



Issue Date	May 13, 2005
Audit Report Number	2005-KC-1006

TO: Frank L. Davis, General Deputy Assistant Secretary for Housing, H

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: Corinthian Mortgage Corporation, Mission, KS, Did Not Always Comply with Federal Housing Administration Requirements

HIGHLIGHTS

What We Audited and Why

We audited Corinthian Mortgage Corporation (Corinthian Mortgage), a nonsupervised direct endorsement lender located in Mission, KS, because its default rate was significantly higher than the U.S. Department of Housing and Urban Development (HUD) Kansas City field office's average over the past 2 years.

Our audit objectives were to determine whether Corinthian Mortgage properly developed and implemented a quality control plan and to determine whether it properly originated Federal Housing Administration loans.

What We Found

Corinthian Mortgage's quality control process did not comply with HUD requirements. Corinthian Mortgage did not ensure that it conducted sufficient and timely quality control reviews. It also did not take prompt corrective action when quality control reports identified material deficiencies. As a result, HUD lacks assurance that Corinthian Mortgage is able to ensure the accuracy, validity, and completeness of its loan origination operations.

Further, Corinthian Mortgage did not follow HUD requirements when processing and underwriting Federal Housing Administration loans. It improperly originated 3 of the 44 loans reviewed. These three loans contained material deficiencies that affected the insurability of the loans, including unsupported assets, underreported liabilities, and unsupported income. Additionally, Corinthian Mortgage submitted one loan with a serious misstatement. As a result, HUD insured four loans that placed the insurance fund at risk for \$472,833.

What We Recommend

We recommend that the general deputy assistant secretary for housing take appropriate administrative action against Corinthian Mortgage based on the information contained in these findings. This action should, at a minimum, include requiring indemnification for the three actively insured loans and reimbursement for losses already incurred on the remaining loan. Corinthian Mortgage should also reimburse the appropriate parties for unallowable costs charged to borrowers.

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

Corinthian Mortgage generally disagreed with our findings. We provided the draft report to Corinthian Mortgage on April 22, 2005, and requested a response by April 29, 2005. Corinthian Mortgage provided written comments on April 29, 2005.

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

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BACKGROUND AND OBJECTIVES

Corinthian Mortgage Corporation (Corinthian Mortgage) began operations in 1985 and became an approved lender for the Federal Housing Administration that same year. Corinthian Mortgage Corporation's headquarters is located in Mission, KS. At the beginning of our audit period, Corinthian maintained six branch offices, four in the Kansas City area. All four of the Kansas City area offices, as well as one other, were sold or closed at the end of 2003. Corinthian Mortgage currently operates only one branch office doing business as Southbanc in Herndon, VA. According to Corinthian staff in the Virginia office, they currently originate an average of only two Federal Housing Administration loans per month. Corinthian performs its own U.S. Department of Housing and Urban Development (HUD)-required quality control reviews.

Corinthian Mortgage originated 758 Federal Housing Administration-insured mortgages that closed between September 1, 2002, and August 31, 2004. We selected Corinthian Mortgage for review because its default rate was significantly higher than the HUD Kansas City field office's average over the past 2 years. During our audit period, the percentage of Federal Housing Administration loans defaulting at Corinthian Mortgage within the first 2 years was 5.66 percent. This was more than twice the Kansas City field office's rate.

Our audit objectives were to determine whether Corinthian Mortgage properly developed and implemented a quality control plan and to determine whether it properly originated loans by correctly documenting and evaluating income, assets, liabilities, credit history, qualifying ratios, allowable charges, and borrower eligibility and by properly submitting any late endorsement requests.

RESULTS OF AUDIT

Finding 1: Corinthian Mortgage's Quality Control Process Did Not Comply with HUD Requirements

Corinthian Mortgage did not comply with HUD's quality control requirements. The written quality control plan fully met HUD's requirements; however, the elements of the plan were not adequately implemented. The deficiencies associated with Corinthian Mortgage's quality control plan and procedures can be attributed to several issues including staff turnover and excessive workload. As a result, Corinthian Mortgage is unable to ensure the accuracy, validity, and completeness of its loan originations.

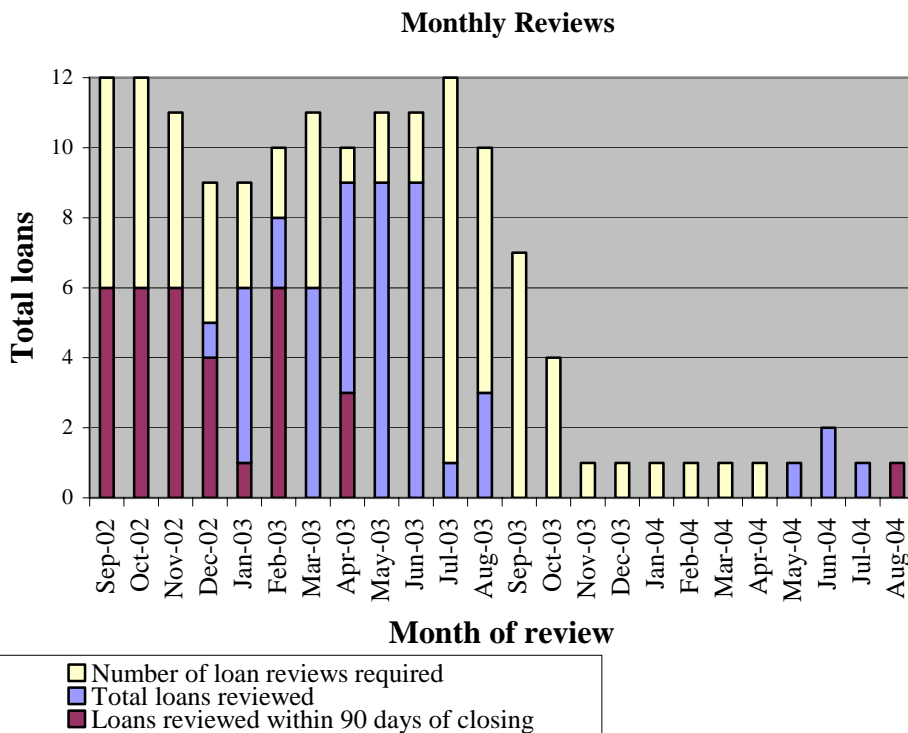
Corinthian Mortgage's Process Did Not Meet HUD Standards

Corinthian Mortgage's written quality control plan included all HUD-required elements. Corinthian Mortgage did not, however, consistently follow the plan. It did not perform sufficient or timely reviews, nor did it take prompt corrective action when deficiencies were identified.

During the audit period, Corinthian Mortgage only began reviewing 10 percent or more of its Federal Housing Administration loans in May 2004. HUD requires that lenders perform a monthly review of at least 10 percent of all Federal Housing Administration loans originated. Additionally, Corinthian did not review any Federal Housing Administration loans that went into default within 6 months of the closing date, although HUD requires that all such loans be reviewed. Furthermore, Corinthian did not perform annual branch office visits for any branch in the Kansas City field office during 2003. Corinthian's explanation is that there was a plan to sell or close the branches, so they did not feel it was necessary to do the site visits.

Quality control reviews should be performed on a regular and timely basis. Corinthian Mortgage did not have quality control reports for 7 months out of our 2-year audit period. For the months that reviews were completed (September 2002-August 2003 and April 2004-August 2004), we determined that the number of days between the last day of the reporting month and publication of the quality control report ranged from 85 days to 305 days. The average was 186 days. Additionally, Corinthian Mortgage did not always perform quality control reviews within 90 days of loan closing. For 16 months, Corinthian Mortgage did not complete any reviews within 90 days of loan closing. HUD requires that the review of a specific mortgage be completed within 90 days of closing. The following chart shows by month the total number of loan reviews required to meet

the 10-percent requirement, the number of loans reviewed, and the number of those loans that were reviewed within 90 days of closing.



Corinthian Mortgage’s senior management did not take prompt action to correct deficiencies noted in its quality control reports. Corinthian’s quality control reports did not include management responses. We were not provided with any other evidence of management responses to the quality control reports.

Under HUD’s Single Family Endorsement program, the lender underwrites and closes the loan without prior HUD review or approval. Therefore, it is imperative that approved lenders establish and implement quality control policies and procedures that meet HUD requirements. Without an adequate quality control process, HUD cannot be assured that Corinthian Mortgage is properly processing and submitting Federal Housing Administration loans for insurance endorsement.

Conclusion

Corinthian Mortgage did not implement a quality control process that complied with HUD requirements. The written quality control plan included all HUD-required elements; however, the elements of the plan were not adequately followed. The deficiencies associated with Corinthian Mortgage’s quality control plan and procedures can be attributed to several issues including staff turnover, excessive workload of the quality control supervisor, increased volume of

indemnification/repurchase issues, and the opening of a high-volume call center. Without a properly implemented quality control process, the lender cannot ensure that its loan originations comply with HUD requirements; that it is protecting itself and HUD from unacceptable risk; and that it is guarding against errors, omissions, and fraud.

Recommendations

Because the branches reviewed are no longer in business, we have no recommendation for this finding.

Finding 2: Corinthian Mortgage Did Not Follow HUD Requirements When Originating Loans

Corinthian Mortgage did not follow HUD requirements when processing and underwriting 3 of the 44 loans reviewed for compliance. The loans contained material deficiencies that affected the credit quality (insurability) of the loans. Additionally, Corinthian Mortgage submitted one loan with a serious misstatement. The loan origination deficiencies occurred because Corinthian Mortgage did not have an adequate control environment to ensure that its employees followed HUD requirements when processing and underwriting loans. As a result, HUD insured four loans that placed the insurance fund at risk for \$472,833 and incurred other related losses.

Loans Did Not Comply with HUD Requirements

Corinthian Mortgage originated three loans totaling \$394,453 that contained significant loan origination deficiencies. These loans contained material errors including unsupported assets, underreported liabilities, and unsupported income. These deficiencies occurred because Corinthian Mortgage did not have adequate controls to ensure that its employees followed HUD requirements when originating loans. Corinthian Mortgage's deficient quality control process may have also contributed to the loan origination deficiencies (see finding 1).

As of February 1, 2005, HUD's data systems showed that two of the three loans were actively insured with Federal Housing Administration insurance. HUD had incurred \$191,049 in claims on the third loan.

The following table summarizes the categories of loan deficiencies.

<i>Deficiency</i>	<i>Number of Loans</i>
<i>Unsupported assets</i>	1
<i>Underreported liabilities</i>	2
<i>Unsupported income</i>	2

Two of the loans contained more than one deficiency. Detailed descriptions of the deficiencies noted are presented below. Appendix C presents a table summarizing the deficiencies on each of the three loans, and appendix E contains detailed case studies of each of these loans.

Unsupported Assets

Corinthian Mortgage did not sufficiently verify borrower assets in one of the three loans with material deficiencies. The material deficiency related to a new bank account with a large unexplained balance.

HUD requires lenders to verify all funds for the borrower's investment in the property. More specifically, HUD requires the lender to obtain an explanation and evidence of source of funds for any large increases in bank accounts or recently opened accounts.

Underreported Liabilities

Corinthian Mortgage did not consider all relevant liabilities when approving two of the three loans. HUD requires lenders to consider all recurring obligations, contingent liabilities, and projected obligations that meet HUD's specific stipulations when evaluating a loan application. Underreported liabilities have a direct effect on the housing and debt ratios. These ratios are an integral part of the underwriting decision. The use of incorrect liability information could result in an invalid underwriting decision.

Unsupported Income

Corinthian Mortgage used an unsupported income amount for two of the three loans. Lenders may not use any income in evaluating the borrower's loan that it cannot verify, is not stable, or will not continue. Overstating income has a direct effect on the housing and debt ratios. These ratios are an integral part of the underwriting decision. The use of incorrect income information could result in an invalid underwriting decision.

Other Deficiencies

Corinthian Mortgage also originated 20 loans that contained minor underwriting deficiencies. While these deficiencies did not affect the overall credit quality (insurability) of the individual loans, this fact does not relieve the lender from following all facets of HUD requirements when originating Federal Housing Administration loans. We provided details of these deficiencies to Corinthian Mortgage during our review. Appendix C presents a table summarizing the deficiencies on each of the 20 loans.

In addition, Corinthian Mortgage submitted one loan to HUD claiming downpayment assistance from the state's housing finance agency that was never received. The state agency determined the borrower was ineligible after the loan closed, but before Corinthian submitted the loan to HUD. Without the grant funds, the borrower did not meet the statutory minimum investment requirement. Therefore, this loan was not eligible for Federal Housing Administration insurance. As of February 1, 2005, HUD's data systems showed that the loan, with an

original mortgage amount of \$78,380, was actively insured with Federal Housing Administration insurance.

Unallowable fees were charged to borrowers in three loans. A listing of the unallowable fees charged to borrowers is presented in appendix D.

Conclusion

Corinthian Mortgage did not have an effective control environment to prevent its employees from approving loans that did not meet HUD requirements. As a result, Corinthian Mortgage originated four loans containing deficiencies that have placed the Federal Housing Administration insurance fund at risk for \$472,833 and caused HUD to incur other related losses.

Recommendations

We recommend that the general deputy assistant secretary for housing

- 2A. Take appropriate administrative action against Corinthian Mortgage for not complying with HUD requirements, including imposing appropriate monetary penalties and requiring Corinthian Mortgage to indemnify HUD for the three loans holding active insurance totaling \$297,269 and the one loan with claims paid totaling \$191,049.
- 2B. Require Corinthian Mortgage to reimburse the appropriate borrowers for \$590 in unallowable fees (see appendix D).

SCOPE AND METHODOLOGY

Corinthian Mortgage originated 758 Federal Housing Administration-insured loans that closed from September 1, 2002, through August 31, 2004. Of these 758 loans, we reviewed 44 loans that defaulted within the first 2 years of the loan. We also reviewed one loan that did not default but was submitted with a major misstatement.

To achieve our objectives, we reviewed HUD's rules, regulations, and guidance for proper origination and submission of Federal Housing Administration loans. We also reviewed previous HUD reviews of Corinthian Mortgage and the HUD case binders for the 44 defaulted loans. In addition, we interviewed HUD staff to obtain background information on HUD requirements and Corinthian Mortgage.

We interviewed Corinthian Mortgage's management and staff to obtain information regarding its policies, procedures, and management controls. We reviewed Corinthian's written policies and procedures to gain an understanding of how its processes are designed to function. We also reviewed Corinthian Mortgage's quality control plan and available quality control reports. Additionally, we reviewed Corinthian Mortgage's case binders for the 44 defaulted loans and the loan with the misstatement.

We relied upon computer-processed data contained in HUD's Single Family Data Warehouse system. We assessed the reliability of these data, including relevant general and application controls, and found them to be adequate. We also performed sufficient tests of the data, and based on the assessments and testing, we concluded that the data are sufficiently reliable to be used in meeting our objectives.

We performed audit work from November through February 2005. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Controls over origination of Federal Housing Administration loans

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following item is a significant weakness:

- Corinthian Mortgage has not properly implemented a quality control plan and process (see finding 1).

APPENDIXES

Appendix A

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

Recommendation Number	Ineligible 1/	Unsupported 2/	Unreasonable or Unnecessary 3/	Funds To Be Put to Better Use 4/
2A		\$191,049		\$297,269
2B	\$590			

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ “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

03/02/05 10:11 FAX

03/02



April 29, 2005

Mr. Ronald J. Hosking
Regional Inspector General
US Department of HUD, Office of Inspector General
Gateway Tower II - 5th Floor
400 State Avenue
Kansas City, KS 66101-2406

Re: Response to Draft Audit Report

Dear Mr. Hosking:

We appreciate the opportunity to offer our comments regarding your audit report. We understand and accept the seriousness of this issue, but feel there are several factors that must be considered relating to your findings and have outlined our response below.

Comment 1

Default Rate

The significantly high default rate for FHA loans originated by our Kansas City area branches is a matter for concern, but was caused by several unique factors that must be considered. First, it has always been our claim that HUD fails to identify and track loans involving down payment assistance from a non-profit or government agency as "high risk". You have the ability to tag loans originated under the section 203K program as "high risk" and therefore allow greater tolerance for default, but loans with down payment assistance, in our view, are equally risky. Since they are originated through the normal 203b program, HUD currently has no way to identify them and analyze their performance rate compared to the remaining population of 203b loans.

Over the years, in order to offer homeownership opportunities to a segment of the population that may not otherwise have that privilege Corinthian Mortgage has been a major participant in the Missouri Housing Development Commission's bond program which offers not only lower than market interest rates, but also down payment assistance grants to qualified buyers. There are also several other grant and assistance programs available in this area such as city sponsored grant programs, Ameridream and Neighborhood Gold. HUD has chosen not to prohibit the use of these programs for borrower down payment assistance, so in order to compete in the marketplace, lenders must accept borrower participation. It is our contention that borrowers receiving grants from non-profit or publicly funded entities are even more likely to default than if they had received a gift from a relative. They have no family or emotional commitment to the party providing the grant, so lack the same sense of obligation they would have if the down payment had been provided by a family member. These borrowers are essentially receiving loans without paying any sort of down payment or closing costs, and history has shown default rates increase significantly for borrowers with no financial commitment in the transaction. We have been able to determine that over 62% of the defaulted loans chosen for audit involved borrower down payment assistance, which has to be considered as a significant factor.

At the beginning of 2003 our Board of Directors began to examine alternatives to the retail business channel and before the end of the 3rd quarter 2003 all of the Kansas City retail branches had been closed or sold. The anticipated change in the company business plan caused the normal mix of loans originated by the retail branches in the last months of their operation to change, partly in order to fulfill the outstanding bond commitments. During 2002 the percentage of FHA loans originated under the MHDC bond program by the Kansas City branches was 27%, but in 2003 that number had grown to 35%; an

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increase of nearly 33%. Since virtually all of the bond loans included some sort of down payment assistance the default rate was bound to increase significantly, as well.

It is our claim that comparing default rates for lenders who are heavy participants in government bond programs with those of lenders who are not is like comparing apples to oranges. In order to make a fair comparison, HUD simply must develop a means to identify the higher risk factors of those loans.

Comment 2

Quality Control

It should be noted that prior to this audit period, Corinthian Mortgage was examined on numerous occasions by HUD as well as various other investors and insurers and always received the highest ratings on our Quality Control process and procedures. Reports were issued timely without fail and management responded to findings promptly as would be expected. Supervision of the Quality Control department changed in August 2002. Through times of additional staffing turnover, heavy origination volume from new business channels, and increased post purchase risk management responsibilities, steps were missed in the Quality Control selection, review and reporting process, and some reports were not produced timely.

In September 2004 department supervision changed again with the return of the previous manager who immediately took steps to bring the selection, review and reporting process back into compliance. The production channels were analyzed and separate "workgroups" were created for quality control reporting. There was a possibility that two of the new workgroups could produce FHA loans, so a concentrated effort was made to complete the review and issue reports in order to bring them current. As of December 31, 2004 reports were issued for all workgroups containing FHA loans within 90 days of the closing date and that schedule will be maintained going forward. (Example: 9/04 report issued 12/30, 10/04 report issued 1/13, 11/04 report issued 2/2, 12/04 report issued 3/17) Management response is now requested to be provided within 2 weeks of report issuance date, and a summary of those responses is forwarded to Sr. Management on a periodic basis. Responses are compared and monitored against subsequent review results to assure corrective action is taken as stated. Trends of improvement or decline are tracked and commented on in Overview reports to Sr. Management. Additional special or "targeted" audits are added if an area of concern or weakness is identified.

HUD's Neighborhood Watch is reviewed monthly to identify any FHA loans defaulting early in their term which are then included as a separate review work group immediately upon discovery. The automated selection process for regular quality control reviews is now monitored to assure at least a 10% sample size for FHA loans. If one or more FHA loans are originated within a workgroup in any given month and none were selected for review by the software, a manual selection is made of FHA loan(s) to be added to the review. We have also stepped up the review appraisal process, and now 100% of FHA loans chosen for quality control review have a review appraisal ordered if an appraisal was required for origination. Onsite branch audits for the remaining "east coast" branches have also been resumed and are expected to be completed no later than the 2nd quarter of 2005.

Comment 3

In spite of the deficiency in completion of the Quality Control reports during the review period, we feel the assumption that Corinthian Mortgage did not follow HUD requirements when processing and underwriting FHA loans or to have the appropriate internal controls in place to be false. Training and oversight for origination offices, particularly underwriters, was always a company priority and was ongoing up until the elimination of the Kansas City area branches and home office underwriting staff.

Comment 4

The lack of documentation of receipt of gift/grant funds from the non-profit organizations was and is a symptom of the program. In most cases, after program approval, the lender advances the grant amount for settlement that has been approved and is reimbursed by the non-profit well after closing. At the advice of our HUD Home Ownership Center in Denver, we required the amount of grant to be shown on the HUD 1 and included documentation to show approval of the grant in our file, although not receipt of the funds. In the case noted where grant funds were not reimbursed, we have now been provided with the case number and borrower name so we will investigate whether our failure to receive the grant funds

Comment 5

was simply the result of an accounting error that can be rectified, or if the housing authority denied payment. We therefore request additional time to research this issue before considering indemnification.

Also on this subject, we would like to comment on the differing advice received from the various HUD Home Ownership Centers. As a nationwide lender, it has been our experience that gift documentation requirements as well as other advice vary greatly between HOCs. Not only does opinion vary between HOC, but in many cases instructions that we have received from them, differs from your examiner's expectations. The result is that lenders are forced to operate under numerous sets of rules that vary greatly which is unreasonable.

Individual Loan Findings

Serious deficiencies were cited in the areas of unsupported assets, underreported liabilities, and unsupported income. It should be noted that all of the loans found to have exceptions were approved by Desktop Underwriter or Loan Prospector, so in many cases, requirements that would be made on a manually underwritten loan were not required on an automated approval.

We disagree with the findings and our responses are provided with your narrative for the three loans included in **Schedule C, Loans with Deficiencies That Affected Insurability**.

Narrative Results of Review:

Case Number: 291-3027843	Loan Purpose: Purchase
Underwriter Type: Desktop Underwriter	Date of Loan Closing: 10/16/02
Insured Amount: \$175,564	Housing/Debt Ratio: 20.93/48.6 percent
Current Status: Property conveyed to insurer	HUD Costs Incurred: \$191,049

Underreported Liabilities:

The borrower's credit report shows a Department of Veterans Affairs mortgage with a \$655 per month payment. This payment is not included in the liabilities. The file includes a month-to-month rental agreement for the property but also includes a sales agreement for the property. Based on the credit report, the mortgage should have been included as a liability when qualifying the borrower. There is not enough documentation in the file to prove that the property was sold or is used as a rental property. The lender stated that the property was rented and is still occupied under the agreement included in the HUD file. An additional \$93 should have been included in the liabilities to account for the difference between the \$655 mortgage payment and 75 percent of the \$750 rental income. This would increase the debt ratio to 50.06 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-11A, Recurring Obligations: The borrower's liabilities should include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the housing expense and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony, etc., extending 10 months or more.

The Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

HUD Handbook 4155.1, REV-4, paragraph 2-7M, Rental Income: If a property was acquired since the last income tax filing and is not shown on Schedule E, a current, signed lease or other rental agreement must be provided. The gross rental amount must be reduced for vacancies and maintenance by 25 percent (or the percentage developed by the FHA office having jurisdiction where the property is located) before subtracting principal, interest, taxes, insurance, and any homeowners' association dues, etc., and applying the remainder to income (or recurring debts, if negative)

Unsupported Assets:

The borrower recently opened a savings account with \$3,000. The lender did not provide any explanation or evidence as to the source of funds for the savings account. The borrower did not need these funds for closing, however, the funds were included in the calculation of reserves and should have been verified. The automated underwriting system might have returned a different decision if the reserves only included the funds that were properly verified. Instead of 3 months worth of reserves, the borrower would only have had 1 month.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-10B, Savings and Checking Accounts: A verification of deposit may be used to verify these accounts, along with the most recent bank statement. If there is a large increase in an account or the account was opened recently, an explanation and evidence of source of funds must be obtained by the lender.

Manual Underwriting Considerations:

Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on manual underwriting requirements, the borrower's creditworthiness should be considered. The application, underwriting worksheet, and Desktop Underwriter listed monthly liabilities of \$1,787. However, the lender did not consider the borrower's liabilities of \$121 in collections listed on the credit report. The credit report shows several late payments in the 6 months before loan closing and several more in the previous 2 years. Additionally, compensating factors are required when ratios exceed the 29 percent and 41 percent guidelines. No compensating factors were provided for this loan.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-3: Past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong offsetting factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-4, paragraph 2-3C: Both collections and judgments indicate the borrower's regard for credit obligations and must be considered in the analysis of creditworthiness.

Response

We agree that the documentation in the loan file is a bit confusing. It appears that the borrower initially applied for a VA loan, intending to sell their current property on N Strathbury Ave. in order to have their VA entitlement reinstated to be used to guaranty this loan. The sale fell through, however, so the loan type was changed to FHA and the Strathbury property was rented instead. A copy of a rental agreement is located in the file and we were able to successfully verify that the renters did and still do occupy the property. Since the file documentation is somewhat unclear, we are unable to tell if the DU findings were re-ran after it was determined the prior home would be rented instead of sold. Using the \$655 payment, and only 75% of the rental income of \$750, results in an additional \$102.50 in debt to be counted towards the DTI. While analyzing the findings it was discovered that a payment of \$195.00 per month was included for the borrower's union dues. According to HUD handbook 4155.1 Rev 5, Chapter 2, Section 4, paragraph 2-11, union dues are not to be counted as debt. Following is an excerpt from the guide:

- D. Obligations Not Considered Debt. Obligations not to be considered debt (or subtracted from gross income) include federal, state, and local taxes; FICA or other retirement contributions such as 401(k) accounts (including repayment of debt secured by these funds); commuting costs; union dues; open accounts with zero balances; automatic deductions to savings accounts; child care; and voluntary deductions.*

Adding the \$102.50 rent differential and subtracting the \$195.00 union dues leaves total debt of \$3,044.31 vs \$3,136.81, and a total debt to income ratio of 47.19% as apposed to 48.63%. We are

Comment 7

confident that if the findings resulted in approve/eligible risk classification with a DTI of 48.63% then it would also have been approved at the lower ratio.

Regarding the additional \$3,000 in assets listed, there is a copy of an account printout certified by a bank representative located in the file. The dates are unclear on our file copy, so we are unable to tell for certain if it provides the balance as of the previous month end as required by the DU findings. However, as you stated, the borrower did not need these funds to close as a total of \$10,837.26 in assets were verified. They needed only \$5,860.41 including the gift to close, so additional verification of these funds would be immaterial.

Due to the fact that the DTI would actually be lower than that considered by DU, we feel confident the findings are reliable and therefore only the requirements set out by the AUS for credit consideration would need to be followed. The additional \$121.00 in collection liability or other derogatory credit was not considered as it was not required to be counted or explained per the findings: "No explanation is required for adverse or other derogatory information."

Narrative Results of Review:

Case Number: 291-3178636	Loan Purpose: Purchase
Underwriter Type: Desktop Underwriter	Date of Loan Closing: 8/11/03
Insured Amount: \$94,254	Housing/Debt Ratio: 31.7/47 percent
Current Status: Delinquent	HUD Costs Incurred: \$0

Unsupported Income:

The application, underwriting worksheet, and Desktop Underwriter stated the borrower's total income was \$2,207. The lender computed the borrower's income based on a 36-hour work week at \$14 per hour. The borrower had only been employed by his current employer for a short time. This is his second change of employment in two years. While the year-to-date income from the borrower's most recent pay stub supports the hourly rate, considering a recent raise, it is only for three and a half months. Historical income data indicate a much lower monthly income. In 2001, the borrower only averaged \$1,524 per month. In 2002, he averaged \$1,627 per month. A more accurate estimate of the borrower's monthly income, based on employment history and length of time at current job, would have been an average of his prior year's earnings and his year-to-date earnings. That calculation results in an average monthly income of \$1,717. Using this income, the housing ratio would increase from 31.7 to 40.7 percent, and the debt ratio would increase from 47 to 60.4 percent. Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on the excessive ratios, compensating factors would have been required for manual underwriting.

HUD Requirements:

HUD Handbook 4155.1, REV-4, chapter 2, section 2: The anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt.

HUD Handbook 4155.1, REV-4, paragraph 2-12: Ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership and otherwise provide for the family. The lender must compute two ratios: (A) mortgage payment expense to effective income, which cannot exceed 29 percent of gross effective income unless significant compensating factors are presented, and (B) total fixed payment to effective income, which can not exceed 41 percent of gross effective income unless significant compensating factors are presented (see HUD Handbook 4155.1, REV-4, paragraph 2-13, for compensating factors that may be used in justifying approval of mortgage loans with ratios exceeding HUD's guidelines).

Comment 8**Response**

We disagree with the findings regarding unsupported income described above. The borrower explained that his reason for leaving the position he held for more than 1.5 years as Youth Counselor was due to his engagement to his wife who was also his supervisor at the time. Company policy prohibited both of them remaining employed, so the borrower found other employment working with children as a Teacher's Aide, but after a two month gap in employment waiting for the start of a new school year. The verification of employment from the school district supports this explanation showing his start date to be 8-16-02. It also shows that he resigned from that position on 3-14-03. Although the borrower's new job in the shipping division of a department store apparently required less training, it is reasonable that the rate of pay would be higher. He began that job on 3-24-03 with no additional gap in employment. By the time this loan closed on 8-12-03 the borrower had been with his current employer for almost 5 months. Given the explanations provided by the borrower and the reasonable expectation that the borrower would be earning a higher rate of pay at his new position we feel it was acceptable for the underwriter to calculate his monthly income from his current rate of pay rather than using an average for years spent working in an entirely different, and lower paying field. Since the income used appears valid, there is no question regarding data integrity or the resulting DU findings showing "Approve/Eligible."

Narrative Results of Review:

Case Number: 291-3195243	Loan Purpose: Purchase
Underwriter Type: Desktop Underwriter	Date of Loan Closing: 9/18/03
Insured Amount: \$124,635	Housing/Debt Ratio: 19.11/35.64 percent
Current Status: Repayment	HUD Costs Incurred: \$0

Underreported Liabilities:

The underwriter did not include the coborrower's \$550 child support payment as a liability in Desktop Underwriter. The payment is listed on the underwriting worksheet and application. Additionally, the coborrower's pay stubs show a garnishment for the child support payment. Without the child support payment, Desktop Underwriter approved the loan with ratios of 19.11 and 35.64 percent. The added liability increases the total debt ratio to 46.44 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-11A, Recurring Obligations: The borrower's liabilities should include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the housing expense and all other recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony, extending 10 months or more.

In the Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines, as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

Unsupported Income:

The underwriting worksheet, Desktop Underwriter, and application state that the borrower has base income of \$3,121 per month. This amount was derived from the average of the most recent 19 months. However, the year-to-date income for the most recent 7 months indicates a base pay of only \$2,848 per month. Based on total income from the borrower's 2002 Internal Revenue Service Form W-2, her

average monthly income in 2002 was \$3,280. There is nothing in the file to explain the decrease in income. The decrease in monthly income would increase the ratios to 20.15 and 48.97 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, chapter 2, section 2: The anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt.

HUD Handbook 4155.1, REV-4, paragraph 2-12: Ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership and otherwise provide for the family. The lender must compute two ratios: (A) mortgage payment expense to effective income, which can not exceed 29 percent of gross effective income unless significant compensating factors are presented, and (B) total fixed payment to effective income, which can not exceed 41 percent of gross effective income unless significant compensating factors are presented (see HUD Handbook 4155.1, REV-4, paragraph 2-13, for compensating factors that may be used in justifying approval of mortgage loans with ratios exceeding HUD's guidelines).

The Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

Manual Underwriting Considerations:

Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on manual underwriting requirements, the borrower's creditworthiness should be considered. The borrower's average credit score was below 620. However, the combined average of the borrower's and coborrower's scores is 631. The credit report shows numerous collection accounts and more than \$1,500 in past due payments. Additionally, the borrowers also have several deferred education loans with a total balance of \$11,757. The deferment periods for the loans end within the first 2 years after loan closing. While these loans are not required to be included as liabilities, they should be considered. These future liabilities could substantially increase the debt ratio, adversely affecting the borrowers' ability to repay the home loan. Another factor to consider is the increase in housing expense. The current housing expense for the borrower's documented is \$750. The housing expense for the new loan is \$1,009, a 25 percent increase. Finally, the borrower's were only able to verify \$6 in assets, other than the gift funds received from a down payment assistance program.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-3: Past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong offsetting factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-4, paragraph 2-3C: We don't arbitrarily require that collection accounts be paid off as a condition for loan approval. Both collections and judgments indicate the borrower's regard for credit obligations and must be considered in the analysis of creditworthiness.

Response

It appears that the DU findings were not updated to include the child support payment. However, it is clear the underwriter recognized and considered the obligation since it was included in the total debt calculation on the MCAW. While \$550 is a significant amount to add to the total debt considered by DU, we feel the findings result would still be Approve at a total debt to income ratio of 46.44%. This

Comment 9

assumption is based on a history of "Approve" results for borrowers with similar credit scores, assets, and job stability.

Comment 10

The calculation method for the borrower's income is also reasonable by industry standards. It would not have been appropriate to have used only the previous year's earnings, which would have resulted in a higher monthly income amount or only current year which would have resulted in a lower figure, but averaging the current year with the prior year's earnings is considered prudent and recognized as acceptable. We were unable to reach the employer to verify whether the borrower's hours, and thus earnings, typically increased over the fall and winter as may be expected in the home health care business which would explain the lower year to date total, but we feel that may be the case. The income used by DU for qualification is based on a reasonable average in our opinion, and should be considered reliable.

Comment 11

We feel the AUS findings are reliable for the above reasons. In spite of the referenced collection accounts, the credit scores for both borrowers are in the mid 600 (specifically 617 and 671) range which is not considered poor. The collections are primarily medical in nature and typically ignored by the AUS models. Both borrowers were divorced recently at the time of origination of this loan which no doubt contributed to some of their credit issues. All of the late payments shown on the credit report were more than 2 years old and the credit report also shows a number of trade lines with perfect payment histories including a home mortgage with no late payments in 73 months reviewed. Taken as a whole we feel the credit was acceptable.

As for the student loan debt not being considered; the credit report clearly shows them to be deferred to 1-05. Following is an excerpt from HUD's 4155.1 Rev 5 Chapter 2 Section 4 paragraph 2-11

- C. ***Projected Obligations.*** *If a debt payment, such as a student loan, is scheduled to begin within twelve months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis, unless the borrower provides written evidence that the debt will be deferred to a period outside this time frame. Similarly, balloon notes that come due within one year of loan closing must be considered in the underwriting analysis.*

Since these debts were not scheduled to begin for 15 months after closing it is appropriate that they were not considered.

Again, since the AUS findings accepted the increase in housing expense and assets comprised only from a gift, neither were questioned by the underwriter.

Unallowable Fees Charged to Borrowers

We are unable to determine why The Loan Admin fee of \$445 and the Wire/admin fee of \$50 were charged to the borrowers. It is possible that the closer failed to recognize the loan type as FHA, but at this date we are unable to know for sure. We agree to refund those fees.

Regarding the \$95 "Other sales agent charge" we disagree with your finding that this was unallowable. Back in 2001 our Home Ownership Center in Denver was asked to address the growing practice in our area of real estate brokers charging additional administrative fees to borrowers and whether or not that would be considered an allowable borrower charge by HUD. We were instructed that if it was "customary in the area" for the borrower to be charged these additional fees then they would consider them to be allowable.

Comment 12

Loans with Minor Deficiencies

We also disagree with many of the findings noted as minor deficiencies and our responses follow.

Comment 4

-You indicated that neither the HUD case binder or Corinthian mortgage file contained a copy of the wire transfer of gift funds for the following cases; 291-3000601, 291-3053213, 291-3104350, 291-3116756, 291-3124775, 291-3134693, 291-3151350, 291-3156811, and 291-3195243. All of these cases involved gift funds received from a non-profit agency. Our files contain ample documentation that the borrower had been approved for the program and at the advice of the Denver HOC only the gift amount showing on the HUD 1 was required as evidence of receipt. None of the cases were rejected for insurance by the HOC, so we feel this is another example of differing standards within HUD.

Comment 13

-Your finding was that the Case Binder did not include documentation that the borrower received an LDP/GSA check, or in one case a CAIVRS approval number for the following loans; 291-3156811, 291-3104350, 291-3113005, and 291-3187428. Prior to the spot being added to the Mortgage Credit Analysis Worksheet to record this information, it was our practice for the processor to verify the LDP/GSA lists and obtain CAIVRS clearance and note the information on a separate "Processor Certification" sheet in the file. At that time HUD did not require that the separate certification be added to the Case Binder file submitted for insuring. As is usually the case whenever forms change, it takes a while for all parties to revise their procedures accordingly. In the files noted above, we found the separate Processor Certifications in our files and none of the files noted were rejected by the HOC for insuring.

Comment 14

-The following cases were noted to be lacking the seller's signatures/costs from the HUD 1s located in the Case Binders; 291-3059012, 291-3059931, 291-3088757, 291-3113005, 291-3117071, and 291-3156811. In all cases a copy of a HUD 1 containing the seller's signatures was found located in our file. The cases were not rejected by the HOC for insuring, so apparently the documentation was accepted as is.

Comment 15

-It was noted that the file did not contain an explanation for a recent \$3,000 deposit on case number 182-0753355. Since the funds were not needed for closing, receipt of gift funds was documented and appropriately entered, and the amount of other assets entered in DU (\$889.76) was actually less than the average daily balance for the account there was no reason to request an explanation for the deposit.

Comment 16

-On case number 291-3057612 it was noted that an increase in balance of the savings account was not questioned. We feel that an explanation was not required since the current balance shown on the written VOD was much less than the two month average shown on the form.

Comment 17

-Findings on case number 291-3070785 related to unsupported assets and unsupported income. We offered the following response to those findings during the audit:

We are unable to determine the hourly rate used by the underwriter at the time of approval for the co-borrower and agree that the gross monthly income for her should be \$2,132. vs \$2,187. However, the VOE located in file shows overtime documented for 20.25 months. We calculate an average of the total overtime to be \$195.88 per month vs \$165.00. We agree with your comment that not all of the child support due the co-borrower has been received regularly and only \$279 is documented as having been received for at least 12 months. With these adjustments, the income should be 65.43 less than the amount used to qualify leaving ratios of 30.58/42.55. These ratios are slightly higher than the guidelines, but we feel strongly that the borrower's income is a legitimate compensating factor. Section 2-13 of HUD handbook 4155.1 states that "Compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines are those listed below." Then listed at item E: "The borrower receives documented compensation or income not reflected in effective income, but directly affecting the ability to pay the mortgage..." Since none of the borrower's income was counted as effective income it surely qualifies as a compensating factor since it was well documented in the loan file.

Comment 18

Regarding your finding of Unsupported Assets, we also disagree. The borrower did not open a bank account with Santa Barbara Bank and Trust; they were the bank providing the rapid refund loan to the

borrowers so they could receive their tax refund immediately. Documentation in the file shows the tax refund to be \$4,029.00 less finance charge and filing fee leaving the borrower with rapid refund loan proceeds of \$3,930.05. HUD guidelines do not require borrowers to establish bank accounts, just that if cash on hand is used it must be properly verified. An abundance of documentation exists in the file supporting the funds received from MHDC and the city of Independence, both on the HUD 1 and on signed certifications and agreements.

Also, since the amount of the borrower's tax refund netted them with \$3,930.05 and they were only required to bring \$195.51 to closing, the remaining \$3,734.54 should be considered an additional compensating factor for approval as substantial documented cash reserves (item G) since it totaled more than 3 months worth of total debt.

Comment 19

-Your report indicated that we failed to develop an average of bonus income for case number 291-3073247. We feel this finding is inaccurate and should not be included in the count of minor deficiencies.

The borrower's income was derived entirely from commission and bonus. Per DU findings "If more than 25% of borrower's annual income is from commissions, obtain and analyze the most recent 2 years tax returns and all schedules, and consider business expenses in underwriting."

In this case, the tax returns did not include any business expense. The borrower's total income was lower in 2002 than in 2001 so an explanation was requested, provided, and seems reasonable. The underwriter chose to use the 2002 income for qualification purposes since it was the most conservative. An average of 2001, 2002 and YTD 2003 would have resulted in a much higher amount.

The VOE shows that for 2001, 2002 and YTD 2003 bonus was between 2 and 8 percent of the amount of commissions. This seemed to be reasonably related the amount of commissions earned so no separate explanation was needed.

Comment 20

-On case number 291-3088757 you found that we failed to establish that the increase of the mortgage payments after the initial buydown would not adversely affect the borrower and increase the likelihood of default. Again, we disagree with this finding. This loan was underwritten via DU and the risk classification was "Approve/Eligible." The findings clearly and accurately show the buydown feature of the loan, so the AUS considered the future payment increases in their evaluation and there is no further obligation for lender consideration.

Comment 21

-Your findings on case number 291-3088104 indicated that the income used to qualify was unsupported. We disagree and following are the comments presented by us during the exam:

We feel that the income used for qualification purposes is actually a conservative estimate and was satisfactorily documented according to the DU findings relied on for approval. DU requirements for documentation of both borrower's income reads as follows: "Income must be supported by 1) The most recent year-to-date pay stub documenting one full month's earnings and any one of the following to verify current employment: a) Written Verification of Employment (VOE); b) Verbal verification of employment (Lender or service provider must document individual verifying the employment); or c) Electronic verification acceptable to FHA"

The borrower's pay stubs indicate she is paid every two weeks. Two pay stubs were provided covering a 4 week period and both show year to date earnings. Also provided is a written VOE as well as a verbal verification of employment for her. A \$9.50 per hour rate of pay is shown on both pay stubs as well as the written VOE. The written VOE states she works a 40 hour week and the pay stubs support this arriving at \$1,646.67 per month, so the \$1,274.00 monthly income used for qualification purposes is a very conservative calculation.

The co-borrower provided one pay stub for a pay period ending February 5, 2003. While this pay stub is for just one week pay, it does include year to date earnings which covers the 30 days required by DU. His rate of pay is shown to be \$10.00 per hour and he also receives earnings for things listed as Truck

Bks, Perf Bonus, Adjusted, Chg Tips, and Vac. The total earnings shown year to date on the February 5th, 2003 pay stub is \$2,190.54 which would calculate to a monthly income of \$1,898.47. ($\$2,190.54$ divided by 5 weeks X 52 weeks divided by 12 months = \$1,898.47 per month) Since just 5 weeks is not a conservative time frame in which to reach a reasonable average, we next calculated monthly earnings from the 2002 W2 provided which came to \$1,702.38 per month. ($\$20,428.54$ divided by 12 = \$1,702.38) The monthly income used for qualification purposes in DU was just \$1,677.00 which is a very conservative estimate. The second source of income documentation provided according to DU findings is a Verbal verification of employment which was found in the file.

Comment 14

-In case number 291-3113005 we were cited for failing to submit a copy of the HUD 1 addendum in the Case Binder. While we agree in principal, we would like to point out that in this case the seller was a relocation company and it is common for the addendums not to be signed in those cases. Also, this file was not rejected by the HOC for insuring so they apparently felt comfortable with the documentation provided.

Comment 22

-The findings on case number 291-3130049 indicated that the VOE in the file did not address overtime, commissions, or bonuses although the income was used in qualification. The only VOE contained in this file was a verbal VOE. The paystubs clearly document the overtime, bonus and commission income which was supported by the W2s in the file. The documentation provided was in accordance with the LP findings requirements in the file.

Comment 23

On case number 291-3133725 it was noted that we failed to include payments for collection accounts in the total liabilities for the borrower. Once again, we disagree with this finding as DU clearly did not require consideration of these accounts as they were more than 5 years old. Specifically, DU's requirements for derogatory credit recites as follows; "Obtain an explanation for major indication of derogatory credit, such as judgments and collections, as well as any minor indications within the past two years." These two collections total only \$394.00 and both were medical in nature.

To close, we again want to state that we appreciate being given the opportunity to respond to your findings. While we admit that our QC procedures were lacking during a portion of your review period, that issue has been completely addressed and we are now in full compliance with all of HUD's requirements. We trust that our individual responses shown above resolve the issues raised in each case, and if you disagree we would appreciate receiving an explanation as to why not and be permitted to further respond. If you have additional question, please do not hesitate to contact me.

Sincerely,

 Lori Wright
 Vice President, Corinthian Mortgage Corporation.

OIG Evaluation of Auditee Comments

- Comment 1** We reviewed Corinthian Mortgage because the default rate for the Kansas City area branches was significantly higher than the HUD Kansas City field office's average over the past two years. We only used default rate as the selection criteria, not to make assumptions or recommendations.
- Comment 2** Corinthian Mortgage does not dispute our findings on its Quality Control activities during our audit period. The Quality Control finding only reflects the deficiencies for our specified audit period. The report does point out that Corinthian Mortgage began reviewing the necessary 10 percent of Federal Housing Administration loans. Additionally, the chart shows this improvement as well as the fact that Corinthian Mortgage also met the 90-day requirement in the final month of our review.
- Comment 3** The Quality Control function is to assure compliance with HUD's origination requirements, protect against unacceptable risk, guard against errors, omissions, and fraud, and assure corrective action. Since Corinthian was not adequately performing this important required function during our audit period, we concluded that it did not have appropriate controls.
- Comment 4** HUD Handbook 4155.1, Revision 4, Paragraph 2-10-C states that "the lender must document the transfer of funds from the donor to the borrower. If the funds are not deposited to the borrower's account prior to closing, the lender must obtain verification the closing agent received funds from the donor for the amount of the gift." The Homeownership Center Reference Guide advises that "evidence of the actual transfer of funds can be shown as a transaction on the HUD-1." Mortgagee Letter 2004-28 clarifies that the lender is not required to submit a copy of the wire transfer to HUD, but "the lender must obtain and keep the documentation of the wire transfer in its mortgage loan application binder." In light of the various instructions provided by HUD, and the fact that the clarifying mortgagee letter was issued after the loans in question, we will remove the inadequate documentation errors related to the documentation of gift funds.
- Comment 5** We acknowledge Corinthian Mortgage's frustration with receiving differing advice from the various Homeownership Centers. We suggest that Corinthian document any guidance provided by any HUD staff. This would allow Corinthian to provide documented proof in the event that actions taken based on the guidance is questioned.
- Comment 6** Corinthian Mortgage's argument is based on what it should have done, not what it did. The fact is, the underwriter did not include all eligible liabilities and income, but did include a liability that was not required. The automated underwriting decision is based on incorrect data, rendering it invalid. The addition of the excluded liability and the removal of the included liability change the debt ratio to at least 47 percent. Since the information pertaining to the rental property was incorrectly entered in the application and the automated

underwriting system, it is unclear what the total amount of the negative rental income would be. The Desktop Underwriter guide says the calculation for negative rental income is 75 percent of gross rental income less mortgage payment and less taxes, insurance, maintenance, and miscellaneous. Corinthian's response takes into account the mortgage payment but does not indicate the amount to be deducted for taxes, insurance, maintenance, and miscellaneous. Additionally, it cannot be assumed that exchanging one type of liability for another would result in the same automated underwriting decision. The loan might have required compensating factors, as well as any other manual underwriting requirements, for approval.

- Comment 7** Condition #33 on the Desktop Underwriter Findings Report states that all cash reserves must be verified. The amount of reserves is a factor for the automated decision and should, therefore, be verified. The \$3,000 in question was included in the reserves, so it should have been verified. Because the \$3,000 was used to open a new savings account; the verification should have included an explanation or evidence as to the source of funds.
- Comment 8** Because the borrower has been at his current job for such a short amount of time, has recently changed jobs and is working in a different line of work; we feel that calculating an average using prior years' income is most prudent. In general, the income of hourly employees should be considered over a longer term.
- Comment 9** Corinthian's argument is based on what should have been done, not what was done. The fact is, the underwriter did not include all required liabilities. The automated underwriting decision is based on incorrect data, rendering it invalid. The loan would have required compensating factors, as well as any other manual underwriting requirements, for approval due to the excessive debt ratio of 46.44 percent.
- Comment 10** Corinthian provided no evidence to substantiate the claim that the lower year-to-date earnings are related to the nature of the borrower's job. We have no guarantee that the income will increase to prior levels. Without evidence to the contrary, the year-to-date earnings most accurately reflect the income of the borrower. The income entered into the automated underwriting system was incorrect, invalidating the decision.
- Comment 11** Although the automated underwriting system did not require separate consideration of these issues, the systems approval was based on unsupported income and underreported liabilities. Based on the invalidity of the decision, the credit issues, future obligations, lack of assets, and increase in housing expense provide strong evidence against compensating factors in a manual underwriting decision.
- Comment 12** According to the Homeownership Center Reference Guide, Broker Administration/Processing/Transaction Fee, etc. are not allowable. Corinthian provided no documentation of the Homeownership Center's advice regarding this fee, nor was there documentation to show that the practice was customary in the area. We did not find this line item on any of the other loans reviewed.

- Comment 13** These loans were listed as having inadequate documentation errors because the HUD file in each case either did not contain evidence indicating that the Limited Denial of Participation or General Services Administration's lists were consulted or that the borrower(s) were assigned a CAIVRS number. These are both HUD requirements that must be met. Evidence was found in the Corinthian Mortgage lender files, therefore, the errors were considered minor.
- Comment 14** Corinthian's argument that if the Homeownership Center did not reject the loan then the documentation must have been sufficient is faulty. The lender is ultimately responsible for the quality of its work, not HUD. The lender was approved as a Direct Endorsement lender with the expectation that HUD regulations would consistently be met.
- Comment 15** Condition #30 on the Desktop Underwriter Findings Report states that all cash reserves must be verified. The amount of reserves is a factor for the automated decision and should, therefore, be verified. The \$3,000 in question was included in the reserves, so it should have been verified. Because the \$3,000 was a significant amount and was made near closing, the verification should have included an explanation or evidence as to the source of funds. The average daily balance has no bearing on this issue.
- Comment 16** The borrower's savings account ending balance as of October 31, 2002 was \$492.27. The file did not contain the actual listing of activity for the month of November. The account ending balance as of November 30, 2002, per the December bank statement, was \$4,220.65. HUD Handbook 4155.1, Revision 4, Paragraph 2-10-B clearly states that any large increase in a banking account requires an explanation and evidence of source of funds.
- Comment 17** This loan is listed as having an unsupported income error because of the overstated child support. Corinthian Mortgage agreed that the income was overstated. While the amount is small, its inclusion was still an error.
- Comment 18** This loan was listed as having an unsupported asset error. However, Corinthian Mortgage did show in the lender file documentation proving the receipt of the tax refund loan. Adequate documentation was not provided in the HUD file; therefore, this loan will be listed as having an inadequate documentation error.
- Comment 19** We agree with Corinthian Mortgage's response on this loan. It will be dropped from the finding.
- Comment 20** The case listed with an inadequate documentation error related to an initial buydown is 291-3076578. This loan was automatically underwritten and approved with a debt ratio of 54.7 percent using the buydown rate. Once the buydown term is up, the ratio will increase to 60 percent. HUD Handbook 4155.1, Revision 4, Paragraph 2-14A requires that the underwriter document which of the acceptable criteria the borrower meets to establish that the eventual increase in mortgage payments will not adversely affect the borrower and likely lead to default. However, the automated underwriting report did not contain a

specific condition related to the buydown so we will remove this loan from the list of loans with minor deficiencies.

Comment 21 This loan was listed as having a minor deficiency because a Verification of Employment was not found in the HUD file for the co borrower. Corinthian Mortgage did show that this document was in the lender file. The error for this loan should be listed as an inadequate documentation error and not an unsupported income error.

Comment 22 We agree with Corinthian Mortgage's response on this loan. It will be dropped from the finding.

Comment 23 The credit report contained handwritten amounts for two collection accounts totaling \$25 per month. One account has a balance of \$294 and a monthly payment of \$15. This payment should have been included in the total liabilities since there are more than 10 payments remaining.

Appendix C

LOAN PROCESSING DEFICIENCY CHARTS

Loans with Deficiencies That Affected Insurability

FHA Case #	Underreported Liabilities	Unsupported Income	Unsupported Assets	Total Errors - per Loan
291-3027843	1		1	2
291-3178636			1	1
291-3195243	1	1		2
Total Errors - per deficiency	2	2	1	5

*** Only the deficiencies that affected insurability are included in this chart. Loan number 291-3195243 contained both deficiencies that affected insurability and minor deficiencies. It is found in both tables.

Loans with Minor Deficiencies

FHA Case #	Underreported Liabilities	Unsupported Income	Unsupported Assets	Derogatory Credit	Unallowable Charges	Inadequate Documentation	Total Errors - per Loan
182-0753355			1				1
291-3009465						1	1
291-3011315					1		1
291-3012327				1	1		2
291-3033826					1	1	2
291-3057612			1				1
291-3059012						1	1
291-3059931						1	1
291-3070785		1				1	2
291-3073247						1	1
291-3088104						1	1
291-3088757						1	1
291-3104350						1	1
291-3113005						3	3
291-3116756						1	1
291-3117071						1	1
291-3133725	1						1
291-3156811						2	2
291-3184076		1				1	2
291-3187428						1	1
Total Errors - per deficiency	1	2	1	1	3	17	25

***Not all errors pertaining to liabilities, income, assets, or credit were considered material deficiencies. Only those errors that could have changed the underwriting decision were considered material. For instance, some errors in income or liabilities did not significantly affect the housing and debt ratios.

Appendix D

UNALLOWABLE FEES CHARGED TO BORROWERS

Case #	Description of Unallowable Charge	Fee Charged
291-3011315	Loan admin fee	\$445
291-3012327	Wire/admin fee	\$50
291-3033826	Other sales agent charge	\$95
Total		\$590

Appendix E

CASE STUDIES OF IMPROPERLY SUBMITTED LOANS

Case Number: 291-3027843

Loan Purpose: Purchase

Underwriter Type: Desktop Underwriter

Date of Loan Closing: 10/16/02

Insured Amount: \$175,564

Housing/Debt Ratio: 20.93/48.6 percent

Status: Property conveyed to insurer

HUD Costs Incurred: \$191,049

Underreported Liabilities:

The borrower's credit report shows a Department of Veterans Affairs mortgage with a \$655 per month payment. This payment is not included in the liabilities. The file includes a month-to-month rental agreement for the property but also includes a sales agreement for the property. Based on the credit report, the mortgage should have been included as a liability when qualifying the borrower. There is not enough documentation in the file to prove that the property was sold or is used as a rental property. The lender stated that the property was rented and is still occupied under the agreement included in the HUD file. A minimum of \$93 should have been included in the liabilities to account for the difference between the \$655 mortgage payment and 75 percent of the \$750 rental income. We cannot be sure if the mortgage amount includes the taxes and insurance that must be deducted from the gross rental income when determining net rental income. This would increase the debt ratio to 50.06 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-11A, Recurring Obligations: The borrower's liabilities should include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the housing expense and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony, etc., extending 10 months or more.

The Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

HUD Handbook 4155.1, REV-4, paragraph 2-7M, Rental Income: If a property was acquired since the last income tax filing and is not shown on Schedule E, a current, signed lease or other rental agreement must be provided. The gross rental amount must be reduced for vacancies and maintenance by 25 percent (or the percentage developed by the FHA office having jurisdiction where the property is located) before subtracting principal, interest, taxes, insurance, and any homeowners' association dues, etc., and applying the remainder to income (or recurring debts, if negative).

Unsupported Assets:

The borrower recently opened a savings account with \$3,000. The lender did not provide any explanation or evidence as to the source of funds for the savings account. The borrower did not need these funds for closing, however, the funds were included in the calculation of reserves and should have been verified. The automated underwriting system might have returned a different decision if the reserves only included the funds that were properly verified. Instead of 3 months worth of reserves, the borrower would only have had 1 month.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-10B, Savings and Checking Accounts: A verification of deposit may be used to verify these accounts, along with the most recent bank statement. If there is a large increase in an account or the account was opened recently, an explanation and evidence of source of funds must be obtained by the lender.

Manual Underwriting Considerations:

Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on manual underwriting requirements, the borrower's creditworthiness should be considered. The application, underwriting worksheet, and Desktop Underwriter listed monthly liabilities of \$1,787. However, the lender did not consider the borrower's liabilities of \$121 in collections listed on the credit report. The credit report shows several late payments in the 6 months before loan closing and several more in the previous 2 years. The underwriter did include \$195 in union dues as a recurring liability. Union dues are not required to be included in the liabilities when calculating the debt ratios. Removing this liability changes the debt ratio to 47%. Compensating factors are required when ratios exceed the 29 percent and 41 percent guidelines. No compensating factors were provided for this loan.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-3: Past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong offsetting factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-4, paragraph 2-3C: Both collections and judgments indicate the borrower's regard for credit obligations and must be considered in the analysis of creditworthiness.

Case Number: 291-3178636

Loan Purpose: Purchase

Underwriter Type: Desktop Underwriter

Date of Loan Closing: 8/11/03

Insured Amount: \$94,254

Housing/Debt Ratio: 31.7/47 percent

Current Status: Delinquent

HUD Costs Incurred: \$0

Unsupported Income:

The application, underwriting worksheet, and Desktop Underwriter stated the borrower's total income was \$2,207. The lender computed the borrower's income based on a 36-hour workweek at \$14 per hour. The borrower had only been employed by his current employer for a short time.

This is his second change of employment in two years. While the year-to-date income from the borrower's most recent pay stub supports the hourly rate, considering a recent raise, it is only for three and a half months. Historical income data indicate a much lower monthly income. In 2001, the borrower only averaged \$1,524 per month. In 2002, he averaged \$1,627 per month. A more accurate estimate of the borrower's monthly income, based on employment history and length of time at current job, would have been an average of his prior year's earnings and his year-to-date earnings. That calculation results in an average monthly income of \$1,717. Using this income, the housing ratio would increase from 31.7 to 40.7 percent, and the debt ratio would increase from 47 to 60.4 percent. Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on the excessive ratios, compensating factors would have been required for manual underwriting.

HUD Requirements:

HUD Handbook 4155.1, REV-4, chapter 2, section 2: The anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt.

HUD Handbook 4155.1, REV-4, paragraph 2-12: Ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership and otherwise provide for the family. The lender must compute two ratios: (A) mortgage payment expense to effective income, which cannot exceed 29 percent of gross effective income unless significant compensating factors are presented, and (B) total fixed payment to effective income, which can not exceed 41 percent of gross effective income unless significant compensating factors are presented (see HUD Handbook 4155.1, REV-4, paragraph 2-13, for compensating factors that may be used in justifying approval of mortgage loans with ratios exceeding HUD's guidelines).

<u>Case Number:</u> 291-3195243	<u>Loan Purpose:</u> Purchase
<u>Underwriter Type:</u> Desktop Underwriter	<u>Date of Loan Closing:</u> 9/18/03
<u>Insured Amount:</u> \$124,635	<u>Housing/Debt Ratio:</u> 19.11/35.64 percent
<u>Current Status:</u> Repayment	<u>HUD Costs Incurred:</u> \$0

Underreported Liabilities:

The underwriter did not include the co borrower's \$550 child support payment as a liability in Desktop Underwriter. The payment is listed on the underwriting worksheet and application. Additionally, the co borrower's pay stubs show a garnishment for the child support payment. Without the child support payment, Desktop Underwriter approved the loan with ratios of 19.11 and 35.64 percent. The added liability increases the total debt ratio to 46.44 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-11A, Recurring Obligations: The borrower's liabilities should include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the housing expense and all other recurring charges including

payments on installment accounts, child support or separate maintenance payments, revolving accounts, and alimony, extending 10 months or more.

In the Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines, as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

Unsupported Income:

The underwriting worksheet, Desktop Underwriter, and application state that the borrower has base income of \$3,121 per month. This amount was derived from the average of the most recent 19 months. However, the year-to-date income for the most recent 7 months indicates a base pay of only \$2,848 per month. Based on total income from the borrower's 2002 Internal Revenue Service Form W-2, her average monthly income in 2002 was \$3,280. There is nothing in the file to explain the decrease in income. The decrease in monthly income would increase the ratios to 20.15 and 48.97 percent.

HUD Requirements:

HUD Handbook 4155.1, REV-4, chapter 2, section 2: The anticipated amount of income and likelihood of its continuance must be established to determine the borrower's capacity to repay the mortgage debt.

HUD Handbook 4155.1, REV-4, paragraph 2-12: Ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership and otherwise provide for the family. The lender must compute two ratios: (A) mortgage payment expense to effective income, which can not exceed 29 percent of gross effective income unless significant compensating factors are presented, and (B) total fixed payment to effective income, which can not exceed 41 percent of gross effective income unless significant compensating factors are presented (see HUD Handbook 4155.1, REV-4, paragraph 2-13, for compensating factors that may be used in justifying approval of mortgage loans with ratios exceeding HUD's guidelines).

The Desktop Underwriter Government Underwriter Service User's Guide for Federal Housing Administration Loans, dated July 2002, chapter 2, paragraph 3, states the lender remains accountable for compliance with all HUD guidelines as well as for any HUD eligibility requirements, credit capacity, and documentation requirements that are not covered in this User's Guide. All data entered into Desktop Underwriter must be true, accurate, and complete.

Manual Underwriting Considerations:

Because the loan approval was based on incorrect information, we question the data integrity and, therefore, the validity of the automated approval of this loan. Based on manual underwriting requirements, the borrower's creditworthiness should be considered. The borrower's average credit score was below 620. However, the combined average of the borrower's and co borrower's scores is 631. The credit report shows numerous collection accounts and more than \$1,500 in past due payments. Additionally, the borrowers also have several deferred education loans with a total balance of \$11,757. The deferment periods for the loans end within the first 2 years after loan closing. While these loans are not required to be included as liabilities, they should be considered. These future liabilities could substantially

increase the debt ratio, adversely affecting the borrowers' ability to repay the home loan. Another factor to consider is the increase in housing expense. The current housing expense for the borrower's documented is \$750. The housing expense for the new loan is \$1,009, a 25 percent increase. Finally, the borrower's were only able to verify \$6 in assets, other than the gift funds received from a downpayment assistance program.

HUD Requirements:

HUD Handbook 4155.1, REV-4, paragraph 2-3: Past credit performance serves as the most useful guide in determining the attitude toward credit obligations that will govern the borrower's future actions. If the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong offsetting factors will be necessary to approve the loan.

HUD Handbook 4155.1, REV-4, paragraph 2-3C: We don't arbitrarily require that collection accounts be paid off as a condition for loan approval. Both collections and judgments indicate the borrower's regard for credit obligations and must be considered in the analysis of creditworthiness.