inspector General for Audit, at (602) 379-7243.

SUMMARY

We reviewed a sample of nine FHA loans and found National City failed to follow up on questionable credit and/or employment documents during the underwriting process for all nine cases. As a result, false employment and credit information used as a basis for approval of the nine loans was not identified. This report recommends that National City indemnify HUD for any past or future losses on these nine loans.

We discussed the findings with National City officials during the audit and at an exit conference held on July 20, 2004. We also provided National City and HUD with a copy of the draft audit report for comments on June 24, 2004. At the exit conference, National City officials stated they agreed with the audit report. On August 6, 2004, National City officials stated they would not provide a formal written response since they agreed with the report.

BACKGROUND

National City is a HUD approved non-supervised Direct Endorsement lender. Per information in HUD's Neighborhood Watch system, National City has 315 branch offices throughout the country and is an approved sponsor for 4,464 loan correspondents. Our review focused on one of National City's branch offices located at 7500 Dreamy Draw Drive Ste 245, Phoenix, AZ 85020. This National City Branch uses a "Doing Business As" (DBA) name of "Accubanc Mortgage". During 2002 and 2003, this office gave underwriting approval to 1,727 FHA loans originated by its loan correspondents for mortgage amounts totaling approximately \$180 million. According to National City, this branch office is a wholesale lender, and therefore does not originate loans, but acts as the underwriter for loans originated by its loan correspondents.

During a previous HUD-OIG audit of Keystone Mortgage, a loan correspondent of National City, we identified the use of false credit and employment documents within 48 FHA loan files, including falsified credit reports, false credit history letters from utility companies, and/or falsified employment documents, such as pay stubs, W-2s, and verification of employment (VOE) forms. National City performed the underwriting on nine of these 48 loans as the sponsoring Direct Endorsement mortgagee. We analyzed the underwriting of these nine loans during our review of National City.

We performed our review during the period February 2004 through May 2004. The objective of our review was to determine if National City failed to appropriately identify and follow up on indicators of fraudulent credit and employment documents within a sample of nine FHA loans.

To accomplish our review objectives, we:

- Reviewed nine FHA insured loans underwritten by National City during the period August 2000 through December 2001,
- Interviewed National City Managers, and
- Performed a limited review of National City's quality control plan and performed limited testing to determine if the plan was implemented.

FINDING 1

NATIONAL CITY FAILED TO RESOLVE QUESTIONABLE CREDIT AND EMPLOYMENT DOCUMENTS WHEN UNDERWRITING FHA LOANS

All nine of the loans reviewed, totaling approximately \$1 million, contained indicators of false credit and/or employment documents that were not appropriately resolved by National City during the underwriting process. This occurred because National City failed to exercise due diligence when underwriting the loans. National City did not identify and follow up on indicators of irregularities that were present in the files. As a result, loans were approved based on false information, causing FHA/HUD to assume unnecessary insurance risks. Two of these nine loans have resulted in mortgage insurance claims to HUD/FHA totaling \$140,404, and five additional loans totaling \$482,410 remain insured and represent a continuing insurance risk to FHA (two loans totaling \$174,264 are no longer insured).

Section 203 (b) (1) of the National Housing Act, as amended, authorizes HUD to provide mortgage insurance for single-family homes. A mortgagee that originates, purchases, holds or sells FHA insured loans, must be formally approved by HUD. Mortgagees must follow the requirements of the National Housing Act and HUD instructions, guidelines, and regulations when originating insured loans. Mortgagees that do not follow these requirements are subject to administrative sanctions.

As part of the loan origination process, mortgagees are required to obtain a credit report for each borrower. The credit report is used as a guide in the underwriting process to evaluate the borrower's attitude toward credit obligations. If the credit report shows the borrower has made payments on previous or current obligations in a timely manner, the underwriter will find the borrower represents a reduced risk. If the borrower has not yet established a credit history with traditional credit accounts, such as credit cards, car loans or mortgages, the mortgagee can develop an "alternative" credit history using utility payment records, rental payments, automobile insurance payments, or other similar non-traditional credit sources. The mortgagee itself may obtain this alternative credit information, or the mortgagee may elect to use a credit-reporting agency to develop and

provide a non-traditional mortgage credit report (reference HUD Handbook 4155.1 REV-5, Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties).

The mortgagee must also obtain documentation evidencing the borrowers' history of employment and income. The anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt.

The underwriter's evaluation of a borrower's credit and income history is used as a basis for determining if the borrower represents an acceptable credit risk under HUD guidelines, and accordingly, whether or not the loan should be approved.

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, ethics and standards. This handbook states that mortgagees and their underwriters must maintain the ability to detect fraud and be aware of the warning signs that may indicate irregularities.

National City did not adhere to these requirements when it failed to appropriately identify and/or resolve questionable credit and employment documents when underwriting FHA-insured loans. All nine loans we reviewed contained indications of fraudulent borrower credit and/or employment documents, yet National City did not follow up on these to ensure the documents were legitimate. In some cases, it appears National City did identify indicators of fraud, yet the underwriters failed to follow up to resolve the discrepancies. As part of our review, we verified the questionable credit and/or employment documents were in fact falsified. The following indicators of fraudulent borrower credit and employment documents were apparent in the loan files but not resolved by National City.

Indicators of False Employment (See Appendix B for individual loan identification):

- Four of nine loans - Borrower pay statements and/or IRS W-2 forms reflected incorrect Social Security and Medicare withholding percentages. (Loans 1,2,5,7)
- Two of nine loans – Employers' signatures were misspelled and/or printed distinctly differently between employment verification documents in the file. (Loans 1,2)
- Two of nine loans – Amount of borrower income was not consistent between borrower W-2, VOE and/or pay stubs. (Loans 4,5)
- For one loan the borrower purportedly received a raise from an hourly rate of \$15 to an annual salary of \$50,000 just prior to the loan. However, this was highly suspicious since the borrower had only worked at the employer for 2.5 months. Also, based upon the claimed year-to-date wages and claimed pay rate, the borrower apparently had only worked 15 hours per week or was absent from work during much of the 2.5-month period he worked for the employer. This loan file also contained

information indicating the borrower had a 3-month gap in employment and this was not explained. Also, it appears the underwriter attempted to verify the employment start date for this borrower's prior employer and was unable to do so. Accordingly, a full two years of employment was not verified. (Loan 4)

- For one loan, the underwriter requested a new copy of a verification of employment for the borrower because the version provided was apparently changed using white out. After the loan officer replied that the employer would not consider making a new VOE a "priority", it appears the underwriter did not follow up on the request for a new verification of employment. Also in this case, the initial borrower loan application did not list one of the borrower's current employers; however, this employer's name appeared on the final application with no explanation for the change. (Loan 5)
- One loan file contained a document indicating National City performed some type of quality control review on the file to re-verify the borrower's employment. However, this document indicated the employment could not be verified because the telephone number for the borrower's employer (also listed on the loan application) was incorrect. It appears National City did not follow up to resolve this discrepancy. (Loan 7)
- One loan file contained a signed handwritten statement from the borrower stating "I (borrower name) am paid in cash from my employer & I have supplied this information to my mortgage broker." However, the loan file contained earnings statements' indicating the borrower was paid through a payroll service (ADP). (Loan 1)
- For one loan, the listed length of the borrower's employment increased from 2 to 3.2 years between two different versions of the loan application, yet the loan file did not contain any explanation for this change. (Loan 2)

Indicators of False Credit (See Appendix B for individual loan identification):

- Eight of nine loans – Borrower credit reports in the loan files contained references to alternative credit sources, yet the reports did not contain any contact information to identify the credit sources, such as a telephone number or address as is typically included on a credit report. Further, the alternative credit reports for these 8 cases did not indicate the accounts were actually verified by the reporting agency. (Loans 1,2,3,5,7,8,9) The one remaining case listed contact information for some creditors; however, no creditor information was provided for the three alternative credit sources shown on the report. (Loan 6)
- Four of nine loans – Borrower credit reports listed alternative credit accounts, yet the names of the creditors were not shown on the reports. For example, the credit reports in these cases listed only "cable bill" or "private contract". (Loans 1,6,7,9)

- One loan file contained separate alternative credit reports for a borrower and co-borrower living at different addresses, yet both credit reports listed the same account numbers for the borrowers' utility accounts. Since the borrowers were living at different addresses, they would not have the same utility account numbers, indicating one or both of the credit reports contained false information. (Loan 6)
- One loan file contained a credit report that listed no account numbers (Loan 1).

During our review, we also noticed other deficiencies indicating the need for National City to strengthen its underwriting and control procedures. For example:

- In one loan file the borrower's derogatory credit information was not adequately explained. (Loan 4)
- In three loan files recent credit inquiries were not explained. (Loans 6,7, 9)
- In one loan file it was claimed the borrower did not have a bank account, yet a cashier's check in the file indicated the borrower did have an account with the bank that issued the check. (Loan 3)
- One loan file included a credit report listing multiple last names for the male borrower, indicating potentially false use of a Social Security number, but this was not resolved in the file. (Loan 6)
- In one file the Social Security card for the borrower was not legible, indicating this document was potentially false, yet this was not resolved in the loan file. (Loan 7)
- One loan was apparently submitted late for endorsement and National City submitted a certification to HUD that the loan was current, yet the payment history in the file indicates the payment for the current month had not been paid. (Loan 8)

RECOMMENDATIONS

We recommend you require National City to:

- 1A. Indemnify HUD/FHA \$622,814 for the losses already incurred, and future losses on the seven loans set out in Appendix B.

AUDITEE COMMENTS AND OIG EVALUATION OF AUDITEE COMMENTS

At an exit conference held July 20, 2004, National City officials stated they agreed with the audit report and did not dispute any facts cited in the report. On August 6, 2004, National City officials stated they would not provide a formal written response since they agreed with the report.

FOLLOW-UP ON PRIOR AUDITS

This is the first Office of Inspector General review of the National City branch office.

ISSUES NEEDING FURTHER STUDY AND CONSIDERATION

Although we did not perform a complete review of National City's quality control function, during the course of our audit we became aware that National City may not have reviewed all loans going into default (60 days past due) within the first six payments as required by HUD Handbook 4060.1 REV-1, CHG-1, Chapter 6. These reviews are intended to limit HUD's risk by enabling the mortgagee to detect potential instances or patterns of fraud or violations of HUD requirements and to identify necessary corrective actions.

National City has a centralized Quality Control Department that performs the quality control review function for all of its branch offices nationwide. For loans originated through the one branch office we reviewed (which underwrote loans from affiliated loan correspondents), we requested documentation from National City evidencing that early default loans were reviewed under its quality control plan. After multiple requests by OIG for this information, National City failed to produce any documentation showing these reviews were performed. Therefore, although National City's quality control plan indicates reviews are to be performed on all early default loans, it appears that these reviews may not have actually been conducted.

Further study and consideration of National City's quality control function, especially as it relates to review of early default loans and loan correspondent activities, is needed to determine if National City has implemented adequate quality control procedures in accordance with HUD requirements.

SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

<u>Recommendation Number</u>	<u>Type of Questioned Cost</u>		<u>Funds Put to Better Use 3/</u>
	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	
1A	\$38,159	\$102,245	\$482,410

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.

SCHEDULE OF NINE FHA LOANS REVIEWED

Loan Number	FHA Case Number	Closing Date	Loan Amount
1	023-0928952	12/11/01	94,208
2	023-0793297	10/4/01	91,563
3	023-0710858	6/6/01	100,424
4 ²	023-0712632	7/6/01	226,796
5 ¹	023-0785681	8/16/01	85,655
6	023-0884063	11/5/01	95,895
7 ¹	023-0809788	9/7/01	88,609
8 ³	023-0748637	7/20/01	96,485
9	023-0317715	8/23/00	100,320

1 Loans were refinanced and are no longer FHA insured.

2 Property was sold under the pre-foreclosure program. Total claim amount to HUD was \$38,159.

3 Foreclosure claim of \$102,245 was paid by HUD. The property has not yet been resold.