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Audit Report Number	2006-AT-1018
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TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing
Commissioner, H

James D. McKay

FROM: James D. McKay
Regional Inspector General for Audit, 4AGA

SUBJECT: Taylor, Bean and Whitaker, Inc., Ocala, Florida,
Met Temporary Interest Rate Buydown Requirements

HIGHLIGHTS

What We Audited and Why

We audited Taylor, Bean and Whitaker, Inc. (auditee), in Ocala, Florida, because of the number of temporary interest rate buydown (buydown) loans it underwrote that went into default.

Our objective was to determine whether the auditee followed U.S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions when it assessed borrowers' eligibility for loans it underwrote that involved buydowns.

What We Found

We identified no instances in which borrowers did not qualify for the buydowns the auditee approved. In most instances, the auditee did not document its assessment of the borrowers' eligibility for the buydowns.

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However, lenders are no longer permitted to qualify borrowers using buydown mortgage payment amounts. Accordingly, there is no need for action to address the auditee's failure to properly document its assessment of borrowers' eligibility for the buydowns.

This report contains no finding. No further action on your part is necessary.

Auditee's Response

We provided the draft report to the auditee on July 17, 2006. The auditee elected not to hold an exit conference and not to provide written comments to the report.

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BACKGROUND AND OBJECTIVES

Taylor, Bean and Whitaker, Inc. (auditee), is a nonsupervised direct endorsement lender, which operates from its home office, located in Ocala, Florida. The auditee has been approved to originate loans and to sponsor loan correspondents since August 21, 1981. In addition to the state of Florida, the auditee is approved to operate in 13 other states. It has 28 Federal Housing Administration-approved branch offices and 1,352 active loan correspondents.

The audit focused on the auditee's underwriting of loans that involved temporary interest rate buydowns (buydowns). For the period January 1, 2002, through April 6, 2006, the auditee underwrote 953 buydown loans in Florida, Georgia, and South Carolina.

Our objective was to determine whether the auditee followed U.S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions when it assessed borrowers' eligibility for loans it underwrote that involved buydowns.

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RESULTS OF AUDIT

We identified no instances in which borrowers did not qualify for the buydowns the auditee approved. However, in most instances, the auditee did not document its assessment of the borrowers' eligibility for the buydowns. We reviewed 30 buydown loans closed between February 2003 and June 2004. The files showed only two loans in which the auditee properly assessed and documented its assessment of the borrowers' eligibility for the buydowns. We discontinued review of five loans because even at the full note rate, the borrowers' debt-to-income ratios were within HUD's limit for approval. For the remaining 23 loans, the files did not show or document the auditee's assessment of the borrowers' eligibility for the buydowns. We reviewed the loan files and determined that the 23 borrowers qualified for the buydowns despite the missing documentation of the auditee's assessment.

In August 2004, HUD changed the buydown requirements, and lenders were no longer permitted to qualify borrowers using buydown mortgage payment amounts. Since the lender is no longer permitted to use buydown mortgage amounts, there is no need for action to address the auditee's failure to properly document its assessment of borrowers' eligibility for the buydowns.

SCOPE AND METHODOLOGY

To achieve our objective, we reviewed HUD's rules, regulations, and guidance for proper approval of temporary interest rate buydown loans (buydowns). We also reviewed previous HUD reviews of the auditee and interviewed HUD staff to obtain background information on the auditee and related HUD requirements.

We interviewed the auditee's management and staff to obtain information regarding its policies, procedures, and management controls for buydown loans.

We obtained origination, default, and other loan information from HUD's Neighborhood Watch and Single Family Data Warehouse systems on the auditee's buydown loan activity. For the period January 1, 2002, through April 6, 2006, HUD's systems show that the auditee underwrote 953 buydown loans in Florida, Georgia, and South Carolina. We limited the review to buydown loans that (1) were in default or had been in default, (2) were active or claim terminated, (3) had a debt-to-income ratio higher than 41 percent, and (4) were closed no later than December 31, 2004. The 953 loans included 83 loans that met the sample criteria. We reviewed 30 loans selected using non-random methods to focus on the highest risk loans. The results of our review apply only to the items selected and cannot be projected to the universe.

The audit generally covered the period January 1, 2003, to December 31, 2004. We performed our review during May and June 2006 at the auditee's office in Ocala, Florida, and at our audit office in Jacksonville, Florida.

We performed our review in accordance with generally accepted government auditing standards.

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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 approval of temporary interest rate buydown loans.

We interviewed auditee officials and reviewed their policies and procedures to gain an understanding of the internal control environment for processing buydown loans. During the audit survey, we reviewed 30 loans for compliance with the buydown requirements.

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

We did not identify any ongoing significant weaknesses in the controls cited above.

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