



Issue Date	September 16, 2005
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Audit Report Number	2005-FW-1016
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TO: Brian D. Montgomery
Assistant Secretary for Housing – Federal Housing Commissioner, H

FROM: Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: Aegis Wholesale Corporation Did Not Follow HUD Requirements When
Processing a Federal Housing Administration Loan

HIGHLIGHTS

What We Audited and Why

We reviewed a Federal Housing Administration loan sponsored by Aegis Wholesale Corporation (Aegis) of Houston, Texas. During an audit of a Federal Housing Administration-approved loan correspondent, we identified a loan sponsored by Aegis that was not properly originated according to U.S. Department of Housing and Urban Development (HUD) regulations. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed these deficiencies to Aegis to determine whether it complied with HUD requirements.

What We Found

Aegis did not comply with HUD regulations, procedures, and instructions in the processing of a Federal Housing Administration-insured single-family mortgage. The lender did not adequately support the borrower's income, the borrower's creditworthiness or the legitimacy of the appraised value of the property. The lender also charged the borrower \$581 in loan discount points without reducing

the borrower's interest rate. As a result, HUD insured a loan that placed the insurance fund at risk for \$58,088 and the borrower incurred excessive costs for the loan.

What We Recommend

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner take appropriate administrative action against Aegis. This action, at a minimum, should include requiring indemnification for the \$58,088 loan and reimbursement of the \$581 in unearned fees to the appropriate parties

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

On September 7, 2005, Aegis provided its formal written response to our report. Aegis agreed to a principal reduction of \$581 for the unearned discount points. It also acknowledged deficiencies with the calculation of the borrower's income and the appraisal, but argued that the borrower was sufficiently qualified and the appraised value adequately supported. The complete text of Aegis's formal and initial response can be found in Appendix B of this report. We omitted the attachments for conciseness and due to Privacy Act concerns.

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BACKGROUND AND OBJECTIVES

Aegis Wholesale Corporation (Aegis) is a nonsupervised lender that began originating Federal Housing Administration loans in 1951.

During the audit of a loan correspondent, we identified one Federal Housing Administration loan sponsored by Aegis that was not originated according to U.S. Department of Housing and Urban Development (HUD) requirements. To resolve the deficiencies, we performed a review of Aegis's underwriting of the loan.

Our objective was to determine whether Aegis complied with HUD regulations, procedures, and instructions when processing the Federal Housing Administration mortgage that it sponsored for a loan correspondent.

RESULTS OF AUDIT

Finding: Aegis Wholesale Corporation Did Not Follow HUD Requirements when Processing a Federal Housing Administration Loan

Aegis did not comply with HUD regulations, procedures, and instructions in the processing of a Federal Housing Administration-insured single-family mortgage. The lender did not adequately support the borrower's income, the borrower's creditworthiness, or the legitimacy of the appraised value of the property. The lender also charged the borrower \$581 in loan discount points without reducing the borrower's interest rate. As a result, HUD insured a loan that placed the insurance fund at risk for \$58,088 and the borrower incurred excessive costs for the loan.

Aegis Did Not Follow HUD Requirements

Aegis overstated the borrower's income and did not show that it was stable. The lender calculated the borrower's income based upon the borrower working a 40-hour workweek. However, pay stubs on file showed the borrower often worked less than 40 hours a week. Further, the borrower changed employment six times in the two years prior to his loan application. The borrower did not stay in the same line of work nor did his income increase with every job change. At the time of application, the borrower had only been with his current employer for six months. HUD regulations state that lenders may not use income in evaluating a borrower's loan that it cannot verify, is not stable, or will not continue.

In addition, Aegis did not make certain all derogatory credit was explained and considered in qualifying the borrower. The borrower had multiple late payments on two separate auto loans. HUD regulations state that lenders must determine whether late payments were due to a disregard for financial obligations, mismanagement of financial obligations, or factors beyond the borrower's control.

Further, Aegis did not ensure the appraisal met HUD standards. In determining the appraised value, the appraiser did not analyze the subject sales contract or list price, adjust the comparables for sales concessions, or include any conventional loans for comparables. As a result, Aegis cannot be certain of the accuracy of the appraised value.

Finally, Aegis allowed the loan correspondent to charge the borrower \$581 in loan discount points, without reducing the borrower's interest rate. The loan

correspondent could not provide documentation to show that the borrower received anything of value for the discount points charged. The Real Estate Procedures Act prohibits giving or accepting any part of a charge for services not performed.

The substantial underwriting deficiencies on this loan unnecessarily place the insurance fund at risk. Further, the unearned fees unfairly imposed costs on the borrower without providing a benefit in return. Aegis should indemnify HUD for the \$58,088 mortgage and repay the appropriate parties for the \$581 in unearned discount points.

Recommendation

We recommend the Assistant Secretary for Housing-Federal Housing Commissioner and Chairman, Mortgage Review Board:

- 1A. Take appropriate administrative action against Aegis Wholesale for not complying with HUD requirements. This should include, at a minimum, requiring Aegis to indemnify HUD for case number 491-7971398, which had an original mortgage amount of \$58,088. HUD should also require reimbursement of the \$581 in unearned fees to the appropriate parties.

SCOPE AND METHODOLOGY

We reviewed Aegis's processing of one Federal Housing Administration loan that it sponsored for a Federal Housing Administration-approved loan correspondent. During our audit of that loan correspondent, we reviewed loans closed from July 1, 2002, through June 30, 2004, that defaulted within the first three years of closing. We identified a loan, sponsored by Aegis, which appeared to be improperly underwritten. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed the deficiencies to Aegis.

To accomplish our objective, we prepare a case narrative of the loan processing deficiencies identified and provided the information to Aegis. We allowed Aegis an opportunity to provide additional information that could affect the initial results of our review of the loans. Aegis provided a written response. We evaluated the response when reaching our conclusions.

In conducting our audit, we used computer-processed data contained in HUD's Neighborhood Watch system. However, we did not rely on the data to accomplish our audit objective. Accordingly, we did not assess the reliability of the data in the system.

We did not assess Aegis's underwriting controls because they were not significant to our objective of reviewing the loan.

We performed the work from May through July 2005. The audit was conducted in accordance with generally accepted government auditing standards.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

Recommendation Number	Ineligible <u>1/</u>	Funds Put to Better Use <u>2/</u>
1A	\$581	\$58,088

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

2/ “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, deobligation 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



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Suite 400
Houston, TX 77042
713-458-6634
Fax: 713-458-6795

September 7, 2005

Department of Housing and Urban Development
Region VI, Office of Inspector General
819 Taylor Street, Room 13A09
Fort Worth, TX 76102

ATTN: Laura Nixon, Senior Auditor

RE: [REDACTED]

Dear Laura;

I have attached the prior FED EX receipt dated June 27th, 2005 in which I initially responded to the May 13, 2005 audit on our loan correspondent Allied Home Mortgage. On June 1/05 I received the extension to 7/01/05.

The following clarifications and supportive documents were sent for HUD review and considerations.

The payment history from the investor was provided evidencing the principal reduction of \$581 in unearned fees. I reviewed the HUD-1 and the GFE and think I followed the thought process on the borrower being charged a discount point which was not disclosed on the GFE which was at the same interest rate the loan closed while the broker received YSP back.

Addressing the issue of **"Income being Over-stated or Un-supported"**.

Borrower has 2+ years verified income. Two year W-2's for 2002/2001 support \$1199/monthly. Thirty month average \$1280. Average hours based on 6-month review of pay stub supports \$1482/monthly income. Borrower provided letter of explanation for job changes. His employment type would be considered laborer paid hourly and he is employable.

1

Comment 1

Comment 2

Comment 3

Comment 4



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Comment 5

The file was a manual underwrite due to the fact that the borrower had no credit scores. Therefore non-traditional credit was provided on the credit report provided by Allied which included:

1. Satisfactory rental history for the borrower with rent at \$500.00/month.
2. No substantial increase or payment shock on housing expense.
3. Satisfactory installment payment history on car loan.
4. Satisfactory payment history from Allstate Insurance.
5. Borrower completed a received Certificate for Homebuyer Education.
Ability for more expendable income from overtime paid at time and a half as reflected on pay stubs.

In general, cash on hand, is common for Hispanic borrowers as a means of saving and a budget letter was provided evidencing the ability to accumulate and save monies at home.

In regards to the appraisal concerns. This appraisal report was done no 4/14/2003 by Shantele Weatherby. It is not possible to obtain additional comments and/or value support from the appraiser who did this appraisal in 2003.

I ask that consideration be given to the following:

Comment 1

Attached is a current Hansen Quality Collateral Risk Assessment reflecting very low risk for value. In-fact the median value as reflected on page two (2) of the report supports \$65,000 and ten (10) area sales.

Comment 6

On the appraisal report dated 4/14/03 the neighborhood data on the report itself indicates an urban area built up over 75% (people stay/homestead); the effective age is 10 years versus actual age of 49 which would indicate well maintained and the property sold under estimated market value; the appraiser stated all sales sold with typical financing with no unusual seller concession noted (discount points ranged from 1 to 4 varying from lender to lender) and the MLS was researched and revealed approximately 8-10 comparable sales considered in the evaluation of the report with the 3 used representing the most comparable properties available. All sales were located within the marketing area of the subject and similar in quality of construction and appeal. All the comparables used reflect minimal gross/net adjustments to the sales prices.



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Comment 7

While I agree that the appraisal issues should have been addressed and questioned by the underwriter at that time the loan was reviewed the overall, current market value is well supported.

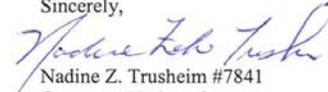
Based on the above information, I respectfully request your considerations and favorable review.

Appropriate actions have been taken in notifying Aegis Wholesale underwriters and branch operation management of the seriousness of these issues in an attempt to provided HUD with corrective actions.

Aegis Mortgage is committed in generating FHA mortgages within the guidelines established by HUD. FHA loans are and will continue to be part of our business operations and will take the authority given to us seriously.

If you have any question, please contact me at 1.800.991-5625 ext 3347 or email Nadine.Zeh@aegismtg.com. Thank you for your patience in allowing me to evaluate our file and prepare this response.

Sincerely,


Nadine Z. Trusheim #7841
Corporate Underwriter



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June 27, 2005

Department of Housing and Urban Development
Region VI, Office of Inspector General
819 Taylor Street, Room 13A09
Fort Worth, TX 76102

ATTN: Laura Nixon, Senior Auditor

RE: 

Dear Laura;

Appreciated allowing me additional time to review and gather documentation on this case. I offer the following clarifications and supportive documents for your review and considerations.

The payment history from the investor is provided evidencing the principal reduction of \$581 in unearned fees. I reviewed the HUD-1 and the GFE and think I followed the thought process on the borrower being charged a discount point which was not disclosed on the GFE which was at the same interest rate the loan closed while the broker received YSP back.

Addressing the issue outlined in HUD's letter on "not underwritten according to HUD requirements, I will address the reasoning on the underwriters approval as noted on the MCAW.

The file was a manual underwrite due to the fact that the borrower had no credit scores. Therefore non-traditional credit was provided on the credit report provided by Allied which included:

1. Satisfactory rental history for the borrower with rent at \$500.00/month.
2. No substantial increase or payment shock on housing expense.
3. Satisfactory installment payment history on car loan.
4. Satisfactory payment history from Allstate Insurance.
5. Borrower completed a received Certificate for Homebuyer Education.

Comment 2

Comment 5



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Comment 4

The borrower is a laborer and has history of being employable. The file contains a letter of explanation on his work history and wanting to pursue the opportunity for home ownership.

In general, cash on hand, is common for Hispanic borrowers as a means of saving and a budget letter was provided evidencing the ability to accumulate and save monies at home.

I have obtained a reviewed the payment history on the borrower and the loan history reflect he is current as of 5/01/05 payment. The borrower has had difficulty with meeting his mortgage obligation but has continually managed to bring payments current. The value of homeownership and keeping his home is supported with his successful achievement of keeping his home.

In regards to the appraisal concerns. This appraisal report was done no 4/14/2003 by Shantele Weatherby. Cooperation is a very big issue and the lack of locating the report is another issue. As a DE Underwriter myself, I can offer consideration be considered to this information: (1) lack of cooperation from the appraiser; (2) neighborhood data on the report itself indicates an urban area built up over 75% (people stay/homestead); the effective age is 10 years versus actual age of 49 which would indicate well maintained and the property sold under estimated market value; the appraiser stated all sales sold with typical financing with no unusual seller concession noted (discount points ranged from 1 to 4 varying from lender to lender) and the MLS was researched and revealed approximately 8-10 comparable sales considered in the evaluation of the report with the 3 used representing the most comparable properties available. All sales were located within the marketing area of the subject and similar in quality of construction and appeal. All the comparables used reflect minimal gross/net adjustments to the sales prices.

Comment 6

Comment 7

The appraisal issues should have been addressed and questioned by the underwriter at that time but they do not show a deviation from of arriving at a value that is supported in the market. The final reconciliation of valuing this residential property used the most relevant method for valuing any residential property, the sales comparison being the most relevant supports \$60,000, and the cost approach. Also, noted is the price/gross living area is well within market.

Based on the above information, I respectfully request your considerations and favorable review.

Appropriate actions have been taken in notifying Aegis Wholesale underwriters and branch operation management of the seriousness of these issues in an attempt to provided HUD with corrective actions.

Aegis Mortgage is committed in generating FHA mortgages within the guidelines established by HUD. FHA loans are and will continue to be part of our business operations and will take the authority given to us seriously.

If you have any question, please contact me at 1.800.991-5625 ext 3347 or email Nadine.Trusheim@aegismtg.com. Thank you for your patience in allowing me to evaluate our file and prepare this response.

Sincerely,



Nadine Z. Trusheim #7841
Corporate Underwriter

OIG Evaluation of Auditee Comments

- Comment 1** We omitted the attachments for conciseness and due to Privacy Act concerns. We also blocked out information in their response due to Privacy Act concerns.
- Comment 2** Aegis agreed to a principal reduction of \$581 for the unearned discount points.
- Comment 3** Aegis' response indicated they confirmed two-plus years of income and computed the average income to be \$1,482 based on pay stubs. We computed the borrower's average pay based on pay stubs to be \$1,485. However, Aegis used income of \$1,560 to qualify the borrower for the loan. Thus, Aegis' response supports our calculation of income and contention that the borrower's income was overstated in the loan file.
- Comment 4** Aegis did not verify that the borrower's income was stable. In their response, Aegis asserts the borrower is employable and provided a letter explaining his job changes. Yet, the file shows the borrower changed employment six times in the two years before his loan application. The borrower's written explanation for the job changes was that he was looking for a better paying job. However, two of his job changes in 2002 resulted in substantial decreases in income. The borrower's total income for all of 2002 was only \$11,610 or \$967 a month.
- Comment 5** Aegis' response that the borrower had a satisfactory installment payment history on the car loan is not supported by the information in the file. Per payment history reports in the file, the borrower had two auto loans. The borrower paid late fees 11 times on the first account and 12 times on the second account.
- Comment 6** Aegis agreed the appraisal issues should have been addressed, but disagreed that the issues affected the appraised value of the property. The appraised value could be affected because the appraiser did not adjust the sales prices of the comparable properties for sales concessions.
- Comment 7** Again, Aegis agreed the appraisal issues should have been addressed, but disagreed that the issues affected the appraised value of the property. In determining the appraised value, the appraiser did not analyze the subject sales contract or list price, adjust the comparables for sales concessions or include any conventional loans for comparables. Accordingly, the accuracy of the appraised value is not supported.

Appendix C

CASE STUDY OF IMPROPERLY ORIGINATED LOAN

Case Number: 491-7971398

Mortgage Amount: \$58,088

Gift Amount: \$0

Date of Loan Closing: July 28, 2003

Status as of 03/31/2005: Reinstated by the mortgagor who retains ownership

Payments before First Default Reported: 1

Summary:

Income Overstated or Unsupported

Aegis overstated the borrower's monthly income by \$140. Aegis calculated the borrower's income based on a 40-hour workweek. However, based on a review of the six pay stubs on file, the borrower only worked an average of 38 hours a week. The borrower worked some overtime hours; however, HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-7(A) does not allow this income to be counted since the borrower does not have a two-year history of receiving the income.

Income Stability Not Verified

Aegis did not verify that the borrower's income was stable or could be expected to continue for at least the first three years of the mortgage. The borrower changed employment six times in the two years before his loan application. The borrower did not stay in the same line of work nor did his income always increase with each job change. After only working for one employer for three months, the borrower took another job, at which his monthly pay dropped approximately \$540 per month. For a four-month period, the borrower claimed to have worked for his uncle's business without receiving compensation. In the verbal verification of employment with the borrower's current employer, the loan correspondent did not obtain a response regarding the probability of continued employment. HUD Handbook 4155.1, REV-4, CHG 1, Section 2 states, "The anticipated amount of income, and likelihood of its continuance, must be established to determine the borrower's capacity to repay the mortgage debt. Income from any source that cannot be verified, is not stable, or will not continue may not be used in calculating the borrower's income ratios."

Creditworthiness Not Fully Considered/Inconsistencies Not Resolved

Aegis did not ensure all derogatory credit was explained and considered in qualifying the borrower. The credit report shows two closed accounts with an automobile dealership. The credit report showed and the manager of the dealership confirmed that the borrower always made his payments on time. However, payment history reports included in the file show that the borrower paid late fees 11 times on the first account and 12 times on the second account. Aegis did not resolve these inconsistencies. HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3, requires lenders to determine whether late payments were due to a disregard for financial obligations, mismanagement of financial obligations or factors beyond the borrower's control.

Appraisal Adjustments for Sales Concessions on Comparables Not Made

The appraiser did not adjust the sales prices of the comparable properties for sales concessions. Two of the comparable properties sold with sales concessions. HUD Handbook 4150.2, Paragraph 4-6(B), requires appraisers to report and analyze the sales concessions on comparable properties and adjust their sales prices as necessary in determining the appraised value.

Appraisal Did Not Include an Analysis of the Subject Sales Contract or List Price

The appraiser did not analyze the subject sales contract or property listing. The sales contract showed the seller agreed to pay \$2,800 in borrower closing costs and other expenses. HUD Handbook 4150.2, Paragraph 4.0 requires strict compliance with Uniform Standards of Professional Appraisal Practice (USPAP). USPAP Standards Rule 1-5(a) requires the appraiser to analyze all agreements of sale, options, or listings of the subject property in determining a property's appraised value. Standards Rules 2-2(a)(ix) states that if the information is unobtainable, the appraiser must provide a statement on efforts made to obtain the information.

Appraisal Did Not Include Any Conventional Loans for Comparables

The appraiser only used comparables financed through the Federal Housing Administration. HUD Handbook 4150.1, REV-1, Paragraph 6-10(B) requires appraisers to obtain at least one conventional loan, if available. The appraiser did not indicate that a conventional comparable was not available.

Ineligible Closing Cost Charged to Borrower

Aegis allowed the loan correspondent to charge \$581 in loan discount points without reducing the borrower's interest rate. Rather than reducing the interest rate, the loan correspondent charged the borrower an above-market interest rate resulting in a yield spread premium of \$1,380. The loan correspondent did not provide any documentation to show the borrower received anything of value for the discount points charged. HUD allows lenders who originate FHA-insured loans to charge borrowers a one-percent loan origination fee and eligible closing and prepaid costs; however, additional fees should be for specific services performed beyond the normal loan processing and underwriting. Section 8 of the Real Estate Settlement Procedures Act prohibits giving or accepting any part of a charge for services not performed. Since the loan

correspondent charged loan discount points without reducing the interest rate, the discount points were unearned fees in violation of the Real Estate Settlement Procedures Act.