

Issue Date	September 28, 2005
Audit Report Number	2005-FW-1019

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

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

SUBJECT: Wells Fargo Did Not Follow HUD Requirements When Processing 10 Loans

HIGHLIGHTS

What We Audited and Why

We reviewed Federal Housing Administration loans sponsored by Wells Fargo of Des Moines, Iowa. During an audit of a Federal Housing Administration-approved loan correspondent, we identified 11 loans sponsored by Wells Fargo 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 Wells Fargo to determine whether it complied with HUD regulations, procedures, and instructions when processing the mortgages.

What We Found

Wells Fargo did not comply with HUD regulations, procedures, and instructions in the processing of 10 out of the 11 Federal Housing Administration-insured single-family mortgages we reviewed. Underwriting deficiencies included overstated income, income stability not verified, understated liabilities, creditworthiness not fully considered, unresolved inconsistencies, and insufficient or ineligible compensating factors. For nine loans, Wells Fargo did not ensure

that the appraisal met HUD requirements. In addition, Wells Fargo allowed the loan correspondent to charge \$11,474 in loan discount points, without reducing the borrowers' interest rates. As a result, the risk to the insurance fund was increased, four ineligible borrowers received financing, and nine 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 Wells Fargo for not complying with HUD requirements. At a minimum, this should include indemnifying HUD \$383,469 for case numbers 492-6765199, 491-8071128, and 491-8206149; reimbursing HUD for the \$64,321 loss on case number 491-7646781; and reimbursing appropriate parties for the \$11,472 in unearned fees. We further recommend that HUD ensure Wells Fargo has implemented sufficient controls to provide reasonable assurance that its underwriting complies with HUD regulations, procedures, and instructions.

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 14, 2005, Wells Fargo provided a written response to our report. Wells Fargo agreed to provide indemnification for the four loans with the most serious deficiencies. However, it expressed disagreement with other report findings including the disallowance of loan discount points when the interest rate on the loan was not reduced. The complete text of Wells Fargo's response can be found in Appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding: Wells Fargo Did Not Follow HUD Requirements when Processing 10 Loans	5
Scope and Methodology	10
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	11
B. Auditee Comments and OIG's Evaluation	12
C. Case Studies of Improperly Originated Loans	20

BACKGROUND AND OBJECTIVES

Wells Fargo is a supervised lender that began originating Federal Housing Administration loans in 1985.

During an audit of a Federal Housing Administration-approved loan correspondent,¹ we identified 11 loans sponsored by Wells Fargo 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 Wells Fargo's underwriting of these loans.

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

¹ Report number 2005-FW-1009, "Allied Home Mortgage Capital Corporation, Nonsupervised Loan Correspondent," Houston, Texas, issued May 24, 2005.

RESULTS OF AUDIT

Finding: Wells Fargo Did Not Follow HUD Requirements when Processing 10 Loans

Wells Fargo did not comply with HUD regulations, procedures, and instructions in the processing of 10 Federal Housing Administration-insured single-family mortgages. Underwriting deficiencies included overstated income, income stability not verified, understated liabilities, creditworthiness not fully considered, unresolved inconsistencies, and insufficient or ineligible compensating factors. For nine loans, Wells Fargo did not ensure that the appraisal met HUD requirements. In addition, Wells Fargo allowed the loan correspondent to charge \$11,472 in loan discount points without reducing the borrowers' interest rates. As a result, the risk to the insurance fund was increased, four ineligible borrowers received financing, and nine borrowers incurred excessive costs for their loans.

Wells Fargo Did Not Follow HUD Requirements

Wells Fargo did not follow HUD requirements for 10 of the 11 loans we reviewed. The following paragraphs summarize the deficiencies with the loans. For more detailed information, see Appendix C.

Case Number 491-7646781

Wells Fargo accepted what appears to be false identification from the borrower. The driver's license and Social Security card appear fictitious. HUD requires lenders to verify information with at least the same care they would exercise in originating a loan that was entirely dependent on the property as security to protect the investment.

Wells Fargo did not verify that the borrower's income was stable or sufficient to qualify for the loan. At the time of application, the borrower had only worked for his current employer for three months. The borrower claimed to have worked as a contractor for the previous 10 months, but the lender did not verify his assertion. Further, the lender calculated the borrower's income based upon a 48-hour workweek even though the borrower's pay stubs showed he worked fewer hours. Using the pay rates as provided in the employment verification and an average of the borrower's regular and overtime hours worked, the borrower's income was not sufficient to qualify for the loan.

Wells Fargo did not ensure the appraisal met HUD standards. In determining the appraised value, the appraiser did not make property adjustments to account for the inferior condition of the subject property and failed to adequately support adjustments to the comparables. In addition, the appraiser did not analyze the subject sales contract or list price. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 492-6765199

Wells Fargo approved the loan even though the borrower's debt to income ratio was too high to qualify for Federal Housing Administration financing. The lender provided four compensating factors. However, only one of the factors was valid and by itself was not sufficient to qualify the borrower.

Wells Fargo 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, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 491-7662516

Wells Fargo did not fully assess the borrower's creditworthiness. The lender did not require the borrower to provide explanations for all collection accounts. HUD requires lenders to obtain explanations from borrowers for all collection accounts to assess their attitudes toward credit and the likelihood they will repay the loan.

Case Number 491-8122656

Wells Fargo 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 or adjust the comparables for sales concessions. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 491-7953575

Wells Fargo did not resolve inconsistencies in the co borrower's claimed employment history or verify the stability of the co borrower's income. The co borrower's employment history changed significantly from the original loan application to the final loan application. Not only did the periods of employment change, the lender also removed a four-month period of unemployment from the final application. Wells Fargo did not resolve these inconsistencies. Accordingly, it cannot show that the co borrower's income was stable.

Wells Fargo 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 or adjust the comparables for sales concessions. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 492-6553929

Wells Fargo did not address the possibility of a significant contingent liability. The borrower indicated the Social Security Administration was seeking repayment on a disability claim. Wells Fargo should have investigated this contingent debt further and made a determination as to what effect it might have on the borrower's ability to repay the loan.

Wells Fargo did not fully assess the borrower's creditworthiness. The lender did not require the borrower to provide explanations for all collection accounts. HUD requires lenders to obtain explanations from borrowers for all collection accounts to assess their attitudes toward credit and the likelihood they will repay the loan.

Wells Fargo 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, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 492-6390936

Wells Fargo did not resolve inconsistencies in the loan file. The file contains inconsistent information on the borrowers' ages, addresses, and employers. HUD requires lenders to verify information with at least the same care they would exercise in originating a loan that was entirely dependent on the property as security to protect the investment.

Wells Fargo 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 or adjust the comparables for sales concessions. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 491-8071128

Wells Fargo approved the loan even though the borrower's debt-to-income ratio was too high to qualify for Federal Housing Administration financing. The lender incorrectly excluded five deferred student loans from consideration. All five loans were scheduled to begin within 12 months of the loan closing and would increase the borrower's total fixed payments by \$580. The lender listed five compensating factors. However, only one of the factors was valid and by itself was not sufficient to qualify the borrower.

Wells Fargo 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 or adjust the comparables for sales concessions. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 491-8034119

Wells Fargo 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, Wells Fargo cannot be certain of the accuracy of the appraised value.

Case Number 491-8206149

Wells Fargo did not resolve questionable assertions by the borrower. Wells Fargo accepted what appears to be false identification from the borrower. It also failed to resolve other questionable items related to the borrower's employment. HUD requires lenders to verify information with at least the same care they would exercise in originating a loan that was entirely dependent on the property as security to protect the investment.

Wells Fargo 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 at least one conventional loan as a comparable. As a result, Wells Fargo cannot be certain of the accuracy of the appraised value.

Unallowable Fees Charged to Borrowers

For nine loans, Wells Fargo allowed the loan correspondent to charge a total of \$11,472 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.

Case number	Discount points charged	Yield spread premiums
491-7646781	\$ 645	\$ 4,243
492-6765199	552	3,809
491-7662516	2,878	7,064
491-8122656	659	4,041
491-7953575	2,843	2,327
492-6553929	460	2,634
492-6390936	2,200	5,721
491-8071128	1,010	1,307
491-8206149	225	5,790
Totals	\$11,472	\$36,936

Conclusion

The underwriting deficiencies on these loans unnecessarily place the insurance fund at risk. Further, the unearned fees unfairly impose costs on the borrowers without providing a benefit in return. Wells Fargo should indemnify HUD \$383,469 for case numbers 492-6765199, 491-8071128, and 491-8206149 and reimburse HUD for the \$64,321 loss on case number 491-7646781. Further, Wells Fargo should repay the appropriate parties for the \$11,472 in unearned fees.

Recommendations

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

- 1A. Take appropriate administrative action against Wells Fargo for not complying with HUD requirements. At a minimum, this should include indemnifying HUD \$383,469 for case numbers 492-6765199, 491-8071128, and 491-8206149 and reimbursing HUD for the \$64,321 loss on case number 491-7646781.
- 1B. Require Wells Fargo to reimburse the appropriate parties for \$11,472 in unearned fees.
- 1C. Ensure Wells Fargo has implemented sufficient controls to provide reasonable assurance that its underwriting complies with HUD regulations, procedures, and instructions.

SCOPE AND METHODOLOGY

We reviewed Wells Fargo's processing of 11 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 11 loans sponsored by Wells Fargo, which appeared to be improperly underwritten. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed the deficiencies to Wells Fargo.

To accomplish our objective, we prepared case narratives of loan processing deficiencies identified and provided the information to Wells Fargo. We allowed Wells Fargo an opportunity to provide additional information that could resolve the deficiencies identified. Wells Fargo 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 Wells Fargo's underwriting controls because they were not significant to our objective of reviewing these eleven loans.

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 TO BE PUT TO BETTER USE

<u>Recommendation Number</u>	<u>Ineligible <u>1/</u></u>	<u>Funds to be put to better use <u>2/</u></u>
1A	\$64,321	\$383,469
1B	\$11,472	

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

	<p>Wells Fargo Home Mortgage MAC X2401-064 One Home Campus Des Moines, IA 50328-0001</p>
<p>September 13, 2005</p>	
<p>Frank 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, TX 76102</p>	
<p>Re: Correspondent: Allied Home Mortgage Capital Corp.</p>	
<p>Dear Mr. Baca:</p>	
<p>Wells Fargo Home Mortgage (WFHM) is committed to originating Federal Housing Administration (FHA) loans that conform to the Department of Housing and Urban Development's (HUD) origination, underwriting and servicing requirements. As the leading originator of Government National Mortgage Association (GNMA) loans over the past few years, WFHM values its relationship with HUD and is committed to continuing to improve its origination, underwriting and servicing operations and processes.</p>	
<p>This letter is in response to the draft report of the Office of Inspector General (OIG) dated August 22, 2005 which details the findings from the review of a small number of FHA-insured loans originated by Allied Home Mortgage Capital Corp. and sponsored by WFHM between July 1, 2002 and June 30, 2004. While we are confident that our overall quality record as an FHA originator and servicer is among the best in the industry, we take the draft findings outlined in the OIG's review very seriously and, even prior to your review, proactively initiated processes to address the issues related to the draft finding.</p>	
<p>Wells Fargo Home Mortgage consistently strives to meet all of HUD's guidelines when originating, processing and closing loans. We have a series of quality controls and measures in place to ensure that issues are detected and addressed. WFHM has taken numerous steps to identify opportunities, determine root causes and create action plans to appropriately address the concerns.</p>	
<p>WFHM continuously implements improvements in its process and controls for FHA originations and underwriting. On a monthly basis, random and targeted samples of FHA originations and loans submitted for endorsement are assessed for adherence to HUD guidelines. These results are reviewed with senior management from the business units to identify opportunities for improvement and the root causes of any errors. In the event the business units do not produce loans that conform to HUD guidelines within established benchmarks, the business units receive direct feedback and the directive to address any deficiencies.</p>	
<p>In addition, on a quarterly basis, each business unit's management team performs an assessment of its risks and internal controls. In the event that any high-risk area is identified</p>	
<p>Wells Fargo Home Mortgage is a division of Wells Fargo Bank, N.A.</p>	

as less than satisfactory, management immediately commits to action plans to address any control weaknesses.

To further enhance our loan quality, in early 2005, the Wells Fargo Institutional Lending (IL) business unit created a National Underwriting and Compliance Group. The purpose of this group is to provide a single point of contact and oversight for credit, compliance, underwriting, and audit issues for the IL business line. The scope covers the prime business for the wholesale and correspondent non-delegated channels. Specifically, this group is accountable for decisioning quality, monitoring and communicating decisioning quality trends and issues by location and decisioner, and partnering with other areas within Wells Fargo to determine the root causes of quality issues and developing appropriate action plans to correct the issues.

Summary of the OIG Draft Audit Report and WFHM's Response

The OIG draft audit report was issued August 22, 2005 for review and comment. The audit period covered by the report was from July 1, 2002 through June 30, 2004. The audit included a review of 11 loans sponsored by Wells Fargo Home Mortgage that were originated by Allied Home Mortgage Capital Corp. ("Allied"). The 11 loans included in this audit were underwritten in Wells Fargo Home Mortgage's Dallas wholesale branch

Prior to the review initiated by the OIG, Wells Fargo Institutional Risk Management reviewed the underwriting practices of the Dallas branch in May 2003 and conducted a follow-up review in March 2004. Institutional Risk Management had previously noted a concern with the underwriting quality of the Dallas branch and began working with the branch to improve loan performance by focusing on underwriting philosophy and quality underwriting practices.

Institutional Risk Management also began working directly with the Allied corporate office on the quality and performance of FHA loans originated by Allied in the Dallas and Fort Worth markets and finalized an action plan with Allied in June 2004. Again, this process was initiated by WFHM prior to the start of the review conducted by the OIG. While Comp ratios in Dallas and Fort Worth remain high for Allied loans sponsored by Wells Fargo, there is a definite improving trend. The number of Allied defaults/claims in both Dallas and Fort Worth has trended down significantly since Feb 2004. Wells Fargo values its relationship with Allied Home Mortgage Capital Corporation and will continue to work with them to maintain a consistent high quality level of loan origination and underwriting.

OIG Finding 1: Wells Fargo Did Not Always Comply with HUD Underwriting Requirements.

According to data from HUD's Single Family Data Warehouse as of December 2004, WFHM does a better job of adhering to prudent lending practices than the industry average. In addition, WFHM has performed at the industry average since the third quarter of 2002. Of the 11 loans reviewed during this audit, four are noted as serious violations resulting in a requested indemnification or reimbursement to HUD for loss. We are confident that the error rate of a small, adverse sample of 11 defaulted loans is not indicative of the overall quality of WFHM's FHA originations. WFHM agrees that we will work with HUD on indemnification and reimbursement parameters on four of the 11 loans cited in the study as not having adhered to HUD requirements and prudent lending practices.

Case #491-7646781

Per OIG: Wells Fargo accepted what appears to be false identification from the borrower. The driver's license and Social Security card appear fictitious. WFHM also did not verify that the borrower's income was stable or sufficient to qualify for the loan. At the time of application, the borrower had only worked for his current employer for three months. The borrower claimed to have worked as a contractor for the previous 10 months, but the lender did not verify his assertion. Further, the lender calculated the borrower's income based upon a 48-hour workweek even though the borrower's pay stubs showed he worked fewer hours. Using the pay rates as provided in the employment verification and an average of the borrower's regular and overtime hours worked, the borrower's income as not sufficient to qualify for the loan.

Comment 1

WFHM response: The OIG's initial report did not address identification issues. However, upon review of the file we concur with their finding regarding this specific issue. The OIG is recommending reimbursement to HUD for losses due to this file. While we concur with the identification issue, we want to state our position regarding the employment issues. Our file contained a letter from the employer indicating a shift would be 12 hours. 8 hours would be base pay, and any hours above 8 would be overtime pay. The letter also indicated the borrower's standard work week would be 4 days, or 48 hours a week. Using seven weeks of pay stubs in our file, the borrower averaged 42.75 hours per week. While this was less than 48 hours we believe that the use of overtime was justified for this particular loan, as the employer indicated the standard shift included overtime, and all pay stubs indicated overtime. Our file contained verifications of employment for the current employment at Volt and for the previous employment at Fleming Co. The gap in employment was from 6/01 through 3/02. It appears the borrower indicated contract work on the application in lieu of providing an explanation for the gap. As the borrower indicated he earned only \$800 per month, we believe a written explanation from the borrower would have been sufficient. Loans underwritten using alternate documentation do not include verification of the likelihood of continued employment. This is only noted on the written verification of employment form. Unless there is a signed contract, alternate documentation includes the assumption of employment at will or the borrower's continued employment for an indefinite period of time.

Comment 2

Per OIG: In determining the appraised value, the appraiser did not make property adjustments to account for the inferior condition of the subject property and failed to adequately support adjustments to the comparables.

Comment 3

WFHM response: We concur with the OIG's statement regarding the lack of an adjustment for the exterior property condition. As for the adjustment for the garage, the underwriter relies on the appraiser's knowledge of the local market for adjustments for garage, room count, number of bathrooms, etc., unless the adjustment appears to be egregious or unreasonable. It is not clear to us what basis the OIG has for stating the adjustment was not adequate. The appraiser noted that comparables two and three did not have garage conversions or recent remodeling. An adjustment for these items is supported, and again, the underwriter would rely on the appraiser's knowledge of the local market for the value.

Case #492-6765199

Per OIG: WFHM approved the loan even though the borrower's debt to income ratio was too high to qualify for FHA financing. The lender provided four compensating factors. However,

only one of the compensating factors was valid and by itself was not sufficient to qualify the borrower.

WFHM response: The OIG initially recommended indemnification of this loan, and we concur with the OIG's findings.

Case #491-7953575

Per OIG: WFHM did not resolve inconsistencies in the co-borrower's claimed employment history or verify the stability of the co-borrower's income. The co-borrower's employment history changed significantly from the original loan application to the final loan application. Not only did the periods of employment change, the lender also removed a four-month period of unemployment from the final application. WFHM did not resolve these inconsistencies. Accordingly, it cannot show that the co-borrower's income was stable.

WFHM response: While indemnification was not requested, we would like to state our position for the employment issues. Our file contained a letter of explanation from the co-borrower indicating he did not work at Volt during 2001. He was in the process of moving from Kansas to Dallas and did not start working at Randstad until March 2001. Per the 2001 W2, Randstad was a staffing agency, and indicated the borrower's earnings for the year. The only W2 provided for 2002 was from the current employer. It appeared that the application was edited to include the unemployment in the time frames for which he worked with the temporary staffing agencies, as the URLA form had a maximum space for only three periods of employment. The co-borrower's explanation letter satisfied the requirement to resolve the inconsistency in his employment history, and the W2's provided the salary information for the previous two years.

Comment 4

Case #492-6390936

Per OIG: WFHM did not resolve inconsistencies in the loan file. The file contains inconsistent information on the borrowers' ages, addresses, and employers.

WFHM response: While indemnification was not requested, we would like to state our position for the inconsistencies noted by the OIG. Borrowers are not legally required to show their actual ages on a mortgage application. They only need to be of age to sign a legal contract. It is not uncommon for borrowers to show 21 as the age on the URLA, no matter what their legal age may be. The application shows the borrowers have lived at the current address for more than two years. It was not necessary for a previous address to be indicated. The Social Search Report shows the address as a previous address. It appears that the borrowers did not update their records with the employers when they moved to the apartment complex. The credit agency shows the current employers because the lender reported that information when requesting the credit report. This is the same information that the borrowers indicated on both the initial and final applications.

Comment 5

Case #491-8071128

Per OIG: WFHM approved the loan even though the borrower's debt-to-income ratio was too high to qualify for FHA financing. The lender incorrectly excluded five deferred student loans from consideration. All five loans were scheduled to begin within 12 months of the loan closing and would increase the borrower's total fixed payments by \$580. The lender listed five compensating factors. However, only one of the factors was valid and by itself was not sufficient to qualify the borrower.

WFHM response: The OIG initially recommended indemnification of this loan, and we concur with the OIG's findings.

Case #491-8206149

Per OIG: WFHM did not resolve questionable assertions by the borrower. WFHM accepted what appears to be false identification from the borrower. It also failed to resolve other questionable items related to the borrower's employment.

WFHM response: The OIG initially recommended indemnification of this loan, and we concur with the OIG's findings.

Per OIG: For nine loans the appraiser did not analyze the subject sales contract and did not fully analyze the property listing.

WFHM response: Mortgagee Letter 2005-02 states that the purchase contract or the listing agreement must be reviewed, which is consistent with USPAP requirements. As a lender, we do not obtain the listing agreement in addition to the purchase contract.

Comment 6

OIG Finding 2: Unallowable Fees Charged to Borrowers

WFHM response: You have requested Wells Fargo to refund \$11,472 in discount points paid by sellers to Allied, the loan correspondent. You commented that HUD believes that yield spread premiums can be a legitimate tool to reduce borrowers' closing costs. You further indicated that the loan correspondent could not provide documentation to show that the borrowers received anything of value for the discount points charged in these cases. Wells Fargo respectfully disagrees on the basis that the fees were charged to the sellers and, therefore, are not regulated by HUD and because Allied provided value-added services related to the transaction.

Comment 7

In all these cases the borrower did not pay the discount points. The HUD-1 Settlement Statements clearly show that the sellers in each transaction paid the discount points. Significantly, HUD does not regulate fees paid by sellers. The FHA regulations addressing closing costs expressly refer to "fees and charges that may be collected from the borrower[.]" HUD Handbook 4000.2 REV-2, 5-3; HUD Handbook 4000.2 REV-3, 5-2. HUD does not permit certain charges to be made to the borrower, but it will allow them to be charged to the seller.

As we previously indicated, in exchange for the compensation that Allied received, Allied performed numerous services in originating and delivering each of these mortgage loans. The services Allied, as the originator of the loan, performed, depending on transaction, included, but are not limited to: took application; obtained appraisals; counseled the borrower; provided disclosures; obtained gift letters; worked with DAP programs; obtained credit report; obtained verification of applicant's income; obtained hazard insurance certificate; worked with borrowers to clear credit issues; obtained title insurance commitment; obtained closing protection letter; obtained verification of income; verified application information; obtained flood certification; scheduled closing; provided information for preparation of closing documents; attended closing. Allied provided all applicant counseling and contact; Allied processed the loan application and submitted a loan package to WFHM to underwrite. All application and processing services were performed by Allied staff, at Allied facilities.

September 13, 2005
Re: OIG: Allied Home Mortgage Capital Corp.
Page 6

Further, as to documentation of the loan correspondent's compensation, each borrower signed a Mortgage Loan Origination Agreement that documents the relationship between the borrowers and the loan correspondent, and how the loan correspondent would be compensated. Copies of these agreements are in each file, and can be provided to you if you wish. WFHM's broker origination agreement also documents the loan correspondent's obligations to perform services on behalf of the borrower for Wells Fargo. Based on the review of the HUD-1s and our general knowledge of the services and facilities provided by Allied as described above, the disclosures to the borrowers, and the fact that HUD does not regulate fees paid by sellers, the compensation paid to Allied appears reasonable and commensurate in value with the services performed.

Conclusion

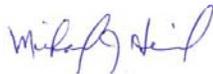
We appreciate the opportunity to review and comment on the draft report prepared by the Office of the Inspector General. While we are confident that WFHM's overall performance as an FHA originator is among the best in the industry, we also understand that there always are opportunities for improvement. This response includes details on a number of specific steps we have taken to address the issues raised in the audit; steps that already have helped us further improve the quality of our FHA originations.

Wells Fargo Home Mortgage is proud of its role as the nation's premier FHA lender and servicer. We are committed to a strong, long-term partnership with the Department of Housing and Urban Development. Please contact either of us if you have any additional questions or need clarification on anything that is included in this response.

Sincerely,



Cara K. Heiden
Division President, Wells Fargo Home Mortgage,
a division of Wells Fargo Bank, N.A.



Michael J. Heid
Division President, Wells Fargo Home Mortgage,
a division of Wells Fargo Bank, N.A.

cc: Vicky Murphy, WFHM Sr. Vice-President
Lew Raccio, WFHM Vice President
Kurt Lofrano, WFHM Vice-President, Credit Risk
Laura Nixon, Sr. Auditor, Dept. of Office of Inspector General

OIG Evaluation of Auditee Comments

- Comment 1** Wells Fargo concurs that the borrower only worked an average of 42.75 hours a week including overtime. In calculating the borrower’s income based on an average of 48 hours, Wells Fargo overstated the borrower’s income in the loan file by \$376 a month.
- Comment 2** Wells Fargo contends a written explanation from the borrower that he worked as a contractor should suffice in lieu of a verification of employment. We disagree. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6, requires the lender to verify the borrower’s employment for the most recent two full years.
- Comment 3** Wells Fargo notes that the underwriter relies on the appraiser’s knowledge of the local market for adjustment such as that needed for a garage unless the adjustment appears to be egregious or unreasonable. We concur, but contend that a \$1,000 adjustment for a one-car garage and a \$2,000 adjustment for a two-car garage is not reasonable.
- Comment 4** Wells Fargo did not provide any documentation to support its assertion that it appeared the application was edited to include unemployment in the time frames for which the co borrower worked with the temporary staffing agencies. The co borrower’s employment history was revised substantially from his April 2002 loan application to his May 2002 application. These revisions should have been explained and supported.

Co Borrower Employment History

April 2003 Loan Application	May 2003 Loan Application
Spectrum Supply Chain (.9 Yrs. on this job)	Spectrum Supply Chain (1.3 Yrs. on this job)
Unemployment (9/01-1/7/02)	Randstad North America (3/20/01-3/15/02)
Ranstad North America (3/01-8/01)	Volt Information (8/17/00-12/17/01)

- Comment 5** Wells Fargo notes that it is not uncommon for borrowers to show 21 as the age on the loan application regardless of their actual age. Wells Fargo does not provide any support for their assertion. Further, in signing the loan application, the borrowers certify that the information is correct and acknowledge their understanding that any intentional misrepresentation may result in civil liability and/or criminal penalties.
- Comment 6** Wells Fargo states that as a lender they do not obtain the listing agreement in addition to the purchase contract. However, Wells Fargo does not offer any explanation as to why the appraiser did not obtain and analyze the sales contract

for the nine loans in question. Uniform Standards of Professional Appraisal Practice require the appraiser to analyze all agreements of sale, options, or listings of the subject property in determining a property's appraised value. As the underwriter, Wells Fargo was responsible for ensuring the appraisals met HUD requirements and adequately supported the appraised values.

Comment 7 Wells Fargo believes it is acceptable for the loan correspondent to charge loan discount points without reducing the interest rate on the loans. Wells Fargo believes the practice is acceptable since HUD does not regulate fees charged to sellers and the loan correspondent provided services in originating the loans. We concur that HUD does not regulate fees charged to sellers. However, the Real Estate Settlement Procedures Act prohibits lenders from accepting fees for services not performed. The loan origination services listed by Wells Fargo were compensated through loan origination fees. The loan correspondent did not provide documentation to show they provided any additional services for the discount points charged.

Appendix C

CASE STUDIES OF IMPROPERLY ORIGINATED LOANS

Case number: 491-7646781

Mortgage amount: \$91,229

Gift amount: \$2,759

Date of loan closing: August 2, 2002

Status as of March 31, 2005: Property conveyed to insurer

Payments before first default reported: 0

Summary:

Inconsistencies Not Resolved

Wells Fargo accepted what appears to be false identification from the borrower. Deficiencies with the driver's license included, but were not limited to: 1) the Department of Public Safety audit number was identical to the driver's license number, 2) the signature of the Department of Public Safety Director was omitted, and 3) the license provides an issue date not found on a Texas driver's license. Deficiencies with the social security card included: 1) the card has lines across the top of the card that extend beyond the card edges, 2) The background of the card is white when it should show up in gray tones, and 3) the social security watermark is so dark it is difficult to read the social security number. HUD Handbook 4000.4, REV-1, paragraph 2-5 requires the mortgagee to obtain and verify information with at least the same care that a mortgagee would exercise in originating a loan that was entirely dependent on the property as security to protect its investment.

Income Overstated or Unsupported

Wells Fargo overstated the borrower income by \$376 and did not justify the use of overtime income to qualify the borrower. Wells Fargo used the hours and pay rates provided in the employment verification (32 regular hours and 16 overtime hours per week). However, the borrower's weekly pay stubs showed that on average the borrower worked fewer hours than indicated on the employment verification (30.71 regular hours and 12.04 overtime hours). Using the pay rates as provided in the employment verification and an average of the borrower's regular and overtime hours worked for seven pay periods, the borrower's income is significantly less. Further, HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-7(A) requires lenders to justify the use of overtime to qualify a borrower if the borrower has received the income for less than two years. Since the borrower had only worked for his current employer for three months, Wells Fargo should have justified the use of the overtime income.

Income Stability Not Verified

Wells Fargo did not verify the borrower's income for the most recent two years or verify the likelihood of the borrower's continued employment. At the time of application, the borrower had only been with his current employer for three months. Prior to his current employment, the borrower indicated he had worked as a contractor for 10 months. Wells Fargo did not verify the borrower's work as a contractor. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6, requires the lender to verify the borrower's employment for the most recent two full years.

Borrower Ineligible for Federal Housing Administration Financing

Wells Fargo did not provide sufficient compensating factors to justify approval of the loan. According to Wells Fargo, the borrower's front and back ratios were 28 and 44 percent. However, these ratios were based on Wells Fargo's incorrect calculation of income. Using the correct income, the borrower's front and back ratios were 32.41 and 50.12 percent. Wells Fargo used the borrower's bonus income as a compensating factor. However, it only confirmed bonus income of \$400 per quarter or \$133.33 a month. Even if the amount of bonus were added to the borrower's income, the back ratio would still be 47.62 percent. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12(B), requires lenders to provide significant compensating factors for back ratios over 41 percent.

Appraisal Adjustments for Property Condition Not Made or Unsupported

The appraiser did not make property adjustments to account for the inferior condition of the exterior of the subject property. In contrast to the comparable sales, the exterior of the subject property was poorly maintained. The driveway had a large diagonal crack, and the sidewalk appeared to have sunken places. The grass had not been trimmed and was growing through the cracks in the sidewalk and driveway. A large stump is in the front yard. The comparables were very well maintained and had mature landscaping not found on the subject property. Also, the appraiser only provided a \$1,000 adjustment for a one-car garage and a \$2,000 adjustment for a two-car garage. These adjustments were not adequate. Further, the appraiser failed to adequately support a \$4,000 adjustment to comparables two and three based on their condition. HUD Handbook 4150.2, paragraph 4-6(B) requires appraisers to make adjustments for quantifiable differences between the subject property and the comparables.

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

The appraiser did not analyze the subject sales contract and did not fully analyze the property listing. The sales contract, dated before the date of the appraisal, showed the seller agreed to pay \$7,700 in closing costs and other borrower expenses. The appraiser should have identified these sales concessions and considered them in determining the final appraised value. In addition, the property sold for \$4,950 more than the list price. The appraiser should have reported this price increase and analyzed it in relation to the appraised value as well. 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. 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.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$645 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 \$4,243. 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: 492-6765199

Mortgage amount: \$107,153

Gift amount: \$3,240

Date of loan closing: May 22, 2003

Status as of March 31, 2005: Forbearance

Payments before first default reported: 0

Summary:

Borrower Ineligible for Federal Housing Administration Financing

Well's Fargo listed four compensating factors to approve a loan for a borrower with a back ratio of 46.89. However, only one of the compensating factors was valid and by itself was not sufficient to qualify a borrower with such a high back ratio. Wells Fargo provided the following compensating factors: 1) new construction/energy efficient; 2) spouse's income not considered in ratios; 3) child support payments end in June 2004; and 4) homebuyers education course. The energy efficient factor can only be used to exceed the qualifying ratios by 2 percent. The remaining factors were not valid compensating factors. The income of a non-purchasing spouse may not be used to qualify for a loan. Further, the file does not contain support for the spouse's income, nor does it indicate an amount. In addition, the loan file does not contain verification of the child support amount or termination date. The homebuyer's education course may be used to reduce the upfront mortgage insurance premium, but is not a 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 over 41 percent. Paragraph 2-13 provides a list of valid compensating factors.

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 appraiser noted that she was not provided a copy of the contract, but did not state what efforts she took to obtain it. The appraiser provided no information regarding the property listing. The sales contract, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit down payment assistance program for \$8,150. 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. 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.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$552 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 \$3,809. 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: 491-7662516

Mortgage amount: \$148,722

Gift amount: \$4,497

Date of loan closing: 08/07/2002

Status as of March 31, 2005: Foreclosure started

Payments before first default reported: 0

Summary:

Creditworthiness Not Fully Considered

Wells Fargo did not require the borrower to provide explanations for 3 of 12 collection accounts appearing on the borrower's credit report. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3, requires lenders to obtain written explanations from the borrower for collection accounts.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$2,878 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 \$7,064. 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: 491-8122656

Mortgage amount: \$128,041

Gift amount: \$3,872

Date of loan closing: August 29, 2003

Status as of March 31, 2005: Foreclosure started

Payments before first default reported: 0

Summary:

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 of 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 or Price

The appraiser did not analyze the subject sales contract or property listing. The sales contract, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit down payment assistance program for 3 percent of the sales price or \$3,872. 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 appraisers to analyze all agreements of sale, options, or listings of the subject property in determining a property's appraised value. 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.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$659 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 \$4,041. 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 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: 491-7953575

Mortgage amount: \$147,115

Gift amount: \$4,448

Date of loan closing: May 01, 2003

Status as of March 31, 2005: Accelerated claim disposition

Payments before first default reported: 1

Summary:

Income Stability Not Verified/Inconsistencies Not Resolved

Wells Fargo did not resolve inconsistencies in the co borrower's claimed employment history. The co borrower's employment history changed significantly from the original loan application to the final loan application. Not only did the periods of employment change, the lender also removed a four-month period of unemployment from the final application. The loan correspondent used an online employment service to verify the borrower's prior employment history. The verifications reported employment timeframes consistent with what loan correspondent used in the final application, but they did not provide the co borrower's previous salaries. Further, the co borrower provided a letter stating that one of the verifications was incorrect. To verify that the co borrower's income was stable, Wells Fargo should have resolved the inconsistencies in the co borrower's employment history. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 requires the lender to assess the stability of borrower's income. As part of the assessment, the lender must verify the borrower's income for the most recent two full years. Further, the borrower must explain any gaps in employment of a month or more.

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 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 or List Price

The appraiser did not analyze the subject sales contract or property listing. The sales contract, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit down payment assistance program for \$3,678. 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. 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

Wells Fargo allowed the loan correspondent to charge \$2,843 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 \$2,327. 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: 492-6553929

Mortgage amount: \$89,294

Gift amount: \$2,700

Date of loan closing: March 27, 2003

Status as of March 31, 2005: Repayment

Payments before first default reported: 1

Summary:

Liabilities Understated

Wells Fargo ignored indications of a possibly significant contingent liability. In a handwritten note from the borrower, the borrower noted that the Social Security Administration was seeking repayment for an undisclosed amount due to what it asserted was an overpayment on the borrower's disability claim. The borrower said he requested a waiver of the overpayment, but that the "matter has yet to be decided." Wells Fargo should have investigated this contingent debt further and made a determination as to what effect it might have on the borrower's ability to pay the mortgage. HUD Handbook 4000.4, REV-1, paragraph 2-5, requires the mortgagee to obtain and verify information with at least the same care that a mortgagee would exercise in originating a loan that was entirely dependent on the property as security to protect its investment.

Creditworthiness Not Fully Considered

Wells Fargo did not require the borrower and co borrower to provide explanations for 2 of 18 collection accounts appearing on their credit report. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3, requires lenders to obtain written explanations from the borrower for collection accounts.

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, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit down payment assistance program for \$7,500. The appraiser should have identified the sales concessions and considered them in determining the final appraised value. Further, the appraiser notes that the property was listed for \$90,000, the contract sales price. However, the seller's real estate listing agreement shows the seller instructed the broker to market the property at \$84,500. 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. 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.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$460 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 \$2,634. 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: 492-6390936

Mortgage amount: \$124,019

Gift amount: \$3,750

Date of loan closing: July 15, 2002

Status as of March 31, 2005: Property conveyed to insurer

Payments before first default reported: 2

Summary:

Inconsistencies Not Resolved

The file contains inconsistent information on the borrowers' ages, addresses and employers. The loan applications and a May 2002 credit report showed that both the borrower and co borrower are 21 years old. However, the credit report showed the borrowers opened up 15 accounts when they would not yet have been of legal age. In addition, the borrowers' driver's licenses showed that the borrower was 23 and the co borrower was 22. Although the loan applications showed the borrowers lived at their current address for over 2 years, their pay stubs provided a different address. A December 2001 credit report, showed the borrower's current employer as LoanByPhone and the co borrower's current employer as Albertson's. The borrowers did not show either company as a current or former employer. HUD Handbook 4000.4, REV-1, paragraph 2-5 requires the mortgagee to obtain and verify information with at least the same care that a mortgagee would exercise in originating a loan that was entirely dependent on the property as security to protect its investment.

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. 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. 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.

Ineligible Closing Cost Charged to Borrower

Wells Fargo allowed the loan correspondent to charge \$2,200 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 \$5,721. 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: 491-8071128

Mortgage amount: \$130,469

Gift amount: \$3,945

Date of loan closing: July 28, 2003

Status as of March 31, 2005: Foreclosure started

Payments before first default reported: 2

Summary:

Liabilities Understated

Wells Fargo did not consider all of the borrowers' debt. Wells Fargo incorrectly excluded five deferred student loans from consideration. All five loans were scheduled to begin within 12 months of the loan closing and would increase the borrower's total fixed payments by \$580. HUD Handbook 4155.1 REV-4, CHG 1, paragraph 2-11(C) requires lenders to include projected obligations in the underwriting analysis if the debt is scheduled to begin within twelve months of the mortgage loan closing.

Borrower Ineligible for Federal Housing Administration Financing

Wells Fargo did not provide sufficient compensating factors to justify approval of the loan. According to Wells Fargo, the borrowers' front and back ratios were 23.16 and 44.85 percent. However, these ratios were based on Wells Fargo's incorrect computation of the borrowers' total fixed payment. Using the correct fixed payment amount, the borrowers' back ratio was 56.44 percent. The underwriter provided the following compensating factors: 1) new construction-energy efficient; 2) deferred loan applicant still in school upward mobility as she is educating herself; 3) derogatory credit old and explained; 4) homebuyer's education course; and 5) good rental history. An energy efficient house and the borrower's potential for increased earnings due to her education are valid compensating factors. However, the remaining factors provided are not valid. The homebuyer's education course may only be used to reduce the upfront mortgage insurance premium. Derogatory credit being old/explained and a good rental history are qualifying factors, but are not valid compensating factors. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12(B), requires lenders to provide significant compensating factors for back ratios over 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. All three 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 appraiser notes that the property was under contract for \$132,845. The sales contract, dated before the date of the appraisal, showed the property was under contract for \$131,500. It also showed the seller agreed to pay \$8,800 in borrower closing costs and other expenses. HUD Handbook 4150.2, paragraph 4.0, requires strict compliance with Uniform Standards of Professional Appraisal Practice. 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. 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.

Ineligible Closing Cost Charged to Borrower

Allied charged \$1,010 in loan discount points, but did not reduce the borrower's interest rate. Instead, they charged the borrower an above-market interest rate resulting in a yield spread premium of \$1,307. 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 Allied 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: 491-8034119

Mortgage amount: \$146,367

Gift amount: \$4,426

Date of loan closing: July 7, 2003

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

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 or property listing. The sales contract, dated before the date of the appraisal, showed the seller agreed to pay \$4,000 toward the borrower's closing costs or prepaids. 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. 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.

Case number: 491-8206149

Mortgage amount: \$145,847

Gift amount: \$4,410

Date of loan closing: October 15, 2003

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

Payments before first default reported: 2

Summary:

Inconsistencies Not Resolved

Wells Fargo accepted what appears to be false identification from the borrower. Deficiencies with the driver's license included, but were not limited to: 1) the driver's license number was identified as "ID" rather than "DL"; 2) the Department of Public Safety audit number was identical to the driver's license number; 3) the signature of the Department of Public Safety Director was omitted; and 4) the borrower's signature on the driver's license was inconsistent with his signature on loan applications. Problems with the social security card included: 1) the copy of the card did not include the square edges from the border of the card; 2) the background of the card was white when it should show up in gray tones; 3) the line on the inside edge of the right column was broken; and 4) the signature was inconsistent with his signature on loan applications.

Wells Fargo also failed to resolve other questionable items related to the borrower's employment. The borrower's claimed employment history was not consistent with what was shown on his credit report. The borrower claimed to have been a full time student for an eight-month period before obtaining his loan. However, the borrower did not provide an explanation as to how he was able to pay his bills, including rent of \$800, without incurring debt. Although the borrower claimed to be currently employed by a home health care organization, Wells Fargo obtained a social security report through a credit bureau that showed that the borrower was self-employed. The report also showed that a woman in Florida used the same social security number and that the number was issued in Florida. HUD Handbook 4000.4, REV-1, paragraph 2-5 requires the mortgagee to obtain and verify information with at least the same care that a mortgagee would exercise in originating a loan that was entirely dependent on the property as security to protect its investment.

Appraisal Adjustments for Sales Concessions on Comparables Not Made

The appraiser did not adjust the sales prices of the comparable properties for sales concessions. All three 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 appraiser only noted that the subject's current and prior sales prices are consistent with his sales analysis. The sales contract, dated before the date of the appraisal, showed the seller agreed to provide a grant to a nonprofit down payment assistance program for \$11,327. 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. 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 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

Allied charged \$225 in loan discount points, but did not reduce the borrower's interest rate. Instead, they charged the borrower an above-market interest rate resulting in a yield spread premium of \$5,790. 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 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 Allied charged loan discount points without reducing the interest rate, the discount points were unearned fees in violation of the Real Estate Settlement Procedures Act.