



Issue Date	July 7, 2005
Audit Report Number	2005-KC-1007

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

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

SUBJECT: Union Planters Bank Did Not Follow HUD Requirements When Processing a
Federal Housing Administration Loan

HIGHLIGHTS

What We Audited and Why

We reviewed one Federal Housing Administration loan sponsored by Union Planters Bank (Union Planters) of Memphis, Tennessee. During an audit of a Federal Housing Administration-approved loan correspondent, we identified a loan sponsored by Union Planters that did not appear to be properly originated according to U.S. Department of Housing and Urban Development (HUD) regulations. Union Planters also charged the borrower fees prohibited by HUD. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed these deficiencies to Union Planters to determine whether it complied with HUD requirements.

What We Found

Union Planters did not comply with HUD requirements when underwriting a Federal Housing Administration-insured mortgage. It did not adequately support the monthly income used in an automated underwriting system that approved the loan. As a result, it improperly placed the insurance fund at risk for \$74,333. In addition, the loan contained \$641 in unallowable fees charged to the borrower.

What We Recommend

We recommend that the assistant secretary for housing - federal housing commissioner take appropriate administrative action against Union Planters. This action, at a minimum, should include requiring indemnification for the \$74,333 loan and reimbursement of the \$641 in unallowable charges to the appropriate parties.

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

Auditee's Response

Union Planters agreed with our conclusions and to indemnify HUD for the improperly originated loan. We provided the draft report to Union Planters on June 30, 2005, and requested a response by July 11, 2005. Union Planters responded on July 5, 2005, and asked that we consider its initial written comments provided on May 16, 2005, as its official response.

The complete text of the auditee's response can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Union Planters Bank (Union Planters) is a supervised lender that began originating Federal Housing Administration loans in 1952.

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

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

RESULTS OF AUDIT

Finding: Union Planters Bank Did Not Follow HUD Requirements When Processing a Federal Housing Administration Loan

Union Planters did not comply with HUD regulations, procedures, and instructions in the processing of a Federal Housing Administration-insured single-family mortgage. The lender did not adequately support the monthly income used in gaining loan approval from an automated underwriting system. The lender also charged the borrower closing fees prohibited on Federal Housing Administration mortgages. As a result, HUD insured a loan that placed the insurance fund at risk for \$74,333.

Union Planters Did Not Follow HUD Requirements

Union Planters overstated the borrower's income when originating a Federal Housing Administration mortgage, which materially affected the insurability of the \$74,333 loan. The lender originated case number 321-2197119 using a monthly income that was based on a 30-month average. However, the borrower's income had continually declined during this period. HUD regulations state that lenders may not use income in evaluating a borrower's loan that it cannot verify, is not stable, or will not continue.

The borrower's income decreased from \$41,060 in 2000 to a projected income of \$31,808 in 2002, just before the loan closing in January 2003. Also, the borrower's income history was not consistent on employment and income verification documents. Union Planters did not address the declining income or the income discrepancies at the time of loan approval. Further, three recent pay stubs showed an average of only 32 hours worked per week and did not indicate any earnings from overtime, although the borrower's monthly income used to qualify for the loan was based on a 40-50 hour work week.

Union Planters also charged the borrower \$641 in prohibited fees. The lender improperly charged the borrower administration, tax service, and overnight courier fees. Appendix C contains a more detailed analysis of the loan.

In response to our review, Union Planters agreed with our results and offered to indemnify the loan.

In summary, Union Planters did not comply with HUD requirements when processing the loan. It overstated the borrower's monthly income and unnecessarily placed the insurance fund at risk for the \$74,333 mortgage. The lender also charged the borrower closing fees not allowed by HUD.

Recommendation

We recommend that the assistant secretary for housing - federal housing commissioner and chairman, Mortgagee Review Board

- 1A. Take appropriate administrative action against Union Planters for not complying with HUD requirements. This should include, at a minimum, requiring Union Planters to indemnify HUD for case number 321-2197119, which had an original mortgage amount of \$74,333. HUD should also require reimbursement of the \$641 in unallowable closing fees to the appropriate parties (see appendix C).

SCOPE AND METHODOLOGY

We reviewed Union Planters's processing of one Federal Housing Administration loan that it sponsored for a Federal Housing Administration-approved loan correspondent. During our audit of that loan correspondent, we reviewed loans closed from June 1, 2002, through May 31, 2004, that defaulted within the first two years after closing. We identified a loan, sponsored by Union Planters, which appeared to be improperly underwritten. Because the sponsor of the loan is ultimately responsible for loan processing deficiencies, we addressed the deficiencies to Union Planters.

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

We relied on computer-processed data contained in HUD's Single Family Data Warehouse system. During the audit of the loan correspondent, we assessed the reliability of the 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 did not assess Union Planters's underwriting controls because they were not significant to our objective of reviewing the loan.

We performed audit work from March through May 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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A	\$614	\$74,333

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

MAY 18 2005

UNION
PLANTERS
BANK

May 16, 2005

Mr. Ronald J. Hosking, Regional Inspector General for Audit
U.S. Dept. of Housing and Urban Development
Region 7
Gateway Tower II, 5th floor
400 State Avenue
Kansas City, Kansas 66101-2406

RE: FHA Case Number: 321-2197119
Borrower: [REDACTED]
Lender's ID #: 0495050806

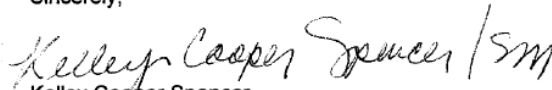
Dear Mr. Hosking:

This letter is in response to HUD's recent audit of Mortgage Express, Inc. an FHA approved loan correspondent, located in LA Vista, Nebraska.

I have reviewed the deficiencies noted in your letter dated 3/30/05 on the above mortgagor. Please be advised that Union Planters will indemnify this loan if you would forward to our office the "Indemnification Agreement". Sorry for any delay in responding to your letter.

If you should have any questions, please call Esther Moit @ 901-580-2828.

Sincerely,



Kelley Cooper Spencer
Vice President
Quality Control
Compliance

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P. O. Box 1860 • Memphis, Tennessee 38101-1860
Customer Service Assistance: 1-800-322-9903 (Toll Free) • (901) 580-6280 (Local)

Appendix C

CASE STUDY OF IMPROPERLY ORIGINATED LOAN

Case number: 321-2197119

Insured amount: \$74,333

Section of Housing Act: 203(b)

Status upon selection:

Default status after 22 months

Date of loan closing: Jan. 10, 2003

HUD costs incurred:

None identified

Unsupported Income:

Loan Prospector provided an automated approval on this loan, but the underwriter did not adequately support the monthly income claimed. The borrower's monthly income was entered as \$3,236 per month into Loan Prospector. The monthly income was based on a 30-month average of the gross earnings reported on a verification of employment. The monthly income included overtime and bonuses. However, the borrower's income was continually declining during the 30-month period.

The verification of employment in the HUD loan file showed total gross earnings of \$41,060 for 2000, \$40,142 for 2001, and \$15,904 through the end of June 2002. However, the 2001 Internal Revenue Service Form W-2 shows the borrower's income as \$38,978. If the year-to-date income for 2002 were projected for the entire year, 2002 gross income would be only \$31,808 (\$15,904 x 2). Therefore, the borrower's income showed a significant decline over the previous 30 months.

Using the 2002 year-to-date income, including overtime, the borrower's current monthly income was only \$2,651 per month (\$15,904/6). A monthly income of \$2,651 produces a 44.5 percent debt ratio. Using the 2002 year-to-date base income only, the borrower's monthly income was \$2,365 per month (\$14,191/6). A monthly income of \$2,365 produces a 49.9 percent debt ratio. Both monthly income calculations are significantly less than the \$3,236 monthly income used in Loan Prospector, and both debt ratios greatly exceed HUD's limit of 41 percent. Further, Union Planters did not identify compensating factors on the mortgage credit analysis worksheet. The loan documentation showed additional negative factors, including the borrower's housing expense was increasing from \$500 per month to \$631 per month, and the borrower had negative reserves.

In addition, the loan files contained only three weekly pay stubs. These pay stubs showed an average of only 32 hours worked per week, with no overtime, and were not current income information. The pay stubs were dated in June 2002, but the loan did not close until January 2003. Therefore, the borrower's income, which was entered into Loan Prospector for approval, was not adequately supported.

HUD Requirements:

Mortgagee Letter 98-14: The Federal Housing Administration has approved Freddie Mac's Loan Prospector for use on Federal Housing Administration-insured mortgages, effective March 2, 1998. The lender remains accountable for compliance with Federal Housing Administration guidelines and those credit, capacity, and documentation aspects not addressed in the Loan Prospector Users Guide.

Freddie Mac's Loan Prospector Automated Underwriting Service Training and Users Guide, section 2, states that the data the user inputs into Loan Prospector must match the application, underwriting documentation, and delivery information at the time the data are entered and that the user is responsible for data integrity.

HUD Handbook 4155.1, REV-4, CHG-1, 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. Income from any source that cannot be verified, is not stable, or will not continue may not be used in calculating the borrower's income ratios.

HUD Handbook 4155.1, REV-4, CHG-1, chapter 2-12B: If the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

HUD Handbook 4155.1, REV-4, paragraph 3-1-E. Mortgage credit analysis requires documentation of income by verification of employment and most recent pay stub (i.e. most recent at time of application and provided the document is not more than 120 days old when the loan closes).

Unallowable Charges:

The HUD-1 settlement statement showed the borrower was charged a \$550 administration fee paid to the sponsor (Union Planters), a \$66 tax service fee paid to First American Real Estate Tax, and a \$25 overnight courier fee paid to Midlands Land Title & Abstract, Inc. This was not a refinance loan. In total, the borrower was overcharged \$641 (550+66+25).

HUD Requirements:

HUD Homeownership Center Reference Guide, Chapter 2, "Closing Costs and Other Fees," states: All closing items associated with a HUD-insured loan, including paid outside closing items, must be itemized on the HUD-1 settlement statement for Real Estate Settlement Procedures Act compliance. Administration fees and tax service fees are not allowed. Overnight courier fees are allowed only on refinance loans, under certain conditions.