



Issue Date	September 22, 2005
Audit Report Number	2005-FW-1017

TO: Brian D. Montgomery  
Assistant Secretary for Housing – Federal Housing Commissioner, H

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

SUBJECT: Allied Home Mortgage Corporation Did Not Follow HUD Requirements When Processing Four Loans

## **HIGHLIGHTS**

### **What We Audited and Why**

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

### **What We Found**

Allied did not comply with HUD regulations, procedures, and instructions in the processing of four Federal Housing Administration-insured single-family mortgages. Allied overstated the borrower's income for two loans and understated the borrower's liabilities for one loan. For all four loans, Allied did not ensure that the appraisal met HUD requirements. In addition, Allied allowed

the loan correspondent to charge three borrowers a total of \$1,919 in loan discount points without reducing their interest rates. As a result, the risk to the insurance fund was increased, and three borrowers incurred excessive costs for their loans.

### **What We Recommend**

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner take appropriate administrative action against Allied for not complying with HUD requirements. At a minimum, this should include indemnifying HUD \$123,028 for one of the loans and reimbursement of the \$1,919 in unearned fees. We further recommend that Allied be required to take action to improve the quality of its appraisals.

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 2, 2005, Allied provided a written response to our report. Allied disagreed with nearly all of our report findings. The complete text of Allied's response can be found in Appendix B of this report.

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## **BACKGROUND AND OBJECTIVES**

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Allied Home Mortgage Corporation (Allied) is a nonsupervised lender that began originating Federal Housing Administration loans in 1991.

During an audit of a Federal Housing Administration-approved loan correspondent,<sup>1</sup> we identified four loans sponsored by Allied that did not appear to be properly originated according to U.S. Department of Housing and Urban Development (HUD) regulations. To resolve the deficiencies, we performed a review of Allied's underwriting of these loans.

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

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<sup>1</sup> Report number 2005-FW-1009, Allied Home Mortgage Capital Corporation, Nonsupervised Loan Correspondent, Houston, TX, issued May 24, 2005.

## RESULTS OF AUDIT

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### Finding: Allied Did Not Follow HUD Requirements When Processing Four Loans

Allied did not comply with HUD regulations, procedures, and instructions in the processing of four Federal Housing Administration-insured single-family mortgages. Allied overstated the borrower's income for two loans and understated the borrower's liabilities in one loan. For all four loans, Allied did not ensure that the appraisal met HUD requirements. In addition, Allied allowed the loan correspondent to charge three borrowers a total of \$1,919 in loan discount points without reducing their interest rates. As a result, the risk to the insurance fund was increased, and three borrowers incurred excessive costs for their loans.

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#### Allied Did Not Follow HUD Requirements

Allied did not follow HUD requirements for the four loans we reviewed. The following paragraphs summarize the deficiencies with the loans. For more detailed information, see Appendix C.

#### **Case Number 491-7796924**

Allied did not verify sufficient income for the borrower to qualify for the loan. Allied improperly included child support income of \$518 per month without obtaining evidence the borrower was receiving the child support. Without the child support income, the borrower did not qualify for the loan.

In addition, Allied did not ensure the appraisal met HUD standards. In determining the appraised value, the appraiser did not analyze the subject sales contract or adjust the comparables for sales concessions. As a result, Allied cannot be certain of the accuracy of the appraised value.

#### **Case Number 491-7795964**

Allied overstated the borrower's monthly income by \$471 and understated the borrower's liabilities by \$117. Allied calculated the borrower's income based on a 40-hour workweek even though the borrower's pay stubs showed he only worked an average of 31.40 hours per week. Also, Allied incorrectly recorded the borrower's liabilities in the automated underwriting system.

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

**Case Number 492-6708865**

Allied 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. As a result, Allied cannot be certain of the accuracy of the appraised value.

**Case Number 492-6810853**

Allied accepted an appraisal with numerous violations of HUD requirements. The appraiser used comparables that were more than six months old without explanation and overstated the sales price of one comparable by more than \$10,000. In addition, the appraiser did not provide explanations for not making adjustments based on differences in lot size and the stated inferior condition of one comparable. The appraiser also provided inconsistent information regarding the condition of the subject property and failed to provide an analysis of the subject sales contract or list price. As a result, Allied cannot be certain of the accuracy of the appraised value.

**Unallowable Fees Charged to Borrowers**

For three of the four loans we reviewed, Allied allowed the loan correspondent to charge the borrowers a total of \$1,919 in loan discount points without reducing the borrowers' interest rates. Instead, the loan correspondent charged the borrowers above-market interest rates. The loan correspondent received compensation in the form of yield spread premiums for the above-market interest rates. HUD believes yield spread premiums can be a legitimate tool to reduce borrowers' closing costs through a higher interest rate. However, the loan correspondent could not provide documentation to show that the borrowers 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.

<b>Case number</b>	<b>Discount points charged</b>	<b>Yield spread premium</b>
491-7796924	\$ 320	\$ 3,575
492-6708865	669	752
492-6810853	930	1,105
<b>Total</b>	<b>\$ 1,919</b>	<b>\$5,432</b>

## **Conclusion**

The underwriting deficiencies on these loans unnecessarily place the insurance fund at risk. Further, the unearned fees unfairly imposed costs on the borrowers without providing a benefit in return. Allied should indemnify HUD \$123,028 for case number 491-7796924 and repay the appropriate parties for the \$1,919 in unearned discount points. In addition, Allied should take steps to ensure appraisals fully support the stated appraised value.

## **Recommendations**

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

- 1A. Take appropriate administrative action against Allied for not complying with HUD requirements. At a minimum, this should include indemnifying HUD \$123,028 for case number 491-7796924.
- 1B. Require Allied to reimburse the appropriate parties for \$1,919 in unearned fees.
- 1C. Require Allied to take steps to improve the quality of its appraisals.

## SCOPE AND METHODOLOGY

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We reviewed Allied's processing of four Federal Housing Administration loans 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 four loans, sponsored by Allied, which appeared to be improperly underwritten. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed the deficiencies to Allied.

To accomplish our objective, we prepared case narratives of loan processing deficiencies identified and provided the information to Allied. We allowed Allied an opportunity to provide additional information that could resolve the deficiencies identified. Allied provided a written response, which we evaluated in 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 Allied's underwriting controls because they were not significant to our objective of reviewing these four loans.

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

## APPENDIXES

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### Appendix A

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

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<b>Recommendation number</b>	<b>Ineligible <u>1/</u></b>	<b>Funds to be Put to Better Use <u>2/</u></b>
1A		\$123,028
1B	\$1,919	

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

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### Ref to OIG Evaluation

### Auditee Comments



6110 Pinemont Drive • Houston, TX 77092

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September 2, 2005

#### **BY OVERNIGHT MAIL**

Mr. Frank E. Baca  
Regional Inspector General For Audit  
U.S. Department of Housing and Urban Development  
Region VI, Office of Inspector General  
819 Taylor Street, Room 13A09  
Fort Worth, Texas 76102

Re: Allied Home Mortgage Corporation  
August 11, 2005

Dear Mr. Baca:

This letter provides the formal comments of Allied Home Mortgage Corporation ("AHMC" or the "Company") regarding the Office of Inspector General ("OIG") letter dated August 11, 2005. The letter was issued to AHMC in connection with an OIG audit of Allied Home Mortgage Capital Corporation, a HUD-FHA approved loan correspondent for which AHMC is the sponsor. The letter reviews the practices of AHMC regarding HUD-FHA insured mortgages that were underwritten by AHMC.

We appreciate this opportunity to provide you with our comments. Respectfully, however, AHMC disagrees with the OIG's conclusions and believes that many of the alleged findings are not supported or represent a misunderstanding of the facts. AHMC has always been committed to complying fully with HUD-FHA requirements and originating quality HUD-FHA insured mortgages.

We address below each of the findings cited in your letter.

**Comment 1**

**Case Number 491-7796924:**

**Income Overstated or Unsupported:**

A review of the file by AHMC with respect to this loan discloses that AHMC properly obtained copies of documents evidencing a court order for child support payments. As a matter of policy and practice, AHMC always obtains evidence in accordance with HUD-FHA guidelines that such payments have been received by the borrower over the prior 12 months. We are unable to determine with certainty the reason why this documentation was missing from the loan file. AHMC respectfully submits, however, that notwithstanding the absence of documentation regarding a 12-month payment history, there is no specific finding made by the OIG that such payments were not in fact received by the borrower.

**Borrower Ineligible for Federal Housing Administration Financing:**

Please see above.

**Appraisal Adjustments for Sales concessions on Comparables not Made:**

AHMC respectfully submits that until the issuance of Mortgagee Letter 2005-02, dated January 4, 2005, HUD-FHA did not provide lenders and appraisers with clear instructions regarding their responsibilities with respect to financing concessions in connection with the appraisal process.

HUD Handbook 4150.1 Rev-1, Valuation Analysis for Home Mortgage Insurance, Chapter 8, Uniform Residential Appraisal Report (2/90), 8-3 states:

“Financing concessions for the subject and the market area should be explained. Be sure to explain whether the subject is consistent with the market area or different.”

**Comment 2**

### Comment 3

This broad language does not provide specific instructions to lenders with respect to identifying and addressing financing concessions or does it require any detailed information to be provided by the appraiser.

Mortgagee Letter 2005-2 clarifies HUD-FHA policy and provides detailed instructions to lenders and appraisers with respect to financing concessions. Importantly, the loan was underwritten in 2002, three years prior to the time that HUD-FHA clarified its policy regarding financing concessions.

Further, HUD Handbook 4155.1 Rev-5, Chapter 1, section 2 (1-7A), and previously Handbook 4155.1 Rev-4, Chapter 1, section 2 (1-7C) states that contributions from sellers or other interested third parties to the transaction that exceed six (6) percent of the sales price or other financing concessions are to be treated as inducements to purchase, thereby reducing the amount of the mortgage. Each dollar exceeding the six percent limit must be subtracted from the property's sales price before applying the appropriate loan to value (LTV) ratio.

The AHMC underwriter that approved the loan and reviewed the appraisal reasonably assumed that "no unusual concession listed" meant that the concessions fell below the six percent requirement. This underwriter is no longer an AHMC employee. All current AHMC underwriters have been thoroughly trained to insure that appraisers reflect the complete information regarding all sales concessions in accordance with the clarification in Mortgagee Letter 2005-02.

### Comment 4

Further, and significantly, the OIG in this finding does not: (1) state an opinion as to a valuation different than the one set forth in the appraisal report; (2) indicate that any of the comparable sales are inaccurately reported or that such sales are not a fair measure of the subject property's valuation; or (3) offer an appraisal at variance with the appraisal for this property.

AHMC respectfully submits that this finding should be dismissed.

## Comment 5

### Appraisal Did Not Include an Analysis of the Subject Sales Contract:

Until the issuance of Mortgagee Letter 2005-02, and well after the approval of the loan, HUD/FHA did not provide specific instructions to lenders and appraisers regarding required appraiser comments on the analysis of the sales contract. The appraisal for the subject property does not reflect any appraiser comments regarding the analysis of the subject sales contract. The AHMC underwriter reasonably assumed that the appraiser found the contract acceptable and no market-based adjustments to comparable sales were required.

AHMC respectfully submits that this finding should be dismissed.

### Ineligible Closing Costs Charged to Borrower:

AHMC respectfully disagrees with the OIG's alleged finding that AHMC charged ineligible closing costs (discount points) to the borrower.

AHMC respectfully submits that HUD does not regulate the interest rate or discount points that may be charged by a lender to a HUD-FHA borrower. Further, HUD does not state anywhere in its requirements that discount points must be used to lower the interest rate on a HUD-FHA insured mortgage.

Specifically, HUD Handbook 4000.2 Rev-2, Paragraph 1-10 states clearly that the interest rate and discount points are negotiated by the applicant and the mortgagee. Further, HUD Handbook 4155.1 Rev-4, Chg-1, Paragraph 3-7, (which was in effect during the period covered by the OIG audit), states that HUD-FHA does not regulate the interest rate on loans that it will insure.

Further, HUD's Form, 92900-B, Important Notice to Homebuyers, a disclosure form that HUD requires a lender to provide to a HUD-FHA borrower, clearly states that HUD does

**Comment 6**

not regulate the interest rate or the discount points that may be paid by the borrower. The borrower is advised to shop around to be sure that the loan terms offered are satisfactory.

The Real Estate Settlement Procedures Act (RESPA) does not prohibit a lender from receiving discount points, in an amount determined by the lender, nor does it require that discount points must be used to reduce a borrower's interest rate. There is no violation of RESPA simply because a lender charges a higher interest rate or discount points.

AHMC respectfully submits that this finding should be dismissed.

**Case Number 491-7795864:**

**Income Overstated or Unsupported:**

**Comment 7**

AHMC performed a underwriting analysis of this loan and calculated the income and adjusted housing liabilities using the income and housing expense figures indicated by the OIG. Significantly, the ratios would still have been 29.98 and 41.62 and acceptable under HUD guidelines.

Further, this was an energy efficient home and the borrower had an expectant pay increase. Also the co-borrower had overtime income that was not considered in the ratios. Her average income over 34 months that includes the years 2000, 2001 and 2002 was \$2,113.00 per month. The loan qualified for approval based on the OIG's figures.

AHMC respectfully submits that the OIG's findings with respect to the borrower's income and liabilities had no material effect on the eligibility of this loan for approval.

**Liabilities Understated:**

**Comment 8**

The input error in Desktop Underwriter is acknowledged by AHMC. Importantly, with the recalculated income and the adjusted housing expenses using the OIG's figures in this

## Comment 2

finding the ratios are within HUD-FHA guidelines and the loan qualified for approval.

### Appraisal Adjustments for Sales Concessions on Comparables Not Made:

AHMC respectfully submits that until the issuance of Mortgagee Letter 2005-02, dated January 4, 2005, HUD-FHA did not provide lenders and appraisers with clear instructions regarding their responsibilities with respect to financing concessions in connection with the appraisal process.

HUD Handbook 4150.1 Rev-1, Valuation Analysis for Home Mortgage Insurance, Chapter 8, Uniform Residential Appraisal Report (2/90), 8-3 states:

“Financing concessions for the subject and the market area should be explained. Be sure to explain whether the subject is consistent with the market area or different.”

This broad language does not provide specific instructions to lenders with respect to identifying and addressing financing concessions or does it require any detailed information to be provided by the appraiser.

Mortgagee Letter 2005-2 clarifies HUD-FHA policy and provides detailed instructions to lenders and appraisers with respect to financing concessions. Importantly, the loan was underwritten in 2002, three years prior to the time that HUD-FHA clarified its policy regarding financing concessions.

## Comment 3

Further, HUD Handbook 4155.1 Rev-5, Chapter 1, section 2 (1-7A), and previously Handbook 4155.1 Rev-4, Chapter 1, section 2 (1-7C) states that contributions from sellers or other interested third parties to the transaction that exceed six (6) percent of the sales price or other financing concessions are to be treated as inducements to purchase, thereby reducing the amount of the mortgage. Each dollar exceeding the six percent limit must be subtracted from the property's sales price before applying the appropriate loan to value (LTV) ratio.

**Comment 4**

The AHMC underwriter that approved the loan and reviewed the appraisal reasonably assumed that “no unusual concession listed” meant that the concessions fell below the six percent requirement. This underwriter is no longer an AHMC employee. All current AHMC underwriters have been thoroughly trained to insure that appraisers reflect the complete information regarding all sales concessions in accordance with the clarification in Mortgagee Letter 2005-02.

Further, and significantly, the OIG in this finding does not: (1) state an opinion as to a valuation different than the one set forth in the appraisal report; (2) indicate that any of the comparable sales are inaccurately reported or that such sales are not a fair measure of the subject property’s valuation; or (3) offer an appraisal at variance with the appraisal for this property.

AHMC respectfully submits that this finding should be dismissed.

**Appraisal Did Not Include an Analysis of the Subject Sales Contract:**

**Comment 5**

As stated previously, HUD-FHA did not provide lenders or appraisers with clear instructions regarding seller concessions and analysis of the sales contract until the issuance of Mortgagee Letter 2005-02, dated January 4, 2005. Importantly, the Smith loan was underwritten and approved by AHMC prior to the issuance of the Mortgagee Letter.

The appraisal does not reflect any comments regarding the analysis by the appraiser of the sales contract which states that the seller will contribute a maximum of \$4,000 towards all seller and borrower closings costs (excluding title premiums) and prepaid items and discount points. The AHMC underwriter assumed that the lack of comments by the appraiser meant that the contract was acceptable and no market-based adjustments to comparable sales were required.

**Comment 9**

Further, and significantly, the OIG in this finding does not: (1) state an opinion as to a valuation different than that set forth in the appraisal report; (2) indicate that any of the comparable sales are inaccurately reported or that such sales are not a fair measure of the subject property's valuation; or (3) offer an appraisal at variance with the appraisal for this property.

AHMC respectfully submits that this finding should be dismissed.

**Appraiser Did Not Include Any Conventional Comparables:**

Further, AHMC respectfully submits that HUD-FHA guidelines, as set forth in Handbook 4150.1 Rev-4, Valuation Analysis for Home Mortgage Insurance, Chapter 6, Section 1, states that a conventional sales comparable should be used if available. However, the guidelines do not require the appraiser to provide a "justification" for the use of comparables only with HUD-FHA financing.

For the reasons set forth above, AHMC respectfully submits that this finding should be dismissed.

**Case Number # 492-6708865:**

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

As stated previously, until the issuance of Mortgage Letter 2005-02, dated January 4, 2005, HUD-FHA did not provide clear instructions to lenders and appraisers regarding comments with respect to the analysis of the sales contract. Importantly, loan was underwritten and approved by AHMC prior to the issuance of the Mortgage Letter.

Further, the appraisal does not reflect any comments regarding the analysis by the appraiser of the sales contract which showed that the seller agreed to provide a "grant" to a nonprofit down payment assistance program for \$7,405. The AHMC underwriter reasonably assumed that the lack of comments by the appraiser meant that the sales

**Comment 5**

contract was acceptable and no market-based adjustment to comparable sales were required.

**Comment 10**

Respectfully, AHMC further submits that the OIG is incorrect in characterizing the \$7,405 seller contribution to a nonprofit agency down payment assistance program as a seller concession or contribution.

**Comment 11**

HUD-FHA requirements as set forth in HUD Handbook 4155.1 Rev-4 (which was in effect during the audit period), Chapter 1, Section 2, Paragraph 1-7A, and Section 3, Paragraph 2-10C do not include down payment assistance programs administered by a nonprofit agency as a seller concession or contribution.

Further, and importantly, the funds with respect to the borrower's down payment in this transaction were provided by a nonprofit agency through a down payment assistance program and not by the seller as indicated by the OIG in this finding.

**Comment 12**

Further, AHMC notes that in 1998, HUD-FHA expressly approved down payment assistance programs administered by a nonprofit agency. This approval by HUD recognizes that the seller makes a contribution or pays an administrative fee to the nonprofit agency. Significantly, the approval by HUD of nonprofit agency down payment assistance programs has never been rescinded. Please see OIG Audit Report Case No. 2000-SE-121-0001, dated March 31, 2000.

**Comment 13**

Further, the listing analysis information is specifically shown under "Report of the prior year sales history for the subject property" under "is the subject property currently listed?"; "No" is clearly checked by the appraiser. AHMC respectfully submits that the OIG is incorrect in its finding.

AHMC respectfully submits that this finding should be dismissed.

**Comment 6**

**Ineligible Closing Costs Charged to Borrower:**

AHMC respectfully disagrees with the OIG's alleged finding that AHMC charged ineligible closing costs (discount points) to the borrower.

AHMC respectfully submits that HUD does not regulate the interest rate or discount points that may be charged by a lender to a HUD-FHA borrower. Further, HUD does not state anywhere in its requirements that discount points must be used to lower the interest rate on a HUD-FHA insured mortgage.

Specifically, HUD Handbook 4000.2 Rev-2, Paragraph 1-10 states clearly that the interest rate and discount points are negotiated by the applicant and the mortgagee. Further, HUD Handbook 4155.1 Rev-4, Chg-1, Paragraph 3-7, (which was in effect during the period covered by the OIG audit), states that HUD-FHA does not regulate the interest rate on loans that it will insure.

Further, HUD's Form, 92900-B, Important Notice to Homebuyers, a disclosure form that HUD requires a lender to provide to a HUD-FHA borrower, clearly states that HUD does not regulate the interest rate or the discount points that may be paid by the borrower. The borrower is advised to shop around to be sure that the loan terms offered are satisfactory.

The Real Estate Settlement Procedures Act (RESPA) does not prohibit a lender from receiving discount points, in an amount determined by the lender, nor does it require that discount points must be used to reduce a borrower's interest rate. There is no violation of RESPA simply because a lender charges a higher interest rate or discount points.

AHMC respectfully submits that this finding should be dismissed.

**Comment 14**

**Case Number 492-6810853:**

**Appraisal Adjustment For Property Condition Not Made or Unsupported:**

AHMC respectfully disagrees with OIG's conclusion. Only one of the comparables was more than six months old it was 200 days old, which is 20 days past the six-month finding. AHMC relied on the sales information provided by the appraiser and did not verify each and every sales history of the comparables, AHMC is not aware that it a HUD/FHA requirement for a lender to verify the sales history of each comparable.

**Comment 15**

AHMC spoke with the appraiser David Harding regarding the comparable used that was twenty-two days over the six-month limit without justification. He stated that in his market area he had been instructed by HUD-FHA that he did not need to supply a justification unless the sales time was over a twelve-month period of time. He stated that he used the MLS system to verify the sales history on comparable three and now verbally verifies the information with each selling Realtor. He also stated that there was very little contributory value to the lot size difference and that the overall value of lots in the market area are typically the same for this size range. Additionally he commented that the inferior condition of comparable three was an error and should have been adjusted by approximately three percent. He did point out that he did make comments regarding the adjustments made for the condition of the properties and there were not any adjustments made for the financing of the individual sales under comments on sales comparisons. AHMC comments on the analysis of the sales contract in explained in the next finding response.

**Comment 4**

Further, and significantly, the OIG in this finding does not: (1) state an opinion as to a valuation different than that set forth in the appraisal report; (2) offer an appraisal at variance with the appraisal for this property.

AHMC respectfully submits that this finding should be dismissed.

**Appraisal Did Not Include An Analysis of the Subject Sales Contract or List Price:**

**Comment 5**

As stated previously, HUD-FHA did not provide lenders or appraisers with clear instructions regarding seller concession and analysis of the sales contract until the issuance of Mortgage Letter 2005-02, dated January 4, 2005. Importantly, the Richardson loan was underwritten and approved by AHMC prior to the issuance of the Mortgage letter.

The OIG indicates that the seller agreed to pay up to \$1,500 closing costs and provide a grant to a nonprofit down payment assistance program for \$3,400.

**Comment 3**

With respect to the \$1,500 seller concession, the AHMC underwriter that reviewed the appraisal reasonably assumed that absent any explanation by the appraiser, this sales concession fell below the six percent requirement stated in HUD Handbook 4155.1 Rev-4, Chapter 1, Section 2(1-7c), that was in effect during the audit period.

**Comment 10**

Further, AHMC respectfully submits that the OIG is incorrect in characterizing the \$3,400 seller contribution to a nonprofit agency down payment assistance program as a seller concession or contribution.

**Comment 11**

HUD-FHA requirements as set forth in HUD Handbook 4155.1 Rev-4 (which was in effect during the audit period), Chapter 1, Section 2, Paragraph 1-7A, and Section 3, Paragraph 2-10C do not include down payment assistance programs administered by a nonprofit agency as a seller concession or contribution.

Further, and importantly, the funds with respect to the borrower's down payment were provided by a nonprofit agency through a down payment assistance program and not by the seller as indicated by the OIG in this finding.

**Comment 12**

Further, AHMC notes that in 1998, HUD-FHA expressly approved down payment assistance programs administered by a nonprofit agency. This approval by HUD recognized that the seller makes a contribution or pays an administrative fee to the nonprofit agency. Significantly, the approval by HUD of the nonprofit agency down

## Comment 16

payment assistance programs has never been rescinded. Please see OIG Audit Report Case No. 2000-SE-121-0001, dated March 31, 2000.

Further, the listing analysis information is specifically shown under "Report of the prior year sales history for the subject property" under "is the subject property currently listed?"; "No" is clearly checked by the appraiser. AHMC respectfully submits that the OIG is incorrect in its finding.

AHMC respectfully submits that this finding should be dismissed.

### **Ineligible Closing Costs Charged to Borrower:**

AHMC respectfully submits that the OIG is incorrect in its finding that AHMC charged ineligible closing costs (discount points) to the borrower.

AHMC respectfully submits that HUD does not regulate the interest rate or discount points that may be charged by a lender to a HUD-FHA borrower. HUD does not state anywhere in its requirements that discount points must be used to lower the interest rate on a HUD-FHA insured mortgage.

Specifically, HUD Handbook 4000.2 Rev-2, Paragraph 1-10 states clearly that the interest rate and discount points are negotiated by the applicant and the mortgagee. Further, HUD Handbook 4155.1 Rev-4, Chg-1, Paragraph 3-7, (which was in effect during the period covered by the OIG audit), states that HUD-FHA does not regulate the interest rate on loans that it will insure.

Further, HUD's Form, 92900-B, Important Notice to Homebuyers, a disclosure form that HUD requires a lender to provide to a HUD-FHA borrower, clearly states that HUD does not regulate the interest rate or the discount points that may be paid by the borrower. The borrower is advised to shop around to be sure that the loan terms offered are satisfactory.

## Comment 6

The Real Estate Settlement Procedures Act (RESPA) does not prohibit a lender from receiving discount points, in an amount determined by the lender, nor does it require that discount points must be used to reduce a borrower's interest rate. There is no violation of RESPA simply because a lender charges a higher interest rate or discount points. AHMC respectfully submits that this finding should be dismissed.

**Conclusion:**

Again, AHMC appreciates this opportunity to respond to your letter. We trust that our response resolves fully all issues raised by the OIG. AHMC understands the importance of, and has always been committed to, complying fully with HUD-FHA requirements.

Sincerely,

A handwritten signature in cursive script, appearing to read "Anna Fitzgerald".

Anna Fitzgerald  
Vice President

## OIG Evaluation of Auditee Comments

- Comment 1** Allied states that its policies and practices required it to obtain evidence of child support payments. This agrees with HUD's requirements, which state that in order for a lender to consider child support income in approving a borrower, the lender must obtain evidence that the borrower received the payments during the prior 12 months. It was Allied's responsibility to obtain sufficient documentation to approve its underwriting decisions. However, Allied did not provide any documentation to show that it obtained such evidence and it states it is unable to determine why the information is missing from its file. Accordingly, it should not have used the child support income in qualifying the borrower.
- Comment 2** Allied submits that HUD's requirements for sales concessions were unclear prior to the issuance of Mortgage Letter 2005-02. We do not concur. Paragraph 4-6(B) of HUD Handbook 4150.2 (effective July 1, 1999), requires appraisers to account for differences between the subject property and the comparable properties. It specifically lists sales concessions as a required adjustment. Further, the Uniform Residential Appraisal Report form provides a separate line item for the appraiser to insert adjustments based on sales and financing concessions.
- Comment 3** Allied states that the underwriter believed the sales concessions were within the six percent limit contained in HUD Handbook 4155.1 REV-5 and REV-4. However, the criteria cited by Allied is not applicable to appraisals. HUD Handbook 4150.2, paragraph 4-6(B), requires appraisers to account for differences between the subject property and the comparable properties. The handbook does not limit the appraisers' responsibilities to sales concessions in excess of six percent or any set percentage.
- Comment 4** Allied suggests that the OIG has not performed sufficient work to show the appraised values were inaccurate. We concur. However, we did identify serious deficiencies with the appraisals that would impact the appraised value. For Case Numbers 491-7796924 and 491-7795964, Allied did not ensure the appraiser adjusted the comparables for sales concessions or analyzed the subject sales contracts. For Case Number 492-6810853, the appraiser used old comparables, overstated the sales price of Comparable 3 by \$10,000 (over 25 percent) and failed to adjust Comparable 3 for its inferior condition. In addition, the appraiser did not perform an analysis of the subject sales contract or list price. As the underwriter, Allied was responsible for ensuring the appraisal met HUD requirements and adequately supported the appraised value.
- Comment 5** Allied argues that HUD did not provide specific instructions requiring appraiser comments on the analysis of the sales contract prior to Mortgage Letter 2005-02. We disagree. Uniform Standards of Professional Appraisal Practice rule 1-5(a) was in effect at the time the loan was underwritten. The rule requires appraisers to analyze all agreements of sale, options, or listings of the subject property in

determining the appraised value. Further, the Uniform Residential Appraisal Report form provides space for the appraiser to respond to “Analysis of the current agreement of sale, option, or listing of the subject property....”

- Comment 6** Allied submits that Real Estate Settlement Procedures Act does not prohibit a lender from receiving discount points, nor does it require that discount points must be used to reduce a borrower’s interest rate. We agree, but the act does prohibit lenders from accepting fees for services not performed. The loan correspondent did not provide documentation to show the borrower received anything of value for the discount points charged. As a result, the discount points charged are in violation of the Real Estate Settlement Procedures Act.
- Comment 7** Allied concurs that the income on the loan was overstated.
- Comment 8** Allied concurs that the borrower’s total debt was understated.
- Comment 9** HUD requires appraisers to use at least one comparable that was financed with a conventional loan. Sound business practices would dictate that the appraiser provide an explanation if she were unable to identify a suitable comparable with a conventional loan.
- Comment 10** Allied asserts that the OIG is mischaracterizing seller contributions to nonprofit down payment assistance programs. We disagree. The report correctly characterizes seller contributions stipulated in the sales contracts as sales concessions that the appraisers should have considered in determining the appraised value. Down payment assistance is a sales concession regardless of the source of the funds. Mortgage Letter 2005-02, states, “The appraiser must report the total dollar amount of the loan charges and/or concessions to be paid **by any party** [Emphasis Added] on behalf of the borrower and describe which party provided the concession in the Subject Section of the appraisal report.”
- Comment 11** Allied misapplies criteria in HUD Handbook 4155.1 REV-4 to suggest that appraisers should not have to consider contributions to down payment assistance programs since the handbook does not consider them seller concessions or contributions. HUD Handbook 4155.1 Rev-4 does not contain appraisal requirements. Accordingly, the specific paragraphs cited by Allied have no bearing on determining a property’s appraised value.
- Comment 12** Allied notes that HUD expressly approved nonprofit down payment assistance programs. We concur and the report does not take exception to their use. However, the appraiser is required to report and analyze the related sales concessions in determining the appraised value.
- Comment 13** Allied indicates that the property was not listed. Yet, page 2 of the appraisal states, “The subject was most recently offered for sale through MLS for \$34,000 (as-is).”

- Comment 14** Allied incorrectly states that only one of the comparables was more than six months old. The appraisal is dated May 20, 2003. Accordingly, the three comparable sales should not have been any earlier than November 18, 2002. However, two of the comparables sales were in October 2002 and one was in July 2002.
- Comment 15** HUD does not allow appraisers to use sales comparables that are more than a year old at the time of the appraisal. HUD Handbook 4150.2, paragraph 4-6(A) (2), Selection of Comparable Sales for Analysis, states, "Sales data should not exceed six months between the date of the appraisal and the sale date of the comparable, and must not exceed twelve months. An explanation is required for sales dates in excess of six months."
- Comment 16** Allied indicates that the property was not listed. Neither the appraisal in HUD's file nor the loan correspondent's loan file contains Form 953, which has a box for indicating whether the property was listed. However, the settlement statement shows a real estate commission was paid on the sale. Therefore, the property was likely listed.

## Appendix C

### CASE STUDIES OF IMPROPERLY ORIGINATED LOANS

Case number: 491-7796924

Mortgage amount: \$123,028

Gift amount: \$3,270

Date of loan closing: December 27, 2002

Status as of March 31, 2005: First legal action to commence foreclosure

Payments before first default reported: 0

Summary:

#### Income Overstated or Unsupported

Allied improperly included child support of \$518 per month in calculating the borrower's income. Although Allied obtained copies of court documents ordering the child support, it did not provide evidence that the borrower had received the income over the prior 12 months. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-7(F), prohibits lenders from using child support income to qualify a borrower unless the borrower provides evidence that he or she has received the child support during the previous 12 months. Without such evidence, Allied should not have considered the income in qualifying the borrower.

#### Borrower Ineligible for Federal Housing Administration Financing

The sponsor's underwriter did not provide sufficient compensating factors to justify approval of the loan. According to the lender, the borrower's front and back ratios were 28.561 and 40.309 percent, respectively. However, these ratios were based on the lender's incorrect calculation of income. Using the correct income, the borrower's front and back ratios were 32.94 and 46.49. The underwriter provided the following compensating factors: 1) new construction/energy efficient and 2) job stability. The energy efficient factor can only be used to exceed the qualifying ratios by 2 percent. Job stability is not valid compensating factor. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12(B), requires lenders to provide significant compensating factors for back ratios of more than 41 percent. Paragraph 2-13 provides a list of valid compensating factors.

#### Appraisal Adjustments for Sales Concessions on Comparables Not Made

The appraiser did not adjust the sales prices of the comparable properties for sales concessions. The appraiser noted, "No unusual concessions listed," but did not provide detailed information regarding the sales concessions or provide an explanation as to what she considered unusual. All

three comparables 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

The appraiser did not analyze the subject sales contract. Under analysis of the current sales agreement, the appraiser notes, “There are no unusual concessions listed on the sales selected.” HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Uniform Standards of Professional Appraisal Practice 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. Rule 2-2(a)(ix) states that if the information is unobtainable, the appraiser must provide a statement on efforts made to obtain the information.

#### Ineligible Closing Cost Charged to Borrower

Allied allowed the loan correspondent to charge \$320 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 \$3,575. The loan correspondent did not provide documentation to show the borrower received anything of value for the discount points charged. HUD allows lenders who originate Federal Housing Administration-insured loans to charge borrowers a 1 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.

Case number: 491-7795964

Mortgage amount: \$126,826

Gift Amount: \$3,834.84

Date of loan closing: December 16, 2002

Status as of March 31, 2005: Reinstated by borrower who retains ownership

Payments before first default reported: 1

Summary:

#### Income Overstated or Unsupported

Allied overstated the borrower's monthly income by \$471. Allied calculated the borrower's income based on a 40-hour workweek. However, based on a review of the pay stubs on file, the borrower did not always work a 40-hour week. Using the borrower's pay through November 9, 2002, we determined that the borrower worked an average of 31.40 hours per week.

#### Liabilities Understated

Allied calculated the total mortgage payment as \$1,193 and recurring expenses as \$462 for a total fixed payment of \$1,655. However, the payment was recorded as \$1,538 in Desktop Underwriter.

#### Appraisal Adjustments for Sales Concessions on Comparables Not Made

The appraiser did not adjust the sales prices of the comparable properties for sales concessions. The appraiser noted, "No unusual concessions listed," but did not provide detailed information regarding the sales concessions or provide an explanation as to what she considered unusual. 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

The appraiser did not analyze the subject sales contract. The sales contract, dated before the date of the appraisal, showed the seller agreed to pay \$4,000 in borrower closing costs and other expenses. HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Uniform Standards of Professional Appraisal Practice 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. Rule 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 Conventional Loans for Comparables

The appraiser only used comparables financed through the Federal Housing Administration. HUD requires appraisers to obtain at least one conventional loan, if available. The appraiser did not indicate that a conventional comparable was not available.

Case number: 492-6708865

Mortgage amount: \$33,434

Gift amount: \$6,832.95

Date of loan closing: May 1, 2003

Status as of March 31, 2005: Foreclosure started

Payments before first default reported: 2

Summary:

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

The appraiser did not analyze the subject sales contract. The sales contract, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit downpayment assistance program for \$7,405. HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Uniform Standards of Professional Appraisal Practice 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. Rule 2-2(a)(ix) states that if the information is unobtainable, the appraiser must provide a statement on efforts made to obtain the information.

Ineligible Closing Cost Charged to Borrower

Allied allowed the loan correspondent to charge \$669 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 \$752. The loan correspondent did not provide documentation to show the borrower received anything of value for the discount points charged. HUD allows lenders who originate Federal Housing Administration-insured loans to charge borrowers a 1 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.

Case number: 492-6810853

Mortgage amount: \$46,507

Gift amount: \$3,400

Date of loan closing: July 25, 2003

Status as of March 31, 2005: Delinquent

Payments before first default reported: 2

Summary:

Appraisal Adjustments for Property Condition Not Made or Unsupported

The appraiser used comparables that were more than six months old without providing justification for doing so. The appraiser showed that only one of the comparables was more than six months old. However, based on the date of the comparable sales, all of the sales were at least 200 days old. HUD Handbook 4150.2, paragraph 4-6(A)(2), states that comparable sales data "... should not exceed six months between the date of the appraisal and the sale date of the comparable, and must not exceed twelve months." The appraiser must provide an explanation for sales in excess of six months. The appraiser also listed comparable 3's sales price as \$50,350 when the actual sales price was \$40,000. He performed the appraisal for comparable 3. He did not provide an explanation for not making adjustments to account for the lot size of comparable 1 or the inferior condition of comparable 3. HUD Handbook 4150.2, paragraph 4-6(B), requires the appraiser to make property adjustments if the difference between the comparable sale and the subject property is quantifiable and supported by the market. The appraiser also provided inconsistent information concerning the condition of the subject property. On page one, he stated that the subject property was in average to good condition, yet on page two, he stated the condition was average.

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. HUD requires appraisers to obtain and analyze all sales contracts and listings in determining a property's appraised value. If such information is not available, the appraiser must provide a statement on what efforts he or she undertook to obtain the information. The sales contract, dated before the date of the appraisal, showed the seller agreed to pay up to \$1,500 toward the borrower's closing costs and provide a grant to a nonprofit downpayment assistance program for \$3,400. HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. Uniform Standards of Professional Appraisal Practice 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. Rule 2-2(a)(ix) states that if the information is unobtainable, the appraiser must provide a statement on efforts made to obtain the information.

### Ineligible Closing Cost Charged to Borrower

Allied allowed the loan correspondent to charge \$930 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 \$1,105. The loan correspondent did not provide documentation to show the borrower received anything of value for the discount points charged. HUD allows lenders who originate Federal Housing Administration-insured loans to charge borrowers a 1 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.