audit report

Issue Date March 15, 2005	
Audit Case Number 2005-AT-1007	

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

FROM:

Sonya D. Lucas
Acting Regional Inspector General for Audit, 4AGA

SUBJECT: Interstate Financial Mortgage Group Corporation
Non-Supervised Direct Endorsement Lender
Miami, FL

HIGHLIGHTS

What We Audited and Why

We audited Interstate Financial Mortgage Group Corporation (Interstate) in Miami, FL. Interstate is a non-supervised direct endorsement lender approved by the U.S. Department of Housing and Urban Development (HUD) to originate and approve Federal Housing Administration-insured single-family mortgages. We selected Interstate for review because of risk factors associated with defaulted loans.

The audit objectives were to determine whether Interstate: (1) complied with HUD regulations, procedures, and instructions in the origination and underwriting of Federal Housing Administration-insured single-family mortgages, and (2) implemented its quality control plan as required. We reviewed a sample of 18 loans to accomplish our objectives.

What We Found

Interstate did not follow HUD requirements when originating and approving 15 Federal Housing Administration-insured loans totaling $1,599,281. Fifteen of the 18 loans we reviewed had problems. All 15 loans contained underwriting deficiencies that, taken as a whole, should have led a prudent person to not approve the loan. Interstate approved the loans based on inaccurate employment, income and gift documentation, and other deficiencies. This occurred because Interstate did not exercise due care in originating and underwriting loans, primarily by not clarifying inconsistencies in the loan files or adequately following up to verify borrower income and employment histories. Interstate also improperly allowed independent loan officers to originate loans and maintained no supporting documentation to ensure HUD that interest rates, loan discount points, and other fees were appropriately charged. These deficiencies increased HUD's risk to the Federal Housing Administration insurance fund.

Interstate did not fully implement its quality control plan. Interstate did not conduct the required number of quality control reviews, including early defaulted loans and rejected loan applications, nor ensure that immediate corrective action was taken when deficiencies were identified by its contractor. Interstate's quality control plan was also incomplete, as it did not include all required elements. We attribute these deficiencies to Interstate's disregard of HUD requirements and instructions. As a result, HUD has no assurance of the accuracy, validity, and completeness of Interstate's loan origination and underwriting operations.

What We Recommend

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require Interstate to: (1) indemnify HUD against future losses on 10 loans totaling $1,057,905, (2) reimburse HUD for a loss already incurred of $36,951 on one property, and (3) reimburse HUD for a loss, if applicable, on another property for which HUD paid a claim of $110,866. We recommend that HUD require Interstate to stop using independent loan officers to originate Federal Housing Administration loans and maintain documentation to justify interest rates, loan discount points, or other fees charged. We further recommend that HUD take appropriate measures to ensure that Interstate conducts required quality control reviews, corrective action is taken and documented for all reported deficiencies, and the written quality control plan complies with HUD requirements. Finally, we recommend that HUD take administrative action, as appropriate, up to and including civil monetary penalties.

Auditee's Response

We discussed our review results with Interstate and HUD officials during the audit. We provided a copy of the draft report to Interstate officials on January 25, 2005, for their comments and discussed the report with them at the exit conference on January 27, 2005. Interstate provided written comments on February 11, 2005.

Interstate expressed concerns regarding finding 1 that it did not exercise due care in originating and underwriting loans we questioned and therefore did not believe it needed to indemnify those loans. Interstate generally agreed with our recommendations for finding 2. We commend Interstate for being responsive and taking prompt action to correct and improve its quality control process. We believe that Interstate's new Quality Control Plan, if correctly implemented and taking into consideration our evaluation and HUD's suggestions, will enable Interstate to better ensure the accuracy, validity, and completeness of its loan and underwriting operations.

The complete text of the auditee's response along with our evaluation of that response can be found in appendix B of this report.

TABLE OF CONTENTS

BACKGROUND AND OBJECTIVES

The U.S. Department of Housing and Urban Development (HUD) approved Interstate Financial Mortgage Group Corporation (Interstate) as a Title II non-supervised lender on September 22, 1999, to originate, purchase, hold, and service or sell loans or insured mortgages. Additionally, HUD approved Interstate to be a direct endorsement lender to underwrite and close Federal Housing Administration loans without prior HUD review or approval.

Interstate originated and underwrote 751 Federal Housing Administration-insured loans with mortgages totaling $83.1 million, which had beginning amortization dates (defined as 1 month prior to when the first principal and interest payments are due) between April 1, 2002, and March 31, 2004. According to HUD's Neighborhood Watch system, 37 of the loans defaulted within the first 2 years of origination.

The audit objectives were to determine whether Interstate: (1) complied with HUD regulations, procedures, and instructions in the origination and underwriting of Federal Housing Administration-insured single-family mortgages, and (2) implemented its quality control plan as required.

Finding 1: Interstate Did Not Follow HUD Requirements When Originating and Approving Loans

Interstate did not follow HUD requirements when originating and approving 15 Federal Housing Administration-insured loans totaling $1,599,281. Fifteen of the 18 loans we reviewed had problems. All 15 loans contained underwriting deficiencies that, taken as a whole, should have led a prudent person to not approve the loan. Interstate approved the loans based on inaccurate employment, income, and gift documentation, and other deficiencies. This occurred because Interstate did not exercise due care in originating and underwriting loans, primarily by not clarifying inconsistencies in the loan files or adequately following up to verify borrower income and employment histories. Interstate also improperly allowed independent loan officers to originate loans and maintained no supporting documentation to ensure HUD that interest rates, loan discount points, and other fees were appropriately charged. These deficiencies increased HUD's risk to the Federal Housing Administration insurance fund.

Inaccurate Employment, Income, and Gift Documentation

HUD Handbook 4000.4, Rev-1, paragraphs 2-1 and 2-5, states that for the authority to participate in the Direct Endorsement Program is a privilege; therefore, a direct endorsement lender must conduct its business operations in accordance with accepted sound mortgage lending practices, ethics, and standards. Lenders are to obtain and verify information with at least the same care that would be exercised if the lender were originating a mortgage entirely dependent on the property as security to protect its investment.

Interstate approved a total of 10 loans based on inaccurate employment, income, and gift documentation. We confirmed with employers and borrowers that Internal Revenue Service W-2s, pay stubs, and employment verification forms were inaccurate. Interstate approved loans in which the borrower never worked for the employer or the employer did not exist. Had Interstate properly verified borrower employment and income with the employer or other sources, the underwriter would have discovered the inaccuracies, and the loans would not have been approved. In addition, we confirmed with donors that two gifts were actually loans to the borrower, and in another instance, the seller provided a gift and made it appear to be from the donor.

Loan Origination and Underwriting Deficiencies

HUD Handbook 4155.1, Rev-4, Chg-1, chapters 2 and 3, require lenders to determine a borrower's ability and willingness to repay the mortgage debt and, thus, limit the probability of default or collection difficulties. Lenders should evaluate the stability and adequacy of income, funds to close, credit history, qualifying ratios, and compensating factors. They must ensure the application package contains sufficient documentation to support their decision to approve the mortgage loan.

Mortgagee Letter 2003-07 states if a property is re-sold 90 days or fewer following the date of acquisition by the seller, the property is not eligible for a mortgage insured by the Federal Housing Administration.

Our review identified several loan origination and underwriting deficiencies with the 15 loans. The review found that Interstate did not:

- Verify borrower source of funds to close (12 loans),
- Ensure compliance with HUD borrower credit requirements (10 loans),
- Verify employment information provided by borrower (10 loans),
- Clarify inconsistent data among loan documents (six loans),
- Provide valid or supported compensation factors when HUD's debt to income ratios of 29 and 41 percent were exceeded (five loans), or
- Ensure compliance with HUD requirements to resell properties (two loans).

The deficiencies noted above are not independent of one another, as many of the loan files contained more than one deficiency. Details of the deficiencies identified on each loan reviewed, including specific HUD requirements not met, are included in appendix C. Appendix D provides a chart summarizing the loan processing deficiencies.

Other Violations

Interstate improperly allowed 16 independent loan officers to originate 121 of 678 Federal Housing Administration loans from January 2002 to August 2004. Though Mortgagee Letter 95-36 permits lenders to contract for certain loan origination functions, the loan officer function may not be contracted out. Interstate reported earnings for independent loan officers on Internal Revenue Service Form 1099 and reported earnings for loan officers employed by Interstate on Internal Revenue Service Form W-2. The Internal Revenue Service Form 1099 is used to report miscellaneous income for payments or services performed by independent contractors, and the Internal Revenue Service Form W-2 is used to report wages and other compensation to employees. Interstate believes the only difference between an independent loan officer and a loan officer employed by Interstate is their tax status. In addition, the employment package for the independent loan officer contains no assurances to Interstate and HUD that they will work solely for Interstate or contains a clause to prevent possible conflict-of-interest situations.

In addition, according to 24 Code of Federal Regulation, part 202.12(a)(8), lenders are required to maintain records on pricing information, satisfactory to the Secretary of Housing and Urban Development, that would allow for reasonable inspection by HUD for a period of at least 2 years. Our review did not find sufficient documentation to allow HUD to readily determine the appropriateness of the loan interest rates and discount points charged by Interstate. HUD also cannot ensure that loan discount points lowered the interest rate charged by Interstate and that other fees charged were proper. Interstate was unaware of this requirement.

Prior HUD Review

HUD conducted a review of Interstate in November 2002. HUD reported that Interstate

- Used false income, employment, asset, occupancy, and gift information to originate and approve Federal Housing Administration-insured mortgages.
- Failed to maintain documentation identifying the source or adequacy of funds used for the down payment and closing costs.
- Failed to provide sufficient compensating factors when front-end ratios were exceeded.
- Failed to resolve conflicting information in the loan file.

The review resulted in Interstate indemnifying 17 Federal Housing Administration loans. Our audit results indicate that these same issues continue to occur.

Conclusion

Interstate disregarded HUD requirements and did not exercise sound judgment and due diligence in the processing and underwriting of loans to be insured by the Federal Housing Administration. In 15 loans, Interstate did not exercise the care expected of a prudent lender by using inaccurate employment, income, and gift documentation. Interstate failed to properly verify employment information or the borrower’s source of funds to close, did not provide valid or supported compensation factors for excessive debt to income ratios, did not properly evaluate borrowers' debts, did not clarify important file discrepancies, and allowed resale properties to be Federal Housing Administration-insured in violation of HUD requirements. Interstate also improperly allowed independent loan officers to originate Federal Housing Administration loans and did not maintain documentation to justify that interest rates, loan discount points, and other fees were appropriately charged. The deficiencies occurred because Interstate failed to exercise due care in originating and approving loans. These deficiencies increased HUD's risk to the Federal Housing Administration insurance fund and resulted in actual losses to HUD.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner:

1A. Require Interstate to indemnify HUD against future losses for the 10 actively insured loans totaling $1,057,905 for which Interstate did not follow HUD requirements.[1] Appendix D lists case numbers for the loans included in this recommendation.

1B. Require Interstate to reimburse HUD $36,951 for losses already incurred.[2] Appendix D lists the case number for the loan included in this recommendation.

1C. Require Interstate to reimburse HUD $110,866 for claims already incurred. Appendix D lists the case number for the loan included in this recommendation.

1D. Require Interstate to stop using independent loan officers to originate Federal Housing Administration loans.

1E. Require Interstate to maintain in its Federal Housing Administration loan files the daily rate sheet or other documentation to justify the interest rate, loan discount points, or other fees charged.

[1] According to Neighborhood Watch, as of January 25, 2005, 3 of the 15 loans have terminated Federal Housing Administration insurance without a claim. (Case numbers 092-9106318, 092-9584181, and 092-9604022) Because these loans no longer represent a risk to the Federal Housing Administration insurance fund, we have removed these 3 loans from our recommendation.

[2] As of January 25, 2005, the claimed amount paid by HUD for case number 092-9264929 increased to $36,951.

Finding 2: Interstate Did Not Fully Comply With Federal Housing Administration Quality Control Requirements

Interstate did not fully implement its quality control plan. Interstate did not conduct the required number of quality control reviews, including early defaulted loans and rejected loan applications, nor ensure that immediate corrective action was taken when deficiencies were identified by its contractor. Interstate's quality control plan was also incomplete, as it did not include all required elements. We attribute these deficiencies to Interstate's disregard of HUD requirements and instructions. As a result, HUD has no assurance of the accuracy, validity, and completeness of Interstate's loan origination and underwriting operations.

Ten Percent of Federal Housing Administration Loans Not Reviewed for Quality Control

According to HUD Handbook 4060.1, lenders may choose to review the lesser of 10 percent of all loans closed on a monthly basis or a random sample that provides a 95 percent confidence level with 2 percent precision. A change to the Handbook, dated November 2003, requires lenders originating 7,000 or fewer Federal Housing Administration loans per year to review 10 percent of the loans. In addition, loans must be reviewed within 90 days of the closing of the loan.

Interstate uses an independent contractor to perform quality control reviews. Interstate's quality control plan requires that it provide the contractor with a monthly list of closed loans. From these lists, the contractor selects loans for quality control review. For the loans selected, the contractor requests the loan files from Interstate.

Interstate did not obtain quality control reviews on 10 percent of closed loans for the 3 months we tested. In May 2003, Interstate closed 89 loans. As of December 1, 2004, only seven of the nine required reviews had been performed. Interstate could not locate the two files to provide them to the contractor for review. In February and April 2004, Interstate closed 23 and 25 Federal Housing Administration loans, respectively. No quality control reviews were conducted for these 2 months. The contractor stated that Interstate never provided the list of closed loans for these 2 months. Interstate did provide the list of closed loans in December 2004 after a second request from the contractor. Interstate still needs to provide the contractor with the loan files selected for quality reviews.

Since Interstate did not ensure that 10 percent of closed loans had a quality control review performed, HUD cannot be assured that a representative sample of loans has been reviewed against HUD requirements. In addition, Interstate has not ensured that quality control reviews are conducted within 90 days of closing, as HUD requires.

Early Default And Rejected Loans Not Reviewed For Quality Control

HUD Handbook 4060.1 requires performing quality control reviews of all loans defaulting within 6 months of closing. The Handbook also requires lenders to perform quality control reviews on 10 percent of rejected loans. In November 2002, HUD conducted a review and found that Interstate did not ensure that quality control reviews were performed on all loans defaulting within 6 months of closing. Since this review, Interstate has only twice provided a monthly list of defaulted loans to the contractor. In addition, Interstate does not provide a list of rejected loans to the contractor to perform quality control reviews. Interstate informed us that they have no plans to submit such information to the contractor for review.

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

Required Corrective Actions Were Not Taken

HUD Handbook 4060.1 requires that prompt action to correct material deficiencies be formally documented by citing each deficiency, identifying the cause of the deficiency, and providing management's response or actions taken. In addition, lenders are required to report any violations of law or regulation, false statements, or program abuses to HUD within 60 days of initial discovery.

HUD's prior review found that Interstate failed to complete follow-up procedures to explain discrepancies found by the quality control contractor and to notify HUD of violations of law, false statement, or program abuse. We reviewed two quality control reports provided by the contractor and found that Interstate did not take corrective actions. In one example, Interstate told the contractor it does not conduct post-closing quality control reviews and will not verify the information. In another example, the contractor noted the existence of fraudulent tax returns on August 30, 2004, and reported this to Interstate on October 11, 2004. However, Interstate did not report this to HUD.

Written Quality Control Plan Did Not Contain Required Elements

HUD Handbook 4060.1 provides that as a condition of HUD approval, lenders must have and maintain a quality control plan for the origination and servicing of insured mortgages. The plan must be a prescribed function of the lender's operations and assure that the lender maintains compliance with HUD requirements and its own policies and procedures.

HUD's prior review found that Interstate had a quality control plan that did not comply with HUD requirements. Interstate updated its written quality control plan in May 2004. However, the plan does not contain the required elements prescribed by HUD.

For example, the quality control plan does not contain the following required elements:

- Personnel are trained to conduct thorough quality control reviews.
- A system of review exists to help identify patterns and look for cases similar to those that have gone into early payment default.
- Appraised values have been established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.
- Federal Housing Administration loans selected for quality control review are reviewed for compliance against HUD requirements.
- Federal Housing Administration loans have been closed and funds disbursed in accordance with lender underwriting and subsequent closing instructions.
- Federal Housing Administration loans selected for quality control review and exceeding the qualifying ratio limits have acceptable documented compensating factors.

Conclusion

Interstate's written quality control plan does not meet HUD requirements. We attribute this to Interstate disregarding its responsibilities to ensure that quality control reviews were conducted and deficiencies were corrected. HUD reported this matter to Interstate. Interstate is unable to ensure the accuracy, validity, and completeness of its loan origination and underwriting operations.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner:

2A. Take appropriate measures to ensure Interstate conducts required quality control reviews, corrective action is taken and documented for all reported deficiencies, and the written quality control plan complies with HUD requirements.

2B. Take administrative action, as appropriate, up to and including civil monetary penalties.

SCOPE AND METHODOLOGY

To achieve our audit objectives we reviewed:

- Applicable laws, regulations, and other HUD program requirements, and
- Files and documents from HUD and Interstate.

We chose a non-representative method to select the loans for review. This method allowed us to select Federal Housing Administration-insured loans with certain characteristics. This approach enabled us to focus our review efforts on loans where there is a greater inherent risk and/or risk of noncompliance or abuse to the Federal Housing Administration insurance fund.

We reviewed 18 Federal Housing Administration-insured loans that had defaulted within the first 2 years from origination. In addition, we reviewed two loans that had a quality control review conducted.

In addition, we interviewed appropriate officials and staff from Interstate and HUD's Atlanta Single Family Homeownership Center. We also interviewed borrowers, employers, and gift donors to verify the information in the files.

We performed our review between May and November 2004. The audit covered the period April 1, 2002, through March 31, 2004, but we extended the period as necessary to achieve the audit objectives.

We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal Control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Program Operations. Policies and procedures that management has in place to reasonably ensure that the loan origination process complies with HUD program requirements and that the objectives of the program are met.

- Validity and Reliability of Data. Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and used during the mortgage loan origination process.

- Compliance with Laws and Regulations. Policies and procedures that management has implemented to reasonably ensure that its loan origination process is administered in accordance with applicable laws and regulations.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe that the following items are significant weaknesses:

- Interstate did not follow HUD requirements when originating and approving 15 Federal Housing Administration–insured loans (see finding 1).

- Interstate has not implemented its quality control plan in accordance with HUD requirements (see finding 2).

APPENDIXES

Appendix A

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

Recommendation Number	Ineligible [1]	Funds To Be Put to Better Use [2]
1A		$ 1,057,905
1B	$ 36,951	
1C	110,866	
Total	$ 147,817	$ 1,057,905

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

2/ Funds to be put to better use are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented resulting in reduced expenditures at a later time for the activities in question. This includes 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

Interstate Financial MORTGAGE GROUP

Licensed Mortgage Lender

February 11, 2005

Ms. Sonya D. Lucas
Acting Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General for Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

Dear Ms. Lucas:

Please accept this letter on behalf of Interstate Financial Mortgage Group ("IFMG") as its response and comments to the draft report (the "Report") received from your office regarding the recent audit conducted by HUD for the period between April 1, 2002 and March 31, 2004. We take the Report seriously and appreciate the opportunity to respond.

IFMG carefully reviewed all aspects of the Report in preparing this response. As more fully described below, IFMG has accepted various recommendations from your audit team to improve its quality control and has implemented procedures and other changes accordingly. We also examined some of the deficiencies found with various case files, responded to those potentially material concerns and provided documentation supporting our position. Finally, we also evaluated the recommendation for IFMG to indemnify HUD for certain loans. We will agree to do so for several loan files.

IFMG's response to the Report is divided into three sections. In Section I, we identify HUD's findings and provide a brief response. In Section II, we describe the quality control and other procedures that have been put into place in order to satisfy HUD that the accuracy, validity and completeness of IFMG's loan origination and underwriting operations adhere to required regulations including the Fair Housing Act, Equal Credit Opportunity Act and the Federal Truth and Lending Act. In Section III, we respond to specific loan deficiencies identified during the audit and identify those loans as to which IFMG will provide indemnification.

1

9200 S. Dadeland Blvd. | suite 600 | Miami, FL 33156 | 305.226.7700 | f. 305.225.2100 | 1.888.226.7977 | www.ifmg.cc

Comment 1

I

FINDINGS BY HUD

Based on the results of its audit, HUD makes two findings. First, the Report finds that IFMG did not follow HUD requirements when originating and approving loans. The Report recommends indemnification against future losses for 13 actively insured loans totaling $1,398,921 and reimbursement for incurred losses of $36,755 and $110,866. See Recommendations 1A, 1B and 1C, respectively. In addition, the Report recommends that IFMG stop using independent loan officers to originate Federal Housing Administration ("FHA") loans. See Recommendation 1D. Finally, the Report recommends that IFMG maintain in its loan files a daily rate sheet or other documentation regarding the interest rate, loan discount points or other fees charged. See Recommendation 1E.

IFMG accepts Recommendations 1B, 1C, 1D and 1E. It agrees to reimburse HUD for the two losses already incurred in the amounts of $36,755 and $110,866. Further, IFMG no longer uses independent loan officers and will not do so in the future to originate FHA loans. IFMG also agrees to maintain in its loan files documentation identifying the interest rate, loan discount points or other fees charged. With regard to Recommendation 1A, IFMG will agree to indemnification against future losses for the loans described below.

The second finding in the Report is that IFMG did not fully comply with Federal Housing Administration ("FHA") quality control requirements. The Report recommends that HUD take appropriate measures to ensure IFMG conducts required quality reviews, corrective action is taken and documented for all reported deficiencies and that the company's written quality control plan complies with HUD requirements. See Recommendation 2A. In addition, the Report recommends that civil monetary penalties be considered against IFMG. See Recommendation 2B. With respect to Recommendation 2A, IFMG has undergone significant changes in both corporate structure and quality control procedures since the audit. We believe that the implemented should changes satisfy HUD's concerns related to quality control issues. IFMG respectfully requests that HUD not impose monetary sanctions based on our internal changes, our willingness to indemnify for numerous loans and our research regarding certain deficiencies identified in the Report, which may have resulted from information in the file that may have been overlooked (as explained below) or which simply reflects a difference in judgment between a Direct Endorsement underwriter and the auditor.

II

QUALITY CONTROL

The issue of quality control, as identified in Finding 2 of the Report, is addressed first here because this finding relates to the continuing relationship between HUD and IFMG and HUD's satisfaction that FHA loans are being underwritten in accordance with governing regulations.

2

Comment 1

A. Changes in the Corporate Structure of IFMG

IFMG has undergone significant changes in its corporate structure. These changes have been ongoing since Zoe Torres took over as Chief Executive Officer. As you can see from the company's prior and current organizational charts, there have been substantial changes in personnel. See Attachments A and B.

Each member of the management team being lead by Ms. Torres has vast underwriting, quality control, secondary markets as well as general business experience. Sandra Castro is the Director of the Quality Control Department. She has over 8 years experience in the mortgage servicing and quality control area acquired while at a Fannie Mae Seller Service and other leading lenders in Miami, Florida. Ibis Leal is the Senior Underwriter for the Wholesale Division. She joined IFMG in October 2004 and brings over 19 years experience in mortgage lending with particular emphasis in quality control underwriting. Betty Fernandez is the Senior Underwriter in the Retail Division. She has been in the mortgage industry for over 9 years. She has considerable experience in loan processing and underwriting, including FHA loans. Susan Magdaleno is the Director of Secondary Market & Closing Director with responsibility for conforming and non-conforming governmental loan programs and supervising all loan closers. Ms. Magdaleno has over 10 years of lending experience. Andrea Loguzzo is the company's Comptroller, responsible for all of the company's internal accounting transactions.

We believe that these changes in the management structure alone have substantially improved the processing of loans, including FHA loans.

B. Review of FHA Loans for Quality Control

HUD Handbook 4060.1 allows lenders to review the lesser of 10 percent of all loans closed on a monthly basis or a random sample that provides 95 percent confidence level with 2 percent precision. The Report notes that IFMG utilizes an outside independent contractor to perform quality control reviews but that IFMG did not satisfy the 10 percent requirement in the three months that were tested (May 2003, February and April 2004).

Comment 1
Comment 2

IFMG has addressed the concerns reflected in the Report in its Quality Control Plan (see Section C below). Furthermore, IFMG retained a new third party independent contractor to perform the quality control reviews. See Attachment C. It is our belief that with the establishment of internal timetables and specific follow-up systems, we will monitor the exchange of information and address possible deficiencies in a timely manner.

Comment 1

C. IFMG Quality Control Procedures

The Report identifies other quality control concerns, including elements that must be included in IFMG's quality control plan. The written quality control plan discussed in the Report was effective as of May 2004.

IFMG has significantly modified its written quality control plan (the "QCP") since the audit. See Attachment D. The new QCP addresses the areas of concern identified in the Report. These items are discussed below.

Comment 3

1. *Training*

The Report indicates the QCP should ensure that personnel are trained to conduct thorough quality reviews. The QCP address training in several aspects. For example, the QCP specifically incorporates the Report's recommendation regarding training. QCP at p. 2. The QCP also states that personnel will be provided with quarterly updates of changes to the QCP and training opportunities. QCP at p. 3. Further, any changes in HUD requirements are identified and presented to IFMG's staff at bi-weekly meetings. QCP at p. 3. Additionally, the QCP contains a quality control review checklist that identifies specific areas to be examined during a review. QCP at p. 7. From a training standpoint, this list provides a new employee with information regarding specific items that should be included with every loan application. Similarly, the QCP contains a list of documents and procedures to be obtained and followed in the application process. QCP at pp. 8-16. This information also ensures that a new employee becomes aware of both the documentation used during the loan process as well as the type of discrepancies that could bring into question the accuracy of the information provided by a potential borrower. In addition to these items, IFMG has a training policy that, among other things, requires new employees to review the QCP, procedures manuals as well as other information provided by IFMG to assure the appropriate processing and underwriting of loans. See Attachment E. These various training components provide new employees with a thorough understanding of the entire loan process, described visually in IFMG's flow chart. See Attachment F.

Comment 4

2. *Early Default Pattern Detection and Corrective Action*

The Report indicates that a quality control plan should have a system of review to identify patterns for loans that have early payment default. The new QCP provides that all loans that have gone into default within the first eighteen months will be analyzed. QCP at p. 4. To this end, the Neighborhood Watch Report will be reviewed on a bi-weekly basis. QCP at p. 4. Management will then be provided with this report and all investor report cards and review the process. QCP at p. 4. When deficiencies are noted, management will take corrective action and report all findings to the appropriate agencies. QCP at pp. 3, 5. When a pattern of deficiency is identified, employees with be provided with corrective instructions. QCP at p. 5. Additionally, in this event, IFMG will then expand its scope of quality review. QCP at p. 3.

4

Comment 5

3. *Appraisals*

The Report states that appraised values should be established using reasonable comparables and other factors, taking into account any expectation of repairs required to meet minimum safety and soundness requirements. This specific requirement is incorporated into the QCP at p. 4. In addition, the QCP devotes three pages of items to be considered when examining an appraisal and also identifies the types of documentation that should accompany an appraisal. QCP at pp. 14-16.

Comment 6

4. *Compliance and Disbursement in Accordance with HUD Requirements and Underwriting*

The Report notes that the QCP must provide that all FHA loans must comply with both HUD requirements as well as underwriting and subsequent instructions. Report at p. 11.

This recommendation is specifically incorporated in various sections of the QCP. See QCP at p. 1 (all loans must conform to FHA/HUD requirements), QCP at p. 2 (files to be reviewed by senior management to ensure compliance with Fair Housing Act, Equal Opportunity Act and FHA and HUD requirements), QCP at p. 3 (assure file is compliant with HUD fair housing marketing regulations) and QCP at p. 6 (each file must contain all required loan processing underwriting and legal documents). Furthermore, a quality control review checklist is also used when the file is reviewed. See Attachment D (located after p. 10 of QCP).

IFMG's Quality Control Department will review all findings and issue an initial report to IFMG's senior management within one month of completion of the initial analysis. Management will review the report and immediately take action to appropriately respond to material findings. QCP at p. 1.

IFMG will report any discrepancies regarding FHA loans to the proper agencies such as:

US Department of Housing and Urban Development
Office of Inspector General – Office of Audit
Brickell Federal Plaza
909 SE 1st Avenue, Room 487
Miami, Florida 33131

Atlanta Homeownership Center
Director
Quality Assurance Division
Five Points Plaza
40 Marietta Street
Atlanta, GA 30303-2806

Department of Housing and Urban Development
Inspector General Hotline (GFI)
400 Virginia Avenue
SW Room C-120
Washington, DC 20024

Comment 7

5. *Civil Monetary Sanctions*

IFMG has taken considerable steps to address the specific concerns identified in the Report. The improvements to its quality control process extend beyond the issues identified in the Report. IFMG has internally reorganized. The new team brings considerable experience and is acutely aware of the requirements for processing loans. Given these changed circumstances, and its agreement to indemnify HUD for various loans (see below), IFMG submits that civil monetary penalties should not be imposed.

III
LOAN FILES

In Finding 1 of the Report, various loan deficiencies are identified for 15 loan files. These items are summarized in Exhibit D of the Report. Based on these findings, the Report recommends that IFMG be required to indemnify HUD against losses already incurred in two loans. See Recommendation 1B and 1C. The Report also recommends indemnification against potential future losses related to 13 other loans. See Recommendation 1A. In addition, the Report recommends that IFMG stop using independent loan officers to originate loans. See Recommendation 1D. Finally, the Report recommends that IFMG maintain in its FHA loan files the daily rate sheet or other documentation justifying the interest rate, loan discount points or other fees charged. See Recommendation 1E.

Comment 8

As noted above, IFMG accepts Recommendations 1B, 1C, 1D and 1E. It will reimburse HUD for the two losses already incurred in the amounts of $36,755 and $110,866, as sought in Recommendations 1B and 1C.

Comment 9

With regard to Recommendation 1D, IFMG no longer uses independent loan officers and will not do so in the future to originate FHA loans. For the period covered by the Report, however, IFMG notes that the HUD Mortgagee approval handbook states that "[a]n Approved mortgagee must employ trained personnel that are competent to perform their assigned responsibilities, including loan origination, services and collection activities to the extent that the mortgagee engages in these activities." The handbook also provides that "[a]ll employees of the mortgagee except receptionists, whether full-time or part-time, must be employed exclusively by the mortgagee at all times and conduct only the business affairs of the mortgagee during normal business hours." Further, 4700.2 Title I Lender Approval Handbook, Chapter 2-10, indicates that "[i]t is not uncommon in the industry to pay employees, especially loan officers, on the basis of Internal Revenue

6

Comment 9

Service Form 1099," and that there is no objection to this practice. Accordingly, so long as a loan officer is employed solely by a particular lender, IFMG interprets these provisions to allow for the designation of loan officers as 1099 employees, a practice previously followed by IFMG.

Comment 10

In accordance with Recommendation 1E, IFMG also agrees to maintain in its loan files documentation identifying the interest rate, loan discount points or other fees charged.

With regard to Recommendation 1A, IFMG will agree to indemnification against potential future losses for three (3) of the remaining loans. For the remaining loans, material questions related to each file are specifically discussed below. We have provided this loan-by-loan analysis to address what appear to be certain inaccuracies and in support of our position regarding the recommendation for indemnification. It should be noted that IFMG's response is based solely on the information contained in each loan file because the loan officers and underwriters involved with these loans are no longer employed by IFMG.

A. *Case No. 092-9017524*

The Report indicates that inaccurate employment information was utilized by the buyer and that IFMG did not confirm employer's name and address. According to the Report, "[i]f Interstate had sent the verification of employment form," it would have discovered that no such employer was located at the address shown.

Comment 11

There are several documents that indicate IFMG independently sought to verify employment. A verification of employment ("VOE") was in fact obtained. See Attachment A1. The VOE also verified salary. The borrower's credit report matched the address provided for the employer. See Attachment A2. The Florida Secretary of State records today still show the employer at the address provided to IFMG. See Attachment A3. There is nothing from the face of this information to trigger a suspicion that the employer or its address were inaccurate.

Comment 12

The Report also concludes that IFMG failed to properly verify the borrower's source of funds, based on questionable deposits and overdrafts. The overdrafts were minor ($116 and $29). In addition, the loan application indicates that the borrower is a single mother with a ten-year old child. See Attachment A4. The questioned deposits were regularly made around the middle of each month and may reflect alimony/child support that does not have to be disclosed or considered for underwriting purposes.

Comment 13

The Report states that IFMG did not properly analyze the borrower's credit because of the collection status of three accounts. However, IFMG's underwriting department requested a credit explanation for the derogatory credit. See Attachment A5 (line 21). In response, the borrower provided a written explanation. See Attachment A6. Further, the credit report revealed that the three derogatory credit references had been fully paid by the borrower and two of these related to medical expenses. IFMG thus

7

considered the credit status of this borrower and, in its judgment, satisfied itself at that time that this borrower was not an inappropriate credit risk.

The reliability of the borrower's pay stub was also raised in the Report based on the assumption that one line at the top of the pay stub refers to the employer being located in Coral Gables while the loan application indicates a location in North Miami Beach. That one line states in its entirety: "Coral Gables, FL 33134." However, the pay stub does not identify this city and zip code information as belonging to the employer. See Attachment A7. Further, this line actually matches the borrower's city and zip code information on the pay stub. Because there is no indication that this one line relates to the employer, there was no reason to question the pay stub's accuracy.

Comment 14

The Report states that IFMG did not ensure that the borrower provided the minimum required investment (of 3% of the sales price). The Report identifies this amount to be $4,584. However, as set forth in HUD form HUD-92900-PUR (the "4155 form"), the statutory investment requirement for this borrow was $3,660, calculated on a sales price of $122,000. See Attachment A8. As reflected in the Report, and also in the closing statement (see Attachment A9), the borrower contributed $3,935 (consisting of a $2,000 deposit, $1,600 cash to close and $335 in paid out-of-pocket expenses). This amount satisfies the minimum requirement, even under the amount calculated in the Report.

Comment 15

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

Comment 16

B. *Case No. 092-9091627*

The Report states that Interstate failed to properly verify information because the borrower stated that a real estate agent obtained the information for the loan approval process and that the borrower never met with IFMG staff until the time of closing.

The borrower's recollection is inaccurate. The second page of the loan application (Fannie Mae form 1003) is signed by both the borrower and the IFMG interviewer. It indicates that the information was taken in a face-to-face interview. See Attachment B1. The borrower also signed the authorization to verify employment on the same date as the application. See Attachment B2.

Comment 17

The Report indicates that had IFMG sent a verification of employment form, it would have discovered that the borrower never worked for the employer. The VOE was in fact sent. See Attachment B3. The employer information coincided with the pay stub information. See Attachment B4. There was no objective information to question the accuracy of this information.

Comment 17

The borrower also stated to the auditors that the loan application contained inaccurate personal asset information. However, this information was not considered in the approval process because of subjective nature of valuations used by borrowers.

Comment 18

8

Comment 19

The Report further states that IFMG did not ensure that the borrower had demonstrated financial capability. However, the borrower provided a source of funds statement under penalty of perjury. See Attachment B5. The borrower also purchased several money orders to satisfy his responsibility to provide the funds needed for closing. See Attachment B6.

Comment 20

The Report questions the documentation supporting the acceptance of excess front-end ratios. In this instance, the borrower had excellent credit. In addition, the loan application reflects that the borrower would not suffer any payment shock because the proposed monthly payment was slightly lower than the existent rent payment ($719 versus $725). See Attachment B7.

Comment 18

The borrower's marital status was shown as married on his loan application and unmarried on the credit report. The Report indicates that this inconsistency should have been resolved, and it was. The mortgage was signed by both the borrower and his wife. See Attachment B8.

Comment 21

The Report indicates that the minimum investment for this borrower was calculated to be $2,879 but that the borrower only provided $2,475. Form 4155 calculates the minimum investment to be $2,247. See Attachment B9. The borrower satisfied this amount with the deposit alone. However, the closing statement indicates that the borrower actually contributed a total of $3,082 ($2,275 deposit, $467 cash to close and $340 prepaid out-of-pocket loan expenses). See Attachment B10. This contribution even satisfies the amount calculated in the Report.

Comment 22

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

C. *Case No. 092-9106318*

Comment 23

Public records show this loan to have been paid in full. See Attachment C1. Therefore, no indemnification is required for this loan. It is not contributing any risk to the FHA insurance fund.

D. *Case No. 092-9114133*

Comment 24

The Report states that IFMG approved this loan based on inaccurate employment and gift information. The VOE and pay stubs, however, contain the same consistent information for the employer. See Attachments D1 and D2.

Comment 25

The Report indicates that the gift donor was actually the borrower's husband and not her uncle. None of the documents provided by the borrower and available to the underwriter at the time called into question the accuracy of the gift letter. The letter itself identifies the donor as the uncle. See Attachment D3. The borrower's bank statements were in her name only. See Attachment D4. The borrower prepaid expenses related to the loan with a check from an account containing her name only. See Attachment D5. Even the title company did not discover that she supposedly was married because it issued the policy in her name only and as "a single woman." See Attachment D6. In addition, the borrower's credit report did not identify any mortgages that would have disclosed the existence of property in her name. See Attachment D7.

Comment 26

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

E. *Case No. 092-924091*

Comment 27

This loan has been foreclosed. IFMG accepts the recommendation to indemnify HUD.

F. *Case No. 092-9264929*

Comment 27

This loan has been foreclosed. IFMG accepts the recommendation to indemnify HUD.

G. *Case No. 092-9368468*

Comment 28

The Report provides that IFMG did not verify the borrower's source of funds based on a bank statement that reflects a transfer of $1,000. The Report states that a bank statement from this account was not in the file. However, the account statement in the file which contains the $1,000 transfer identifies the transfer as an "Online Banking transfer from Check 0078." See Attachment G1. The first page of that bank statement confirms that a checking account, with the same last four digits of "0078", belonged to the borrower. Additionally, the borrower provided $2,277.88 at time of closing. See Attachment G2.

Comment 29

The Report additionally questions the ability of the borrower to maintain current employment because the borrower had been employed at several jobs over a short period of time. All past employment was verified by IFMG. See Attachment G3 (consisting of six VOEs). There were no significant gaps in employment and the borrower also held more than one job at a time, demonstrating an ability to obtain gainful employment. See Attachment G3.

Comment 30

The Report questions the accuracy of the appraisal report on the basis that the sales price of $86,414 "is $4,600 more than comparable properties sold during the same period." The appraisal report identifies two comparables, each valued in excess of $87,000, which sold within eight months of the appraisal date. See Attachment G4.

Comment 31

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

H. *Case No. 092-9403894*

Comment 32

This loan has been paid in full. See Attachment H1. Therefore, no indemnification is required for this loan. It is not contributing any risk to the FHA insurance fund. Because IFMG learned of this fact in finalizing this response, its response to the findings in the Report are still included below in the event that the loan status is not accurate.

Comment 33

The Report questions the borrower's credit worthiness based on a bankruptcy discharge of a mortgage. The borrower explained that the bankruptcy was due to personal illness. See Attachment H2. The borrower even provided hospital admission forms. See Attachment H3. The credit report shows that the borrower timely paid prior mortgages and these mortgages had been satisfied. See Attachment H4. Additionally, the borrower had a demonstrated ability to save as shown by account balance verifications with aggregate balances of about $7,000. See Attachment H5.

Comment 34

The Report also states that the borrower did not provide the minimum required investment, calculated in the Report to be $2,910. The Report states that the borrower provided only $2,653. Form 4551 shows that the statutory minimum investment is $2,362. See Attachment H6. The borrower in fact provided $2,992.91 at closing, which even meets the amount contained in the Report. See Attachment H7. The borrower's contribution consists of a deposit for $1,000, cash at closing of $1,652.91 and prepaid paid expenses of $340. It appears that the Report inadvertently did not consider the expenses prepaid by the borrower, as was correctly done with other loans such as Case No. 092-9017524.

Comment 35

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

I. *Case No. 092-9509172*

Comment 38

This loan became current as of March 2004 and therefore is not contributing any risk to the FHA insurance fund. The last payment date is January 13, 2005. See Attachment I1.

Comment 36

The Report concludes that this loan was approved without adequate justification for excess ratios. However, this loan was approved for Loan Prospector documentation requirements despite the ratios. See Attachment I2.

Comment 37

The Report further states that a credit report was ordered on the same day as closing. In fact, there are two credit reports in the file – one is dated May 21, 2003 (see Attachment I3) and the other is dated June 27, 2003 (see Attachment I4).

Comment 38

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

J. *Case No. 092-9511392*

Comment 41

This loan is current as of January 10, 2005. See Attachment J1. It is therefore not contributing any risk to the FHA insurance fund.

Comment 39

The Report indicates that source of funds to close could not be determined from bank accounts. Pursuant to the purchase and sale agreement, the source of closing funds was the seller who agreed to pay up to $4,868 of buyer's closing costs. See Attachment J2. The Report further states that the rental income of $850 could not be verified from bank statements. This rental income was from a lease that was to commence after the closing date. See Attachment J3. Thus, there would be no rental income reflected in any bank statements provided to IFMG which predate the start of the lease. The Report also notes that such rental income can be considered only if shown on the borrower's tax return. Because the rental property previously had been owner occupied and converted to a lease only subsequent to the borrower's last tax return, it was properly considered.

Comment 40

The Report states that one of several borrower bank accounts contained $7,996 and was opened two months before closing. The borrower had several other accounts, one of which was opened in July 1999 and had average balances between $5,700 and $8,600 in the preceding twelve months. See Attachment J4. The borrower also had cash reserves representing approximately six times the amount of his new principal, interest, taxes and insurance on the home. This information was reflected as a compensating factor on Form 4551. See Attachment J5.

Comment 41

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

K. *Case No. 092-9563354*

Comment 42

The Report questions the accuracy of the employment, income and gift information based on interviews with the employer. A verification of employment was received by IFMG. See Attachment K1. According to the Report, in an interview with the auditor, the employer could not dispute whether his mother-in-law, the former president of the company, may have signed the VOE for the employer. Further, the borrower's pay stub matched the employer information on the VOE. See Attachment K2. The Report also indicates that the donor stated in an interview that she was not the borrower's sister and that the amount reflected as a gift was actually a loan. There was no information in the file, however, to doubt the accuracy of the letter affidavit signed by the donor. See Attachment K3.

Comment 43

The Report states that IFMG did not properly analyze the borrower's credit based on a lack of credit history. IFMG, however, requested and received alternative credit information from two sources. See Attachment K4 and K5.

12

Comment 44

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

L. *Case No. 092-9584181*

Public records show this loan to have been paid in full. See Attachment L1. Therefore, no indemnification is required with this loan. It is not contributing any risk to the FHA insurance fund.

Comment 45

M. *Case No. 092-9604022*

Comment 46

The Report indicates that IFMG did not verify the borrower's source of funds to close and financial capability to make mortgage payments because bank statements revealed less than an average monthly balance of $800. However, the source of funds to close was a gift from the borrower's daughter in the amount of $5,085. See Attachment M1. With regard to the ability to pay, the borrower's mortgage payment-to-income and fixed payment-to-income ratios were 17.2% and 18.7%, respectively, well within guidelines. See Attachment M2.

The Report further questions the borrower's employment information. This loan was a Fannie Mae Desktop Underwriter ("DU") approved loan, however. See Attachment M3. There was no reason to question employment information given the DU approval and the low ratios.

For these reasons, IFMG submits that it should not have to provide indemnification for this loan.

N. *Case No. 092-9615614*

Comment 47

This loan has been foreclosed. IFMG accepts the recommendation to indemnify HUD.

O. *Case No. 095-0034417*

Comment 48

This loan is current as of January 26, 2005. See Attachment O1. It is therefore not contributing any risk to the FHA insurance fund. Further, IFMG has not previously encountered any problems with the incorrectly entered transaction dates and does not expect a reoccurrence of this problem.

IV
CONCLUSION

IFMG has taken the findings in the Report seriously and modified, improved and/or implemented numerous procedures to ensure that it will stay up to date with quality control standards dictated by HUD. IFMG believes that it has used prudent

13

lending practices to meet its goal of assembling a complete and accurate loan package that reflects the borrower's situation. It appears that some of the findings in the Report were simply subject to a difference of opinion between the judgment exercised by IFMG's Direct Endorsement underwriters and the judgment exercised by an auditor in a subsequent assessment of the loan file. Nonetheless, the newly implemented changes will enable IFMG to better evaluate the accuracy, validity and completeness of its loan origination process.

IFMG believes it has taken the appropriate steps to solve the concerns raised in the Report. While no controls, no matter how stringent and regardless of their breadth, can prevent every act of deception by a borrower, IFMG will continue to work diligently to handle FHA loans properly. We understand the importance of complying with HUD-FHA requirements and are committed to demonstrating this understanding through our loan origination practices. Our new practices should provide a more formidable deterrence to any potential abuse.

Please contact me if you require additional information.

Sincerely,

Zoe A. Torres
Chief Executive Officer

cc: Mr. Barry Shulman, Senior Auditor
Ms. Eileen Leung Tam, Auditor,CIA

OIG Evaluation of Auditee Comments

Comment 1

I. FINDINGS BY HUD

A. Changes in the Corporate Structure of IFMG

B. Review of FHA Loans for Quality Control

C. IFMG Quality Control Procedures

Interstate reported significant changes to its corporate structure and to its Quality Control Plan.

We agree with Interstate that the hiring of knowledgeable staff is vital in the processing and underwriting of quality loans. The development of a written Quality Control Plan to comply with HUD requirements is also vital in assuring HUD that Interstate's loan origination and underwriting operations will be accurate, valid, and complete. It is in the implementation and application of the plan that HUD can evaluate whether Interstate's loan origination and underwriting operations meet HUD requirements.

Comment 2

II. QUALITY CONTROL

B. Review of FHA Loans for Quality Control

Interstate retained a new third party independent contractor to perform the quality control reviews.

Quality control reviews conducted in accordance with HUD requirements is the responsibility of Interstate. Among the requirements is to review at least 10 percent of all Federal Housing Administration loans, all loans that default within the first six payments, and at least 10 percent of all rejected loans. These reviews must be conducted within 90 days of loan closing.

C. IFMG Quality Control Procedures

Comment 3

1. Training

Interstate agreed with recommendation 2A and modified its written Quality Control Plan to ensure that personnel are trained to conduct thorough quality control reviews.

Comment 4

2. Early Default Pattern Detection and Corrective Action

Interstate modified its written Quality Control Plan to ensure that all loans that have gone into default within the first 18 months will be analyzed. Section 6-6D of HUD Handbook 4060.1 requires that lenders 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.

Comment 5

3. Appraisals

Interstate agreed with recommendation 2A and modified its written Quality Control Plan to ensure that appraised values should be established using reasonable comparables and adjustments and take into account any expectation of repairs required to meet minimum safety and soundness requirements.

Comment 6

4. Compliance and Disbursement in Accordance with HUD Requirements and Underwriting

Interstate modified its written Quality Control Plan to ensure that all Federal Housing Administration loans must comply with HUD requirements as well as underwriting and subsequent closing instructions.

Interstate's written Quality Control Plan should also include assurances that Federal Housing Administration loans selected for quality control review are reviewed for compliance against HUD requirements. Additionally, those loans exceeding the qualifying ratio limits must have acceptable and documented compensating factor(s).

Comment 7

5. Civil Monetary Sanctions

Interstate requests that HUD not impose civil monetary sanctions based on changes it made to its corporate structure since the time of the audit and its willingness to indemnify HUD for various loans.

Recommendation 2B has been revised. We will refer to HUD to determine whether administrative action against Interstate is warranted.

Comment 8

III. LOAN FILES

Interstate agrees to reimburse HUD in the amounts of $36,755 for a loss (recommendation 1B) and $110,866 for a claim (recommendation 1C) already incurred on two Federal Housing Administration-insured properties. An update from HUD's computer system indicates that the loss to the insured property increased to $36,951.

Comment 9

III. LOAN FILES

Interstate concurred with recommendation 1D and agreed to no longer use independent loan officers and will not do so in the future to originate Federal Housing Administration loans. Interstate had interpreted Section 2-10 of HUD Handbook 4700.2, Title I Lender Approval Handbook, to allow loan officers to be 1099 employees.

HUD approved Interstate to be a Title II non-supervised lender, who may originate, purchase, hold, service or sell loans or insured mortgages. A Title I lender, on the other hand, may originate and receive insurance on property improvement loans or loans for manufactured housing.

Comment 10

III. LOAN FILES

Interstate agreed with recommendation 1E to maintain in its loan files documentation identifying the interest rate, loan discount points or other fees charged. Interstate needs to ensure that the documentation justifies and not just identifies the interest rate, loan discount points or other fees charged.

Comment 11

<u>Case Number 092-9017524</u>

Based on the verification of employment form, credit report, and Florida Secretary of State records, Interstate reasoned there is nothing from the face of the information to believe that the employer or its address were inaccurate. However, our site visit to the premises verified that no such employer existed at the time. Therefore, it is questionable how Interstate and the credit reporting agency was able to independently obtain the verification. In addition, the corporation name on the State record is different than that listed on the verification of employment form. Our discussion with the employer listed on the State's record confirmed that they were not associated with the employer on the verification of employment form and they did not employ the borrower.

Comment 12	**<u>Case Number 092-9017524</u>** Interstate believed that the questioned deposits may have reflected alimony or child support that does not have to be disclosed or considered for underwriting purposes. However, Section 2-10 of HUD Handbook 4155.1, Rev-4, Change 1, requires that all funds for the borrower's investment in the property must be verified. This includes the $2,000 earnest money deposit, which the borrower paid on February 26, 2002. According to borrower's bank statements, the borrower made deposits of $3,725 from February 20, 2002 to February 28, 2002 despite a claimed monthly salary of $2,590. Interstate did not verify the source of funds for the earnest money deposit and thus cannot assure HUD that the funds were from an acceptable source. In addition, though the overdraft fees are minor, the repetition of such fees may reflect borrower's lack of discipline in managing her cash resources.
Comment 13	**<u>Case Number 092-9017524</u>** Since the borrower had provided a written explanation of the collection accounts and they were fully paid, Interstate believed that the borrower was not an inappropriate credit risk. Section 2-3C of HUD Handbook 4155.1, Rev-4, Change 1, does not require that collection accounts be paid off as a condition for loan approval, but the existence of collections indicate the borrower's regard for credit obligations and must be considered in the analysis of the borrower's creditworthiness.
Comment 14	**<u>Case Number 092-9017524</u>** Interstate stated that the "Coral Gables, FL 33134" listed on the pay stub was not identified as the employer's address and therefore was not inconsistent with the address listed on the loan application. However, the copy of the pay stub contained in the loan file submitted to HUD clearly identifies the name of the employer with the Coral Gables address. Interstate failed to question the inconsistency of the employment address between the pay stub and the loan application. Interstate also did not address borrower's relatively high annual salary as an accounts payable clerk.

Comment 15

<u>Case Number 092-9017524</u>

Interstate equated the statutory investment requirement as the minimum required investment. Mortgagee Letter 98-29, Single Family Loan Production- Mortgage Calculation Simplification specifies a method for calculating the minimum required investment. According to this requirement, we calculated the minimum required investment to be $4,584. Since the borrower only contributed $3,935, Interstate did not ensure that the borrower provided the minimum required investment.

Comment 16

<u>Case Number 092-9017524</u>

For the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan. In addition, Interstate did not comment on its failure to provide valid compensating factors for exceeding the qualifying ratio as required by Section 2-13 of HUD Handbook 4155.1, Rev-4, Change 1.

Comment 17

<u>Case Number 092-9091627</u>

Though we verified with the borrower that the real estate agent handled the loan process (i.e., obtaining borrower's personal and financial data and documentation for loan approval), Interstate believes that the borrower's recollection is inaccurate. Given the borrower's statement, we do not believe the interviewer's signature on the loan application sufficiently proves that the interviewer met with the borrower and was not instead provided with the loan documents from the real estate agent, who is an interested third party.

In addition, Interstate believes there was no objective information to question the accuracy of the employment information. We disagree. Had Interstate met with the borrower, they would have known that the employment information as stated on the loan application was inaccurate. The borrower informed the real estate agent of the inaccurate employment information, but was told it had to be this way for the loan to qualify. Further, the borrower certified that he never worked for the claimed employer. When shown the verification of employment form and pay stub, the borrower stated that they were false.

Comment 18	**<u>Case Number 092-9091627</u>** Interstate shared that the borrower's inaccurate personal asset information was not considered in the approval process due to the subjective nature of the valuations. In addition, Interstate believed the inconsistency with the borrower's marital status was resolved when the mortgage was signed by both the borrower and his wife. We question whether Interstate met with the borrower. While we agree that the valuations are subjective, the personal asset information provided to HUD was inaccurate. In addition, the borrower informed us that he was never married to the woman whose name is on the mortgage.
Comment 19	**<u>Case Number 092-9091627</u>** Interstate disagreed that it did not ensure that the borrower demonstrated financial capability. Section 2-10 of HUD Handbook 4155.1, Rev-4, Change 1, requires that all funds for the borrower's investment in the property must be verified. Though the loan file included a source of funds statement indicating a monthly savings of $742, the loan file also contained the borrower's bank statement that does not support this amount. Interstate should have reconciled the data from both statements. In addition, based on our verification with the borrower, the income on the source of funds statement is inaccurate.
Comment 20	**<u>Case Number 092-9091627</u>** Interstate did not comment on whether or not it failed to document compensating factors to justify the excess ratio. Section 2-12 of HUD Handbook 4155.1, Rev-4, Change 1, states that a ratio exceeding 29 percent may be acceptable if significant compensating factors are presented.
Comment 21	**<u>Case Number 092-9091627</u>** Interstate equated the statutory investment requirement as the minimum required investment. Mortgagee Letter 98-29, Single Family Loan Production-Mortgage Calculation Simplification specifies a method for calculating the minimum required investment. According to this requirement, we calculated the minimum required investment to be $2,879. The borrower stated he only invested $2,175 for the earnest money deposit and $300 for fees related to the loan for a total of $2,475.

Comment 22

Case Number 092-9091627

For the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan.

Comment 23

Case Number 092-9106318

Recommendation 1A has been revised to reflect those Federal Housing Administration loans that have been paid in full.

Comment 24

Case Number 092-9114133

Interstate commented that the verification of employment form and the pay stubs contained the same consistent employer information. However, the employer informed us that he did not employ the borrower, did not sign the verification of employment form, and the information on the pay stub and the verification of employment form are inaccurate. If Interstate had sent a verification of employment form to this employer, the inaccurate employment and salary information would not have been validated. In addition, Interstate did not comment that the loan application, verification of employment form, and credit report show the borrower beginning employment in March 2000 when the employer was not incorporated until March 2001.

Comment 25

Case Number 092-9114133

Interstate stated that none of the documents provided by the borrower and available to the underwriter called into question the accuracy of the gift letter. Since Interstate did not contact the donor to confirm the gift information or conduct Internet searches on the prior residence of the borrower, we agree that Interstate would not have known that the gift donor was not the borrower's uncle.

Comment 26

<u>Case Number 092-9114133</u>

For the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan. Interstate did not comment on not properly verifying the borrower's source of funds to close, analyzing the borrower's credit to ensure that she demonstrated financial capability and responsibility, verifying questionable employment information, or reconciling basic personal information.

Comment 27

<u>Case Number 092-9242091</u>
<u>Case Number 092-9264929</u>

As noted on page 6 of their response, Interstate agrees to reimburse HUD for the loss amount and claim paid by HUD for the two Federal Housing Administration-insured properties.

Comment 28

<u>Case Number 092-9368468</u>

Interstate did not directly comment on whether it obtained the bank statement in question, but did agree that the bank account belonged to the borrower.

Section 2-10 of HUD Handbook 4155.1, Rev-4, Change 1, requires that all funds for the borrower's investment in the property must be verified. The $1,000 used to pay the earnest money deposit appeared to have come from another one of the borrower's bank accounts. However, Interstate did not obtain a copy of this other bank statement to show that the $1,000 came from an acceptable source and that the borrower had sufficient funds to close. Additionally, after the $1,000 check cleared, subsequent withdrawals for food items and gas resulted in five overdraft charges and a negative balance.

Comment 29

<u>Case Number 092-9368468</u>

Interstate did not comment on whether it properly analyzed the borrower's stability of income, but commented that it had verified all borrower's past employment.

Comment 29	Section 2-6 of HUD Handbook 4155.1, Rev-4, Change 1 requires lenders to verify the borrower's employment for the most recent 2 full years. Though Interstate verified the borrower's employment for the most recent 2 full years, it did not appear to have considered the borrower's stability of employment and income. At the time of the loan application, the borrower had been with the employer for a little over one year. Previously, the borrower was employed at three different jobs spanning between 2-6 months.
Comment 30	**<u>Case Number 092-9368468</u>** Interstate responded that according to the appraisal report, two of the comparables were valued in excess of $87,000. We question why the appraiser did not use comparables that were the same model (floor plan) as the subject unit. The data we obtained shows that the sales price of the subject unit ($86,414) is $4,600 higher than that of similar units at similar periods.
Comment 31	**<u>Case Number 092-9368468</u>** For the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan. Interstate did not comment on its failure to resolve conflicting information related to the borrowers' past rental amount.
Comment 32	**<u>Case Number 092-9403894</u>** Interstate learned that the loan has been paid in full and, therefore, no indemnification is required. As of February 18, 2005, HUD's system does not indicate that this loan has been paid in full. It reflects that the loan is active and was reinstated by the borrower.
Comment 33	**<u>Case Number 092-9403894</u>** Interstate believed it properly analyzed the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility.

Comment 33

Section 2-3 of HUD Handbook 4155.1, Rev-4, Change 1 states that past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. This requirement also states that a borrower whose previous residence was foreclosed within the previous 3 years is generally not eligible for an insured mortgage. Documentation in the loan file suggests that the borrower's previous residence was being foreclosed, which resulted in him filing for bankruptcy in 2000. The borrower applied for the Federal Housing Administration loan in 2003. In discharging the bankruptcy, the court also discharged the $94,000 liability the borrower owed on the property.

Case Number 092-9403894

Comment 34

Interstate equated the statutory investment requirement as the minimum required investment. Mortgagee Letter 98-29, Single Family Loan Production- Mortgage Calculation Simplification specifies a method of calculating the minimum required investment. According to this requirement, we calculated the minimum required investment to be $2,910. The borrower informed us that besides the $1,000 in earnest money deposit, he paid $1,653 at closing. He did not pay $275 for the appraisal report or $65 for the credit report, which was paid outside of closing. Therefore, the borrower's investment in the property is $2,653, which is less than the minimum required investment.

Case Number 092-9403894

Comment 35

For the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan. Interstate did not comment on its failure to verify inconsistent rental payments with the borrower.

Case Number 092-9509172

Comment 36

Interstate believed that since the loan was approved for Loan Prospector documentation requirements, they did not need to provide compensating factors to justify the excess qualifying ratios of 31.8 percent and 46.3 percent. Section 2-12 of HUD Handbook 4155.1, REV-4, CHG 1, states that qualifying ratios exceeding 29 percent or 41 percent, respectively, may be acceptable if significant compensating factors are presented.

Comment 37

Case Number 092-9509172

Interstate stated that there are two credit reports in the file dated May 21, 2003 and June 27, 3003 (date of closing). However, the credit report dated May 21, 2003, in Interstate's loan file was not in the loan file submitted to HUD. The one page excerpt of the May 21, 2003, credit report listed the borrower as having serious delinquencies, a number of delinquent accounts, and proportionally high balances to credit limits.

Comment 38

Case Number 092-9509172

Since the mortgage was reinstated by the borrower as of March 2004, Interstate believed the loan is not contributing any risk to the Federal Housing Administration insurance fund. We believe the present status of a loan does not dictate its future performance.

In addition, for the above reasons, Interstate feels that it should not have to indemnify this loan. Based on our evaluation of Interstate's responses, we maintain our position that HUD should require Interstate to indemnify this loan. Interstate did not comment on the borrower's inaccurate employment and income information or its failure to provide a verification of deposit or other documentation to support the borrower's financial ability to close and make mortgage payments.

Comment 39

Case Number 092-9511392

Interstate stated that the rental income was from a lease to commence after the closing date and therefore the rental income would not be reflected in any of the bank statements or the borrower's tax return.

Section 2 of HUD Handbook 4155.1, Rev-4, Change 1 states that the anticipated amount of income, and likelihood of its continuance, must be established to determine the borrower's capacity to repay the mortgage debt. Specifically, the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first 3 years of the mortgage loan. Since the lease of the borrower's other property is on a monthly basis, there is no guarantee the monthly income from the lease will continue. There is also no rental history of the property.

Comment 39

Therefore, the net rental income may only be considered as a compensating factor and must be adequately documented by the lender as stipulated by Section 2-7M of the Handbook. Accordingly, we disagree with Interstate for including the monthly net rental income of $241 when calculating the borrower's monthly income. Our calculation of qualifying ratios less the net rental income was 34.9 percent and 61.7 percent.

We subsequently learned from the borrower that he moved back into his prior residence after living in the Federal Housing Administration-insured property for only 3 or 4 months. This raises a concern of the owner-occupancy of the Federal Housing Administration-insured property and supports our contention that the rental income may not be permanent.

Comment 40

<u>Case Number 092-9511392</u>

Interstate did not address our concern that the borrower's employment income did not appear to be deposited into any of his three bank accounts. Interstate did note that the borrower's large cash reserve was used as a compensating factor to justify the excessive ratios. However, we believe the compensating factor used is inadequate in light of our calculation of the ratios.

Comment 41

<u>Case Number 092-9511392</u>

Since the loan is current as of January 2005, Interstate believed the loan is not contributing any risk to the Federal Housing Administration insurance fund. We believe the present status of a loan does not dictate its future performance.

In addition, for the above reasons, Interstate feels that it should not have to indemnify this loan. Based on the borrower's excessive qualifying ratios, we maintain our position that HUD should require Interstate to indemnify this loan.

Comment 42

<u>Case Number 092-9563354</u>

Interstate disagreed that it did not properly verify the borrower's employment and gift data. Given that Interstate did not contact the employer to verify the borrower's employment information, we agree that they would not have known that the employer did not distribute the pay stub in the loan file. Since Interstate did not contact the gift donor, it would not have known that the gift was actually a loan.

Comment 43

<u>Case Number 092-9563354</u>

Interstate disagreed that it did not properly analyze the borrower's credit based on a lack of credit history. Though Interstate requested and received alternative credit information for the borrower, we believe this information should be considered in calculating the qualifying ratios.

Comment 44

<u>Case Number 092-9563354</u>

For the above reasons, Interstate feels that it should not have to indemnify this loan. However, we maintain our position that HUD should require Interstate to indemnify this loan. Interstate did not comment on its failure to verify the borrower's source of funds to close, whether the borrower has the financial capability and discipline to manage her finances and pay the mortgage, borrower's questionable salary as an administrative assistant, and its failure to ensure that the borrower provided the minimum required investment.

Comment 45

<u>Case Number 092-9584181</u>

Recommendation 1A has been revised to reflect those Federal Housing Administration loans that have been paid in full.

Comment 46

<u>Case Number 092-9604022</u>

The loan has been paid in full and is no longer a risk to the Federal Housing Administration insurance fund. Recommendation 1A has been revised to reflect the change.

Comment 47

<u>Case Number 092-9615614</u>

Interstate concurs with our recommendation to indemnify the loan.

Comment 48

Case Number 095-0034417

Interstate believes that since the loan is current as of January 2005, it does not contribute any risk to the Federal Housing Administration insurance fund. We believe the present status of a loan does not dictate its future performance. In addition, Interstate does not expect a reoccurrence of entering faulty transaction dates into HUD's system.

Mortgagee Letter 2003-07 clearly states that any resale of a property occurring 90 or fewer days from the last sale may not be eligible for Federal Housing Administration financing. Therefore, we maintain our position that HUD should require Interstate to indemnify this loan.

Appendix C

NARRATIVE LOAN DEFICIENCIES

Case Number: 092-9017524

Interstate approved the loan based on inaccurate employment information. Interstate did not confirm the employer's name and address as listed on the loan application. The verification of employment form shows the employer located in North Miami Beach, FL. Our site visit to the North Miami Beach address and discussions with various persons on the premises indicated there was no such employer at the address. Interstate failed to properly verify employment information and, therefore, generated and submitted inaccurate employment and salary data to HUD. If Interstate had sent the verification of employment form to this address, employment information would not have been validated.

- Questionable Source of Funds – Interstate failed to properly verify the borrower's source of funds to close. We noted several questionable deposits and overdraft charges. During the bank statement period when the sales contract was executed, the borrower deposited more than $4,000, with three deposits made on consecutive days, despite a monthly salary of $2,590. Other bank statements show deposits totaling no more than $2,780. Bank statements also showed three overdraft charges and one returned check charge, which raises concerns about the borrower's financial capability.

- Credit Issue – Interstate did not properly analyze the borrower's credit performance to ensure that the borrower demonstrated financial responsibility. The credit report showed the borrower had three accounts in collection status. Thus, the borrower's poor credit was not fully considered by Interstate in its analysis of the borrower's liabilities.

- Questionable Employment and Salary – Interstate failed to verify conflicting and questionable employment and salary information provided by the borrower. The pay stub shows the employer located in Coral Gables, FL, while the loan application and verification of employment form shows the employer located in North Miami Beach, FL. The verification of employment form also indicated the borrower's annual salary of $44,507 as an accounts payable clerk. Our Internet search revealed that the average annual salary for an accounts payable clerk is $24,164.

- Excess Ratios Without Adequate Justification – Interstate did not provide valid compensating factors for exceeding the ratio. Interstate justified the excess front-end ratio by stating that: (1) the borrower has the ability for increase in earnings due to job training and (2) the borrower was a first-time homebuyer. The verification of employment form does not indicate that earnings will increase. The loan application also showed that the borrower had recently begun employment.

Interstate also did not ensure that the borrower provided the minimum required investment. We calculated the minimum required investment as $4,584, but the borrower only provided $3,935.

Case Number: 092-9091627

Interstate failed to properly verify employment, income, and asset information. Our interview with the borrower indicated that the real estate agent obtained the borrower's personal and financial data and documentation for loan approval. The borrower never met with Interstate staff and only signed documents at the time of closing.

The borrower never worked for the employer listed on the verification of employment form and pay stub. The borrower mentioned the inaccurate employment and income information to the real estate agent before closing but was told that it had to be this way for the loan to qualify. Interstate inappropriately relied on the documents provided by the real estate agent, who is an interested party to the sales transaction. Had Interstate sent a verification of employment form to the employer, the inaccurate employment and income information would have been disclosed.

In addition, the borrower indicated to us that the loan application contained inaccurate asset information. The loan application submitted to HUD valued his vehicle at $11,000 when the sales price was only $7,500. The loan application also showed that the borrower owned $8,000 in personal property when he did not.

- Questionable Source of Funds – Interstate did not ensure that the borrower demonstrated financial capability. According to a document in the loan file, the borrower claimed to have monthly savings of $742, but the bank statement does not indicate such a high balance.

- Inconsistent Data – Interstate did not resolve conflicting or inconsistent information in the loan file. The loan application showed the borrower as married, while the credit report showed he was unmarried. A letter from a utility company misspelled the borrower's name and also indicated that the borrower opened an account 8 months after starting to rent the property.

- Excess Ratios Without Adequate Justification – Interstate failed to document the basis for accepting an excess front-end ratio of 31 percent.

Interstate also did not ensure that the borrower provided the minimum required investment. We calculated the minimum required investment as $2,879, but the borrower only provided $2,475.

Case Number: 092-9106318

Interstate approved the loan based on inaccurate employment and income information. We verified with the borrower's employer that the information on the verification of employment form and pay stub are inaccurate. Though we were unable to verify income information for a co-borrower, we did confirm that the signature on the verification of employment form was also inaccurate. Interstate failed to properly verify employment and income information and, therefore, generated and submitted to HUD inaccurate employment and income data for both the borrower and co-borrower. If Interstate had sent the verification of employment form to the employers, the inaccurate information would not have been validated.

- Questionable Source of Funds – Interstate did not verify the borrower's source of funds to close. Before closing in November 15, 2002, we noted unexplained deposits totaling $4,260 when the ending bank balance 2 months earlier in September 15, 2002, was only $353.

- Credit Issues – Interstate did not properly analyze the borrower's credit. The borrower reported living in a rental property. Based on Internet searches of county records, the address is located in a restricted commercial zone. In addition, the landlord listed on the credit report does not agree with the owners listed in our search. Interstate relied on the credit report without obtaining additional documentation to support borrowers' past rental history. Therefore, we question whether the borrowers resided at the former residence, paid the rent amount listed on the loan application, and whether the borrowers can make future mortgage payments.

- Questionable Employment – Interstate failed to verify questionable employment information provided by the borrower. Internet searches of state records revealed that the signature of the borrower's employer on the Uniform Business Report does not agree with the signature on the verification of employment form. Florida records also show a different owner for the co-borrower's employment address than that stated on the credit report. Given the availability of such access to State records, Interstate should have found these discrepancies and resolved them before loan approval.

The subject property sold for $91,000, or $21,000 more than the prior sale 4 months earlier. The appraisal report noted that the seller had totally renovated the property. However, we found no documentation in the loan file to indicate that Interstate made a determination that the renovations justified the increased appraisal value.

Case Number: 092-9114133

Interstate approved the loan based on inaccurate employment and gift information. We verified with the employer that the borrower worked independently as an interpreter for his clients who, in turn, paid the borrower directly. The employer confirmed that the verification of employment form and pay stubs were inaccurate, including the signature on the verification of employment form. Interstate failed to properly verify employment information and, therefore, generated and submitted inaccurate employment data to HUD. We also verified that the gift donor was the husband and not the borrower's uncle as stated on the gift letter. If Interstate had sent a verification of employment form to the employer and contacted the gift donor, the information would not have been validated.

- Questionable Source of Funds – Interstate did not properly verify the borrower's source of funds to close. The verification of deposit form shows the borrower having three bank accounts. However, the loan file only contained the bank statement of one account.

- Credit Issues – Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility. The borrower had four credit card accounts with large balances. Two accounts had balances that exceeded the credit limits and were 30-59 days past due. Interstate also failed to obtain additional documentation to support the borrowers' past rental history. The credit report and loan application showed the borrower paid rent to a rental property. However, Internet searches revealed that the property was listed to the borrower and her husband. We question whether the borrower paid rent and has the capability and discipline to pay a monthly mortgage. Thus, the borrower's poor credit was not fully considered by Interstate in its analysis of the borrower's liabilities.

- Questionable Employment – Interstate failed to verify questionable employment information. The loan application, verification of employment form, and credit report show the borrower beginning employment in March 2000. However, according to State records, the employer was not incorporated until March 2001. Given the availability of access to State records, Interstate should have found the discrepancy and resolved it before loan approval.

- Inconsistent Data – Interstate did not reconcile basic personal information. The loan application shows the borrower having two dependents, while the credit report shows no dependents.

Case Number: 092-9242091

Interstate approved the loan based on inaccurate employment and income information. We verified with the employer that it never hired the borrower. In addition, the Internal Revenue Service Form W-2, pay stub, and verification of employment form were altered to look as if they belonged to the borrower. Interstate failed to properly verify employment and income information and, therefore, generated and submitted inaccurate employment and salary data to HUD. If Interstate had sent the verification of employment form to the employer, the information would not have been validated.

- Questionable Source of Funds – Interstate did not verify or question borrower's source of funds to close. The pay stub showed that the borrower was paid only once per month, but many additional deposits were recorded on the bank statements.

- Questionable Employment – Interstate did not exercise sound judgment in assessing the borrower's income. The initial loan application showed monthly employment income of $1,520 at one employer. The final loan application submitted to HUD showed monthly employment income of $4,273 at another employer. We believe this difference should have made a prudent person question the employment and the substantial increase in salary between the two employments.

- Inconsistent Data – Interstate did not resolve inconsistencies presented in the loan file. The borrower's signature on the Purchase Contract Addendum is not the same as the loan application, Social Security card, driver's license, etc. The gift donor also did not know the spelling of the borrower's name.

Properties sold during the prior 2 years in close proximity to the subject property were sold at a much lower price even with larger lot sizes. We found no documentation in the loan file to indicate that Interstate questioned the appraisal value or sales price, both at $100,000.

The borrower only made one payment before defaulting on the subject property. Within 2 months of purchasing the subject property, the borrower purchased another property.

Case Number: 092-9264929

Interstate approved the loan based on inaccurate employment, income, and gift information. We verified with the employer that the employment information on the pay stub and verification of employment form are inaccurate, including the signature on the verification of employment form. We also verified with the donor that the $3,100 listed on the gift letter was not actually a gift to the borrower. The donor loaned the borrower $2,000, and the remaining $1,100 was provided by the borrower for deposit into the donor's bank account to look like a gift. In addition, despite signing the gift letter as the borrower's cousin, the donor said he was just a friend. Interstate failed to properly verify employment, income, and gift information and, therefore, generated and submitted inaccurate employment, salary, and gift data to HUD. If Interstate had sent the verification of employment form to the employer and contacted the gift donor, the inaccurate information would not have been validated.

- Questionable Source of Funds – Interstate failed to properly verify the borrower's source of funds to close. The bank statement for the gift donor indicated that on the same day the $3,100 gift amount was withdrawn, there was a deposit of $3,300.

- Questionable Employment **–** Interstate failed to properly verify questionable employment information provided by the borrower. According to Internet searches, the employer's address on the loan application and verification of employment form is a residential property, and the telephone number provided is to a different address than the residential property. Given the availability of access to State records, we believe Interstate should have found these discrepancies and resolved them before loan approval.

The prior sale of the subject property was within 1 year of the current sale and the current sales price of $102,000 was $48,000 more than the prior sale. The appraisal report noted that after the prior sale, the subject property was renovated. We found no documentation in the loan file to indicate that Interstate questioned the relatively high increase in sales price.

Case Number: 092-9368468

- Questionable Source of Funds – Interstate did not properly verify the borrower's source of funds to close. There was a $1,000 transfer from a bank account, but there is no copy of the respective bank statement to support that adequate funds were available to the borrower.

- Credit Issues – Interstate did not resolve conflicting information related to the borrowers' past rental history. The loan application showed monthly rent of $700, while the credit report stated the borrowers lived with family rent-free.

- Questionable Employment – Interstate did not properly analyze whether the borrower's income was stable. The borrower had been employed a little over 1 year and employment history shows several jobs of short duration. Besides one employment for about 6 months, all other employments were for less than 2 months. As such, we question borrower's ability to maintain current employment and income levels.

The sales price of $86,414 is $4,600 more than comparable properties sold during the same period. We found no documentation in the loan file questioning the appraisal report to ensure the accuracy of the appraisal value at $87,000.

Case Number: 092-9403894

- Credit Issues **–** Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility. The borrower failed to repay a $94,000 mortgage loan. During this time, the borrower had been employed with the same employer for about 14 years. While this debt was satisfied as part of a bankruptcy judgment in September 2000 and despite the borrower's reason for the bankruptcy, we believe this poor credit history was not fully considered by Interstate in its analysis of the borrower's liabilities.

- Inconsistent Data **–** Interstate did not verify inconsistent rental payments with the borrower. We verified with the borrower that he lived with his parents and paid them $550 per month. The credit report showed the borrower paid $750 per month. The loan application also showed the borrower paid $750 per month, whereas, the estimated monthly housing expenses were $705. Since the borrower paid $550 per month and estimated monthly housing expenses increased to $705 per month, it becomes questionable whether the borrower has the financial ability to pay the increased amount.

Interstate did not ensure that the borrower provided the minimum required investment. We calculated the minimum required investment at $2,910, but the borrower only provided $2,653.

Case Number: 092-9509172

Interstate approved the loan based on inaccurate employment and income information**.** The employer informed us that he never employed the borrower. The employer also stated that the employment and salary documents (verification of employment form, pay stubs, and 2001 and 2002 Internal Revenue Service Form W-2s) are inaccurate, including the signature on the verification of employment form. Interstate failed to properly verify employment and income information and, therefore, generated and submitted inaccurate employment and salary data to HUD. If Interstate had sent the verification of employment form to the employer, the inaccurate information would not have been validated.

- Questionable Source of Funds **–** Interstate failed to provide a verification of deposit or other documentation in the loan file to support the borrower's financial ability to close and make mortgage payments.

- Credit Issue – Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility. The credit report was ordered and completed the same day as closing.

- Questionable Employment **–** Interstate failed to properly verify employment information. The employer's vice president signed the verification of employment form on June 12, 2003. Our Internet search of State records revealed that this official was president at the time the verification of employment form was signed. Given the availability of access to State records, we believe Interstate should have found the discrepancy and resolved it before loan approval.

- Excess Ratios Without Adequate Justification – Interstate did not provide any compensating factors to justify the excess ratios of 31.8 percent and 46.3 percent.

Case Number: 092-9511392

- Questionable Source of Funds – Interstate did not properly verify the borrower's source of funds to close. In reviewing the limited transaction details statement from the borrower's three bank accounts, we could not determine that employment income was deposited.

- Excess Ratios Without Adequate Justification – Interstate disregarded HUD requirements when calculating the qualifying ratios. Interstate calculated the front and back qualifying ratios on the Mortgage Credit Analysis Worksheet as 31.3 percent and 43.1 percent, respectively. Section 2 of HUD Handbook 4155.1, Rev-4, Change 1 states that the anticipated amount of income, and likelihood of its continuance, must be established to determine the borrower's capacity to repay the mortgage debt. Specifically, the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. Since the lease of the borrower's other property is on a monthly basis, there is no guarantee the monthly income from the lease will continue. There is also no rental history of the property. Therefore, the net rental income may only be considered as a compensating factor and must be adequately documented by the lender as stipulated by Section 2-7M of the Handbook. Accordingly, we disagree with Interstate for including the monthly net rental income of $241 when calculating the borrower's monthly income. Our calculation of qualifying ratios less the net rental income was 34.9 percent and 61.7 percent.

Case Number: 092-9563354

Interstate approved the loan based on inaccurate employment, income, and gift information. The employer informed us that the borrower had never worked there, and that the employer did not issue the pay stub. The employer mentioned that the borrower's husband had worked on her house. The employer also could not be certain that the signature on the verification of employment form was that of her mother-in-law (former president of the company). We also verified with the gift donor that the $1,500 provided was not a gift but a loan. The gift letter claimed the monies went to the donor's sister, but the donor and borrower are not related. The donor signed the gift letter to help the borrower get approval for the loan.

- Questionable Source of Funds **–** Interstate did not verify borrower's source of funds to close. The bank statement for the period June 6 through July 7, 2003, showed total deposits of $1,200 and an ending balance of negative $5.59. On August 5, 2003, the borrower made a deposit of $2,000 and withdrew $1,500 the following day. Other than this $2,000 deposit, the bank statement for the period July 8 through August 6, 2003, showed total deposits of $850 and an ending balance of $103.20.

  We also noted that the borrower's bank statements had recurring overdraft and non-sufficient fund charges. Most of these charges occurred 1 month before closing. The borrower had six overdraft and three non-sufficient fund charges. Interstate asked the borrower about these charges and was satisfied with the response. The borrower's reason for the charges was that funds were withdrawn from the bank account using a debit card, and the deposits that followed were untimely. This explanation raises serious questions about whether the borrower has the financial capability and discipline to manage her finances and pay the mortgage. Therefore, we believe Interstate did not exercise sound judgment when assessing this matter.

- Credit Issues **-** Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility. The credit report shows the borrower having no credit history. Other information in the loan file shows the borrower making installment payments to vendors. Interstate did not reconcile the borrower's credit report against vendor letters indicating outstanding debt. We question the accuracy of the credit report and whether the borrower may have other non-disclosed debts.

- Questionable Employment **–**Interstate failed to verify questionable employment and salary information provided by the borrower. The loan application listed the borrower's annual salary as an administrative assistant at $42,000. However, our Internet searches revealed that the average annual salary for such a position for that area was $30,315.

Interstate did not ensure that the borrower provided the minimum required investment. We calculated the minimum required investment at $4,277, but the borrower only provided $3,415.

Case Number: 092-9584181

Interstate approved the loan based on inaccurate employment and income information. We verified with the employer that the Internal Revenue Service Form W-2s and pay stub are inaccurate, and the employer's signature on the verification of employment form was also inaccurate. Interstate failed to properly verify employment and income information and, therefore, generated and submitted inaccurate employment and salary data to HUD. If Interstate had sent the verification of employment form to the employer, the inaccurate information would not have been validated.

- Credit Issue **–** Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial capability and responsibility. The credit reports do not show any credit history. There were two reference letters from creditors in the loan file that used the same fonts. We believe that Interstate should have contacted the creditors to verify the authenticity of the letters.

- Questionable Employment – Interstate failed to verify questionable employment information provided by the borrower in the loan application. The name of the employer, address, and phone number are not listed in the Internet telephone directories. Internet searches of State records revealed that the employer is not incorporated or registered in Florida, and the Federal Employment Identification number (on the Internal Revenue Service Form W-2 in the loan file) does not exist in Florida. Given the availability of access to the Internet and State records, Interstate should have found the discrepancy and resolved it before loan approval.

The sales price of $176,000 was an increase of $46,000 from the prior sale about 2 years earlier. We did not find documentation in the loan file that Interstate questioned the accuracy of the $176,000 appraisal value.

The borrower appears to have used another Social Security number to obtain the loan and purchase the property.

Case Number: 092-9604022

- Questionable Source of Funds - Interstate did not ensure that the borrower demonstrated financial capability to pay the mortgage debt. The borrower's mother provided all funds to close. The borrower's bank statements show less than a $700 monthly ending balance. At the time of the loan application, the borrower lived with her parents and paid no rent. The loan application estimated the borrower's monthly housing expense at $757.

- Credit Issue **–** Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial responsibility. Both credit reports indicate that the borrower has "serious delinquency and derogatory public record or collection filed."

- Questionable Employment – Interstate failed to verify questionable employment information provided by the borrower. The bank statements only show deposits from the first employer. There is no indication of deposits from the second employer.

- Inconsistent Data – Interstate failed to clarify important file discrepancies. The borrower certified in a letter that all bills had been paid in a timely manner for the past 3 years; however, this conflicts with the credit report, which indicates problems with borrower's credit. The borrower's signature on the gift letter does not agree with other documents in the loan file such as the loan application, Social Security card, driver's license, etc. The initial loan application indicated the borrower had worked for a second employer for 2 years, which would have her beginning employment in October 2001; however, the final loan application submitted to HUD indicated the borrower began employment in November 2000. The initial loan application indicated that the borrower did not intend to occupy the property as her primary residence; however, the final loan application submitted to HUD indicated otherwise.

Case Number: 092-9615614

Interstate approved the loan based on inaccurate gift information**.** We verified with the donor that the gift was actually provided by the seller. The seller deposited the funds into the donor's bank account and then had the donor obtain a cashier's check payable to the borrower. This was intended to have the gift appear to be from the donor. Interstate failed to properly verify gift information and, therefore, submitted inaccurate gift data to HUD. If Interstate had contacted the gift donor, the inaccurate information would not have been validated.

- Questionable Source of Funds **-** Interstate did not ensure the continuity and stability of the borrower's source of funds or considered the probability of the borrower's continued employment. The verification of employment form states that the probability of continued employment is based on the company's needs. In addition, the verification of employment form shows the borrower employed from October 30, 1997, to January 2, 1998, and rehired August 27, 1998, to August 25, 1999.

- Credit Issues **–** Interstate did not properly analyze the borrower's credit to ensure that the borrower demonstrated financial responsibility. We verified with the borrower that the seller paid three collection accounts. The seller also prepared a justification letter for the collection accounts that the borrower signed at closing. The borrower informed us that the justification stated in the letter was incorrect.

- Inconsistent Data **–** Interstate failed to clarify important file discrepancies. The credit report shows the borrower has five dependents, while the loan application shows zero dependents. The loan application shows $3,000 held in deposit, the Mortgage Credit Analysis Worksheet shows $3,000 as a gift from a cousin, and the gift letter shows the gift from the borrower's father.

- Excess Ratios Without Adequate Justification **–** Interstate exceeded HUD's allowable limits without compensating factors. Interstate calculated both qualifying ratios at 33.5 percent. We recalculated the front- and back-end qualifying ratios at 28 percent and 49 percent, respectively. Interstate did not separate monthly overtime and bonuses in calculating total monthly income (HUD Handbook 4155.1, Rev-4, section 2-7A). Interstate used $3,279 for total monthly income, while we used $3,930.92. Interstate also calculated the total monthly fixed payment as $1,100 while we calculated this payment at $1,921. It failed to consider monthly liabilities of $821 in its calculation. There were no compensating factors for approving the loan at the higher ratios.

- Property Resale – Interstate disregarded Mortgagee Letter 2003-07 when approving this loan. The letter states that any resale of a property may not occur 90 or fewer days from the last sale to be eligible for Federal Housing Administration financing. The seller purchased the subject property on August 27, 2003, and resold it to the borrower on October 15, 2003, (49 days later).

The property was appraised and sold for $125,000, which is an increase of $52,000 from the prior sale. The appraisal report appeared to be missing some basic data. We found no documentation in the loan file to indicate that Interstate questioned the accuracy of the appraised value.

Case Number: 095-0034417

- Property Resale – Interstate should not have approved this loan based on Mortgagee Letter 2003-07. The letter states that any resale of a property may not occur 90 or fewer days from the last sale to be eligible for Federal Housing Administration financing. Interstate's loan file indicated that the seller purchased the subject property in February 2004 and resold it to the borrower on March 29, 2004.

  Interstate also appears to have improperly entered this transaction into HUD's Computerized Homes Underwriting Management System. Interstate's loan file indicated that the seller purchased the subject property in February 2004 and resold it to the borrower on March 29, 2004. However, Interstate entered January 1, 2004, and May 26, 2004, into the HUD system for this transaction. The erroneous dates entered into HUD's system would have prevented HUD from identifying the loan as ineligible for Federal Housing Administration financing.

Appendix D

SUMMARY OF LOAN DEFICIENCIES

	Questionable Source of Funds	Credit Issues	Questionable Employment Data	Inconsistent Data	Excess Ratios w/o Adequate Justification	Property Resale	Finding 1 Recommendation
092-9017524	x	x	x		x		1A
092-9091627	x			x	x		1A
092-9106318	x	x	x				
092-9114133	x	x	x	x			1A
092-9242091	x		x	x			1C
092-9264929	x		x				1B
092-9368468	x	x	x				1A
092-9403894		x		x			1A
092-9509172	x	x	x		x		1A
092-9511392	x				x		1A
092-9563354	x	x	x				1A
092-9584181		x	x				
092-9604022	x	x	x	x			
092-9615614	x	x		x	x	x	1A
095-0034417						x	1A
	12	10	10	6	5	2	