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Audit Report Number 2006-FW-1007

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

FROM:   
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SUBJECT: BSM Financial LP Originated Loans on Overvalued Properties to Less Than Creditworthy Borrowers, Putting Borrowers and HUD at Risk

## **HIGHLIGHTS**

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

We audited BSM Financial LP (lender) because of an unusually high ratio of defaults compared to the average default rate of lenders in the U.S. Department of Housing and Urban Development's (HUD) San Antonio, Texas, office jurisdiction. Forty-seven percent of the defaults involved one seller, Palm Harbor Homes, Inc., a manufactured home producer that owned 50 percent of the lender. We reviewed all of the defaulted loans (51 of 109) that involved Palm Harbor as the seller in the San Antonio area that closed between February 1, 2003, and January 31, 2005, and in the Austin, Texas, area that closed between January 2, 2002, and June 30, 2004.

Our objective was to determine whether BSM followed HUD loan origination requirements for the 51 loans selected for review.

### **What We Found**

The lender approved mortgages on overvalued properties for borrowers that were less than creditworthy. This occurred because the lender allowed an identity-of-interest seller to add ineligible and unsupported costs to the home construction costs, and inadequately reviewed the appraisals. Also, the lender

did not adequately document analyses of borrowers' credit. Further, the lender's processing had technical deficiencies such as not ensuring the borrowers signed off on construction draws and permitted the seller to process employment, bank, and credit verification documents. Lender officials told us they were unfamiliar with Federal Housing Administration requirements for manufactured housing loans when they first started originating such loans. Consequently, HUD and the borrowers unnecessarily incurred increased risks through higher insurance exposure and higher mortgage payments. The unqualified borrowers defaulted on their mortgage obligations (finding 1).

### **What We Recommend**

We recommend that you require the lender to reimburse the insurance fund \$1,989,588 for foreclosure losses incurred on 19 loans, buy down 28 loans by \$319,267 for the amounts added to the loans, and after the buy down re-amortize and indemnify HUD for the \$2,765,619 remaining balance on these 28 loans. In addition, we recommend that you ensure the lender implements adequate procedures to originate construction-permanent loans in accordance with HUD requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.6, REV-3. Please furnish us with copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided a copy of the draft report to the lender on January 24, 2006, and met with the lender for an exit conference on February 22, 2006. The lender provided a written response at the exit conference. The lender disagreed with the findings. We made some revisions to the report based on the lender's response but the response generally did not change our position. The complete text of the lender's response, without the voluminous exhibits, along with our evaluation of the response, can be found in appendix B of this report.

## TABLE OF CONTENTS

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Background and Objectives	4
Results of Audit	
Finding: The Lender Originated Loans on Overvalued Properties to Less Than Creditworthy Borrowers, Putting Borrowers and HUD at Risk	5
Scope and Methodology	19
Internal Controls	20
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	21
B. Auditee Comments and OIG's Evaluation	22
C-1 Recommended HUD Loss Reimbursements, Indemnifications, and Buy-Downs	79
C-2 Schedule of Loan Deficiencies	80
C-3 Case Narratives	81
D. Criteria	131

## **BACKGROUND AND OBJECTIVES**

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The National Housing Act, Section 203(b)(1), authorizes the U.S. Department of Housing and Urban Development (Department or HUD) to provide mortgage insurance for single-family homes. The Department must approve a mortgage company that originates Federal Housing Administration-insured loans. Participating mortgage companies must follow the National Housing Act and Department instructions when originating Federal Housing Administration-insured loans. Mortgage companies that do not follow the requirements are subject to administrative sanctions.

The National Housing Act authorized the construction/permanent mortgage program, and HUD announced it in 1992. The loan program combines the features of a construction loan, a short-term interim loan for financing the cost of construction, and a traditional long-term permanent residential mortgage with one closing. Borrowers must secure the loan in their name, contract with a builder and provide a copy of the contract to the lender, own or be purchasing a lot, and approve each payment before disbursement to the contractor. The lender is responsible for normal processing and underwriting plus obtaining the borrowers' approval for contractor payments, verifying if the loan was fully drawn and if not, applying any remaining funds to the loan balance, obtaining a borrower certification that the property is free and clear except for the mortgage, and performing the final inspection.

We audited BSM Financial LP (lender), located at 16479 Dallas Parkway, #211, Addison, Texas 75001. The lender is a nonsupervised direct endorsement lender. HUD approved the lender on August 24, 2000, to originate single-family loans under Section 203 (b) (1) of the National Housing Act. BSM Financial LP is a limited partnership. KJ Financial owns 50 percent and is the general partner. Palm Harbor Homes owns 50 percent and is the limited partner. For the period between June 1, 2003, and May 31, 2005, the lender's ratio of defaults within the first year was 186 percent of the average of all lenders in the San Antonio HUD office jurisdiction.

Our objective was to determine whether the lender followed (HUD) loan origination requirements for the 51 loans selected for review.



## RESULTS OF AUDIT

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### Finding: The Lender Originated Loans on Overvalued Properties to Less Than Creditworthy Borrowers, Putting Borrowers and HUD at Risk

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The lender approved mortgages on overvalued properties for borrowers that were less than creditworthy. This occurred because the lender allowed an identity-of-interest seller to add unallowable and unsupported costs to the home construction costs, and inadequately reviewed the appraisals. Also, the lender did not adequately document analyses of borrowers' credit. Further, the lender's processing had technical deficiencies, such as not ensuring the borrowers signed off on construction draws and permitting the seller to process loan and credit documents. Lender officials told us they were unfamiliar with Federal Housing Administration requirements for manufactured housing loans. Consequently, HUD and the borrowers unnecessarily incurred increased risks through higher insurance exposure and higher mortgage payments, and unqualified borrowers defaulted on their mortgage obligations.

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#### **The Seller Added Unallowable and Unsupported Costs**

The lender allowed the seller, Palm Harbor Homes, to add unallowable and unsupported costs to the construction costs in 46 of 51 loans reviewed. To determine the maximum financing available to a borrower building a house on land already owned or being acquired, the lender should apply the appropriate loan-to-value limits to the lesser of the appraised value plus allowable closing costs or the documented acquisition cost of the property.<sup>1</sup> If the lender or seller adds unallowable and unsupported costs to the construction cost, the mortgage is inappropriately increased. However, to the construction costs, Palm Harbor added

- Closing costs that it agreed to pay in the purchase memo;
- The gift and fee used for the downpayment;
- Trade-in loan payoffs;
- Referral fees;
- Gift cards;
- Moving expenses;
- A big screen television, a pool table, and playground equipment; and

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<sup>1</sup> Documented cost of the property includes the builder's price or the sum of all subcontractors' bids, materials, etc.; cost of land; interest and other costs associated with any construction loan obtained by the borrower to fund construction; the closing costs to be paid by the borrower; and reasonable discount points.

- Unsupported costs.

The lender used a purchase memo provided by the seller to calculate the maximum mortgage. The purchase memo states it is not a binding contract for either the buyer or the seller. The lender's files had copies of the required construction contracts that were not executed until the dates the loans were closed. The sales prices on these two documents for the loans were usually different and inconsistent with the HUD-1 settlement statement. The lender did not resolve the differences, although HUD requires lenders to review all legal instruments and other documents executed at closing and certify to HUD that the transaction and loan meet statutory and regulatory requirements, and that the loan has been closed in accordance with the terms and sales price as specified in the sales contract.

Contrary to HUD requirements, the seller's "contributions to a nonprofit" for downpayment assistance were used to fund the closings in seven of ten cases for which we reviewed the closing agent's receipts and disbursement ledger. We did not review the receipts and disbursements ledger for the remaining 25 cases that involved downpayment assistance. The seller's proceeds from the sales were reduced by the downpayment assistance contributions as shown by the settlement statements. The closings were held and funded by the lender and the closing agent disbursed the funds. The "gifts" from the nonprofit were not received until after the disbursement of funds and were not available to pay the borrowers' downpayments at the closings. After receiving the funds from the nonprofit, the closing agent returned the funds plus the agreed fee, still in escrow, to the nonprofit. HUD Handbook 4155-1, paragraph 2-10 C, provides that an outright gift of the borrower's cash investment is acceptable but the gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied. Also, when gift funds are provided at closing, the lender is responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

We interviewed 9 of 51 borrowers, and all but one told us the price increased from what the seller initially told them, without an explanation for the increases.

To illustrate, case number 495-6384702 shows the seller added unallowable and unsupported costs to the sales price. Palm Harbor provided documentation of construction costs that showed the following:

Sales price of \$96,440 from the purchase memo, which differs from the \$94,508 price on the residential construction contract.

C. Itemization of Possible Costs:		96440
1. CASH PRICE		
Trade-In		
Other		
Cash Downpayment	1000	
2. TOTAL DOWN PAYMENT		1000
3. INVENTORY TAX		
4. UNPAID BALANCE OF CASH PRICE		95440
		(1 minus 2 plus 3)
5. Plus amounts paid to others on buyer's behalf:		
To Public Officials for:		
Title and Filing Fees		
Official Fees, Permits		
Other		
To Insurance Companies:		
Property Insurance		
Life Insurance		
Insurance		
To		
TOTAL PAID TO OTHERS FOR BUYER		95440
UNPAID BALANCE		(4 plus 5)

Seller's representation to pay costs for buyer from the purchase memo

Seller to pay Buyers closing costs and prepaids up to \$7500

Seller to contribute up to to Genesis Down payment assistance program \$3375

Seller to pay FHA non-allowable fee up to \$1100

Seller to pay title policy up to \$1325

NOTE: See the "Arbitration Provision & Agreement" which is part of this transaction.

WHEELS, AXLES AND TIRES: ☐ YES, Included ☒ NO, Not Included

Palm Harbor commission sheet showing summary of sale and the sale price of \$82,487.

PALM HARBOR RETAIL OPERATIONS		Commission Sheet for Southwest
LOCATION: 09	CUSTOMER: 19585	DATE SET: 1/31/03
TRADE-IN P.O. #	P.O. #	9/14/95
MAKE OF HOME: HARRIS	MODEL: HPT976A9	SERIAL # 11507
HOME INVOICE COST - (EXACT)		SIZE: 32x26
TOTAL SET UP CHARGES (INCLUDING FREIGHT COST TO SITE)		4400
COST TO PULL TRADE-IN BACK TO SALES CENTER		158.587
ART UNIT - SIZE: 4	TON	4400
FURNITURE		1500
APPLIANCES/MISC. ITEMS/PAYOFFS		1268
SHORTING & DOCKING		2768
OUTWORK (HOOKUPS, SEPTIC, FOUNDATION)		4900
LAND IMPROVEMENTS		750
LAND PARCEL DESCRIPTION		5650
FINANCE FEES & POINTS		73.905
TRADE-MFG		
DOWN PAYMENT ASSISTANCE		
REFERRAL		
OTHER ADDITIONS		
OTHER DELETIONS		
SALES PRICE	82,487.80	TOTAL COST

The seller added unallowable costs of \$15,453 to the sales price shown on the seller documentation, including closing costs of \$9,925, the gift and fee of \$3,375 used for the downpayment, a \$1,500 big screen television, and an unsupported amount of \$653. The lender used the sales price shown on the purchase memo to calculate the maximum mortgage without considering the seller's concessions. Also, the lender's closing agent used the seller's proceeds to fund the downpayment. The "gift" funds from the nonprofit was not received until five days after closing, which the closing agent returned with the fee provided by the seller.

In case number 495-7006330, the lender did not provide a resolution or explanation of the difference in the sales price. Palm Harbor's sales price for the manufactured home on the contract and the purchase memo was \$58,707. The sales price on the HUD-1 settlement statement was \$58,087. When we asked the lender and Palm Harbor to explain the sales price difference to verify the construction costs, they provided the following:

Sales price of \$58,707 from the purchase memo

F. Pricing Itemization:		<input checked="" type="checkbox"/> FINANCED	<input type="checkbox"/> CASH
BASE CASH PRICE			\$58,597.77
TAXABLE OPTIONS / IMPROVEMENTS			\$0.00
TAXABLE SUB-TOTAL			\$58,597.77
NON-TAXABLE OPTIONS / IMPROVEMENTS			
TOTAL BASE PRICE			\$58,597.77
INVENTORY TAX			\$109.74
FEES			
TOTAL HOME VALUE (Insurance Value)			\$58,707.51
INSURANCE (TERM: Months)			\$0.00
EXTENDED SERVICE CONTRACT			\$0.00
LENDER PREPAID FINANCE CHARGES			\$0.00
TOTAL CASH PRICE			\$58,707.51
TRADE-IN ALLOWANCE			

Sales price of \$58,087 from the HUD-1

104. Invoice due to PIH	\$50,109.51
105. Construction Costs	\$7,977.79
Adjustments for items sold to PIH	

Palm Harbor commission sheet showing summary of sale (Does not support the HUD-1 sales price.)

Form 601

### PALM HARBOR RETAIL OPERATIONS COMMISSION SHEET FOR SOUTH FLA. ST

LOCATION: Palm Harbor Village #009 LANDHOME YES ☒ NO ☐

CUSTOMER: 98222 CONFORMING (FHA, VA) ☒ NONCONFORMING ☐

CUSTOMER NUMBER: 15833 LENDER: BOM

MONTH: July DATE SET: 7/1/04 PARTICIPATION ☐ RATE: \_\_\_\_\_

TRADE-IN P.O. #: \_\_\_\_\_ P.O. #: 92218 CIRCLE ONE: \_\_\_\_\_

MAKE OF HOME: palm harbor Model: 76TH SERIAL #: YH2210024 SIZE: 17' x 76' ☒ NEW ☐ USED

HOME INVOICE COST (EXACT) ..... 0001

TOTAL SET UP CHARGES (INCLUDING FREIGHT COST TO SITE) ..... 0001

COST TO PULL TRADE-IN BACK TO SALES CENTER - ..... 0001

AIR UNIT - SIZE \_\_\_\_\_ TON ..... 0001

FURNITURE ..... 0001

APPLIANCES/MISC. ITEMS/PAYOFFS ..... 0001

SKirting & Decking ..... 0001

SITEWORK/HOOKUPS, SEPTIC, FOUNDATION ..... 0001

LAND IMPROVEMENTS ..... 0001

LAND PARCEL DESCRIPTION \_\_\_\_\_ LAND PO \_\_\_\_\_ 0001

FINANCE FEES & POINTS ..... 0001

TRADE MFG: \_\_\_\_\_ SIZE: \_\_\_\_\_ X SERIAL #: \_\_\_\_\_ OVERALL FINANCE: 0100

DOWN PAYMENT ASSISTANCE ..... 0075

REFERRAL ..... 0001

OTHER ADDITIONS ..... 0001

OTHER DEDUCTIONS ..... 0001

SALES PRICE \_\_\_\_\_ PROFIT \$ \_\_\_\_\_ TOTAL COST \$ \_\_\_\_\_

31109

2000

1750

1191

5752

If lender staff had asked the seller for additional information to resolve the difference in sales prices, it would have found the seller added \$11,787 in unsupported costs to the sales price.

Manufactured home cost from commission sheet	\$ 31,109
Setup charge	\$ 2,000
Air conditioner	1,750
Warranty	750
Listed land improvements	<u>11,191</u>
	<u>15,191</u>
Total allowable cost	\$ 46,300
HUD-1 sales price	<u>58,087</u>
Unsupported amount of sales price	<u>\$ 11,787</u>

**The Underwriters Did Not Adequately Review the Appraisals**

The underwriters did not adequately review the appraisals in 45 of the 51 cases reviewed. Also, they did not resolve or obtain explanations of appraisal deficiencies that would indicate lower property values. Forty-Six of the 51

cases had inflated acquisition costs. In 43 of the 46 cases with inflated acquisition costs, the lender and appraiser overvalued the properties by more than 10 percent, based on appraisals by the county appraisal districts. Also, in 33 instances, the appraisers and underwriters did not reduce the sales prices used to calculate the maximum loans by the amount of seller concessions that were more than 6 percent of the sales prices. The appraisers used property sales for comparables that were

1. In different neighborhoods and environments (39 of 51);
2. More than six months old, which may reflect a different or changing market (26 of 51);
3. Not similar to the subject in size, age, and design (15 of 51); and
4. Inappropriately adjusted (42 of 51).

To obtain a perspective of the values, we compared the lender's values with the local appraisal districts' values. The lender's value averaged 32 percent higher than the appraisal districts' value for the 51 loans. The lender's property values ranged from 7 percent less to 63 percent more than the local appraisal district values. According to state law, all Texas appraisal districts must set property tax values at market value. We confirmed this with the deputy chief appraiser for Bexar County (San Antonio). State law also requires the districts to use the same standards used by all licensed appraisers, the Uniform Standards of Professional Appraisal Practice.

The following two examples illustrate inadequate appraisal reviews.

Case number:	495-6556052
Valuation date:	April 15, 2003
Sales price:	\$ 82,640
Lender appraised value:	\$ 90,000
Appraisal district value:	\$ 38,880
Difference in value:	\$ 51,120

The lender did not reduce the sales price used to calculate the maximum mortgage for seller concessions over 6 percent of the sales price. This resulted in an overvalued property and an overinsured mortgage. The lender should have reduced the mortgage by at least \$1,740, the difference between the concession in sales contract and 6 percent of the sales price. The mortgage credit analysis worksheet listed the 6 percent limit as \$4,958, and the sales contract states the seller will pay up to \$6,700 in closing costs.

The underwriter did not adequately review the appraisal. The underwriter wrote a note in the file saying the value was \$90,000 according to the appraiser, but the comparables indicated the value should have been \$88,500. The underwriter indicated the value did not need to be adjusted since the sales price was much lower than the value. The appraiser stated the market was good and

statistics showed stable to increasing prices and decreasing marketing times. The appraiser also stated the home had additional features that included front and rear steps, a vaulted ceiling, ceiling fans, a built-in kitchen, and an indoor utility room as additional features. However, appraisal deficiencies noted below indicate a lower value.

1. The three comparables were 5 miles, 10 miles, and 25 miles from the subject property, respectively. The comparables were not in the same neighborhood.
2. Comparables one and two were more than six-months old. The appraiser did not provide the required explanation. If the market had been good, as the appraiser indicated, there should have been sufficient comparables in the neighborhood within the six-month requirement.
3. The appraiser did not adjust the comparables consistently with land values of the subject property. The subject property's lot size was .57 acres and cost \$25,500. The appraiser adjusted comparables one and two, each five acres, down by \$5,000 for lot size (\$1,000 per acre) and did not adjust comparable three for a lot almost twice the size of the subject property (1.12 acres).
4. The subject property had 1,216 square feet of living area at \$68 per square foot.
  - a. Comparable one was 856 square feet larger and adjusted down by \$8,600 or about \$10 per square foot. The appraiser listed comparable one's price per square foot as \$53, indicating a downward adjustment closer to \$45,000.
  - b. Comparable two was 96 square feet smaller and adjusted up by \$1,000 or about \$10 per square foot. The appraiser listed comparable two's price per square foot as \$79, indicating an upward adjustment closer to \$7,500.
  - c. Comparable three was 180 square feet larger and adjusted down by \$1,800 or about \$10 a square foot. The appraiser listed comparable three's price per square foot as \$64, indicating a downward adjustment closer to \$11,000.
5. Comparable two had an unexplained downward adjustment of \$5,000 for "below grade quarters."
6. Comparables one and three appeared to be either traditionally built or doublewides and not similar to the subject, which was a singlewide home.
7. The underwriter did not require an explanation for the highline tower in the back yard. The appraisal showed "Based on the plat map available, no adverse easements or encroachments were noted." However, according to HUD requirements, if the overhead transmission lines were within engineering (designed) fall distance (tower height), the appraiser should have sent the appraisal back to the lender unfinished, and the appraiser should have rejected the property.





Street view of subject property



Closer view of subject property





Close-up view of subject property

Case number:	495-6749841
Date appraised:	September 16, 2003
Sales price:	\$ 81,513
Lender appraised value:	\$ 93,000
Appraisal district value:	\$ 58,980
Difference in value:	\$ 34,020

The underwriter did not adequately review the appraisal. The deficiencies noted below indicate a lower value.

1. The four comparables were not in the same neighborhood, being 9.29 miles, 9.71 miles, 13.40 miles, and 14.51 miles from the subject, respectively.
2. The appraiser noted the balanced market in the area and stated the average time on market was three to six months. However, in addition to not being in the same neighborhood, comparable two had been on the market 10 months and may have reflected a different or a changing market. The appraiser did not provide the required explanation. The selection of comparables seems inconsistent with the appraiser's statement that the market was in balance and average time on the market was three to six months. If this had been true, there should have been sufficient comparables in the neighborhood within the six-month requirement.

3. The comparables were not similar to the subject property, which was a singlewide manufactured home. Comparable one was a traditionally built house, and comparables two, three, and four were doublewides.
4. The appraiser did not make proper adjustments for the lot sizes. The subject had .53 acres and cost \$25,000.
  - a. Comparable one had four acres that cost \$25,000. The appraiser did not adjust for the lot size.
  - b. Comparable two had 4.9 acres that cost \$25,000. The appraiser did not adjust for the lot size.
  - c. Comparable three had 12 acres that cost \$40,000. The appraiser adjusted the lot down by only \$15,000.
5. The appraisal indicated the subject property had a patio deck and porch balcony; however, the home only had stoops with steps.



Front side view showing stoop and steps



Front view showing stoop and steps



Rear view showing stoop and steps

### **Lender Did Not Adequately Document Credit Analyses**

In 13 of 51 cases, we found no evidence to show the lender adequately documented its analysis of the borrowers' late payments. The lender should have determined whether the late payments were because of a disregard for financial obligations, an inability to manage debt, or factors beyond the borrowers' control. Further, the lender did not require the borrowers to provide a sufficient written explanation that was logical and consistent with credit information in the file.

The lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation and all aspects of the property being financed. However, in seven cases the lender did not resolve conflicting information. For example, for case number 495-6861163, the lender did not question why the fee inspector conducted the final property inspection before the appraisal for this construction-permanent loan. In this case, the seller had already finished the house. With pictures from the inspection showing a completed home and pictures from the appraisal showing vacant land, the lender had enough documentation to seriously question the appraisal. The final inspection was done on January 12, 2004, before the appraisal, dated January 20, 2004. Also, the lender did not question why the wrong picture of the subject property was included with the appraisal. If the appraiser had taken a picture of the correct property, the picture would have shown a completed house, and the property would not have qualified under the construction-permanent loan program. Therefore, the lender should have limited the loan-to-value ratio to 90 percent. Further, the borrower worked 157 miles from the property he purchased. The lender did not determine how the borrower intended to commute to his job. This was a first payment default and resulted in HUD paying a claim.

### **Technical Deficiencies in Lender's Processing**

The lender's processing had technical deficiencies, including not ensuring the borrowers signed off on construction draws, allowing the seller to process borrower loan documents, and not determining or certifying the application of remaining escrow funds.

In all cases we reviewed, the lender did not require the borrowers to approve any construction draws before payment as required by HUD. Also, for at least 3 of the 51 loans the lender allowed the seller to process borrower loan and credit documents. All nine of the borrowers we spoke with confirmed that they dealt only with the seller. However, in each instance, the lender verified



employment information without passing the information through the seller. In addition, the lender relied on alternative credit documents handled by the seller to approve and justify credit decisions. We found two credit confirmations from companies that do not provide that information.

The lender did not determine whether there were any remaining funds left in escrow after all work was completed or certify that it applied any remaining escrowed funds to reduce the outstanding loan as required by HUD.

### **Lender Needs to Implement Adequate Procedures for Manufactured Housing Loans**

Lender officials told us they were unfamiliar with Federal Housing Administration requirements for manufactured housing loans when they first started originating such construction permanent loans. Other lenders told them they were just like traditionally built homes, but they found them very different. However, the seller continued to do business as usual, and would process the loans, send in the packages, and expect funding. Lender officials said they had to educate the seller, but still had a 50 percent default rate. They said they began a follow up program with the borrowers and this turned around the defaults. HUD needs to ensure the lender has implemented adequate procedures to originate manufactured housing loans.

### **Lender Needs to Reimburse and Indemnify HUD for 47 of 51 Loans Reviewed**

Because of the relationship between the lender and the seller, the lender should have known that the seller added amounts that did not add to the value of the collateral and were in excess of what should have been the acquisition cost of the manufactured home, land improvements and profit. The seller owns 50 percent of the lender. Further, the seller generally interfaces with the borrowers, processes the loan documentation, and submits the loan documentation to the lender for underwriting, so the underwriters should have examined all documentation very closely. The lender should buy down 28 loans by \$319,267; the amount of unallowable costs the seller was permitted to add to the sales prices which the borrowers should not have to pay. Also, after the buy down, the lender should indemnify HUD for the \$2,765,619 remaining balance on the 28 loans. Further, the lender should reimburse HUD \$1,989,588 for 19 loans in which HUD has paid claims and realized losses. As of the date of this report, HUD had resold six of the 19 properties at a \$428,992 loss. HUD had not resold the other 13 the properties on which it had paid claims of \$1,560,596 (see appendixes C-1, C-2, and C-3 for details on the 47 loans).

## Recommendations

We recommend that you

- 1A. Require the lender to reimburse the insurance fund for foreclosure losses incurred on 19 loans in the amount of \$1,989,588 (see appendix C-1).
- 1B. Require the lender to buy down 28 loans by the \$319,267 in ineligible costs added to the loans (see appendix C-1).
- 1C. Require the lender to reamortize and indemnify HUD for the 28 loans totaling \$2,765,619 after the buy down (see appendix C-1).
- 1D. Ensure that the lender implements procedures to originate construction-permanent loans in accordance with HUD requirements.

## SCOPE AND METHODOLOGY

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We conducted an in-depth review of 51 loans. Initially, we briefly reviewed all (61) of the San Antonio defaulted loans between February 1, 2003, and January 30, 2005, and found 24 loans involved one seller that owned half of the lender. We selected these 24 loans for an in-depth review because we found the sales price differed among the documents in the HUD mortgage file. We expanded our scope to include the Austin/San Marcos area. We briefly reviewed an additional 48 loans originated between January 2, 2002, and June 30, 2004, and selected for in-depth review another 27 loans involving the same seller in the Austin/San Marcos area. We reviewed relevant Federal regulations, HUD handbooks, and Federal Housing Administration and the mortgage company's loan origination files. Our review of the loan origination files included

- Collecting certain data to determine whether a pattern of defaults existed;
- Examining loan documents for inconsistent and derogatory information;
- Comparing the final application with the preliminary application, verifications of deposit and employment, credit reports, and any other relevant documentation available for inconsistency;
- Examining the appraisal and comparing the subject property with the values from the local appraisal district;
- Interviewing the borrowers; and
- Reviewing the title company closings.

We interviewed HUD Quality Assurance Division staff and held an entrance conference with the lender's executives on May 16, 2005. We performed our fieldwork at the lender's office and HUD's office in San Antonio, Texas, from April 25 to November 30, 2005. We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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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.

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## Relevant Internal Controls

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

- Requirements for loan originations.

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:

- The lender originated loans on overvalued properties to less than creditworthy borrowers, putting borrowers and HUD at risk (finding 1).



## APPENDIXES

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### Appendix A

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

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Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A	\$1,989,588	
1B		\$ 319,267
1C		2,765,619
Totals	\$1,989,588	\$3,084,886

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments



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February 22, 2006

#### VIA HAND DELIVERY

Mr. Frank E. Baca  
Regional Inspector General for Audit  
U.S. Department of Housing  
and Urban Development  
Office of the Inspector General  
Forth Worth Regional Office, 6AGA  
819 Taylor Street, Room 13A09  
Fort Worth, TX 76102

**RE: BSM Financial LP  
HUD OIG Draft Audit Report**

Dear Mr. Baca:

BSM Financial LP d/b/a BankSource Mortgage ("BSM" or "Company") is in receipt of the Draft Audit Report ("Report"), dated January 24, 2006, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of the Inspector General ("OIG"). The Report is based on a review of certain loans originated by BSM in the San Antonio, and Austin, Texas areas that involved one manufactured housing seller, Palm Harbor Homes, Inc. ("Palm Harbor"). The review was conducted between April and November of 2005, and covers loans closed between February 1, 2003 and January 31, 2005, in the San Antonio area and between January 2, 2002 and June 30, 2004 in the Austin area.

The Report states that its primary objective was to determine whether BSM followed HUD loan origination requirements for the fifty-one loans selected for review. The Report contains one finding alleging that, in connection with the specific group of loans examined, the mortgages were approved on overvalued properties for borrowers that were less than creditworthy. Based on these findings, the Report recommends that HUD require the Company to: (1) reimburse the insurance fund for foreclosure losses incurred on 19 loans; (2) buy down the principal balance of 28 loans; (3) reamortize these 28 loans and indemnify HUD for the remaining balance of each of these loans; and (4) implement adequate procedures to originate Construction-Permanent loans in accordance with HUD requirements.

DC-789274 v1 0308301-0102

Mr. Frank E. Baca  
February 22, 2006  
Page 2

The OIG provided the Company with an opportunity to submit written comments for inclusion in the final report. This response summarizes BSM's history and operations, including the extensive improvements BSM has implemented since the loans in question were originated, and addresses the individual findings in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations.

**I. INTRODUCTION**

**A. BSM Financial LP**

BSM is a small mortgage lender, with thirty-one branches and approximately 300 employees. BSM opened for business in August of 2000 and, on August 24, 2000, it received HUD approval as a non-supervised mortgagee. BSM sells all loans that it originates into the secondary market on a servicing-released basis, and its primary investors include Wells Fargo Home Mortgage, Countrywide Home Loans, and National City Mortgage. It sponsors 184 loan correspondents, is an authorized agent for three principals, and acts as principal for three authorized agents.

FHA lending constitutes approximately twenty-five percent (25%) of BSM's current loan production. As FHA-insured loans comprise a substantial portion of its business, the Company takes its relationship with the Department and its responsibilities under the FHA program seriously. We strive to comply with applicable rules and regulations and are committed to educating and training our employees on issues of FHA compliance. In addition, BSM is dedicated to working with minority borrowers and members of underserved communities.

BSM places a premium on FHA compliance. It is careful to ensure compliance with insurer, guarantor, and investor requirements and takes its Quality Control responsibilities seriously. In addition, BSM is dedicated to consumer service. We aim to make the lending process as simple as possible for borrowers and work closely with each individual applicant to ensure that he or she receives the type of financing that best fits his or her needs. For the past five years, we have endeavored to provide dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA program.

**B. Significant Improvements in BSM's Originations and Quality Control**

As discussed above, BSM is dedicated to the FHA program and diligently educates and trains its employees on issues regarding FHA compliance. To this end, BSM has made a number of changes to its underwriting guidelines, Construction-

Mr. Frank E. Baca  
February 22, 2006  
Page 3

Permanent loan program, and its Quality Control department over the past few years. During its evaluation of BSM, the Report states that the auditors concentrated on Construction-Permanent loans originated by the Company during the first few years of its operations. During that time, like most of the mortgage industry, BSM experienced tremendous growth. The industry was in the midst of a refinance boom, interest rates were lower than they had been in decades, and mortgage companies were facing difficulties in finding enough knowledgeable and experienced employees to handle their expanded business. Like other lenders, BSM's business grew rapidly and strained the Company's developing infrastructure, which was at the time largely manual in nature. Due to growing pains experienced during this early period in the Company's existence, BSM made a number of changes to its policies and procedures, including implementing its automated processes, tightening its underwriting standards, centralizing its Construction-Permanent loan department, and enhancing its Quality Control and compliance functions.

We believe that these actions resulted in significant improvements in the Company's loan quality and performance since the audit period and, importantly, satisfy the Report's recommendation that BSM implement procedures to originate Construction-Permanent loans in compliance with FHA guidelines. Therefore, we briefly outline some of these underwriting and Quality Control changes prior to addressing the Report's specific findings.

#### **1. Improved Underwriting Standards**

Prior to the Department's audit in 2005, BSM, on its own, addressed its underwriting practices and initiated specific changes. The Company has: (1) created a senior management position to monitor its underwriting; (2) re-evaluated and modified its underwriting policies and practices; (3) terminated underwriters; and (4) created automated systems to track loan data and monitor employee performance. Specifically, in October 2002, BSM created the senior management position of Vice President/Underwriting Manager and hired Cindy Jiles to serve in this position. Ms. Jiles brings more than 25 years of experience in the mortgage industry to the Company and has proved to be an invaluable addition to BSM. Ms. Jiles now supervises the Company's underwriting department and is responsible for developing and maintaining quality assurance standards for underwriting conventional and government loan programs, training Company employees on underwriting policies and procedures, and evaluating the competency of staff in complying with Company policy and FHA guidelines.

Mr. Frank E. Baca  
February 22, 2006  
Page 4

In addition, BSM made certain policy changes regarding its underwriting requirements and performance. In April of 2003, the Company issued a formal Credit Policy for FHA loans. The highlights of the Policy are as follows:

- For borrowers with credit scores less than 580: (1) specific compensating factors are required; (2) two months of reserves are required; and (3) downpayment assistance grants are not permitted.
- For borrowers with credit scores of less than 620: (1) qualifying ratios must not exceed HUD's benchmark guidelines; and (2) one month of reserves is required.
- For borrowers with credit scores of 620 or greater: (1) specific compensating factors are required for all loans with ratios exceeding HUD's benchmark guidelines; (2) qualifying ratios are limited to a maximum of 45% (with the exception of energy efficient housing and borrowers with credit scores above 580); and (3) collections may not be paid off in order to qualify for FHA financing.

In addition to the specific underwriting policy changes, BSM also significantly improved its systems to create automated processes and monitoring programs where possible. To that end, in 2002, BSM implemented a data system, DataTrac by Del Mar Database, to control the flow of data in the Company and provide for various quality checks at different stages of loan processing. This system allows BSM to ensure accurate and complete information in each loan transaction. Among other things, this system enables BSM to resolve any discrepancies in loan file information prior to closing and has improved our ability to submit loan files and up-front mortgage insurance premium ("UFMIP") payments to the Department in a timely fashion. We continue to monitor and improve our underwriting standards and processing systems.

## **2. Construction/Permanent Loan Program Centralization and Improvements**

In addition to the changes to its overall underwriting standards, the Company made several enhancements to its operations and underwriting standards in connection with Construction-Permanent loans secured by FHA financing. As a Texas mortgage lender that specializes in providing financing to low- to moderate-income borrowers, the Company's loan portfolio includes a significant percentage of loans secured by manufactured homes, which are often underwritten using the Department's Construction-Permanent loan guidelines.

Mr. Frank E. Baca  
February 22, 2006  
Page 5

As it began tracking its Construction-Permanent loan performance in the Texas manufactured housing market, BSM determined that manufactured housing loans required a special set of underwriting considerations to ensure that qualified borrowers obtained FHA financing, but that such loans did not present a greater risk to BSM, its investors, or the Department. Thus, to ensure prudent underwriting, processing and closing that strictly complied with HUD's documentation requirements for Construction-Permanent loans, BSM centralized certain functions of its Construction-Permanent loan department to one office staffed by individuals who are familiar with the special considerations, as well as the unique underwriting and processing guidelines, necessary in these types of loans.

To that end, in January of 2003, BSM hired staff expert in this area, stationed them in the Company's headquarters in Addison, Texas, and began originating manufactured housing loans exclusively out of the Addison office. The Company retained an Operations Manager with 25 years of experience in FHA financing and manufactured housing transactions to oversee this division. Moreover, all underwriters, closers, funds, and shippers in BSM's Construction-Permanent loan division work exclusively with this loan product. The consolidation of the Company's Construction-Permanent loan originations has enabled BSM to ensure that qualified employees experienced in manufactured housing loans handle these specialized transactions, streamline the processes necessary to complete these transactions, and increase our monitoring of these loans for compliance with HUD's underwriting and documentation guidelines. Finally, BSM requires its employees to counsel borrowers in manufactured housing transactions regarding all aspects of the loan programs to ensure they fully understand the construction and loan process, as well as their increased obligations as homeowners.

### **3. Quality Control Enhancements**

BSM also has made significant strides in improving the Company's Quality Control department. In October of 2002, BSM hired a Vice President of Underwriting and Quality Control to focus on the consistency and quality of the Company's loan production. This individual fully analyzed the Company's performance, removed problematic employees, and conducted extensive training for existing employees regarding compliance with FHA guidelines. Since that time, BSM has bolstered its Quality Control department to six individuals whose sole responsibility is to monitor loan quality and performance. BSM's current Director of Quality Assurance, Katie Waymire, has over 30 years of experience in the mortgage industry and reports directly to senior management regarding Quality Control processes, reviews, and findings. Moreover, one of the current Quality Control staff members, John Eickhoff, is a former licensed

Mr. Frank E. Baca  
February 22, 2006  
Page 6

appraiser and FHA fee inspector with over 20 years of experience with FHA appraisal requirements. This individual reviews and investigates appraisals, orders and examines field reviews, and provides guidance for the Company's underwriters during their review of appraisals prior to closing in FHA transactions.

In addition to conducting Quality Control reviews in compliance with HUD guidelines, BSM has created a software program to track every issue identified by HUD through its Report Cards, audits, Notices of Return, etc. This system organizes this data by branch office and individual employee. Our Quality Control staff analyzes the data to isolate issues reflected in these reports and provide training to BSM employees based on these findings.

Finally, BSM has created a formalized, internal corporate training program to increase compliance with the Department's requirements and further improve loan quality. The Company recently hired two full-time employees to head this department. These individuals have created a mandatory training program for all new employees and also conduct ongoing training for the Company's current employees regarding HUD/FHA guidelines and prudent underwriting practices. As discussed in response to the Report's specific findings, these full-time trainers have provided guidance and counseling to BSM's employees on many of the issues that are the subject of the Report's findings. For instance, the Company recently issued a training tool reminder to its Construction-Permanent loan division that includes Company policy regarding FHA inspections for proposed manufactured housing (**Exhibit A-1**).

#### **4. Improved Loan Performance**

As evidenced by the above discussion, BSM is not the same company that originated the loans cited in the Report. We believe that the significant changes detailed above, including the fact that the Company consolidated its Construction-Permanent loan program and placed an emphasis on ensuring that these transactions are originated and closed in accordance with HUD requirements, resulted in considerable improvement in the Company's loan quality and performance. BSM's FHA loan portfolio consists of quality originations and the Company does not pose a risk to the FHA Insurance Fund. BSM's default/claim rates evidence the quality of its loan originations. For example, the Company's current FHA Connection/Neighborhood Watch data reflects a 149% default/claim rate (**Exhibit A-2**). As this response and supporting documentation demonstrate, any deficiencies that existed in connection with the findings in the Report were inadvertent and largely technical in nature, and the Company has taken steps to ensure that such deficiencies do not recur.

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 7

## II. RESPONSES TO THE FINDING

The Report contains one finding, including seven main sub-findings, in which it alleges that BSM did not originate 47 loans in compliance with HUD requirements or prudent lending practices. Upon receipt of the draft Report, BSM conducted a thorough review of the findings and loan files, as well as examined applicable HUD/FHA guidelines and internal Company procedures at the time these loans were originated in an effort to provide pertinent information and documentation with this response. Our review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD's requirements. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate BSM's general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report and evidence our adherence to FHA requirements in connection with several of the cited sub-findings and loans.

### A. Acquisition Costs

In the first sub-finding, the Report alleges that the Company permitted the manufactured home seller, Palm Harbor, to add unallowable and unsupported costs to the acquisition costs in 46 loans. In each of these cases, the Report asserts that the Company did not ensure that the loan closed according to the sales contract, as the sales price shown on the HUD-1 Settlement ("HUD-1") differed from the sales price shown on the closing documents, which reflected costs that the seller added to the manufactured home's sales price. Specifically, the Report asserts that the seller added closing costs that it had agreed to pay, including downpayment assistance funds, moving expenses, personal property costs, and other unsupported costs, to the purchase prices of the manufactured homes in these cases. The Report indicates that it made these determinations after reviewing commission sheets prepared by, and obtained from, Palm Harbor, not BSM.

BSM understands and appreciates that, for purposes of determining the maximum mortgage amount, it must apply the applicable loan-to-value limits to the lesser of: (1) the appraised value plus allowable closing costs; or (2) the documented acquisition cost of the property. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 1-8(D); HUD Handbook 4155.1 REV-5, ¶ 1-8(D). For purposes of this calculation, HUD defines the "acquisition cost" to include: (1) the builder's price; (2) the cost of the land; (3)



Comment 2

Mr. Frank E. Baca  
February 22, 2006  
Page 8

interest and other costs associated with any construction loan obtained by the borrower to fund construction of the property; (4) the closing costs to be paid by the borrower; and (5) reasonable discount points. Id. In several of the cases cited in the Report, BSM fully complied with these requirements, and correctly calculated the acquisition cost used to determine the maximum mortgage amount.

To establish the acquisition cost, in compliance with HUD guidelines, BSM obtained a copy of the fully executed sales agreement between the manufactured home seller regarding the manufactured dwelling, as well as a fully executed sales agreement between the seller of the land and the borrower. See HUD Handbook 4155.1 REV-4, CHG-1, ¶¶ 2-16, 3-1(H); HUD Handbook 4155.1 REV-4, ¶¶ 2-17(K), 3-1(H). The Company properly calculated the acquisition cost by adding the total sales price for both the manufactured home and the undeveloped land reflected on these documents. This total acquisition cost is reflected on both the Mortgage Credit Analysis Worksheet ("MCAW") and the HUD-1 in these cases. HUD requirements expressly state that a lender must close the loan in accordance with the terms and sales prices as specified in the sales contracts. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-5. In these cases, the HUD-1s evidence that the transactions closed in accordance with the sales prices on the manufactured home and land contracts contained in the BSM files.

Notwithstanding BSM's compliance with HUD guidelines, the Report alleges that the closing documents evidenced that the total manufactured home price used to calculate the acquisition cost included certain impermissible amounts. In several cases cited in the loan files, this is not the case. The purchase memos obtained from the borrowers in these cases indicate that, for most of the fees at issue, the seller was to pay these costs from its own funds. The purchase memos do not, however, indicate that the seller had included those costs into the price of the manufactured home referenced on these documents. To the extent that the seller incorporated these costs in the price of the home it sold to the borrower, BSM was unaware of this circumstance in these loans. As demonstrated in the individual cases discussed in detail below, none of the documentation that BSM was required to obtain and that was included in the loan file at closing regarding the borrower's purchase of the manufactured home indicated that the sales price included such costs.

Comment 3

As indicated in the Report, the auditors determined that such additional costs were included in the manufactured home price only after a review of commission sheets created and retained by the seller. These documents were obtained by BSM from Palm Harbor at the OIG's request during the review, but not before (Exhibit B-1). After examining these commission sheets as part of this audit, it is clear that the seller often created these commission sheets after closing and, in any event, BSM was not provided

Mr. Frank E. Baca  
February 22, 2006  
Page 9

Comment 3

with these documents or the information contained therein at any point during loan origination. FHA guidelines do not require lenders to obtain such documentation from builders or home sellers, and BSM in fact had not obtained these commission sheets until requested to do so by the auditors during this review. Therefore, in many of the cases cited in the Report, the Company had no knowledge that the sales prices indicated on the purchase memos contained in the loan files and endorsement binders included any costs other than those acquisition costs permitted by HUD requirements.

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Comment 4

In addition, we note that, while the OIG may dislike the practice of builders and manufactured home dealers increasing a property's sales price in the amount of a downpayment assistance grant or other costs associated with the transaction, such action by these entities does not expressly violate FHA guidelines. HUD requirements govern only the practices of FHA-approved lenders and require that they follow guidelines to ensure that borrowers qualify for financing and that the value of the underlying property for which financing is obtained is supported. We are not aware of any HUD guidelines that dictate what considerations a seller/builder must use to determine property value, nor are we aware of any restriction on the increase of the property value by the seller/builder in amount of downpayment assistance gifts. As discussed below, provided the seller/builder makes a donation to a permissible nonprofit entity after loan closing, which the Report does not question in any of the cases cited, HUD guidelines do not dictate whether a builder or seller may increase a property's sales price in the amount of that future contribution or any other cost associated with the transaction prior to providing that price to the FHA lender. Moreover, BSM cannot control what factors a manufactured home dealer uses to set the price of its properties. Any determinations by the seller to increase the purchase price of the manufactured home to cover its costs in connection with the transaction were outside of BSM's knowledge and control, as well as HUD's jurisdiction.

Comment 2

Comment 1

In summary, BSM complied with HUD guidelines in documenting the sales transactions and calculating the acquisition costs in these cases. The Company was not required to and did not obtain commission sheets or other documentation or information from the seller in many of these cases indicating that the purchase price conveyed to BSM included any unallowable fees. Moreover, the Company had no reason to question the accuracy of the manufactured home sales price indicated on the purchase memos received from Palm Harbor and reasonably relied on the information contained in the sales agreements it received in these FHA transactions. As BSM adhered to all applicable requirements in connection with calculating the borrowers' acquisition costs in several cases cited in the Report, these allegations, as well as the recommendations that the Company buy-down and indemnify these loans, should be

Mr. Frank E. Baca  
February 22, 2006  
Page 10

removed from the final report.<sup>1</sup> To demonstrate the Company's compliance with HUD requirements with regard to acquisition costs, we discuss such compliance in a sample of nine cases cited in this sub-finding below.

1. **FHA Case No. 495-6384702**

In the loan, the Report alleges that the lender could not support the sales price on the contracts, as the monitors' review found that the seller added \$15,452 in unallowable costs to the sales price, including closing costs it had agreed to pay, non-allowable FHA costs, a title policy, a big-screen television, downpayment assistance funds, and other unidentified costs.

Contrary to the allegation in this case, BSM complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with HUD's Construction-Permanent loan guidance, BSM obtained a purchase memo, which indicated that the manufactured home price was \$96,440 (Exhibit C-1), and a lot purchase reservation agreement evidencing the cost of the land as \$28,560 (Exhibit C-2). There was no evidence on either of these documents that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, as acknowledged in the Report itself, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity from its own funds (Exhibit C-1). BSM had no reason to question the validity of the sales prices included in the required documentation, and

<sup>1</sup> While we strongly believe that both of the Report's recommendations regarding these loans should be removed, we would like to briefly address the inappropriateness of recommending both indemnification and a principal reduction in connection with the same loan. In the event that a borrower agrees to indemnify HUD for an FHA loan, the lender agrees to be liable for the entire amount of any insurance claim that the Department would satisfy in connection with that loan in the event that the borrower did not fulfill her repayment obligation, as well as any expenses the Department had incurred in connection with the property securing the loan. As a result of a lender's agreement to indemnify HUD, the Department will suffer absolutely no loss in that FHA transaction and will retain the up-front insurance premium. Because a lender's agreement to indemnify is an agreement to cover all of HUD's potential losses, a principal reduction in connection with the same case would impose an additional and unnecessary penalty on the lender. Such action would constitute double jeopardy, as it would punish the Company twice for the concerns addressed by the lender's agreement to indemnify. Moreover, we understand that the Report's recommendation for both indemnification and principal reductions in this instance is contrary to the Department's standard policy of requesting either a principal reduction or indemnification in the event the loan is in default. We invite the OIG to consult the Quality Assurance Divisions in HUD's Homeownership Centers to confirm their practice of imposing only one, but not both, of these penalties in the case of an over-insured loan.

Mr. Frank E. Baca  
February 22, 2006  
Page 11

there was no evidence in the loan file during loan origination to suggest that the seller had added any impermissible costs to the sales price. To the extent that the seller's commission sheet reflects that these costs, or other unallowable costs of a big-screen television, were included in the manufactured home's price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. With regard to the personal property allegedly included in that price, BSM understands and appreciates that "personal property items such as ... televisions ... given by the seller to consummate the sale result in a reduction to the mortgage." See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 1-7(B). Thus, had the Company been aware of such an inducement to purchase in this instance, it would have reduced the purchase price by the market value of that item.

As the seller represented, and BSM understood, that the purchase memo sales price included only permissible costs associated with the manufactured home, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$125,000 (\$96,440 + \$28,560 = \$125,000). BSM properly used this acquisition cost to calculate the maximum mortgage amount on the MCAW (Exhibit C-3), and included it as the contract sales price on the HUD-1 (Exhibit C-4). As BSM correctly calculated the acquisition cost in this case, the loan is not over-insured, and neither a principal reduction or indemnification is warranted. We respectfully request that this allegation be removed from the final report.

## 2. FHA Case No. 495-6727403

In this case, the Report alleges that the lender did not ensure that the loan closed according to the sales contract, as the combined sales price on the manufactured home and land contracts was \$95,080; however, the HUD-1 indicated a sales price of \$98,000 and, had the Company reviewed the closing, it would have discovered that the seller added unsupported costs to the sales price, including closing costs it had agreed to pay, non-allowable FHA costs, a title policy, and downpayment assistance funds.

BSM maintains that it complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with HUD guidelines, BSM obtained a purchase memo, which indicated that the manufactured home price was \$73,100 (Exhibit D-1), and an unimproved property contract documenting the cost of the land as \$24,900 (Exhibit D-2). Combining these two numbers yields an acquisition cost of \$98,000, which BSM used to calculate the maximum mortgage amount on the MCAW (Exhibit D-3), and included as the contract sales price on the HUD-1 (Exhibit D-4). Thus, contrary to the assertions in this case, BSM did ensure that the loan closed in accordance with the sales contract and had no reason to further review the sales prices in these cases. Moreover, even if BSM had

Mr. Frank E. Baca  
February 22, 2006  
Page 12

done so, the documents it possessed at closing would not have revealed any evidence that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit D-1**). BSM had no reason to question the validity of these statements, and there was no evidence in the loan file during loan origination to suggest that the seller had added these costs to the sales price.

As BSM correctly calculated the acquisition cost in this case, the loan is not over-insured, and neither a principal reduction or indemnification would be appropriate. We therefore respectfully request that this allegation and these recommendations be removed from the final report.

3. r – FHA Case No. 495-6545687

In the case, this sub-finding alleges that the lender could not support the sales price on the contracts, as the auditors found that the seller added \$17,538 in unallowable costs to the sales price, including closing costs it had agreed to pay, playground equipment, downpayment assistance funds, and unidentified costs.

Contrary to the allegation in this case, BSM complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with HUD requirements, BSM obtained a purchase memo, which indicated that the manufactured home price was \$129,134 (**Exhibit E-1**), and an unimproved property contract evidencing the cost of the land as \$30,516 (**Exhibit E-2**). There was no evidence on either of these documents that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit E-1**). BSM had no reason to question the validity of the sales prices included in the required documentation, and there was no evidence in the loan file during loan origination to suggest that the seller had added any further costs to the sales price. To the extent that the seller's commission sheet reflects that these costs, or other unallowable costs for playground equipment, were included in that sales price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. Therefore, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$159,650 (\$129,134 + \$30,516 = \$159,650). BSM properly included this acquisition cost as the contract sales price on the HUD-1 (**Exhibit E-3**).

Mr. Frank E. Baca  
February 22, 2006  
Page 13

Comment 1

As BSM correctly calculated the acquisition cost in this case, the loan is not over-insured, and neither a principal reduction nor indemnification is warranted. We therefore believe that this allegation and these recommendations should be removed from the final report.

4. – FHA Case No. 495-6529962

In this loan, the Report asserts that the lender could not support the sales price on the contracts, as the auditors found that the seller added certain unallowable costs to the sales price, including closing costs it had agreed to pay, downpayment assistance funds, and other unidentified costs.

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Comment 9

Comment 3

Comment 2

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Contrary to the allegation in this case, BSM complied with HUD guidelines in calculating the acquisition cost based on the information provided to it by the seller and borrower. In compliance with HUD requirements, BSM obtained a purchase memo, which indicated that the manufactured home price was \$81,000 (**Exhibit F-1**), and an unimproved property contract evidencing the cost of the land as \$23,900 (**Exhibit F-2**). There was no evidence on either of these documents to suggest that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit F-1**). BSM had no reason to question the validity of this documentation. To the extent that the seller's commission sheet reflects that these costs, or other unallowable costs for playground equipment, were included in that sales price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. Therefore, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$105,000 ( $\$81,100 + \$23,900 = \$105,000$ ). BSM properly included this acquisition cost as the contract sales price on the HUD-1 (**Exhibit F-3**). As BSM correctly calculated the acquisition cost in this case based on information available to it at the time of closing, neither a principal reduction nor indemnification is appropriate.

5. – FHA Case No. 495-6037036

In the \_\_\_\_\_ case, the sub-finding alleges that the lender could not support the sales price on the contracts, as the auditors discovered that the seller added certain unallowable costs to the sales price, including closing costs it had agreed to pay, non-allowable FHA costs, a title policy, downpayment assistance funds, a gift certificate, and unidentified costs.

Mr. Frank E. Baca  
February 22, 2006  
Page 14

Comment 1

Comment 2

Comment 10

Comment 3

Here, BSM properly calculated the acquisition cost based on the information provided by the seller and borrower at the time of closing. In compliance with HUD's Construction-Permanent loan guidelines, BSM obtained a purchase memo, which indicated that the manufactured home price was \$103,100 (Exhibit G-1), and an agreement to sell real estate evidencing the cost of the land as \$27,400 (Exhibit G-2). There was no evidence on either of these documents that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (Exhibit G-1). To the extent that the seller's commission sheet reflects that these costs, or other unallowable costs of a gift certificate, were included in that sales price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. Thus, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$130,500 (\$103,100 + \$27,400 = \$130,500). BSM properly used this acquisition cost to calculate the maximum mortgage amount on the MCAW (Exhibit G-3), and included it as the contract sales price on the HUD-1<sup>2</sup> (Exhibit G-4).

Comment 1

As BSM correctly calculated the acquisition cost in this case, neither a principal reduction nor indemnification is warranted. We therefore respectfully request that this allegation be removed from the final report.

6. Case No. 495-6334452

In this case, the Report alleges that the lender did not ensure that the loan closed according to the sales contract, as the combined sales price on the manufactured home and land contracts was \$122,540.12; however, the HUD-1 indicated a sales price of \$123,000 and, had the Company reviewed the closing, it would have discovered that the seller added unsupported costs to the sales price, including closing costs it had agreed to pay, non-allowable FHA costs, a title policy, downpayment assistance funds, and other unidentified costs.

Comment 1

BSM maintains that it complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with

Comment 10

<sup>2</sup> Please note that this contract sales price was broken out on the HUD-1 to identify the \$27,400 cost of the land, the \$6,424 amount of the manufactured home price that was held in escrow during the construction period, and the \$96,675 cost of the manufactured home minus the escrow hold-back, which totaled \$130,500 (Exhibit G-4).

Mr. Frank E. Baca  
February 22, 2006  
Page 15

Comment 2

Comment 11

Comment 3

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HUD guidelines, BSM obtained a purchase memo, which indicated that the manufactured home price was \$105,034.33 (**Exhibit H-1**), and an unimproved property contract documenting the cost of the land as \$17,800 (**Exhibit H-2**). Combining these two numbers yields an acquisition cost of \$122,834.33, which BSM rounded up slightly to \$123,000 to calculate the maximum mortgage amount on the MCAW (**Exhibit H-3**), and include as the contract sales price on the HUD-1 (**Exhibit H-4**). Thus, contrary to the assertions in this case, BSM ensured that the loan closed in accordance with the sales contract and had no reason to further review the sales prices in these cases. Moreover, even if BSM had conducted a further review, these documents would not have revealed any evidence that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit H-1**). BSM had no reason to question the validity of the sales prices included in the required documentation, and there was no evidence in the loan file during loan origination to suggest that the seller had added any other costs to the sales price. As BSM correctly calculated the acquisition cost in this case, neither a principal reduction nor indemnification would be appropriate.

7. - FHA Case No. 495-6419246

In the loan, the Report asserts that the lender could not support the sales price on the contracts, as the auditors found that the seller added certain unallowable costs to the sales price, including closing costs it had agreed to pay, downpayment assistance funds, and other unidentified costs.

Comment 2

Comment 12

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BSM obtained a purchase memo in this case, which indicated that the manufactured home price was \$73,100 (**Exhibit I-1**), and an unimproved property contract evidencing the cost of the land as \$42,900 (**Exhibit I-2**). There was no evidence on either of these documents that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit I-1**). BSM had no reason to question the validity of these statements. To the extent that the seller's commission sheet reflects that these costs were included in that sales price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. Therefore, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$116,000 ( $\$73,100 + \$42,900 = \$116,000$ ). BSM properly included this acquisition cost as the contract sales price on



Mr. Frank E. Baca  
February 22, 2006  
Page 16

Comment 1

the HUD-1 (**Exhibit I-3**). As BSM correctly calculated the acquisition cost in this case based on information available to it at the time of closing, neither a principal reduction nor indemnification is inappropriate and this allegation and recommendations should be removed from the final report.

8. I – FHA Case No. 495-6482719

In this case, the Report alleges that the lender did not ensure that the loan closed according to the sales contract, as the combined sales price on the manufactured home and land contracts was \$138,031; however, the HUD-1 indicated a sales price of \$140,000 and, had the Company reviewed the closing, it would have discovered that the seller added unsupported costs to the sales price, including closing costs it had agreed to pay, non-allowable FHA costs, a title policy, downpayment assistance funds, and other unidentified costs.

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Comment 13

Comment 2

Comment 3

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Comment 13

BSM maintains that it complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with HUD guidelines, BSM obtained a purchase memo, which indicated that the manufactured home price was \$101,150 (**Exhibit J-1**), and an unimproved property contract documenting the cost of the land as \$38,850 (**Exhibit J-2**). Combining these two numbers yields an acquisition cost of \$140,000, which BSM used to calculate the maximum mortgage amount on the MCAW (**Exhibit J-3**), and included as the contract sales price on the HUD-1 (**Exhibit J-4**).<sup>3</sup> Thus, contrary to the assertions in this case, BSM did ensure that the loan closed in accordance with the sales contract and had no reason to further review the sales prices in these cases. Moreover, even if BSM had conducted a further review, these documents would not have revealed any evidence that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (**Exhibit J-1**). BSM had no reason to question the validity of the sales prices included in the required documentation, and there was no evidence in the loan file during loan origination to suggest that the seller had added any further costs to the sales price. As BSM correctly calculated the acquisition cost in this case, neither a principal reduction nor indemnification would be appropriate.

<sup>3</sup> Please note that this contract sales price was broken out on the HUD-1 to identify the \$38,850 cost of the land, the \$6,891 amount of the manufactured home price that was held in escrow during the construction period, and the \$94,258 cost of the manufactured home minus the escrow hold-back, which totaled \$140,000 (**Exhibit J-4**).

Mr. Frank E. Baca  
February 22, 2006  
Page 17

9. d – FHA Case No. 495-6483454

Finally, in the d case, the Report asserts that the lender could not support the sales price on the contracts, as the auditors found that the seller added certain unallowable costs to the sales price, including closing costs it had agreed to pay, downpayment assistance funds, and other unidentified costs.

Contrary to the allegation in this case, BSM complied with HUD guidelines in calculating the acquisition cost based on the information provided by the seller and borrower. In compliance with HUD requirements, BSM obtained a purchase memo, which indicated that the manufactured home price was \$68,500 (Exhibit K-1), and an unimproved property contract evidencing the cost of the land as \$36,500 (Exhibit K-2). There was no evidence on either of these documents to suggest that the manufactured home dealer included any costs other than those permitted by HUD guidelines in the purchase price of the manufactured unit. In fact, the purchase memo stated that the seller was to pay closing costs and FHA non-allowable fees, as well as make a donation to a nonprofit downpayment assistance entity (Exhibit K-1). To the extent that the seller's commission sheet reflects that these costs were included in that sales price, BSM had no knowledge of these circumstances at the time it originated, underwrote, and closed this loan. Therefore, the Company used the sales amounts reflected on the sales agreements in the loan file to calculate the acquisition cost, and arrived at a figure of \$105,000 (\$68,500 + \$38,500 = \$105,000). BSM properly included this acquisition cost as the contract sales price on the HUD-1 (Exhibit K-3). As BSM correctly calculated the acquisition cost in this case based on information available to it at the time of closing, neither a principal reduction nor indemnification is appropriate and this allegation and recommendations should be removed from the final report.

B. Seller Concessions

The Report asserts that, in 33 loans, the lender did not reduce the sales prices used to calculate the maximum mortgage amount by the amount of seller concessions that constituted more than six percent (6%) of the sales prices. Specifically, the Report asserts that, in these cases, the contract to purchase the home included seller contributions or concessions in excess of the 6% limit listed on the MCAW, including: (1) closing costs agreed to be paid by the manufactured dealer; (2) seller contributions to downpayment assistance funds; and (3) seller payments for title policies and fees borrowers are not permitted to satisfy under HUD requirements. BSM respectfully disagrees with these allegations. Below we discuss the Company's compliance with HUD requirements, as well as provide examples of individual cases in which the Company correctly calculated the seller concessions.

Comment 1

Comment 2

Comment 14

Comment 3

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 18

#### 1. Compliance with HUD Guidelines Regarding Seller Concessions

As you know, FHA guidelines permit sellers to contribute up to 6% of the property's sales price toward the buyer's actual closing costs, prepaid expenses, discount points, and other financing concessions. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 1-7; HUD Handbook 4155.1 REV-5, ¶ 1-7. While a seller's payment of more than 6% of the borrower's closings costs normally requires a dollar-for-dollar reduction to the sales price prior to calculating the maximum mortgage amount, HUD requirements expressly state that only those "closing costs normally paid by the borrower are considered contributions if paid by the seller." Id. Moreover, FHA guidelines state that "items typically paid by the seller, under local or state law or custom, such as real estate commissions, charges for pest inspections, fees paid for trustees to release a deed of trust, etc. are not considered contributions." Id. (emphasis added). Finally, with regard to downpayment assistance and other gift funds, HUD guidelines indicate that the Department requires a dollar-for-dollar reduction only when the gift funds do not meet HUD guidelines regarding permissible gifts. See id. Contrary to the assertions in sub-finding 2, BSM maintains that it complied with all of the above-cited requirements in underwriting several of the cases cited in the Report.

Comment 1

In connection with the closing costs agreed to be paid by the manufactured home dealer, in the cases cited in this sub-finding, as evidenced in the responses to individual allegations below, BSM ensured that the seller-paid closing costs indicated on the HUD-1 did not exceed the 6% limitation listed on the MCAW. As the seller's contribution to closing costs normally paid by the borrowers in these cases did not exceed 6% of the sales price, BSM complied with HUD requirements and no reduction in the maximum mortgage amount was warranted.

Comment 15

With regard to downpayment assistance funds, as indicated above, such gift funds are not required to be included in the 6% seller contribution amount provided the gift funds are given in accordance with FHA requirements. To that end, for downpayment assistance grants, HUD guidelines require lenders to document the transfer of the gifts from the non-profit agency to the borrower. Specifically, lenders must obtain evidence from the agency of the amount of the funds being provided, as well as evidence that no repayment by the borrower is required. See HUD Single Family Reference Guide, Page 2-11. BSM complied with these requirements in this case and the Report does not question the Company's adherence to its obligations in this regard. In each of the loans cited, the borrowers received downpayment assistance from an independent, non-profit downpayment assistance provider. The actual funds received by the borrowers were not provided by the builder. While the builder may have made donations to the nonprofit assistance agency in the amount of the assistance gifts

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 19

Comment 15

received by these borrowers, HUD requirements expressly state that such circumstances are permissible under FHA guidelines, provided that the nonprofit organization receives the contribution from the seller/builder outside of closing of the particular transaction. See Mortgagee Letter 02-22(E). Although BSM is an independent company from Palm Harbor, the seller in these cases, BSM understands that the nonprofit agencies wired the funds used for the downpayment assistance in these cases to the settlement agent at or before closing. Thus, the downpayment assistance gifts in these loans came from the nonprofit entities' funds, not Palm Harbor's sales proceeds in these cases, even though Palm Harbor routinely donated funds to the nonprofit entities as indicated on the purchase memos referencing seller contributions to such funds. Moreover, the gift letters from the downpayment assistance providers expressly state that no repayment of the assistance gift is required. Therefore, the downpayment assistance grants in the cases at issue complied fully with all HUD requirements of which BSM is aware. As such, contrary to the allegations in the Report, the Company was not required to characterize the downpayment assistance grant amounts as seller concessions in its calculation of the 6% limitation in these transactions.

Comment 1

Comment 16

Finally, in connection with the seller's payments for title policies and fees borrowers are not permitted to satisfy under HUD requirements, as discussed above, HUD requirements dictate that "items typically paid by the seller, under local or state law or custom, such as real estate commissions, charges for pest inspections, fees paid for trustees to release a deed of trust, etc. are not considered contributions." Id. (emphasis added). In the Texas manufactured housing market, and in connection with many homes sold directly by builders and manufactured home dealers, it is common practice for the builder/seller to pay for the borrower's title policy in connection with the purchase transaction. As this is not a closing cost "normally paid by the borrower" in these types of transactions, BSM properly excludes this seller payment in its calculation of the 6% seller contribution limit. Additionally, if a purchase transaction involves fees that HUD guidelines do not permit lenders to pass on to FHA borrowers, builders/sellers traditionally agree to pay these fees in addition to making contributions to closing costs normally paid by the borrower under FHA guidelines. As you know, FHA guidelines in place at the time the loans cited in the Report were originated contained an exclusive list of fees that lenders could pass on to FHA borrowers. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 1-7; HUD Handbook 4000.2 REV-2, ¶ 5-3; HUD Handbook 4000.2 REV-3, ¶ 5-2. As HUD requirements did not permit collection of the non-allowable fees referenced in the cases cited in the Report from the borrowers, these costs obviously did not constitute closing costs "normally paid by the borrower." See id. Because such fees were not permissible borrower closing costs for FHA purposes and, therefore, were traditionally paid by the builder/seller, BSM was not required to include such fees in the

Mr. Frank E. Baca  
February 22, 2006  
Page 20

calculation of the 6% seller concession amount in the cases cited in the Report. Finally, we note that, in some cases cited in sub-finding 2, inclusion of these costs into that calculation in many cases would have nevertheless resulted in seller concessions of less than 6% of the sales price.

In summary, BSM maintains that it satisfied its obligations with regard to ensuring that the seller did not contribute more than 6% of the sales price to assist in paying the borrower's closing costs in the cases cited in sub-finding 2. As BSM complied with all applicable requirements in connection with these calculations, these allegations should be removed from the Report. We provide examples of the Company's compliance with HUD guidelines in this regard below.

## **2. Examples of Compliance**

### **a. Case No. 495-6384702**

In the loan, the Report asserts that the 6% seller concession limitation was \$7,500; however, the contract to purchase the home evidenced \$13,000 in seller contributions or concessions and the sales price was not reduced by the amount of concessions exceeding the 6% limitation.

In this loan, contrary to the allegation in sub-finding 2, BSM accurately calculated the seller concessions, which were below the 6% limitation. The MCAW indicated that the 6% limitation in this case was \$7,500 (**Exhibit C-3**), and the purchase memo stated that seller paid closing costs would be limited to this \$7,500 amount (**Exhibit C-1**). While the purchase memo also indicates that the seller would contribute funds to a downpayment assistance fund and pay for a title policy and certain FHA non-allowable fees, as discussed above, HUD guidelines did not require BSM to include these costs in the seller concessions for purposes of evaluating whether such costs exceeded 6% of the sales price. As a result, the seller contributions in this case did not exceed the 6% limitation, and a dollar-for-dollar reduction in sales price was not warranted. BSM complied with HUD guidelines in underwriting this loan and, therefore, we respectfully request that the allegations and recommendations associated with this finding be removed from the final report.

### **b. - FHA Case No. 495-6727403**

In the case, the Report asserts that the 6% seller concession limitation was \$5,880; however, the purchase memo included \$12,180 in seller contributions or concessions and the sales price was not reduced by the amount of concessions exceeding the 6% limitation.

Comment 1

Comment 17

Mr. Frank E. Baca  
February 22, 2006  
Page 21

Comment 18

Here, BSM accurately calculated the seller concessions, which were below the 6% limitation. The MCAW indicated that the 6% limitation in this case was \$5,880 (**Exhibit D-3**), and the purchase memo between the seller and borrower indicated that seller paid closing costs would be limited to \$5,633 (**Exhibit D-1**). Moreover, the HUD-1 indicates that the seller actually paid \$5,796.45 in the borrower's normal closing costs (**Exhibit D-4**), which was less than the \$5,880 limitation in this loan. While the purchase memo also indicates that the seller would contribute funds to a downpayment assistance group and pay for a title policy and certain FHA non-allowable fees, as discussed above, HUD guidelines did not require BSM to include these costs in the seller concessions for purposes of evaluating whether such costs exceeded 6% of the sales price. As a result, the seller contributions in this case did not exceed the 6% limitation, and a dollar-for-dollar reduction in sales price was not warranted.

c. FHA Case No. 495-6037036

In the loan, sub-finding 2 asserts that the 6% seller concession limitation was \$7,830; however, the contract to purchase the home included \$16,261 in seller contributions or concessions and the sales price was not reduced by the amount of concessions exceeding the 6% limitation.

Comment 16

Comment 19

Contrary to these assertions, the MCAW indicated that the 6% limitation in this case was \$7,830 (**Exhibit G-3**), and the purchase memo between the seller and borrower indicated that seller paid closing costs would be limited to \$7,830 (**Exhibit G-1**). Moreover, the HUD-1 indicates that the seller actually paid \$7,174 in closing costs and prepaids (**Exhibit G-4**), which was less than the \$7,830 limitation in this loan. While the purchase memo also indicates that the seller would contribute funds to a downpayment assistance fund and pay for a title policy and certain FHA non-allowable fees, as discussed above, HUD guidelines did not require BSM to include these costs in the 6% limitation. As a result, BSM complied with HUD guidelines in underwriting this loan and, therefore, the allegations and recommendations associated with this finding should be removed from the final report.

d. FHA Case No. 495-6334452

In this loan, the Report asserts that the 6% seller concession limitation was \$7,380; however, the contract to purchase the home included \$12,863 in seller contributions or concessions and the sales price was not reduced by the amount of concessions exceeding the 6% limitation.

Comment 1

Here, BSM accurately calculated the seller concessions, which were below the 6% limitation. The MCAW indicated that the 6% limitation in this case was \$7,380

Mr. Frank E. Baca  
February 22, 2006  
Page 22

Comment 20

(Exhibit H-3), and the purchase memo between the seller and borrower indicated that seller paid closing costs would be limited to \$6,763 (Exhibit H-1). Moreover, the HUD-1 indicates that the seller actually paid \$5,533.96 in the borrower's normal closing costs and pre-paid items (Exhibit H-4), which was much less than the \$7,380 limitation in this loan. While the purchase memo also indicates that the seller would contribute funds to a downpayment assistance fund and pay for a title policy and certain FHA non-allowable fees, as discussed above, HUD guidelines did not require BSM to include these costs in the seller concessions for purposes of evaluating whether such costs exceeded 6% of the sales price. As a result, the seller contributions in this case did not exceed the 6% limitation, and a dollar-for-dollar reduction in sales price was not warranted.

Comment 1

e. - FHA Case No. 495-6482719

Finally, in this case, the Report asserts that the 6% seller concession limitation was \$8,400; however, the contract to purchase the home included \$15,879 in seller contributions or concessions and the sales price was not reduced by the amount of concessions exceeding the 6% limitation.

Comment 16

Contrary to these allegations, the MCAW indicated that the 6% limitation in this case was \$8,400 (Exhibit J-3), and the purchase memo between the seller and borrower indicated that seller paid closing costs would be limited to \$8,394 (Exhibit J-1). Moreover, the HUD-1 indicates that the seller actually paid only \$3,826.12 in the borrower's normal closing costs (Exhibit J-4), which was far less than the \$8,400 limitation in this loan. While the purchase memo also indicates that the seller would contribute funds to a downpayment assistance fund and pay for a title policy and certain FHA non-allowable fees, as discussed above, HUD guidelines did not require BSM to include these costs in the seller concessions for purposes of evaluating whether such costs exceeded 6% of the sales price. As a result, the seller contributions in this case did not exceed the 6% limitation, and a dollar-for-dollar reduction in sales price was not warranted. Moreover, even if the \$1,393 title policy cost and the \$1,250 in non-allowable costs reflected on the purchase memo (Exhibit J-1) had been included in the 6% calculation, the total costs paid by the seller in this transaction would have been \$6,469.12, which was still well below the \$8,400 limitation in this instance. BSM complied with HUD guidelines in underwriting this loan and, therefore, we respectfully request that the allegations and recommendations associated with this finding be removed from the final report.

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 23

**C. Examination of Appraisal Reports**

In the third sub-finding, the Report alleges that the underwriters in the cases cited did not adequately review the appraisals or obtain explanations of appraisal deficiencies that would indicate lower property values. Specifically, sub-finding 3 alleges that, in 43 of the appraisals at issue, the lender and appraiser overvalued the properties by more than 10 percent, based on appraisals by the county appraisal districts. Additionally, the Report asserts that the appraisers used property sales for comparables that were: (1) in different neighborhoods and environments; (2) more than six months old, which may reflect a different or changing market; (3) not similar to the subject property in size, age and design; or (4) inappropriately adjusted. Finally, in three cases, the Report alleged that the appraisal included an incorrect picture of the subject property or one of the comparables. As discussed in detail below, BSM respectfully disagrees with the vast majority of allegations in this sub-finding and maintains that its underwriters adequately examined the appraisals in these cases in accordance with HUD guidelines. We address each of the matters raised in sub-finding 3 in turn below.

**1. BSM Generally Complied with HUD Guidelines Regarding Reviewing Appraisals**

As part of Company policy and practice, BSM diligently undertakes to obtain and verify all information, including the property appraisal, as if it were entirely dependent on the property as security to protect the Company's investment. HUD Handbook 4000.4, REV-1, CHG-2, ¶ 2-5. The Company understands and appreciates that its underwriters must assume the responsibility of reviewing appraisal reports to ensure reasonable conclusions, sound reports and compliance with HUD requirements, as well as the decisions relating to the acceptability of appraisals. HUD Handbook 4000.4, REV-1, CHG-2, 2-4(C); Mortgagee Letter 97-45; see also HUD Handbook 4000.4 REV-1, CHG-2, ¶ 3-3. It is our policy and procedure to require that each underwriter review the appraisal in accordance with HUD valuation policy to determine whether the appraiser's conclusions are acceptable and, in the event that an appraisal report's findings are inconsistent or otherwise unacceptable, we require our underwriters to obtain additional information or explanation from the appraiser or return the case to the appraiser for reconsideration. See HUD Handbook 4000.2, REV-2, ¶ 2-15.

In each of the cases cited in sub-finding 3, BSM obtained an appraisal from an independent, third party appraiser. None of the appraisers were employees of the Company. Moreover, our review of the appraisal reports indicates that at least 13 different appraisers conducted the appraisals and completed the Uniform Residential Appraisal Reports ("URAR") being questioned in the Report. The number and variety of

Comment 1



Mr. Frank E. Baca  
February 22, 2006  
Page 24

Comment 1

independent appraisers conducting the appraisals at issue indicates that there was no effort to inflate appraised values in these cases on the part of the Company or a particular appraiser. This diversity in independent appraisers also supports that the comparables used, analyses conducted, and valuations reached by these industry professionals represent standard practices for the appraisal of Texas manufactured homes and that the underwriters' evaluation of these appraisal procedures and acceptance of such valuations as reasonable was well within HUD requirements.

In each of the loans at issue in the Report, BSM's underwriter reviewed the URAR and was satisfied with the overall value conclusions of the appraiser based on the information provided. A lender does not physically visit the subject property when it contracts with an independent third party appraiser and therefore must be able to rely on the appraiser's observations noted in the appraisal report. The underwriters in the loans at issue reasonably relied on the appraisers' expertise and experience in appraising properties, and accepted the appraisers' conclusions based on this reliance and the appraisers' explanations provided on the face of the URARs. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e). HUD recently visited the issue of lender responsibility for appraisal review, and determined that holding lenders strictly liable for the quality of appraisals performed by independent third-parties was not appropriate. See 69 Fed. Reg. 43,504 (July 20, 2004). In amending its regulations, the Department reiterated that, provided the underwriter reviews the appraisal report and determines that the appraiser's conclusions were reasonable and supported by the analysis contained in the URAR, the lender would be in compliance with HUD guidelines. Id.

Comment 22

Here, BSM reasonably relied on the appraiser's observations and representations, as indicated in the appraisal reports. BSM recognizes that some of the appraisal reports in the cases cited in sub-finding 3 contain certain information that the appraisers should have explained in greater detail, primarily with respect to comparables selected or adjustments made. While the appraiser's explanations in a given case may not have been as thorough as possible, the appraisers did explain their reasons for selecting the comparables and making the adjustments to value indicated on each URAR. Moreover, any deficiencies that occurred in this regard were isolated and do not reflect the Company's overall standards for appraisal review. While a few oversights may have occurred in some of the appraisals at issue, the underwriter reasonably determined that the appraiser's conclusions were acceptable in these cases. These appraisal reports appeared to meet applicable HUD/FHA guidelines and appraisal standards. BSM therefore reasonably relied on the appraiser's representations with respect to the properties' condition and value. Moreover, as

Mr. Frank E. Baca  
February 22, 2006  
Page 25

discussed above, one of the current Quality Control staff members has over 20 years of experience with FHA appraisal requirements. This individual, among other things, assists BSM's underwriters during their review of appraisals prior to closing in FHA transactions to ensure compliance with applicable HUD guidelines.

As demonstrated in the individual responses below, in each case, the value reached by the appraiser was supported. Each borrower cited in sub-finding 3 received good title to the property and the Department's lien position was not affected. We address each of the Report's specific issues with the appraisals in these cases in turn below.

Comment 1

## **2. Use of Appraisal District Valuations Is Not Appropriate**

First, in each of the cases identified in the Report, sub-finding 3 alleges that the lender and appraiser overvalued the properties based on the auditors' review of appraisals conducted by the county appraisal districts. Specifically, the Report states that the auditors compared the lenders' values (which we assume refers to the appraised value as determined by the independent, third-party appraiser in each case) with the values derived by the local appraisal districts and determined that many of the appraisers' values were significantly higher than the appraisal districts' values. The Report indicates that, according to Texas law, appraisal districts must set property tax values at 100% of market value. This sub-finding also points out that the monitors confirmed with the Deputy Chief Appraiser for Bexar County, one of the counties in which properties secured by the FHA loans in question were located, that state law also requires the appraisal districts to use the same Uniform Standards of Professional Appraisal Practice ("USPAP") employed by licensed appraisers.

Comment 23

As an initial matter, please note that lenders do not value real property for purposes of determining maximum loan amounts or purchase prices in FHA loans. Rather, lenders rely on independent, FHA-approved appraisers who are experts in the valuation of real property to conduct an objective analysis of the real estate that will secure the FHA loan and determine its market value at the time of purchase. As discussed above, lenders are required only to examine that appraisal and ensure that information is accurate and reasonable and that the appraiser's determined value will support the sales price agreed upon by the borrower and seller. Provided the appraisal is reasonable on its face, FHA guidelines permit lenders to rely on the independent appraiser's valuation to underwrite the loan. Thus, contrary to the assertion in the Report, the Company in these cases could not have overvalued the properties securing the FHA loans, as lenders do not engage in such valuation activity.

Comment 22

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 26

Comment 23

Nevertheless, the Report asserts that, in each case in which a Texas appraisal district valued the property securing one of the cited FHA loans for a lesser amount than the value determined by the independent appraiser, the initial appraiser's determination resulted in an overvaluation of the real property by the difference between the two assessments. BSM strongly disagrees with this allegation for several reasons.

In Texas, a local appraisal district established in each county conducts appraisals for the purpose of determining land value used to calculate property taxes (**Exhibit L-1**). While the Report is correct that these appraisal districts are governed by the same USPAP rules that FHA-approved appraisers must follow and must set property tax values at 100% of market value during their appraisals, the appraisal districts are not subject to FHA requirements regarding appraisals. Moreover, these districts are governed by Texas tax law provisions that ultimately result in very different appraisal practices and land valuations than those employed by appraisers under FHA requirements. As such, comparing an appraisal district's valuation of a home for tax purposes at some point after the loan closing with the independent appraiser's determination of value at the time of closing is not a fair comparison.

Comment 1

For instance, while local appraisal districts set the value of property each year for taxation purposes (**Exhibit L-1**), the appraisal districts are not required to, and do not conduct, an individual appraisal of each residential property located in the district on an annual basis (**Exhibit L-2**). In fact, Texas law requires only that the district repeat the appraisal process for property in the county at least once every three years (**Exhibit L-2**). Therefore, examining the appraisal district's valuation does not necessarily give an accurate picture of the home's value at the time of purchase or sale of the property. A local appraisal district's valuation will not be as current as an independent appraiser's value done at the time of settlement and may reflect changes in the local market place that affected home values since the time of loan closing. For that reason, the Department requires FHA-approved lenders to obtain an independent review of the real property's value by a professional appraiser to determine the actual value of the property at the time of sale, see HUD Handbook 4000.2 REV-3, ¶ 2-3, and allows lenders to pass this cost on to borrowers. See HUD Handbook 4000.2 REV-3, ¶ 5-2. If HUD had determined that the local taxing authority's valuation was accurate enough to establish value for purposes of calculating mortgage amounts, surely it would require lenders to use this valuation, rather than require lenders to obtain another appraisal at a cost of hundreds of dollars to the FHA borrower. For these reasons, we believe that the Report's reliance on the Texas appraisal district's valuations in its allegations in these cases is misplaced and not supported by either FHA guidelines or common sense.

Comment 23

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 27

Comment 23

Moreover, according to information provided to the public by the Texas Comptroller of Public Accounts, which agency is ultimately responsible for overseeing the property tax system in Texas, local appraisal districts use "mass appraisals" to determine value for large numbers of properties in an effort to save time and funds. Under this "mass appraisal" system, the appraisal district classifies real properties into groups based on a variety of factors, including size and construction type, and appraises the value of "typical properties in each class" (**Exhibit L-2**). Based on this information, the local appraisal district values cited in the Report do not represent a detailed, individualized analysis of the properties securing the FHA loans at issue. Rather, they represent the standard value for a "typical property" in the class that the subject property fits into in that particular county. While that valuation may assist an appraiser in determining the worth of real property, the Department has determined that the most accurate way to assess real property value is to conduct an appraisal of the actual real property securing the loan insured by HUD to establish an estimated value for mortgage insurance purposes. See HUD Handbook 4000.2 REV-3, ¶ 2-3. BSM did so in each of the cases cited in sub-finding 3.

Comment 24

In addition, according to the Texas Comptroller of Public Accounts, the appraised home value for a homeowner who qualifies for Texas's homestead tax exemptions may not increase more than 10 percent per year since that home's last reappraisal as the owner's qualified homestead (**Exhibit L-2**). Based on this guidance, as each of the loans in the Report are secured by owner-occupied property, it appears that several of the appraisal district's valuations may reflect less than fair market value based on Texas's homestead limitation on valuation increases. In many jurisdictions throughout the United States, legal limitations on valuations for tax purposes, as well as a strong real estate market such as the one existing during the time the loans at issue were originated, can cause real estate appraisals for sales purposes to greatly exceed valuations determined by local taxing authorities. As the appraisal district's valuations can be limited by the homestead exemption and other available exemptions so as to reflect a valuation less than fair market value, the appraisal district's determinations cannot fairly be used to cite the accurate, fair market value of a specific real property.

Comment 23

Comment 1

Finally, in each of the cases cited in the Report, the allegations rely heavily on the assumption that the appraisal district property value amount is the maximum amount. As discussed above, if the initial appraiser's analysis resulted in a higher value than that determined by the appraisal district, the sub-finding automatically concludes that the real property was overvalued by that exact amount at the time of closing. We are not aware, however, of any HUD guideline that sets a ceiling for maximum value on property securing FHA loans based on the local tax authority's value determination. In fact, in the 47 cases cited in the Report, such a threshold would have been impossible

Comment 23

Mr. Frank E. Baca  
February 22, 2006  
Page 28

Comment 23

to meet. All of the properties securing the FHA loans at issue were in the process of being constructed and were not complete at the time the appraisals in question were performed. Therefore, at that time, the appraisal districts had not yet examined the properties or determined an appraised value for tax purposes. As a result, the independent FHA appraiser could not have accessed the appraisal district's valuation or used it as a ceiling for, or even a comparison to, the valuation the appraiser independently arrived at after diligently examining the subject property and listed comparables in compliance with HUD guidelines.

Comment 1

Comment 22

In summary, as a local appraisal district makes value determinations for different reasons and under different standards than FHA-approved appraisers, as the district's appraisals occur after the time of closing and may not accurately reflect market conditions at the time of settlement, and as the district's appraisals often are based on "mass appraisals" and not on an individual, critical analysis of the subject property securing the loan, FHA guidelines require lenders to obtain independent appraisals by FHA-approved appraisers at the time the loan secured by the real property is closed. This practice ensures that the real property's value will support the FHA mortgage amount and best protects the Department's and the lender's interests. In each of the cases cited in the Report, BSM complied with HUD requirements in obtaining and reviewing the appraisals provided. For the reasons discussed above, the Report's reliance on the local appraisal district's valuations is inappropriate and not in accordance with HUD requirements. Accordingly, we respectfully request that the allegations regarding local appraisal district valuations be removed from the final report.

### **3. BSM Properly Analyzed the Appraisers' Comparable Property Choices**

Comment 1

As discussed above, the Report asserts that, in all but two of the loans at issue, the appraisers used comparable properties that were: (1) in different neighborhoods and environments; (2) more than six months old; (3) not similar to the subject property in size, age and design; or (4) inappropriately adjusted. Finally, in three cases, the Report alleged that the appraisal included an incorrect picture of the subject property or one of the comparables. BSM respectfully disagrees with these assertions in many of the cases, and believes that it fully complied with HUD guidelines in reviewing the appraisals in most of the cases cited in the Report. We address each of the specific allegations regarding the comparables in sub-finding 3 below.

Mr. Frank E. Baca  
February 22, 2006  
Page 29

a. Comparable Sales More than Six Months Prior to the Appraisal

First, sub-finding 3 asserts that, in 26 loans, the sales date of at least one comparable property cited by the appraiser was more than six months prior to the appraisal, and uses this information to support the allegation that the appraiser overvalued the subject property.

As discussed above, BSM understands and appreciates that its underwriters must assume the responsibility of reviewing appraisal reports to ensure reasonable conclusions, sound reports and compliance with HUD requirements, as well as the decisions relating to the acceptability of appraisals. HUD Handbook 4000.4, REV-1, CHG-2, 2-4(C); Mortgagee Letter 97-45. When reviewing the appraisal, the Company appreciates that HUD guidelines indicate that "comparable sales data should not be over six months old" and that "if a comparison is seven or eight months old, the reviewer should expect an explanation for its use." See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2); see also HUD Handbook 4150.2, CHG-1, ¶ 4-6(A2).

Contrary to many of the allegations regarding comparable sales in sub-finding 3, while the appraisers included properties with prior sales more than six months before the appraisal, each appraiser provided an explanation on the URAR regarding his or her reasons for using the older sales. For instance, in the loan, **FHA Case No. 495-6844999**, while some of the five comparables used had sales more than six months prior to the appraisal, the appraiser noted this fact on the URAR, and explained that the sales were within "FNMA guidelines of 12 months" and were chosen because, "due to the limited number of sales within the subject market area ... there were no other sales available in the subject market area similar to the subject" (**Exhibit M-1**). This language evidences that the appraiser adequately justified the use of these comparables to arrive at the stated value. Similarly, in the loan, **FHA Case No. 495-6673573**, although two of the comparable sales occurred more than six months before the appraiser's review, the sales were within 12 months of the appraisal and the appraiser addressed this issue by stating on the URAR that these comparables were used "due to the limited number of sales within the subject market area" and that "these were the best and most recent sales available prior to and after adjustments" (**Exhibit N-1**). Moreover, as is often the case in rural, manufactured housing markets, turnover is low with this type of housing and finding recent, comparable sales is sometimes difficult. As evidenced by the comments of the appraisers in these two cases, often the most comparable properties have been sold over six months, but less than a year, prior to the appraisal date.

Comment 1

Comment 25

Comment 26

Mr. Frank E. Baca  
February 22, 2006  
Page 30

In these two cases and several others cited in this section of sub-finding 3, BSM's underwriter reviewed the appraisal reports and was satisfied with the overall value conclusions of the appraisers based on the information provided. A lender does not physically visit the subject property or review the available comparables sales data when it contracts with an independent third party appraiser. Lenders like BSM therefore must be able to rely on the appraiser's decisions regarding comparable sales and observations noted in the appraisal report. In the cases cited in the Report, BSM reasonably relied on the appraiser's observations and representation that the comparables were the best available sales data, even though some of the comparables had been sold over six months ago. These appraisal reports appeared to meet applicable HUD/FHA guidelines and appraisal standards. For these reasons, we respectfully request that the allegations and recommendations regarding the age of comparable sales be removed from the final report.

b. Comparable Properties Located in Different Neighborhoods

Second, the Report alleges that, in 38 cases, the closest comparables were outside of the subject property's neighborhood.

When reviewing the appraisal, BSM appreciates that its underwriters must examine the distance between the subject property and comparables, and that the comparables should be located in the same or similar neighborhoods and environments as the subject property. See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). In the majority of cases cited in the Report, BSM's underwriters properly reviewed the appraisals and determined that this requirement was satisfied.

For instance, in the 1. loan, FHA Case No. 495-6673573, although the Report alleges that the closest comparable was seven miles from the subject, in fact, two of the comparables listed were within one mile of the subject (**Exhibit N-1**). Moreover, the appraiser expressly stated on the URAR that comparables one, two and three were all located in the same subdivision as the subject property (**Exhibit N-1**). While the additional two comparables were located in the adjoining community, the appraiser indicated, which is often the case with manufactured housing properties that experience low turnover in rural markets, the appraiser's search for comparables was expanded "due to the limited number of sales within the subject market area" (**Exhibit N-1**). Similarly, in the 2. loan, FHA Case No. 495-6460736, while the comparables were approximately two miles away from the subject property, the appraiser expressly stated on the URAR that "all comparables are located in a competing subdivision and have similar amenities" (**Exhibit O-1**).

Mr. Frank E. Baca  
February 22, 2006  
Page 31

Comment 1

In these two cases and several others cited in this section of sub-finding 3, The underwriter reasonably relied on the appraisers' expertise and experience in appraising properties, and accepted the appraisers' conclusions, notwithstanding the distance of the comparables. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24 C.F.R. § 203.5(e). As BSM complied with its obligations under FHA requirements, indemnification would not be appropriate. Therefore, we respectfully request that the allegations and recommendations regarding neighborhood analysis be removed from the final report.

c. Similarity of Comparables to Subject Property

Third, sub-finding 3 asserts that, in 17 cases, the subject property is not sufficiently similar to the comparable properties to allow for a reasonable evaluation of the sales prices of the selected real estate, and uses this information to support the allegation that the appraiser overvalued the subject property.

When reviewing the appraisal, the Company appreciates that HUD guidelines indicate that its underwriters must ensure that the comparables are "reasonably equal to the subject in size, age and design." See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). FHA requirements regarding such analysis, however, acknowledge that "it is not always possible to find three comparable very close in similarity to the subject" and instructs lenders to ensure that the appraiser makes necessary adjustments under such circumstances. Id. In fact, in the example given in the Handbook citation included in Appendix D to the Report, HUD guidelines indicate that comparable properties are sufficiently similar if they are within three hundred square feet of the finished living area of the subject property. Id.

Comment 26

Notwithstanding the HUD requirements cited in connection with sub-finding 3, the Report alleges that comparable properties are not similar enough as a result of differences in square footage. For instance, in the \_\_\_\_\_ loan, **FHA Case No. 495-6673573**, the Report asserts that the comparables are not similar to the subject property because all three were approximately 300 square feet smaller and were adjusted up for fewer rooms and less square footage. Here, although the comparables were slightly smaller, the underwriter adhered to HUD requirements by determining that these differences were within HUD guidelines and by examining the URAR and ensuring that the appraiser made the necessary value adjustments to compensate for the differences (**Exhibit N-1**). In this case and several others cited in this section of sub-finding 3, BSM's underwriter reviewed the appraisal reports and was satisfied with the overall value conclusions of the appraisers based on the information provided. Lenders like BSM must be able to rely on the appraiser's decisions regarding comparable sales and

Comment 22



Mr. Frank E. Baca  
February 22, 2006  
Page 32

Comment 22

Comment 1

observations noted in the appraisal report. In the cases cited in the Report, BSM reasonably relied on the appraiser's observations and representation that the comparables were the most similar recently sold properties available, even though some of the comparables were slightly bigger or smaller in size. As a result, we respectfully request that the allegations and recommendations regarding the age of comparable sales be removed from the final report.

d. Adjustments to Comparable Values

Fourth, the Report alleges that, in 41 cases, the appraiser made inappropriate adjustments to the comparable properties reflected on the URARs.

Comment 27

Comment 1

With regard to adjustments, BSM understands and appreciates that its underwriters must analyze the reasonableness of the adjustments made to comparable properties and ensure consistency in such adjustments. See HUD Handbook 4150.1 REV-1, ¶ 9-2 (as incorporated into HUD Handbook 4150.2). In the majority of the cases cited in sub-finding 3, the Company maintains that it complied with these requirements in reviewing the URARs contained in the loan files. For example, in the San Juan, FHA Case No. 495-6460736, the Report asserts that the appraiser adjusted the third comparable property up by \$6,000 for quality of construction without providing an adequate explanation for the adjustment. Contrary to this assertion, the URAR clearly indicates that comparable three had merely "good" quality of construction while the subject property and two additional comparables had "good/upgrades" quality of construction (**Exhibit O-1**). As the third comparable did not have similar upgrades reflected in its sales price, the appraiser made a \$6,000 upward adjustment to compensate for this difference. Furthermore, sub-finding 3 alleges that a \$4,000 downward adjustment was made to comparable three for a two-car garage without an explanation. To the contrary, the URAR clearly indicates that the remaining three properties merely had a graded drive, which was less valuable than the garage on comparable three and thus necessitated the reasonable downward adjustment (**Exhibit O-1**). While the appraiser did not further explain these adjustments in the comments section of the URAR, such explanation was unnecessary as the differences in the properties was apparent from the property description grid contained in the URAR.

In compliance with HUD guidelines, in this case and several others cited in this section of sub-finding 3, the underwriter reviewed the URAR in this case, determined that the adjustments made were reasonable based on the differences in property condition, and properly determined that the URAR supported the valuation analysis provided by the appraiser in this case. As you know, FHA guidelines permit such reliance by underwriters absent deficiencies on the face of the appraisal, as appraisers are retained for their knowledge and expertise in valuing real estate. See, e.g., 24

Mr. Frank E. Baca  
February 22, 2006  
Page 33

Comment 1

C.F.R. § 203.5(e). As BSM complied with its obligations under FHA requirements, indemnification would not be appropriate. Therefore, we respectfully request that the allegations and recommendations regarding neighborhood analysis be removed from the final report.

e. Appraisal Pictures

Comment 27

Finally, in three cases, the Report asserts that the pictures of either the subject or comparable property contained in the URAR reflect an incorrect lot or manufactured home. In two of these cases, the Company's file copies are not clear enough to provide a meaningful response to the allegations in sub-finding 3. With regard to the loan, **FHA Case No. 495-6460736**, however, BSM respectfully disagrees with the assertion in the Report. In this case, sub-finding 3 alleges that the appraisal does not include a photograph of comparable one and the pictures of comparables two and three suggest that they are traditionally built homes rather than manufactured housing. While we acknowledge that the copy of the picture of comparable one on the URAR included in the Company's files is dark, it was included in the URAR (**Exhibit O-1**). With regard to the second and third comparables, BSM respectfully disagrees that the photographs raise any questions regarding the appraiser's description of these properties. The picture of comparable two on the URAR contained in the Company's loan file clearly evidences a manufactured home, and the photograph of comparable three demonstrates that it was a manufactured home with an addition (**Exhibit O-1**). The increased square footage of this comparable supports that this is a manufactured home with somewhat more space than the other properties analyzed, and indicates that the photographs included in the URAR accurately depict the properties described therein (**Exhibit O-1**). BSM therefore complied with HUD requirements in analyzing this URAR, and we believe that this allegation should be removed from the report.

Comment 1

D. Credit Qualifications

In 18 cases, the Report asserts that BSM did not adequately document its analysis of borrowers' late payments. In particular, the Report states that BSM should have determined whether late payments appeared on borrower credit reports because of a disregard for financial obligations, an inability to manage debt, or factors beyond the borrowers' control. In addition, the Report alleges that BSM did not require the borrowers to provide a sufficient written explanation that was logical and consistent with credit information in the file.

BSM respects the importance of analyzing a borrower's credit performance and examining his or her attitude towards credit obligations. It is BSM's policy and practice, with respect to every FHA applicant, to scrutinize the applicant's credit record and

Mr. Frank E. Baca  
February 22, 2006  
Page 34

Comment 1

reasonably determine the applicant's creditworthiness. Given the potential risks not only to the Department, but to the Company, of making a poor credit decision, the Company's management endeavors to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis. BSM's employees take their underwriting responsibilities seriously and understand that they will face severe consequences for unsatisfactory analysis of borrower credit. BSM never would knowingly jeopardize the Company's stability or its relationship with the Department.

That being said, we note that HUD delegated to FHA lenders the responsibility for analyzing a borrower's credit and determining an individual's creditworthiness. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. While HUD has established specific guidelines, credit analysis remains largely subjective. For example, where derogatory credit items are present, lenders have discretion to consider the borrower's unique circumstances and determine whether financing is appropriate. As the Department has recognized that underwriting is more of an art than a science and requires the careful weighing of the circumstances in each individual case, it is BSM's policy to carefully scrutinize a borrower's credit history to obtain any documentation or explanation necessary to assess a borrower's credit risk. See Mortgagee Letters 00-24 and 95-07; see also HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; HUD Handbook 4155.1 REV-5, ¶ 2-3. While two underwriters may make different decisions about a borrower's credit in the same case, both underwriters may have complied with FHA requirements and made reasonable underwriting decisions. BSM takes its underwriting responsibility seriously and would never knowingly approve a loan to an unqualified borrower.

Comment 1

In each of the cases cited in the Report, BSM complied with FHA guidelines by examining the borrowers' overall pattern of credit behavior and reasonably determining that the borrowers qualified for FHA financing. The Company properly considered each borrower's previous housing obligations, recent and/or undisclosed debts, collections, judgments, and bankruptcies, and BSM underwriters reasonably determined that past derogatory items did not reflect a current disregard for financial obligations. The loan files contain required documentation and BSM prudently exercised the discretion granted to it by the FHA. As discussed below, the borrowers in these cases generally were hard-working individuals who took responsibility for their financial obligations. As a result, BSM adhered to FHA requirements by reasonably determining that the borrowers were creditworthy and qualified for FHA loans. We address a representative sample of the cited loans below.

Comment 1

1. FHA Case No. 495-7006330

In the Isbell loan, sub-finding 4 alleges that BSM did not adequately evaluate the borrower's credit history or provide adequate explanations for derogatory credit items. The Report claims that the borrower had four accounts in collection during the past two years and had one delinquent student loan.

In this case, the underwriter analyzed the totality of the borrower's credit history in accordance with HUD guidelines and the discretion afforded in such cases. As you know, when analyzing the borrower's credit record, a period of financial difficulty in the past does not necessarily equate to an unacceptable credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. When delinquent accounts are present, a lender must determine whether the late payments were due to a disregard for, or an inability to manage, financial obligations or to factors beyond the control of the borrower. *Id.* With regard to the borrower's credit history in this case, with the exception of one account, the credit report reflected a series of outstanding medical accounts. Although the Company realizes that it should have obtained a statement from the borrower explaining these accounts, the underwriter was justified in determining that such medical debt did not present a credit risk. These accounts are payable to an emergency medical facility and local hospital, demonstrating the unexpected nature of the costs incurred. As emergency medical care and the associated costs are beyond a borrower's control, it was reasonable for the underwriter to assign less weight to such accounts in determining the borrower's credit risk.

Moreover, all but one of the borrower's collection accounts were older than 12 months (**Exhibit P-1**). For example, while the credit report indicates a 90-day late payment on the borrower's student loans, this payment actually occurred prior to May 2002, or more than 24 months prior to closing (**Exhibit P-1**). Additionally, contrary to the allegations in the Report, the credit report indicates that the borrower paid the student loan in full (**Exhibit P-1**). Given that the late payment was more than two years old and that the borrower had since paid the loan in full, the underwriter reasonably determined that the borrower had accepted his credit obligations.

In fact, the underwriter had no reason to question the borrower's recent credit history. As demonstrated by the credit report, within the 12 months prior to closing, the borrower incurred a new auto loan and a credit card, and maintained each of these accounts in good standing (**Exhibit P-1**). Thus, as the borrower had maintained a good payment record since enduring a time of financial difficulty, the underwriter made a prudent decision that the borrower was creditworthy. We respectfully maintain that indemnification is unwarranted in connection with this sub-finding and believe these allegations should be removed from the Report.

2. Flores, A. – FHA Case No. 495-6673573

In the Alex Flores loan, the Report alleges that the borrower was not creditworthy, had more than five accounts in collection or charged off, and that the lender did not require the borrower to provide an explanation for the poor credit.

It is BSM's policy to carefully scrutinize a borrower's credit history and to examine the borrower's overall pattern of credit behavior. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. In this case, while the borrower's credit report evidenced delinquent accounts, the nature of the debt and the total amount outstanding did not suggest that the borrower was a credit risk. Specifically, two of the accounts were for medical emergency services performed by SW Texas ER Physicians, demonstrating that the account arose from unforeseen medical problems beyond the borrower's control (**Exhibit Q-1**). Moreover, the borrower's outstanding accounts that were incurred in the two years prior to closing amounted to less than \$1,000 and no single account carried a balance of \$250 (**Exhibit Q-1**). With good debt-to-income ratios of 24%/35% documented on the MCAW (**Exhibit Q-2**), the underwriter had no reason to doubt the borrower would satisfy these obligations or otherwise suspect the borrower's current attitude toward credit obligations. In fact, the borrower's delinquent account with Time Warner Cable in the amount of \$91 was paid in full prior to closing. This satisfaction of an outstanding account demonstrates that the borrower had taken responsibility for his credit obligations.

In addition to the above, the loan file contained other evidence to support the underwriter's determination of the borrower's creditworthiness. Specifically, the credit report showed that the borrower had purchased a new automobile and made six months of timely payments. (**Exhibit Q-1**). The loan file also documented a 21-month history of timely rent payments, a factor that the Department has expressly acknowledged as significant in analyzing a borrower's credit worthiness. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. Moreover, the MCAW demonstrated that the total monthly mortgage payment would be more than \$380 less per month than the borrower's existing monthly rental expenses, which the borrower had consistently made on time. (**Exhibit Q-2**). As the Department has expressly acknowledged that a minimal increase in the borrower's housing expense is a compensating factor that may justify mortgage approval, the fact that the borrower's monthly housing expenses decreased by almost 30% in this case is further evidence that the underwriter exercised reasonable judgment in approving the loan. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-13; see also HUD Handbook 4155.1 REV-5, ¶ 2-13.

Comment 1

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 37

While we acknowledge that the underwriter should have obtained an explanation from the borrower with regard to his delinquent accounts, in light of the medical nature of the borrower's debt, the minimal amount owed, and the borrower's demonstrated ability to make both automobile and rental payments, the underwriter properly examined all of the information in the loan file and reasonably determined that any past credit problems did not pose a risk to the borrower's ability to make regular mortgage payments. Thus, we believe that indemnification is not appropriate in this loan and that these allegations should be removed from the Report.

3. I s - FHA Case No. 495-6719550

In this case, sub-finding 4 of the Report alleges that BSM did not adequately evaluate the borrower's credit history, which, the Report states, showed seven recent accounts either written off or placed in collection. The Report also alleges that BSM did not obtain an adequate borrower explanation for bad credit.

As discussed above, when analyzing the borrower's credit record, a period of financial difficulty in the past does not necessarily equate to an unacceptable credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. When delinquent accounts are present, a lender must determine whether late payments were due to a disregard for, or an inability to manage, financial obligations, or to factors beyond the control of the borrower. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. In this case, the credit report demonstrates that five of the seven accounts in collection were for medical costs (**Exhibit R-1**). Specifically, these accounts are payable to an emergency medical facility and a local hospital and physician, indicating the unexpected nature of the costs and events beyond the borrower's control (**Exhibit R-1**). Although we acknowledge that the underwriter should have obtained an explanation from the borrower, it was reasonable for the underwriter to assign less weight to these accounts and determine that the accounts did not reflect poorly on the borrower's current attitude toward credit obligations.

With regard to the two remaining collection accounts, one account was over 12 months old and the other required only \$131 to satisfy the obligation (**Exhibit R-1**). In light of the age and the minor amount of the derogatory credit items, as well as the borrower's excellent alternative credit history, the underwriter reasonably determined the borrower's creditworthiness in this case. Specifically, the loan file contained several alternative credit sources that indicate the borrower's willingness and ability to make timely payments. For example, the file contained a Verification of Rent ("VOR") that

Mr. Frank E. Baca  
February 22, 2006  
Page 38

Comment 1

indicated the borrower made over 24 months of timely rent payments (**Exhibit R-2**). As you know, HUD has expressly acknowledged that timely payment of housing obligations is significant in analyzing a borrower's credit worthiness. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. Additionally, the loan file contained a letter of credit from the City Public Service of San Antonio, Texas demonstrating the borrower's timely payment of utility obligations for over 24 months (**Exhibit R-3**); a notification of timely Internet-service payments for nearly 24 months (**Exhibit R-4**); a notice of current insurance payments for 16 months (**Exhibit R-5**); and a letter stating that the borrower had timely paid his legal paternity fees (**Exhibit R-6**). As with housing expenses, HUD has also expressly acknowledged that other types of credit that the mortgage applicant is required to make on a periodic basis may also be used in the underwriting process. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-4; see also HUD Handbook 4155.1 REV-5, ¶ 2-4. Here, the consistent and timely payment of numerous alternative credit sources is further evidence of the borrower's creditworthiness, and the underwriter reasonably determined that the borrower was eligible for FHA financing. Given these facts, we believe that indemnification is not appropriate for this loan and that these allegations should be removed from the Report.

4. I - FHA Case No. 495-6749841

In the case, the Report alleges that the lender did not require the borrower to provide an explanation for his poor credit, as well as that the borrower had 14 recent accounts in collection or that had been written off.

In this case, the underwriter analyzed the totality of the borrower's credit history in accordance with HUD guidelines and the discretion afforded in such cases. While we acknowledge that the underwriter should have obtained a letter of explanation for the derogatory items, we believe the underwriter made a prudent decision to approve the loan. Specifically, the borrower incurred only six collection accounts within the two years prior to closing, totaling a mere \$1,128 in outstanding payments. While other collection accounts appeared on the borrower's credit report, these accounts either were older than two years from the date of closing or represented medical expenses the underwriter understood to be beyond the borrower's control. In both circumstances, the underwriter concluded that an explanation was unnecessary and that the items had no reflection on the borrower's ability to pay his housing obligation.

Moreover, since the borrower's last collection account, the borrower opened ten new accounts, three of which had been paid in full by the time of closing, demonstrating the borrower's improved credit record (**Exhibit S-1**). With the remaining seven obligations, the borrower maintained a consistent and timely payment history (**Exhibit S-1**). Thus, using the discretion afforded underwriters in making FHA loans, the

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 39

underwriter in this case properly examined the credit information in the loan file and reasonably determined that the borrower's past derogatory credit had little effect on the borrower's ability to meet his credit obligations. We believe the underwriter reasonably concluded that the borrower qualified for the loan, and we respectfully maintain that indemnification is unwarranted in connection with this sub-finding.

5. - FHA Case No. 495-6545687

In the \_\_\_\_\_ loan, sub-finding 4 alleges that the borrowers were not creditworthy because they had 15 accounts recently placed in collection or written off.

Contrary to HUD's allegations, while the Report notes that the "borrowers are not creditworthy," in fact only S \_\_\_\_\_, and not his wife, \_\_\_\_\_, applied for the mortgage loan. Thus, the debts and derogatory credit items of \_\_\_\_\_, as a non-purchasing spouse, should not have been included in the Report, leaving only nine collection accounts to be analyzed by the underwriter (**Exhibits T-1 and T-2**). Of the remaining accounts, most of them were more than 36 months old, which the underwriter reasonably concluded required no explanation from the borrower or otherwise reflected on the borrower's ability to make a current mortgage payment (**Exhibit T-1**). Moreover, two of the accounts that were more than 12 months old were unpaid medical expenses to local hospitals (**Exhibit T-2**), which demonstrates the unexpected nature of these costs. As the underwriter in this case determined that the costs were beyond the borrower's control, it was reasonable to assign less weight to such accounts in determining the borrower's credit risk. Finally, the loan file clearly documented that the borrower had paid in full an account that had been placed in collection (**Exhibit T-3**). This satisfaction of an outstanding account demonstrated that the borrower had taken responsibility for his credit obligations.

In addition to the derogatory items on the borrower's credit report, the credit report contained significant evidence of the borrower's excellent recent credit history, demonstrating that the borrower understood the nature and responsibility of his credit responsibility. Specifically, the borrower had 12 accounts, both installment and revolving, with an excellent pay history, some of which demonstrated two years of consistent and timely payments (**Exhibit T-1**). The underwriter, therefore, was justified in determining that the borrower posed a low credit risk and was otherwise qualified for FHA approval. Based on the borrower's improved credit history, we believe that indemnification is not appropriate for this loan and that these allegations should be removed from the Report.



Mr. Frank E. Baca  
February 22, 2006  
Page 40

6.

FHA Case No. 495-6454616

In this case, the Report alleges that BSM did not adequately evaluate the borrowers' credit because the borrowers had five recent accounts placed for collection or written off "without a logical explanation."

Contrary to the allegations in this case, the underwriter properly obtained written credit explanations from the borrowers, which contained no inconsistencies or otherwise gave the underwriter reason to doubt the borrowers' explanations. In fact, two of the borrowers' accounts involved unexpected medical expenses (**Exhibit U-1**). As explained by the borrower, the unpaid medical bills resulted from an injury to the borrowers' child at a daycare center that were not paid because the daycare center's insurance company, despite agreeing to do so, had been slow in making such payment (**Exhibit U-2**). Thus, given that the daycare center agreed to pay this bill through its insurance carrier, the underwriter was justified in not considering the account as any reflection on the borrowers' attitude toward credit or financial responsibility. Additionally, please note that the underwriter obtained an explanation (**Exhibit U-3**) for a collection account shown as paid by the borrowers credit report (**Exhibit U-2**).

With regard to the remaining accounts, most of these items were incurred two years prior to closing, which the underwriter reasonably determined required no explanation. Moreover, the borrowers provided a written explanation that identified another account as paid off. Specifically, as detailed in the explanatory letter and supporting documentation in the loan file (**Exhibit U-4**), the borrowers and creditor agreed to settle the outstanding balance (listed in the credit report as the eighth account with "CBCS" as the creditor) for 50% of its value. Thus, because the borrowers paid the agreed-upon amount prior to the credit report being obtained demonstrated that the borrowers were responsible creditors with the intention of upholding their credit obligations. With only one remaining account with a minimal balance of \$187, given the borrowers' credit explanations, the underwriter had no reason to believe the borrowers would not satisfy the debt or otherwise pose a credit risk. In fact, loan file contained explanation letters for older credit items (**Exhibit U-5**), which the underwriter reasonably considered in evaluating the borrowers overall credit history. As the borrower adequately explained recent credit inquiries, disputes over amounts due, and the effect of unforeseen medical expenses, we believe the underwriter made a prudent decision to approve this loan. Thus, indemnification is not appropriate and these allegations should be removed from the Report.

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 41

7. FHA Case No. 495-6037036

Here, the Report alleges that the Company did not adequately evaluate the borrowers' credit. In particular, the Report asserts that the borrowers had seven recent credit accounts placed in collection or written off without a "good explanation" and that the borrowers stated that they were not aware that these accounts were not paid off.

As discussed above, it is BSM's policy to carefully scrutinize a borrower's credit history and to obtain any documentation or explanations necessary to assess a borrower's credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. Contrary to the allegations in this case, the borrowers provided sufficient explanation to justify many of the derogatory items appearing on the credit report. As the borrowers explained, the Ramirezes applied for government assistance to cover outstanding medical bills incurred in 1996 and paid what they believed to be the outstanding balance (**Exhibit V-1**). The fact that the borrowers also stated that they were unaware that the accounts remained outstanding in no way suggested that the borrowers were a credit risk or undermined the sufficiency of their explanation. Moreover, the borrowers explained that they were shopping for a home and a car and received a number of credit inquiries as a result of these efforts (**Exhibit V-1**). Based on this explanation, the underwriter was justified in assigning little weight to these recent credit inquiries.

In addition to the borrowers' explanations, the borrowers' credit history and other documentation in the file demonstrated the borrowers' understanding and acceptance of financial responsibility. First, with the exception of one write off, all of the collection accounts appearing on the borrowers' credit report were older than 24 months, which the underwriter reasonably determined did not require an explanation (**Exhibit V-2**). Second, the borrowers' credit report demonstrated an excellent pay history on four current accounts and the borrowers maintained acceptable credit scores of 566 and 640 (**Exhibit V-2**). Additionally, the borrowers had satisfied any outstanding judgments against them (**Exhibit V-2**), which demonstrated the borrowers' affirmative efforts to reestablish good credit.

Third, the loan file contains a VOR that shows 96 consecutive months of timely payments (**Exhibit V-3**), a factor that the Department expressly recognizes as significant in analyzing a borrower's credit worthiness. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. With an additional letter from the Office of the Attorney General of the State of Texas, noting that Mr. Ramirez had fulfilled all child support obligations (**Exhibit V-4**), the documentation in the loan file sufficiently demonstrated the borrowers' understanding of the importance

Comment 1

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 42

of accepting responsibility for monetary obligations. The underwriter, therefore, had more than adequate evidence to make a reasonable conclusion that the borrowers were creditworthy. For these reasons, we believe that indemnification is not appropriate.

8. FHA Case No. 495-6425206

In this case, sub-finding 4 alleges that the Company did not adequately evaluate the borrowers' credit history or provide adequate explanations for certain derogatory credit items and outstanding debts, including: (1) 31 inquiries on the credit report; (2) nine accounts recently placed in collection or written off; and (3) a failure to report or verify a student loan that allegedly would have caused the borrowers' debt-to-income ratio to increase to 42%.

First, with regard to the Report's alleged unexplained credit inquiries, we note that the 31 inquiries represent the combined total for both borrowers (**Exhibit W-1**). Moreover, a closer examination of the credit report reveals that at least six of the inquiries were related to home financing, and many others represented inquiries to more than one credit bureau per borrower for a single creditor. For example, the credit report noted that four inquiries were made on the same day to "Equifax" (one report from Experian for each of the borrowers) and to "Fannie Mae" (one report from Equifax for each of the borrowers) (**Exhibit W-1**). Given that the borrowers were shopping for a mortgage loan and the fact that HUD delegated to FHA lenders the responsibility for analyzing a borrower's credit, the underwriter was justified in seeking no further clarification or explanation from the borrowers for the reported credit inquiries. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3.

Second, with regard to the collection accounts appearing on the borrowers' credit report, our underwriter paid careful attention to the borrowers' credit report and obtained documentation of credit when necessary to fully comply with FHA guidelines. In this case, in accordance with HUD requirements, the underwriter obtained a written explanation for these accounts from the borrowers, despite the fact that most of the accounts were opened over two years prior to closing (**Exhibit W-2**). Specifically, the borrowers explained the unexpected and tragic medical emergencies endured by family members, as well as an unforeseen period of unemployment, that caused the borrowers to fall behind on many of their monthly obligations (**Exhibit W-2**). The borrowers also described efforts to reestablish credit after rebounding from excessive medical bills and emphasized their current record of timely payments on existing recurring obligations (**Exhibit W-2**). Based on this explanation, we believe that the underwriter in this case reasonably determined that the borrowers' demonstrated a commitment to meeting their financial obligations and did not pose a significant credit risk.

Mr. Frank E. Baca  
February 22, 2006  
Page 43

Comment 1

Finally, with regard to the Report's allegation that BSM did not verify the borrower's student loan, while we acknowledge that the underwriter should have verified payment of the loan, we note that the credit report indicated that the account had not been active since 1997, nearly six years prior to the date of closing. Nevertheless, even if the underwriter had included an additional \$142 in the borrowers' debt-to-income calculation, the back-end qualifying ratio would have increased only slightly over 41% and the loan file contained sufficient compensating factors to justify approval of the loan. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-12(B); see also HUD Handbook 4155.1 REV-5, ¶ 2-12(B). Specifically, the file contained a VOR evidencing the borrowers' timely payment of their housing obligations for 20 consecutive months (**Exhibit W-3**). Also, the MCAW demonstrated a \$134 decrease in the total monthly mortgage payment compared to the borrower's existing monthly rental expenses (**Exhibit W-4**). As you know, the Department has expressly acknowledged that consistent payment of a borrower's housing obligation and a minimal increase in the borrower's housing expense are compensating factors that justify mortgage approval. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-13; see also HUD Handbook 4155.1 REV-5, ¶ 2-13. In this case, based on the borrowers' sufficient explanation, improved credit history, and the borrowers' demonstrated commitment to paying their housing obligations, the underwriter made a prudent decision to deem the borrower creditworthy and to approve the loan. Thus, for the reasons stated above, we believe that indemnification is not appropriate for this loan and that these allegations should be removed from the Report.

9. **FHA Case No. 495-6460736**

In the case, this sub-finding alleges that the Company did not adequately evaluate the borrower's credit history or provide adequate explanations for the derogatory credit items. In particular, the Report states that the borrowers had 40 credit inquiries on the credit report and 15 accounts recently reported as placed for collection or written off.

It is BSM's policy to carefully scrutinize a borrower's credit history and to obtain any documentation or explanations necessary to assess a borrower's credit risk. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. In accordance with FHA guidelines, therefore, the underwriter obtained a written statement from the borrower to explain the circumstances leading to the collection accounts and credit inquiries appearing on the borrower's credit report (**Exhibit X-1**). As detailed in the borrower's letter, the borrower was shopping for both a home and a truck, and the borrower's credit was accessed on numerous occasions in connection with these efforts (**Exhibit X-2**), often by each of the three major credit bureaus. Thus,

Mr. Frank E. Baca  
February 22, 2006  
Page 44

as the 40 inquiries do not represent individual inquiries by different institutions, we believe that the borrower provided sufficient explanation.

With regard to the collection accounts appearing on the borrower's credit report, most of these accounts reflect a series of outstanding medical expenses, which the borrower explains in his credit letter (**Exhibit X-2**). As both the borrower and his wife experienced unexpected health problems and hospital stays, the borrower's explanation letter adequately demonstrated the unexpected nature of the costs. The underwriter, therefore, was justified in determining that such medical debt did not present a significant credit risk. Moreover, the loan file contained a letter from the borrower's previous landlord, demonstrating timely rental payments for three and a half years and the borrower's commitment to satisfying his housing obligations (**Exhibit X-3**). The loan file also contained a letter from the borrower's insurance agent stating that the borrower had made 12 months of timely insurance payments, further evidencing the borrower's understanding of his credit obligations (**Exhibit X-4**). As HUD expressly recognizes current housing payments as a factor favoring approval of a loan, we believe the underwriter reasonably concluded that the borrower provided a sufficient credit explanation to be deemed creditworthy in this case. Thus, for the reasons stated above, we believe that indemnification is not appropriate for this loan and that these allegations should be removed from the Report.

10. **FHA Case No. 495-6482719**

In the case, the Report alleges that BSM did not ensure the borrowers had the ability and willingness to repay the mortgage debt. The Report asserts that the borrowers have a poor credit history and that BSM did not adequately explain the borrowers' derogatory credit collections not included in a May 1999 bankruptcy or the approximately 35 credit inquiries appearing on the borrowers' credit report. Moreover, the Report claims that BSM did not verify a previous Veterans Administration mortgage with a balance of \$84,070 or explain the borrower's bankruptcy.

Contrary to the allegations in the Report, the underwriter properly analyzed the borrowers' credit history and obtained the necessary explanations from the borrowers in accordance with FHA guidelines. First, with regard to the derogatory items on the borrowers' credit report, with the exception of one account, all items were more than two years old from the date of the closing and the underwriter was justified in not requiring a borrower explanation for such dated items (**Exhibit Y-1**). Moreover, the underwriter used the Freddie Mac Loan LP automated loan evaluation system in the Chaffin loan, which produced a "Refer" feedback certificate, but required only "Accept" documentation standards (**Exhibit Y-2**). In accordance with HUD directives, see Mortgagee Letters 99-26, 98-14, because the LP program and "Accept" documentation

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 45

Comment 1

status did not direct the underwriter to obtain additional credit documentation, BSM did not obtain additional explanations on dated derogatory credit accounts. Moreover, with regard to the borrowers' only derogatory account incurred within two years of the date of closing, the credit report showed a mere \$155 balance (**Exhibit Y-1**), which the underwriter reasonably believed to have no affect on the borrowers' ability to meet their housing obligations. In fact, the loan file included two VORs demonstrating that the borrowers' had made 46 consecutive months of timely rental payments (**Exhibit Y-3**), and the credit report evidenced the borrowers satisfactory credit scores of 665 and 651 (**Exhibit Y-1**) – both factors the Department has recognized as significant justification for the approval of an FHA loan. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. Thus, without evidence to suggest the borrowers' derogatory accounts required further explanation, we believe the underwriter reasonably concluded that the borrower posed a minimal credit risk.

With regard to the Report's alleged 35 credit inquiries, the credit report contained in the loan file showed only 20 inquiries, the majority of which demonstrated that the borrowers were shopping for a new home (**Exhibit Y-1**). Moreover, contrary to the Report's claim that BSM or the borrower failed to explain a four-year old bankruptcy, the loan file contained a detailed explanation letter from the borrower, in accordance with HUD guidelines, indicating that the bankruptcy resulted from a series of unexpected medical expenses and other financial hardships that the borrowers could not control (**Exhibit Y-4**). Finally, with regard to the previous Veterans Administration mortgage identified by the Report, we note that, contrary to the Report's allegations, the underwriter properly verified that this debt was no longer outstanding. Specifically, as indicated on the borrower's credit report, this debt had been paid (**Exhibit Y-1**), and the underwriter had no reason to obtain additional verification. Given this fact, in addition to all the above, we believe that indemnification is not appropriate for this loan and that these allegations should be removed from the Report.

**E. Interested Third Party Involvement**

In this sub-finding, the Report alleges that, in 19 cases, the Company permitted the manufactured home dealer's sales representatives to process borrower loan documents, including employment and credit documents. The Report supports this allegation by stating that it interviewed nine borrowers, all of whom confirmed that they only dealt with the seller; however, the sub-finding acknowledges that, in each of these instances, BSM verified employment information without passing the information through the seller. Although, for the vast majority of the loans cited in this sub-finding, the Report does not contain details about which documentation was received from the seller in each case, based on the few specific assertions in Appendix C-3 of the Report,

Mr. Frank E. Baca  
February 22, 2006  
Page 46

we generally understand that the concerns involve borrower income and asset documentation, as well as borrower credit reports. We address each of these in turn below.

#### 1. Borrower Income and Asset Documentation

With regard to a borrower's income documentation, such as pay stubs, W-2 forms, benefit income documents and tax returns, and the borrower's bank statements, at the time most of the loans at issue in the Report were originated, FHA guidelines provided that "credit reports" and "[v]erification forms must pass directly between lender and provider without being handled by any third party" and that faxed documents should be verified. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1; Mortgagee Letter 01-01. It is BSM's policy and practice to obtain credit reports and verifications directly from the providers and to ensure that faxed documentation is accurate and complete.

BSM, however, is unaware of any prohibition against a borrower furnishing the types of documents cited in these cases, such as pay stubs, W-2 forms, tax returns and bank statements, or against a borrower's use of a third party's facsimile machine to do so. Paragraph 3-6 of the Mortgagees' Handbook Application Through Insurance (Single-Family) states: "The credit report and verification forms must not pass through the hands of the applicant, a real estate agent, or other interested third party." The Handbook references credit reports and verification forms, not bank statements, W-2 forms, pay stubs, or benefit income documents. In fact, the Handbook expressly states that the "applicant must provide a copy of his/her most recent pay stub." HUD Handbook 4000.2 REV-2, ¶ 3-6(B)(2) (emphasis added). The Mortgage Credit Analysis Handbook further states that, regarding employment documentation, a lender may obtain pay stubs and W-2 forms "from the borrower," and, regarding verifications of deposit, a lender may obtain bank statements "from the borrower." HUD Handbook 4155.1 REV-4, CHG-1, ¶ 3-1(E) and (F). These HUD guidelines only address the provision of verifications of deposit and employment, and do not restrict lenders from accepting faxed copies of other required documentation from borrowers. In compliance with these requirements, with regard to the documentation referenced in the above chart, BSM obtained pay stubs, bank statements, and other documents from the borrower.

Furthermore, as you know, borrowers often meet with loan officers outside of a lender's office in order to accommodate a borrower's work schedule, and borrowers often use fax machines made available by real estate agents or manufactured home dealer sales representatives, to which the borrowers would not otherwise have access, in order to deliver documents to the lender. To the best of our knowledge and

Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 47

recollection, in the cases referenced in the Report, the borrowers used the manufactured home sales representative's or another company's fax machine for this purpose. Whether the borrowers personally faxed the documents to the Company or handed the documents to an office assistant to fax, the borrowers themselves would have brought most of the documents to the corporate office for delivery to BSM. This would also explain why the borrowers whom the monitors interviewed recollect only interacting with the manufactured dealer's representatives.

Moreover, in many of the loans referenced in the Report, the loan files contained additional documentation verifying the information contained in the documents faxed from the manufactured housing dealer. For instance, in the [redacted] loan, **FHA Case No. 495-6727403**, while the W-2 forms and pay stubs contained in the file were faxed by Palm Harbor to BSM, the Company obtained a summary of the borrower's tax return information directly from the Internal Revenue Service, which confirmed the information contained in the faxed employment documentation obtained via facsimile (**Exhibit Z-1**).

In summary, contrary to the allegations in the Report, FHA requirements in place at the time most of the loans at issue were originated did not prohibit lenders from obtaining bank statements, pay stubs, W-2 forms, or tax returns from the borrower via fax. Finally, as you know, HUD recently amended its guidelines to prohibit a lender from using documentation related to credit, employment, or income that is transmitted through, or by using the equipment of, a real estate agent or builder. See HUD Handbook 4155.1 REV-5, ¶ 3-1. In compliance with these requirements, BSM has ceased permitting its employees from accepting any income or asset document that has been delivered via a real estate agent's or home seller's fax machine. Nevertheless, based on the FHA requirements cited above, we maintain that the Company complied with HUD guidelines in obtaining the documentation contained in the loan files referenced in the Report. As no violation of HUD/FHA requirements exists in this regard, this allegation should be removed from the final Report.

## **2. Borrower Credit Reports**

In the remaining cases cited in the Report, sub-finding 5 asserts that the credit report was faxed from an individual employed by the seller.

As discussed above, BSM understands and appreciates that FHA guidelines require that "credit reports" and "[v]erification forms must pass directly between lender and provider without being handled by any third party" and that faxed documents should be verified. See HUD Handbooks 4060.1 ¶ 6-5(D) and 4155.1 REV-4, CHG-1, ¶ 3-1; Mortgagee Letter 01-01. It is BSM's policy and practice to obtain credit reports and verifications directly from the providers of the information contained therein.

Comment 1



Comment 1

Mr. Frank E. Baca  
February 22, 2006  
Page 48

Nevertheless, the Company acknowledges that, in certain instances, credit reports were received through the seller's fax machine. While in certain instances, it is clear from the documentation that the credit report initially was derived from the credit reporting bureau, and was inadvertently sent to the seller prior to delivery to BSM, we appreciate that these documents should have been verified with the originating entity to ensure that the documents contained complete and accurate information regarding the borrower's income, rental history, or credit. Having said that, with regard to several of the credit reports, BSM in fact did reorder a credit report and verify that the information on the initial report was accurate and complete. For example, in the loan, **FHA Case No. 495-6470914**, while the loan file contained a credit report ordered by the manufactured home dealer, it also contained a credit report ordered by, and delivered directly to, BSM (**Exhibit AA-1**). In this case and others in which the loan files contained documentation to support the faxed credit information, as the loan file documentation complied with HUD requirements, we believe that the final report should exclude such allegations.

**F. File Documentation**

In five cases, the Report alleges that BSM did not resolve conflicting information. Specifically, the Report states that the lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation and all aspects of the property being financed. It is BSM's policy to thoroughly review all documentation and information provided by borrowers and to resolve any inconsistencies in the information provided. This policy has been in place since the Company's inception, and we regularly remind Company employees of the importance in maintaining consistent documentation in the loan file. As an illustration of the Company's policy, we respond to the Report's allegations in one case below.

**1. | - FHA Case No. 495-6460736**

In this case, the Report alleges that BSM did not resolve earnest money discrepancies. Specifically, it alleges that the Company reported \$5,000 in earnest money on the MCAW, but the HUD-1 demonstrated \$1,000 in earnest money deposited with the seller and an additional \$500 for which the holder of the deposit is shown.

While the Company acknowledges that the MCAW initially demonstrated a \$5,000 earnest money deposit, the underwriter in this case reconciled the correct amount and obtained documentation of the earnest money deposit prior to settlement. The loan file contained a copy of the borrowers' \$1,000 check to Palm Harbor and a copy of the deposit-holder's invoice, evidencing receipt of the earnest money deposit (**Exhibit BB-1**). Moreover, the underwriter understood that the borrower used an

Mr. Frank E. Baca  
February 22, 2006  
Page 49

Comment 1

additional \$500 from his income tax return to complete the \$1,500 deposit. The underwriter, therefore, revised the final URLA to reflect these correct amounts prior to closing (**Exhibit BB-2**) and the amount shown on the HUD-1 is, in fact, correct (**Exhibit BB-3**). While we believe that the underwriter also corrected the earnest money amount on the MCAW prior to closing, we have been unable to locate a corrected copy of the MCAW prepared in 2003. Nevertheless, we note that the MCAW has, in fact, been revised to reflect the borrowers' correct amount of earnest money (**Exhibit BB-4**). BSM, therefore, resolved all inconsistencies in this case and objects to the inclusion of this allegation in the Report.

**G. Calculations of Income and Liabilities**

In four cases, the Report alleges that BSM either overstated the borrowers' income or understated the borrowers' monthly debt obligations. BSM understands and appreciates that, when using income in addition to a borrower's salary and wages to qualify him or her for FHA financing, a lender must obtain additional documentation to determine that such income can be expected to continue for the first three years of the mortgage loan. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-7. BSM's underwriters must review a borrower's income in each FHA transaction, ensure that any income used to qualify the borrower is documented in compliance with FHA guidelines, and determine that such income can rationally be included in the effective income based on the borrower's earnings history. Moreover, the Company's policies and procedures consistently have required underwriters to examine all of a borrower's outstanding liabilities, such as installment loans, revolving charge accounts, child support and student loans, extending ten months or more from closing when determining whether a particular borrower qualifies for FHA financing. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-11. These policies and procedures were in place at the time when the loans in question were originated and they remain in place today. As a result, BSM respectfully disagrees with the allegations in two of the cases included in this sub-finding. Our individual responses to these cases are set forth below.

**1. - FHA Case No. 495-6384702**

In the ~~very~~ case, the Report alleges that BSM overstated the borrowers' income by \$334. Although the Report does not identify the source of the allegedly overstated income, based on the documentation in the file, it appears that the Report refers to secondary income received by ~~the borrower~~ as an inactive enlisted member of the United States Navy.

Comment 28

As you know, and as is BSM's policy, in order to include secondary income in the borrower's qualifying monthly income, a lender must obtain additional documentation to

Mr. Frank E. Baca  
February 22, 2006  
Page 50

Comment 28

determine that the secondary income can be expected to continue for the first three years of the mortgage loan. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-7. In this case, the underwriter obtained a copy of the borrower's immediate reenlistment contract, documenting his term of duty until December 08, 2003 (Exhibit CC-1), nearly one year after the date of closing (Exhibit C-4). While we acknowledge that the contract guarantees neither the borrower's enlistment for an additional two years nor his continuing receipt of the secondary income, the contract indicates that he immediately reenlisted following his late date of discharge on December 8, 2001 and had served a total of thirteen years as an inactive Navy reservist (Exhibit CC-1). Based on the borrower's previous and consistent history of service as a reservist, the underwriter had no reason to doubt that he would continue to receive secondary income from the Navy for the next three years of the mortgage loan. We believe the underwriter properly calculated the borrowers' income in this case, and, therefore, object to the inclusion of this allegation in the Report.

2. - FHA Case No. 495-6578006

In this case, the Report alleges that BSM understated the borrowers' monthly payments by \$378, thereby increasing their housing cost to income ratios from 19%/45% to 45%/53% in excess of HUD's 29%/41% guidelines.

While the Company acknowledges that the borrowers' liabilities were understated in this case, contrary to the allegations in the Report, BSM should have included only an additional \$115 in monthly debt obligation. While the borrowers' credit report shows a current account with a \$1,524 balance, based on the borrowers' \$271 monthly payment, this obligation would have been satisfied well within the ten months following closing (Exhibit DD-1). The underwriter, therefore, was not required to count this obligation among the borrowers' monthly recurring debts.

Comment 1

Nevertheless, even with the additional \$115 in monthly debt, because the qualifying income used to calculate the borrowers' qualifying ratios did not include overtime and bonus income the borrowers had earned on a regular basis, the borrowers still qualified for the FHA loan. Specifically, had the underwriter calculated the borrower's income on a 14.71 year-to-date average, including overtime income, the borrower's qualifying monthly income totaled \$2,332, \$309 more than originally used to qualify the borrower (Exhibit DD-2). Using a similar calculation, based on a 15.33 year-to-date average, including bonus income, the co-borrower's qualifying monthly income equaled \$2,666 (Exhibit DD-3), for a total qualifying income of \$4,998. As both the borrower and co-borrower had been employed for well over two years at their current places of employment (Exhibits DD-2 and DD-3), which the underwriter documented on the MCAW (Exhibit DD-4), the underwriter justifiably could have used \$4,998 in

Mr. Frank E. Baca  
February 22, 2006  
Page 51

Comment 1

monthly income to qualify the borrowers for the loan. Based on this amount, therefore, the borrowers' qualifying ratios, in fact, equaled 17.86%/43.67%.

While we recognize that a 43.67% back-end ratio slightly exceeds HUD's benchmark 41% guideline, the loan file documented significant compensating factors to justify approval in the Weems case. First, as discussed above, the underwriter noted, on the MCAW, the borrowers' excellent job stability, which demonstrated the borrowers' potential for increased earnings (**Exhibit DD-4**). See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-13. Second, as indicated on the borrowers' credit report, the borrowers had timely paid their housing obligation on an existing conventional mortgage for more than 24 months (**Exhibit DD-1**). As the Department has expressly recognized timely housing payments as a significant compensating factor, even with an additional \$115 in monthly debt, we believe the underwriter reasonably approved the Weems loan. Inclusion of these allegations in the Report, therefore, is unwarranted.

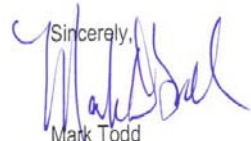
### III. CONCLUSION

BSM takes the matters raised in the draft Report seriously. Because FHA lending comprises a significant portion of BSM's overall business operations, the Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, BSM generally complied with FHA underwriting requirements and made loans to qualified FHA borrowers. BSM's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of BSM, or do not affect the underlying loans' insurability. BSM at no time misrepresented information it submitted to the Department. Moreover, since the loans cited in the Report were originated, the Company has made several management changes, and has continued to enhance its underwriting practices and manufactured housing origination division. The Company identified and responded to operational and underwriting concerns, and it has exercised responsible management supervision.

We believe that this response and accompanying exhibits demonstrate that certain of the Report's recommendations in connection with the cited loans are unwarranted. We respectfully request that the OIG revise its recommendations to fit the facts of this case and remove allegations from the Report in those instances in which BSM has demonstrated its compliance with HUD requirements.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip L. Schulman, at (202) 778-9027. Thank you for your kind consideration.

Mr. Frank E. Baca  
February 22, 2006  
Page 52

Sincerely,  
  
Mark Todd  
Chief Operating Officer

cc: Phillip L. Schulman, Esq.

## **OIG Evaluation of Auditee Comments**

**Comment 1** We have reviewed the auditee's responses to the finding and we have revised parts of our report in consideration of the comments or to make our points clearer. However, the comments did not materially change our position on issues raised in the report.

**Comment 2** The lender used purchase memos for the manufactured home to calculate the mortgage amounts. They clearly indicate they are not binding contracts on the buyer or the seller. At loan settlement, the lender obtained executed residential construction contracts that included the contractor's price to build. The sales prices shown on the purchase memos, construction contracts, and the HUD-1 settlement statements were inconsistent. The lender had reason to question the sales prices. The lender did not resolve the differences. If the lender had attempted to resolve the differences, it should have found that the seller, the lender's 50 percent owner, added costs that did not add to the value of the collateral. Further, it should have found costs that exceeded the maximum amount of seller concessions that should have been used to reduce the maximum mortgage.

**Comment 3** We appreciate the auditee's cooperation in obtaining from its related company the additional documentation requested during our audit. In our opinion, the additional documentation would have been available to the lender at the time of the loan originations.

**Comment 4** The lender is responsible for ensuring downpayment assistance funds are provided by the donor at closing are received for the amount of the purported gift and that the funds came from an acceptable source. As stated in the revised finding the seller increased its price and the seller's proceeds were reduced at closing. As mentioned in the finding, in seven of ten cases for which we reviewed the closing agent's receipts and disbursements records, these funds were used to fund the closing. We did not review the receipts and disbursements records for the remaining 25 cases involving downpayment assistance. For the seven cases, the nonprofit funds were not received until after the closing and the loan proceeds and funds in escrow had been disbursed.

**Comment 5** The residential construction contract from the lender's file shows the contractor's price to be \$94,598. The purchase memo, stating it is not a binding contract, shows the price to be \$96,440 and that the lender related seller is paying as much as \$13,300 in costs for the buyer. The purchase memo did not disclose the seller also provided the big screen television valued at \$1,500, shown on the additional information provided by the seller. The seller's concessions exceeded the maximum allowed by HUD (6 percent of the sales price) without reducing the maximum mortgage.

**Comment 6** We appreciate the lender's comment regarding our recommendation for principal reduction and indemnification of certain loans. The comment does not change our position. In those cases where we are recommending principal reduction and indemnification, we do not believe the borrowers should be penalized, if they do not default, by having to pay the unauthorized amounts included in what they thought were FHA loans. Any indemnification should be for an amount after the principal reduction, in the event of default.

**Comment 7** The residential construction contract from the lender's file shows the contractor's price to be \$71,585. The purchase memo shows the price as \$73,100 and that the lender related seller is paying as much as \$11,089 in costs for the buyer. The lender did not resolve the differences in sales prices shown on various documents. The lender also did not reduce the mortgage by the amount in excess of the maximum amount (6 percent of the sales price) allowed for seller concessions.

**Comment 8** The residential construction contract from the lender's file shows the contractor's price to be \$126,666. The purchase memo shows the price to be \$129,134 and that the lender related seller is paying as much as \$17,223 in costs for the buyer. The seller's concessions exceeded the maximum (6 percent of the sales price, or \$9,579 in this case) allowed by HUD without reducing the maximum mortgage.

**Comment 9** The residential construction contract from the lender's file shows the contractor's price to be \$79,477. The purchase memo shows the price to be \$81,100 and that the lender related lender was paying as much as \$12,004 in costs for the buyer. The lender did not resolve the differences in sales prices shown on various documents. The lender also did not reduce the mortgage by the amount in excess of the maximum amount (6 percent of the sales price, or \$6,300 in this case) allowed by HUD without reducing the maximum mortgage.

**Comment 10** In this case the lender either did not obtain a residential construction contract or did not provide a copy of it in the file provided to us. However, the construction note principal is generally the same as the contractor's price and shows it to be \$101,083. The purchase memo shows the price as \$103,100 and that the lender related seller is paying as much as \$16,261 in costs for the buyer. The lender did not resolve the differences in sales prices shown on various documents and did not reduce the mortgage by the amount in excess of the maximum amount (6 percent of the sales price, or \$7,716 in this case) allowed by HUD.

**Comment 11** The residential construction contract from the lender's file shows the contractor's price was \$104,235. The purchase memo shows the price to be \$105,034 and that the lender related seller is paying as much as \$12,863 in costs for the buyer. The lender did not resolve the differences in sales prices shown in various documents and did not reduce the mortgage by the amount in excess of the maximum amount of seller concessions allowed by HUD.

**Comment 12** The residential construction contract from the lender's files shows the contractor's price to be \$72,190. The purchase memo shows the price as \$73,100 and shows the lender will pay \$13,425 in costs for the buyer. This exceeds the maximum amount of seller concessions allowed by HUD. The lender did not reduce the mortgage amount by the excess of the maximum allowed.

**Comment 13** The residential sales contract from the lender's file shows the contractor's price to be \$98,987. The purchase memo shows the price as \$101,150 and that the lender related seller was paying as much as \$15,879 in costs for the buyer. The lender did not resolve the

differences in sales price or reduce the mortgage amount by the excess of the maximum allowed.

**Comment 14** The residential construction contract from the lender's file shows the contractor's price to be \$67,676. The purchase memo shows the price as \$68,500 and that the lender related seller was paying as much as \$12,809 in costs for the buyer. The lender did not resolve the differences in sales price or reduce the mortgage amount by the excess of the maximum allowed.

**Comment 15** In response to the auditee's comments we clarified our finding and case narratives. In cases involving downpayment assistance, the seller's nonprofit contribution, amounting to the gift and fee, were deducted from the seller's proceeds at the closing. The seller's "contributions" to the nonprofit were used to satisfy fund requirements for closing 7 of 10 cases for which we reviewed the closing agent's receipt and disbursement ledger. In these cases, the "gifts" were not received from the nonprofit until after closing. The lender did not obtain verification that the closing agent received all the funds before closing and that those funds came from an acceptable source.

**Comment 16** As listed on the purchase memos and other documentation, the seller added concessions that exceeded 6 percent of the sales price. As previously indicated, there were differences in sales prices shown on different documents. If the lender had resolved the differences the lender should have found that the seller added other unallowable and unsupported costs to the sales prices used to calculate the mortgages. Regarding "cost borrowers are not permitted to satisfy," HUD handbook 4155.1, paragraph 1-9, contains items for which the borrower will need cash to pay at closing in addition to the minimum required investment. Items such as title insurance are included in the list. Since items such as this were included, as an amount the seller would pay, they should have been considered seller's concessions and used in calculating the amounts by which to reduce the mortgages.

**Comment 17** As stated in the finding, the purchase memo used to calculate the mortgage shows the seller was going to pay the buyer's closing costs up to \$7,500, FHA non allowable closing costs of \$1,100, title policy of \$1,325, and the gift and fee \$3,375. The lender related seller did not disclose the value of the \$1,500 big screen television or the other amount included in the sale price shown on the purchase memo. However, if the lender had investigated the differences in the sales prices on the residential sales contract and other documentation, the lender should have determined the \$15,453 in costs being added to the manufactured home sales price. Although HUD currently allows seller contributions to nonprofits for downpayment assistance, in this case the seller's contribution was used to fund the closing. The nonprofit "gift" was not available and the lender did not ensure the gift funds were received at closing.

**Comment 18** As stated in our case narrative, the purchase memo used to calculate the mortgage shows the seller was going to pay the buyer's closing costs up to \$5,633, FHA non allowable closing costs of \$875, title policy of \$1,200, and the gift and fee of \$3,381. The lender did not investigate the difference in sales prices shown on various documents and did not reduce the sales price by the amount of concessions over 6 percent of the sales price.



**Comment 19** Regardless of the amount the lender related seller actually paid in borrower expenses, the seller added \$21,418 to the manufactured home sales price. The purchase memo shows the seller will contribute as much as \$7,830 in prepaids and closing expenses, \$1,100 in FHA non allowable closing costs, \$1,400 for a title policy, and \$5,931 for the gift and fee. The purchase memo did not disclose the \$1,000 gift certificate given by the seller and shown on other documentation.

**Comment 20** Regardless of the amount the lender related seller actually paid in borrower expenses, the purchase memo lists the seller concessions as up to \$6,763 in buyer closing costs and prepaids, \$1,100 in FHA non allowable closing costs, \$1,225 for a title policy, and \$3,715 for the downpayment assistance gift and fee. There was also an unexplained increase of \$460. We could not determine all of the costs added because the seller did not provide the acquisition cost documentation. The lender did not investigate or resolve the difference in sales prices shown on various documents.

**Comment 21** Regardless of the amount the lender related seller actually paid in borrower expenses, the purchase memo lists the seller concessions as up to \$8,394 in buyer closing costs and prepaids, \$1,250 in FHA non allowable closing costs, \$1,393 for a title policy, and \$4,842 for the downpayment assistance gift and fee. There was also an unexplained increase of \$322. We could not determine all of the costs added because the seller did not provide the acquisition cost documentation. The lender did not investigate or resolve the difference in sales prices shown on various documents.

**Comment 22** Under the direct endorsement program the lender shall have the property appraised in accordance with such standards and requirements as the Secretary may prescribe. A direct endorsement lender that submits an appraisal that does not satisfy FHA requirements is subject to administrative sanction by the Mortgagee Review Board, depending on whether the lender knew or had reason to know the appraisal was deficient. In the cases we reviewed, the lender had reason to question the appraisals but did not. The appraisers compared singlewide manufactured homes to doublewide manufactured homes and traditionally built homes. We noted initial lot photographs that were different from the final inspection pictures. We noted final inspection pictures that showed new homes that appeared to be used homes. Upon closer review, the appraisers used comparables that were over six months old and that were not next-door, down the street or in the same subdivision, but were miles from the subject. The appraiser adjustments appeared unjustified. Generally, the appraisers did not adequately explain most of the differences and that some explanations conflicted with the facts. As we stated in the report, the appraisal districts' values were lower and OIG believes the appraisal discrepancies indicated a lower value. Not all the discrepancies in the report were significant by themselves; however, we noted multiple discrepancies on each of the appraisals in the report. The lender's appraisal reviews should have noted the discrepancies and the lender should have resolved them by getting appropriate answers from the appraiser or another appraisal.

**Comment 23** We used the appraisal district values to gain a perspective on the lender's values. As indicated by the finding, the appraisal districts follow the same professional

appraisal standards as required for appraisers of HUD insured properties. State law requires appraisal districts to value properties at market value. The appraisal district in each county sets the value of property each year.

**Comment 24** We have no reason to believe that any manufactured home increased in value by 10 percent or more in the state of Texas. Therefore, we do not believe the ceiling on the value increase for properties with homestead exemptions established by the appraisal districts would apply in these cases. Further, the values determined by HUD after the claims and sales indicate the appraisal district appraisals were more in line with the market values.

**Comment 25** In case 495-4844999, the appraiser stated in the appraisal report, “Demand/supply factors are in balance, marketing times typically range three to six months.” On the form 1004C, Manufactured Home Appraisal Report Addendum, the appraiser states there are seven sales between \$24,500 and \$147,000 and 37 listings between \$25,000 and \$199,000. If marketing time ranged between three and six months, the appraiser should have been able to find sales less than six months old and the lender should have noticed the inconsistency and questioned the appraiser.

**Comment 26** In case 495-6673573, the appraiser dated the appraisal June 21, 2003 and two comparables were dated July 3, 2002, and July 25, 2002, almost a year before the appraisal. Comparables four and five were within a mile of the subject but these are traditionally built homes and not comparable to the subject, a manufactured home. Comparables one, two, and three are seven miles from the subject and more than 300 square feet smaller than the subject. They were 25, 23, and 15 percent, respectively, smaller than the subject. The lender should have questioned the comparables.

**Comment 27** In case 495-6460736, the comparables were located in a different neighborhood. The appraiser did not explain what upgrades were worth \$6,000, which was five percent of the sales price. The quality of the pictures of the comparables was such that one could not determine whether the homes were similar. The lender should have questioned the appraiser.

**Comment 28** We correctly calculated the borrowers’ income. However we revised our narrative in this case to include the effect in the debt to income ratio. This ratio would change from about 44 percent to 47 percent, which exceeds HUD’s guidelines.

## Appendix C-1

Case	FHA case no.	Mort. amt.	Lender	Appraised values (* REO = Real Estate Owned)			Status	Indemns	Buy-down amt	Claims paid	Claims/prop. sold	Net loss	Foreclosure loss
				County	HUD REO*	HUD REO* sold (Mtg. & Co.)							
1	495-7006330	\$ 64,020	\$ 103,000	\$ 38,370		44,630	Reinstated	\$ 52,233	\$ 11,787				
2	495-6861163	99,439	120,000	90,920	49,000	29,080	Foreclosed			105,389.50			
3	495-6844994	92,793	108,000	39,350		68,150	Foreclosed			95,014.97			
4	495-6555423	109,385	120,000	77,240		42,760	Foreclosure	\$ 107,066	2,319				
5	495-6673573	104,362	106,000	74,700		31,300	Reinstated	\$ 97,688	6,674				
6	495-6487743	132,914	140,000	121,540		18,460	Reinstated	\$ 117,129	15,785				
7	495-6581533	113,223	135,000	73,820	55,000	52,500	Foreclosed			115,713.25		63,213.25	
8	495-6487731	80,733	82,000	45,907	40,000	23,950	Foreclosed			87,046.00		63,096.00	
9	495-6384702	123,068	138,000	92,200		45,800	Modified	\$ 107,616	15,432				
10	495-6601936	157,182	162,000	83,400	81,000		Foreclosed			160,943.88			
11	495-6719550	93,390	97,000	45,761		51,239	Reinstated	\$ 85,042	8,348				
12	495-6749841	87,187	93,000	58,980		34,020	Conveyed Pd			89,073.00			
13	495-6727403	96,485	98,000	64,800	41,000	33,200	Foreclosed			96,485.00			
14	495-6378006	118,176	125,000	64,800		60,200	Reinstated	\$ 112,701	5,475				
15	495-6545683	137,182	160,000	106,860		53,140	Foreclosure	\$ 135,644	17,538				
16	495-6529982	103,377	105,000	100,350		4,650	Reinstated	\$ 94,774	8,603				
17	495-6470914	154,574	157,000	136,280		20,720	Foreclosed			157,110.54			
18	495-6436416	118,146	120,000	66,370		53,630	Modified	\$ 109,639	8,507				
19	495-6436442	122,815	133,500	103,850		29,650	Foreclosure	\$ 108,248	14,567				
20	495-6471830	94,516	100,000	36,790		43,210	Modified	\$ 80,914	13,602				
21	495-6476763	123,068	130,000	105,900		24,100	Foreclosure	\$ 105,468	17,600				
22	495-6505803	128,433	105,000	51,680		53,320	Current	\$ 116,497	11,936				
23	495-6037036	128,433	132,000	100,670		31,330	Modified	\$ 107,065	21,418				
24	495-6114990	125,352	137,637	108,637	41,000	47,500	Foreclosed			132,997.45		85,497.45	
25	495-6285316	132,094	137,000	90,863		46,135	Default	\$ 114,449	17,645				
26	495-6295511	79,748	81,000	86,270		(5,270)	Modified	\$ 71,699	8,049				
27	495-6334452	122,035	123,000	90,042		32,958	Default	\$ 108,813	13,222				
28	495-6394483	72,877	157,000	23,676		133,324	Default	\$ 71,810	1,067				
29	495-6400545	112,610	125,000	79,025		45,975	Foreclosed			117,005.20			
30	495-6419246	115,090	123,000	73,707		49,293	Default	\$ 102,165	12,925				
31	495-6425206	111,617	115,000	89,584		25,416	Modified	\$ 100,644	10,973				
32	495-6460736	133,941	138,000	91,079		46,921	Foreclosed			141,515.40			
33	495-6462595	121,152	155,000	108,472	58,000	55,622	Foreclosed			126,317.55		70,695.55	
34	495-6465024	101,200	102,000	97,920		4,080	Reinstated	\$ 89,565	11,635				
35	495-6482719	137,837	140,000	102,593		37,405	Foreclosed			137,837.00			
36	495-6483454	104,176	115,000	88,747		26,253	Foreclosure	\$ 91,367	12,809				
37	495-6487833	109,137	135,000	96,035		38,965	Reinstated	\$ 95,622	13,515				
38	495-6489197	113,223	115,000	92,275		22,725	Reinstated	\$ 98,512	14,711				
39	495-6484883	104,165	116,000	51,386		64,614	Modified	\$ 99,289	4,876				
40	495-6521654	117,476	129,000	57,860	27,000	33,000	Foreclosed			120,739.30		87,739.30	
41	495-6536032	81,362	90,000	38,880	26,000	26,029	Foreclosed			84,778.32		58,749.52	
42	495-6708780	85,271	90,000	58,970		31,030	Modified	\$ 73,661	11,610				
43	495-6727274	112,868	115,000	67,350	41,000		Current	\$ 106,299	6,569				
44	495-6735474	99,841	117,000	63,140		53,860	in Foreclosure			112,601.00			
45	495-6748318	112,601	129,000	89,100		39,900	in Foreclosure			99,841.00			
46	495-6593271	115,710	120,000	92,061	45,000		in Foreclosure			118,552.12			
47	495-6644061	129,228	137,000	91,478		45,522	in Foreclosure			129,228.00			
		\$ 5,253,612						\$ 2,765,619	\$ 319,267			428,991.57	1,989,588.18
										1,560,596.61	Claims paid on 18 Loans		
											28 loans		

**BankSource Financial LP**  
**Schedule of loan origination deficiencies**

Appraisal Deficiencies														
Case no.	Sales price was not reduced for concessions	Inflated acquisition costs	Comparables					Wrong prop comp picture	Final inspection before appraisal	Borrower was not creditworthy	Documents handled by seller	Wrong mortgage percentage applied	Insufficient information obtained	Overstated income/understated debt
			Inappropriate (full)	Six months or older (1)	Different neighborhood	Not similar	Unsupported adjustments							
405-70064330	X	X		X-2	X	X	X		X	X				
405-65611163	X	X		X-2	X	X	X		X	X				
405-65849999	X	X		X-3	X	X	X		X	X				
405-65554525	X	X		X-2	X	X	X		X	X				
405-66735773	X	X		X-2	X	X	X		X	X				
405-6487745	X	X		X-2	X	X	X		X	X				
405-65815533	X	X			X	X	X			X				X
405-64827331	X	X		X-2	X	X	X		X	X				X
405-67384702	X	X		X-3	X	X	X		X	X				
405-67195590	X	X		X-3	X	X	X		X	X				
405-67498841	X	X		X-2	X	X	X		X	X				
405-6727403	X	X		X-2	X	X	X		X	X				
405-6578006	X	X		X	X	X	X			X				
405-6545687	X	X		X	X	X	X							
405-6529962	X	X			X	X	X		X					
405-6470914	X	X			X	X	X			X				
405-64564019	X	X			X	X	X							
405-64718330	X	X		X	X	X	X		X	X				X
405-6476765	X	X		X	X	X	X		X	X				
405-6502803	X	X		X	X	X	X		X	X				
405-6037036	X	X		X	X	X	X							
405-6114990	X	X			X	X	X							
405-6285316	X	X		X	X	X	X							
405-6295517	X	X		X	X	X	X		X	X				X
405-6334452	X	X			X	X	X		X	X				
405-6394485	X	X			X	X	X			X				
405-6400545	X	X			X	X	X			X				X
405-64119246	X	X		X-2	X	X	X		X	X				
405-6425206	X	X			X	X	X		X					
405-6460736	X	X		X	X	X	X							
405-6462585	X	X			X	X	X							
405-6466924	X	X			X	X	X		X					
405-6482719	X	X			X	X	X							
405-6483454	X	X		X-3	X	X	X							
405-6487853	X	X		X-2	X	X	X			X				
405-6489197	X	X		X-2	X	X	X							
405-6494883	X	X		X	X	X	X							X
405-6521654	X	X		X	X	X	X							
405-6556052	X	X		X-2	X	X	X							
405-6708780	X	X		X	X	X	X							
405-6727274	X	X			X	X	X							
405-6735474	X	X		X-3	X	X	X							
405-6748318	X	X		X	X	X	X							
405-6593271	X	X		X	X	X	X							
405-6644061	X	X		X	X	X	X							

(1) Number of comparables more than six months old.

## Appendix C-3

### CASE NARRATIVES

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**FHA Case Number(s):** 495-6861163  
**Lender Number(s):** 4010036  
**Loan Amount:** \$99,439  
**Contract Sales Price:** \$70,002  
**Endorsement Date:** March 24, 2004  
**Default Date:** April 1, 2004  
**Current Loan Status:** Foreclosed  
**Claim Paid:** \$105,389

Deficiencies in loan origination:

1. The lender did not adequately review the appraisal indicating the value of the property to be \$120,000, whereas the local appraisal district valued the property at \$90,920. The appraiser overvalued the property by \$29,080. The following deficiencies indicate a lower value.
  - a. The lender did not reduce the sales price used to calculate the maximum mortgage for the seller concessions over 6 percent of the sales price. This resulted in an overvalued property and an over-insured mortgage. The lender should have reduced the mortgage by at least \$4,171, the difference between the concession in the sales contract and 6 percent of the sales price. The Mortgage Credit Analysis Worksheet listed the 6 percent limit as \$6,060, and the sales contract states the seller will pay up to \$10,231 in closing costs.
  - b. The initial picture of the empty lot is not the same as the subject lot. The initial picture shows no trees and the finished house has seven trees.
  - c. The inspector did the final inspection, January 12, 2004, before the appraisal dated January 20, 2004. Final inspections are normally after the appraisals in such cases.
  - d. Comparables one and three sales dates are over six months old.
  - e. The closest comparable was listed as 5 miles from the subject; however, the actual distance was closer to 14 miles.
  - f. The acreage adjustments are not logical. The subject property has 1.36 acres that cost \$31,000:
    - Comparable one has nine acres more and was adjusted down by \$9,000;
    - Comparable two has five acres more and was adjusted down by \$5,000; and
    - Comparable three has eleven acres more and was adjusted down by \$11,000.
  - g. There is a \$22,000 difference in the final adjusted values between the highest and lowest comparables. The adjusted values should be closer to subject property's value.

2. The lender did not resolve why and how the borrower was going to commute between the subject property and his place of employment 157 miles away.
3. The lender did not limit the loan ratio to 90 percent, and therefore the loan is over-insured by \$7,130. The seller built this home as a speculative house. The lender did not issue the Conditional Commitment before construction started or obtain a 10-year warranty.

**FHA Case Number:** 495-7006330  
**Lender Number:** 4050091  
**Loan Amount:** \$64,020  
**Contract Sales Price:** \$58,708  
**Endorsement Date:** October 8, 2004  
**Default Date:** January 2005  
**Current Loan Status:** Reinstated

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The contract sales price was \$58,708 and the sales price shown on the HUD-1 Settlement Statement was \$58,087. The closing documents also showed that the seller added \$11,787 in unsupported costs to the sales price.
2. The lender did not adequately review the appraisal that valued the property at \$103,000, whereas the local appraisal district valued the property at \$58,370. The appraiser overvalued the subject property by \$44,630. The following deficiencies indicate a lower value:
  - a. The lender did not reduce the sales price used to calculate the maximum mortgage for seller concessions over 6 percent of the sales price. This resulted in an overvalued property and an over insured mortgage. The lender should have reduced the mortgage by at least \$1,789, the difference between the concessions in the sales contract and 6 percent of the sales price. The Mortgage Credit Analysis Worksheet listed the 6 percent limit as \$3,942 and the sales contract states the seller will pay up to \$5,732.
  - b. The sales dates for comparables two and three are over six months old.
  - c. The closest comparable is about four miles from the subject.
  - d. The subject property was not similar to the comparables. The subject was new, generally smaller and a single-wide manufactured home:
    - Comparables two and three were at least 250 square feet larger than the subject.
    - Comparables one and two were double-wide manufactured homes.
    - Comparable three was a traditionally built home.
  - e. The site value from the cost approach was \$19,000 more than the property cost.
  - f. The appraiser did not adjust the comparables consistently with land values of the subject. The subject had 1.19 acres that cost \$7,000:
    - Comparable one had five acres more and was adjusted down by \$1,000.
    - Comparable two had six acres more and was adjusted down by \$2,000.
    - Comparable three had three acres less and was adjusted up by \$8,000.

- g. There was a \$40,000 difference in the final adjusted values between the lowest and highest comparable. The adjusted values should be closer to the subject property's value.
- 3. The lender did not adequately evaluate the borrower's credit history or provide adequate explanations for derogatory credit items. The mortgage credit analysis worksheet shows the borrowers only assets included a gift of \$3,215 and \$1,200 deposited in the closing agent's escrow account on June 10, 2004, to be refunded at closing according to the closing agent. The borrower apparently had no bank account. The lender did not confirm the source of the deposit.

The lender did not confirm the source of funds used to pay delinquent debts. The file contained evidence that the borrower owed creditors on accounts that were significantly past due and out for collection prior to applying for the mortgage to purchase the home. The lender related seller obtained credit reports on the borrower on March 11, April 20, and May 1, 2004 as evidenced by the lender's credit report dated May 4, 2004. The lender's credit report indicated the borrower owed the Department of Education \$1,347 on a defaulted student loan, \$1,117 to a former landlord for rent incurred prior to moving in October 2003, and \$1,253 to a fitness club that reported it was unable to contact the borrower because he had moved and left no forwarding address. The borrower also owed for medical services and other delinquent debts amounting to more than \$1,000 that dated back to 2002. The lender's files contained correspondence dated March 31, 2004 and April 21, 2004 from the former landlord and the Department of Education, respectively, indicating the past due amounts had been satisfied. The lender did not obtain confirmation as to the source of funds used to satisfy these debts.

The lender included the student loan on the Mortgage Credit Analysis Worksheet but did not address the delinquent fitness club debt or other delinquent debts that would indicate the borrower's attitude toward his obligations.

<b>FHA Case Number(s):</b>	<b>495-6844999</b>
Lender Number(s):	3120578
Loan Amount:	\$92,793
Contract Sales Price:	\$94,250
Endorsement Date:	May 20, 2004
Default Date:	August 1, 2004
Current Loan Status:	Foreclosed
Claim Paid:	\$ 95,015

Deficiencies in loan origination:

- 1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts was \$75,157, whereas and the sales price shown on the HUD-1 Settlement Statement was \$89,597. The closing documents also showed that the seller added \$31,367 in unsupported and unallowable costs, including costs the seller agreed to pay on behalf of

the buyer. The seller added \$12,412 to pay off the trade-in, \$350 to haul the trade-in to the seller's lot, a \$1000 referral fee, \$9,512 in closing costs, \$4,535 for the downpayment assistance gift and processing fee, and a \$3,558 unexplained price increase.

2. The lender did not adequately review the property appraisal of \$108,000 or reduce the sales price for seller concessions over 6 percent. This resulted in overvalued collateral. The Mortgage Credit Analysis Worksheet lists the 6 percent as \$5,655 and the HUD-1 shows the seller and lender paid \$9,456 in closing costs. We could not determine the current value, because the local appraisal district had not performed an appraisal. Several of the discrepancies indicate a lower value:
  - a. The closest comparable is 2.7 miles from the subject property.
  - b. Three of the comparable sales are over six months old.
  - c. The cost approach shows the lot cost \$14,450, and the file shows \$7,406. The appraiser overstated the comparable land adjustments by \$7,406, thus overstating the value of the subject property.
3. The borrower was not creditworthy; three of the five active credit accounts were in collection status with no explanation. The seller provided the lender with two alternate credit letters, one of which was false, and the other we could not verify.

<b>FHA Case Number:</b>	<b>495-6555425</b>
Lender Number:	3041302
Loan Amount:	\$109,385
Contract Sales Price:	\$75,000
Endorsement Date:	September 9, 2003
Current Loan Status:	Forbearance

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$97,150, whereas the sales price shown on the HUD-1 Settlement Statement was \$99,470. The closing documents also showed that the seller added unsupported costs of \$2,319 to the total sales price.
2. The lender did not adequately review the appraisal that valued the property at \$120,000, whereas the local appraisal district valued the property at \$77,240. The appraiser overvalued the property by \$42,760. The following discrepancies indicate a lower value:
  - d. The sales dates for comparables one and three were at least six months old.
  - e. The closest comparable is about five miles from the subject property.
  - f. The subject property is not similar to the comparables:
    - All three comparables are at least 200 square feet larger.
    - The appraiser adjusted the square footage differences by \$10 per square foot; however, the cost approach used \$58 per square foot.
  - g. The subject property has 2.11 acres which cost \$22,150, and the appraiser's adjustments do not appear reasonable:



- Comparable one has five acres and was adjusted down by \$2,000.
  - Comparable two and three had ten acres and were adjusted down by \$5,000.
- h. There is a \$39,200 difference in the final adjusted values between the lowest and highest comparable.
3. The lender did not document the borrower's source of funds as required by the Loan Prospector Feedback sheet.

**FHA Case Number:** 495-6673573  
**Lender Number:** 3062252  
**Loan Amount:** \$104,362  
**Contract Sales Price:** \$92,000  
**Endorsement Date:** October 23, 2003  
**Default Date:** December 1, 2003  
**Current Loan Status:** Reinstated

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts was \$92,000 while the sales price shown on the HUD-1 Settlement Statement was \$92,103. If the lender had reviewed the closing, they would have found the seller added unsupported costs of \$6,674 to the sales contract price.
2. The lender did not adequately review the appraisal that valued the property at \$106,000, whereas the local appraisal district valued the property at \$74,700. The appraiser overvalued the subject property by \$31,300. The following deficiencies indicate a lower value:
  - a. Comparables two and three sales dates were over six months old.
  - b. The closest comparable is seven miles from the subject.
  - c. The property is not similar to the comparables: All three comparables were about 300 square feet smaller, and were adjusted up for fewer rooms and less square footage.
3. The borrower was not creditworthy, and had more than five accounts in collection or charged off. The lender did not require the borrower to provide an explanation for the poor credit. The borrower's only asset was a 401K retirement account balance of \$1,785 listed on the loan application and a different amount of \$1,467 listed on the Mortgage Credit Analysis Worksheet. The loan application shows the borrower's net worth to be a negative \$105,685. The vested amount shown on the 401K account verification did not agree with the amount shown on other lender documents. The lender certified that the verifications of employment and deposits were requested and received by the lender without passing through the hands of any third person. The lender files show the verifications of employment and the 401K retirement account passed through the lender related seller, as evidence by the identity of the sender shown on the faxed documents.

The lender listed compensating factors as “good job stability” and “not a lot of debt.” The lender did not require an explanation of the accounts in collection and written off that were shown on the credit reports to address the deficiencies in the borrower’s past credit history.

<b>FHA Case Number:</b>	<b>495-6487745</b>
Lender Number:	3021318
Loan Amount:	\$138,914
Contract Sales Price:	\$135,000
Endorsement Date:	May 15, 2003
Default Date:	September 2003
Current Loan Status:	Reinstated

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$15,785 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$7,972 in closing costs, \$1,250 for FHA non-allowable costs, \$1,412 for a title policy, \$500 for appliances, \$5,386 for the downpayment assistance gift and processing fee, and a \$735 unexplained credit.
2. The seller’s contribution for downpayment assistance was used to fund the closing. The downpayment assistance contribution was deducted from the seller’s proceeds. The closing was held on March 24, 2003, and funded by the lender on March 25, 2003. The closer disbursed the funds on March 27, 2003. The “gift” funds from the nonprofit were not received until April 2, 2003. The “gift” and the fee were returned to the nonprofit on April 4, 2003.
3. The lender did not adequately review the appraisal that valued the property at \$140,000, whereas the local appraisal district valued the property at \$121,540. The appraiser overvalued the subject property by \$18,460. The following deficiencies indicate a lower value:
  - a. Comparable one and two sales dates were over six months old.
  - b. Comparable one is two miles away, and comparables two and three are over ten miles away.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$135,000 and the 6 percent limitation is \$8,100. The contract to purchase the home included \$16,020 in seller contributions or concessions.
  - d. The property site has .51 acres and cost \$31,150, and the adjustments do not appear reasonable:
    - Comparable one had five acres more and was adjusted down by \$5,000;
    - Comparable two had nine acres more and was adjusted down by \$10,000; and
    - Comparable three had one acre more and was adjusted down by \$1,000.

- e. The difference between the final adjusted values is \$41,000 between the lowest and highest comparable values. The values should be closer.

**FHA Case Number:** 495-6581533  
**Lender Number:** 3033027  
**Loan Amount:** \$113,223  
**Contract Sales Price:** \$115,000  
**Endorsement Date:** September 18, 2003  
**Current Loan Status:** Foreclosed April 7, 2005  
**Claim Paid:** \$115,713

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$16,045 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,102 in closing costs, \$1,250 for FHA non-allowable costs, \$1,300 for a title policy, \$2,125 for an unspecified rental, \$5,377 for the downpayment assistance gift and processing fee and a \$109 unexplained credit.
2. The seller's contribution for downpayment assistance was used to fund the closing. The closing was held on June 17, 2003 and funded by the lender on June 18, 2003. The closer disbursed the funds on June 18, 2003. The "gift" from the nonprofit was not received until September 2, 2003. The "gift" and the fee were returned to the nonprofit on September 2, 2003.
3. The lender did not adequately review the appraisal that valued the property at \$135,000, whereas the local appraisal district valued the property at \$73,820. The appraiser overvalued the subject property by \$61,180. The following deficiencies indicate a lower value:
  - a. The closest comparable is over two miles away. Comparable one is six miles away and comparable three is over eleven miles from the subject,
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$115,000 and the 6 percent limitation is \$6,900. The purchase contract for the home included \$14,029 in seller contributions or concessions.
  - c. Comparable one is not a manufactured home but a site built traditional home, and the appraiser's adjustments do not appear reasonable or adequately explained. Comparable one was:
    - Adjusted down by \$10,000 for design and appeal without explanation;
    - Adjusted up \$2,000 for having 3 less rooms; and
    - Adjusted down \$3,000 for a two-car garage. The subject property had a parking pad.
  - d. There are no photos of comparable two and comparable three.

- e. The subject property has 7.28 acres that cost \$15,900. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had .75 acres and was adjusted up by \$1000;
    - Comparable two had 1 acres and was adjusted up by \$9,000; and
    - Comparable three had .5 acres and was adjusted down by \$9,000.
  - f. The subject has a living area of 2077 square feet and the appraiser did not compute the price per square foot. The comparables price per square foot range from \$60 to \$76, however, the appraiser used approximately \$13 per square foot to adjust the comparables:
    - Comparable one had 77 feet less in living area and was adjusted up by \$1,000;
    - Comparable two had 291 feet more in living area and was adjusted down by \$3,800; and
    - Comparable three had 621 feet less in living area and was adjusted up by \$8,100.
  - g. The appraiser's adjustments for age are not reasonable or consistent and are not adequately explained. Comparable one is a year older and was adjusted up by \$2,000 and comparable three is four years older than the subject property and was adjusted up by \$3,700.
  - h. The subject's appraised value was \$135,000; however, the final adjusted values of the comparables range from \$113,000 to \$144,773. The values should be closer.
3. The lender overstated the borrowers income, thus the borrower's debt to income ratio exceeded the limit. The borrower's debt to income ratio was 55 percent and the limit was 41 percent.

<b>FHA Case Number:</b>	<b>495-6482731</b>
Lender Number:	3032675
Loan Amount:	\$80,733
Contract Sales Price:	\$82,000
Endorsement Date:	June 27, 2003
Current Loan Status:	Foreclosed February 1, 2005
Claim Paid:	\$87,046

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$11,153 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$5,881 in closing costs, \$1,250 for FHA non-allowable costs, \$1,000 for a title policy, \$2,196 for the downpayment assistance gift and processing fee, and an unidentified amount of \$826.
2. The lender did not adequately review the appraisal that valued the property at \$82,000, whereas the local appraisal district valued the property at \$45,907. The appraiser overvalued the subject property by \$36,093. The following deficiencies indicate a lower value:
  - a. The comparables are not similar to the subject,

- The closest comparable is 5 miles away out of the area,
  - The comparables are at least 130 square feet larger, and
  - The comparables are doublewides whereas the subject is a singlewide.
- b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$82,000 and the 6 percent limitation is \$4,920. The purchase contract of the home included \$10,327 in seller contributions or concessions.
- c. The subject had .519 acres that cost \$12,000. The appraiser's adjustments to the comparables for land do not appear reasonable.
- Comparable one had at least two acres more than the subject property and was adjusted down \$2,481.
  - Comparable two had at least four acres more and was adjusted down by \$4,490.
  - Comparable three had a half-acre more than the subject property and was adjusted down by \$841.

**FHA Case Number:** 495-6384702  
**Lender Number:** 34487  
**Loan Amount:** \$123,068  
**Contract Sales Price:** \$125,000  
**Endorsement Date:** March 24, 2003  
**Current Loan Status:** Modified July 27, 2004

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$15,452 in unsupported and unallowable costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$7,500 in closing costs, \$1,100 for FHA non-allowable costs, \$1,325 for a title policy, \$1,500 for a big screen television, \$3,375 for the downpayment assistance gift and processing fee, and an unidentified cost of \$652.
2. The seller's contribution for downpayment assistance was used to fund the closing. The contribution was deducted for the seller's proceeds. The closing was held on January 28, 2003 and funded by the lender on January 29, 2003. The closer disbursed the funds on January 30, 2003. The "gift" from the nonprofit was not received until February 4, 2003. The gift and the fee were returned to the nonprofit on March 13, 2003.
3. The lender did not adequately review the appraisal that valued the property at \$138,000, whereas the local appraisal district valued the property at \$92,200. The appraiser overvalued the subject property by \$45,800. The following deficiencies indicate a lower value:
  - a. Comparables two and four sales dates were over six months old.
  - b. The closest comparable is 25 miles from the subject.

- c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions or concessions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$125,000 and the 6 percent limitation is \$7,500. The contract to purchase the home included \$13,300 in seller contributions or concessions.
  - d. The subject had one acre that cost \$28,560 and the appraisers adjustments do not appear reasonable:
    - Comparable one had almost eight acres more and was adjusted down by \$7,820;
    - Comparable two had seven acres more and was adjusted down by \$7,190;
    - Comparable three had five acres more and was adjusted down by \$5,070; and
    - Comparable four had four acres more and was adjusted down by \$4,000.
4. The lender did not adequately evaluate the borrowers' credit history or provide adequate explanations for derogatory credit. The borrowers credit report shows 24 accounts in collection or written off. The borrowers have 14 student loans totaling \$66,558 that can only be deferred another 30 months.
  5. The lender overstated the borrowers' income by \$334.

<b>FHA Case Number:</b>	<b>495-6601956</b>
Lender Number:	3053181
Loan Amount:	\$157,182
Contract Sales Price:	\$159,650
Endorsement Date:	September 4, 2003
Current Loan Status:	Foreclosed July 1, 2005
Claims Paid:	\$160,944

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$18,335 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$9,912 in closing costs, \$8,259 for the downpayment assistance gift and fee, \$900 for moving, \$224 for storage, and an unexplained credit of \$960.
2. The seller's contribution for downpayment assistance was used to fund the closing. The contribution was deducted from the seller's proceeds at closing. The closing was held and funded on May 30, 2003. The closer disbursed the funds on June 2, 2003. The "gift" from the nonprofit was not received until August 26, 2003. The gift and the fee were returned to the nonprofit on August 27, 2003.
3. The lender did not adequately review the appraisal that valued the property at \$162,000, whereas the local appraisal district valued the property at \$83,400. The appraiser overvalued the subject property by \$78,600. The following deficiencies indicate a lower value:

- a. Comparable two's sales date is over six months old.
- b. The closest comparable is almost three miles from the subject property.
- c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$159,650 and the 6 percent limitation is \$9,579. The contract to purchase the home included \$18,171 in seller contributions or concessions.
- d. Comparable one is not a manufactured home like the subject, but is a traditionally built home and is 700 square feet smaller than the subject property.
- e. The difference in final adjusted values of the comparables is \$46,000. The lowest adjusted value is \$146,000 and the highest is \$192,000. The values should be closer.

**FHA Case Number:** 495-6719550  
**Lender Number:** 3072393  
**Loan Amount:** \$93,390  
**Contract Sales Price:** \$93,893  
**Endorsement Date:** November 13, 2003  
**Current Loan Status:** Modified February 14, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$93,893, while the sales price shown on the HUD-1 Settlement Statement was \$84,246. If the lender staff had reviewed the closing, it would have found the seller added unallowable and unsupported costs of \$4,174 to the sales price, including a \$700 gift certificate/customer reimbursement, \$670 for insurance, and an unidentified amount of \$2,804.
2. The lender did not adequately review the appraisal that valued the property at \$97,000, whereas the local appraisal district valued the property at \$46,761. The appraiser overvalued the subject property by \$50,239. The following deficiencies indicate a lower value:
  - a. Comparables one, two and three sales dates were over six months old.
  - b. The comparables were at least 300 square feet larger than the subject.
  - c. Comparable four is not a manufactured home but a traditionally built home.
  - d. The subject property has one acre that cost \$24,500 and the adjustments do not appear reasonable:
    - Comparable one has the same amount of land and was adjusted up by \$4,000.
    - Comparable two had four acres more land and was adjusted down by \$4,000.
    - Comparable four had one and a half acres more land and it was adjusted down by \$4,000.

The lender did not adequately evaluate the borrower's credit history, which showed seven recent accounts either written off or placed in collection. Further, the lender did not obtain an

adequate borrower explanation for the bad credit. The lender listed the compensating factors as “two months reserves” and “not a lot of debt” but did not require a sensible explanation for the borrower’s poor credit characteristics as it should have. Letters documenting alternative credit were faxed from the seller.

<b>FHA Case Number:</b>	<b>495-6749841</b>
Lender Number:	3081544
Loan Amount:	\$87,187
Contract Sales Price:	\$81,513
Endorsement Date:	September 4, 2003
Current Loan Status:	Claim with out conveyance March 9, 2005
Claim Paid:	\$89,073.44

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$78,858, whereas, the sales price shown on the HUD-1 Settlement Statement was \$81,513. If the lender staff had reviewed the closing, they would have found the seller added \$4,983 in unsupported costs to the sales price.
2. The lender did not adequately review the appraisal that valued the property at \$93,000, whereas the local appraisal district valued the property at \$58,980. The appraiser overvalued the subject property by \$34,020. The following deficiencies indicate a lower value:
  - a. The closest comparable is nine miles away from the subject property.
  - b. Comparable one is a traditional site built home and not a manufactured home like the subject.
  - c. Comparable two sales date is over six months old.
  - d. The subject property is a half-acre that cost \$25,000. The adjustments for land for the comparables do not appear reasonable:
    - Comparable one and two have more than three acres and were not adjusted.
    - Comparable three has more than eleven acres and was adjusted down by \$15,000.
3. The lender did not require the borrower to provide an explanation for the poor credit. The borrower had 14 recent accounts in collection or written off. The lender listed compensating factors as “two months reserves” and “homebuyer education,” but did not require a sensible explanation regarding the borrower’s 14 accounts in collection totaling \$2,261 and the poor credit characteristics.



**FHA Case Number:** 495-6727403  
**Lender Number:** 3080164  
**Loan Amount:** \$96,485  
**Contract Sales Price:** \$98,000  
**Endorsement Date:** October 21, 2003  
**Current Loan Status:** Foreclosed February 1, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$95,080, whereas the sales price shown on the HUD-1 Settlement Statement was \$98,000. If the lender staff had reviewed the closing, they would have found the seller added \$12,100 in unallowable and unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$5,633 in closing costs, \$1,200 for the title policy, \$875 for FHA non-allowables, \$3,381 for the gift and fee used as the downpayment, and an unidentified price increase of \$1,011.
2. The lender did not adequately review the appraisal that valued the property at \$98,000, whereas the local appraisal district valued the property at \$64,800. The appraiser overvalued the subject property by \$33,200. The following deficiencies indicate a lower value:
  - a. The closest comparable is almost three miles from the subject property.
  - b. Sales dates for comparable one and three were over six months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution or concessions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$98,000. The 6 percent limitation is \$5,880. The contract to purchase the home included \$12,180 in seller contributions or concessions.
  - d. Comparable one is a traditional site built home, not a manufactured home like the subject.
  - e. Comparables one and three are about 400 square feet larger, and comparable two is about 100 square feet smaller than the subject property.
  - f. The subject has a half-acre lot that cost \$24,900; however, the land adjustments for the comparables do not appear reasonable:
    - Comparable one is the same size and was adjusted up by \$5,000.
    - Comparable two had more than 4 acres more than the subject property and was not adjusted.
    - Comparable three had almost eleven acres more than the subject property and was adjusted down by \$15,000.
3. The borrower was not creditworthy. The lender did not require the borrower to explain five accounts placed in collection or written off.

**FHA Case Number:** 495-6578006  
**Lender Number:** 3040572  
**Loan Amount:** \$118,176  
**Contract Sales Price:** \$80,940  
**Endorsement Date:** October 1, 2003  
**Current Loan Status:** Partial reinstatement

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$103,940, whereas the sales price shown on the HUD-1 Settlement Statement was \$104,443. If the lender staff had reviewed the closing, it would have found the seller added \$5,475 in unallowable and unsupported costs to the sales price. The seller added \$3,000 for an item called transport, a \$200 gift card, an electric deposit of \$400, and an unidentified amount of \$1,875.
2. The lender did not adequately review the appraisal that valued the property at \$125,000, whereas the local appraisal district valued the property at \$64,800. The appraiser overvalued the subject property by \$60,200. The following deficiencies indicate a lower value:
  - a. The closest comparable is five miles from the subject.
  - b. All three comparables are at least 200 square feet larger than the subject.
  - c. Comparable three's sales date is over six months old.
  - d. The subject property had two acres that cost \$23,000. The appraiser's adjustments do not appear reasonable:
    - Comparable one had almost eight more acres than the subject property. It was adjusted down \$12,000.
    - Comparable two had a half-acre and was adjusted up by \$3,000.
    - Comparable three had almost three acres more than the subject property, and was adjusted down by \$7,000.

**FHA Case Number:** 495-6545687  
**Lender Number:** 3021791  
**Loan Amount:** \$157,182  
**Contract Sales Price:** \$169,650  
**Endorsement Date:** November 12, 2003  
**Current Loan Status:** Special Forbearance February 6, 2004

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$17,538 in unallowable and unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$10,793 in closing costs, a \$500 set of playground equipment, \$6,430 for the gift and fee for the downpayment, and an unidentified credit of \$185.

2. The seller's contribution for downpayment assistance was used to fund the closing. The contribution was deducted from the seller's proceeds at closing. The closing was held on June 25, 2003 and funded by the lender on June 28, 2003. The closer disbursed the funds on July 3, 2003. The "gift" from the nonprofit was not received until September 2, 2003. The "gift" and the fee were returned to the nonprofit on September 2, 2003.
3. The lender did not adequately review the appraisal that valued the property at \$160,000, whereas the local appraisal district valued the property at \$106,860. The appraiser overvalued the subject property by \$53,140. The following deficiencies indicate a lower value:
  - a. The closest comparable is two miles away.
  - b. The closest comparable sales date is over a year old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$159,650 and the 6 percent limitation is \$9,579. The Purchase Contract of the home included \$17,223 in seller contributions or concessions.
  - d. Comparable three is a traditional site built home, not a manufactured home like the subject property.
  - e. The subject property had slightly over two acres that cost \$31,000. The appraiser's adjustments do not appear reasonable:
    - Comparable one had almost six acres and was adjusted down by \$4,000.
    - Comparable two had almost three acres more and was adjusted up by \$16,000.
    - Comparable three had two acres less than the subject property, and it was adjusted up by \$11,000.
4. The lender did not resolve the discrepancy between occupancy of their new home with the lease of their old home. The seller appears to have completed the new home in August 2003, as indicated by the final inspection dated August 22, 2003 and septic license dated August 26, 2003. The borrowers leased their old home to a tenant on April 22, 2003. There is no indication that the borrowers were renting or living anywhere between April 22, 2003, and August 22, 2003.

**FHA Case Number:** 495-6529962  
**Lender Number:** 3030699  
**Loan Amount:** \$103,377  
**Contract Sales Price:** \$105,000  
**Endorsement Date:** July 29, 2003  
**Current Loan Status:** Delinquent

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added unsupported costs of \$19,968 to the sales price, including costs the seller agreed to

pay on behalf of the buyer. The seller added \$8,603 in closing costs, \$2,801 for the gift and fee used for the downpayment, and an unidentified amount of 8,564.

2. The lender did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the sales price, resulting in overvalued collateral. The total contract price on the Mortgage Credit Analysis Worksheet is \$105,000 and the 6 percent limitation is \$6,300. The contract to purchase the home included \$12,004 in seller contributions or concessions.

<b>FHA Case Number:</b>	<b>495-6470914</b>
Lender Number:	3020941
Loan Amount:	\$154,574
Contract Sales Price:	\$157,000
Endorsement Date:	July 2, 2003
Current Loan Status:	Foreclosed March 1, 2005
Claim Paid:	\$157,110

Deficiencies in loan origination:

1. The lender did not support the sales price on the contracts. We found the seller added \$20,015 in unsupported and unallowable costs to the acquisition price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$10,953 in closing costs the seller agreed to pay, \$1,250 for unallowable closing costs, \$2,000 for a pool table, \$4,160 for the downpayment assistance, and an unidentified amount of \$1,652.
2. The seller's contribution for downpayment assistance was used to fund the closing. The seller's proceeds from the sale were reduced by the downpayment assistance contribution to a nonprofit as shown by the settlement statement. The closing was held March 28, 2003 and funded on March 31, 2003. The closer disbursed the funds on April 1, 2003. The "gift" from the nonprofit was not received until April 15, 2003. The "gift" and the fee were pending return to the nonprofit on April 17, 2003.
3. The lender did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the sales price. This resulting in overvalued collateral. The total contract price on the Mortgage Credit Analysis Worksheet is \$157,000 and the six percent limitation is \$9,420. The contract to purchase the home included \$16,363 in seller contributions or concessions.
4. The lender did not adequately evaluate the borrowers' credit. The borrowers had eight accounts in the past two years that were either written off or placed in collection. The lender did not obtain an explanation or identify compensating factors.

**FHA Case Number:** 495-6454616  
**Lender Number:** 3031223  
**Loan Amount:** \$118,145  
**Contract Sales Price:** \$116,400  
**Endorsement Date:** May 6, 2003  
**Current Loan Status:** Modified

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$116,400, whereas the sales price shown on the HUD-1 Settlement Statement was \$120,000. If the lender staff had reviewed the closing, they would have found the seller added \$16,303 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$8507 in closing costs, \$5,455 for the gift and fee used for the downpayment, and an unidentified amount of \$2,341.
2. The lender did not adequately review the appraisal that valued the property at \$120,000, whereas the local appraisal district valued the property at \$66,370. The appraiser overvalued the subject property by \$53,630. The following deficiencies indicate a lower value:
  - a. Comparables one, two, and three are ten miles from the subject property, and comparable four is five miles from the subject property.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$120,000. The 6 percent limitation is \$7,200. The Purchase Contract of the home included \$13,962 in seller contributions or concessions.
  - c. The Subject had 10 acres that cost \$31,400 (\$3,140 per acre) and the appraiser's adjustments for land do not appear reasonable:
    - Comparable one had 15 acres more than the subject and was adjusted down by \$15,000.
    - Comparable two had about 6 acres less and was adjusted up by \$6,000.
    - Comparables three and four had 5 acres more and were adjusted up by \$5,000.
  - d. Three of the four comparables have at least 200 square feet in living space more than the subject property.

**FHA Case Number:** 495-6456442  
**Lender Number:** 3031731  
**Loan Amount:** \$122,815  
**Contract Sales Price:** \$112,336.29  
**Endorsement Date:** June 25, 2003  
**Current Loan Status:** Reinstated  
**Claims Paid:** \$200 Forbearance

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts was \$94,107, whereas the sales price shown on the HUD-1 Settlement Statement was \$112,336. If lender staff had reviewed the closing, they would have found the seller added unsupported costs of \$14,567 to the sales price.
2. The lender did not adequately review the appraisal that valued the property at \$133,500, whereas the local appraisal district valued the property at \$103,850. The appraiser overvalued the subject property by \$29,650. The following deficiencies indicate a lower value:
  - a. The closest comparable is eight miles away.
  - b. The appraiser's adjustments do not appear reasonable. The subject property had 9.5 acres that cost \$37,278.
    - Comparable one has 15 acres more than the subject and was adjusted down by \$15,000.
    - Comparables two and three had 4.5 acres less and were adjusted up by \$4,800.
    - Comparable four had 8 acres less and was adjusted up by \$8,000.
  - c. The comparables were adjusted up \$7,500 because the subject had a swimming pool. But no sufficient explanation was given.
  - d. The adjusted values ranged from \$125,251 to \$162,861. The adjusted values should be closer.

**FHA Case Number:** 495-6471830  
**Lender Number:** 3032531  
**Loan Amount:** \$94,516  
**Contract Sales Price:** \$96,000  
**Endorsement Date:** June 10, 2003  
**Current Loan Status:** Modification

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$13,602 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$7,415 in closing costs, \$5,095 for the

downpayment assistance gift and processing fee, an “Overcharge on Guzman” for \$3,500, and an unexplained credit of \$2,408.

2. The lender did not adequately review the appraisal that valued the property at \$100,000, whereas the local appraisal district valued the property at \$56,790. The appraiser overvalued the subject property by \$43,210. The following deficiencies indicate a lower value:
  - a. The closest comparable is five miles away.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount seller contributions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$96,000. The 6 percent limitation is \$5,760. The contract to purchase the home included \$10,162 in seller contributions or concessions.
  - c. Comparable three’s sales date was over six months old.
  - d. The subject has a living area of 1809 square feet and the appraiser did not compute the price per square foot. The comparables price per square foot range from \$49 to \$69; however, the appraiser used approximately \$20 per square foot to adjust the comparables:
    - Comparable one had about 321 square feet more and adjusted down \$6,421.
    - Comparable two had about 459 square feet less and adjusted up \$9180.
    - Comparable three had about 319 square feet more and adjusted down \$6,380.
  - e. Comparable three was adjusted down by \$10,000 for strict deed restrictions without an adequate explanation.

<b>FHA Case Number:</b>	<b>495-66476765</b>
Lender Number:	3020944
Loan Amount:	\$123,068
Contract Sales Price:	\$125,000
Endorsement Date:	November 12, 2003
Current Loan Status:	Delinquent May 1, 2005
Claims Paid:	\$200 Special Forbearance

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$17,600 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,593 in closing costs, \$1,400 for the title policy, \$1,250 for FHA non-allowables, \$6,613 for the gift and fee used as the downpayment, and an unidentified price increase of \$1,744.
2. The lender did not adequately review the appraisal. According to the local appraisal district, the appraiser overvalued the property by \$24,100 (\$130,000 mortgagee appraisal less \$105,900 local appraisal district). Several of these discrepancies indicate a lower value:
  - a. All the comparables are 5 miles away from the subject.

- b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$125,000 and the 6 percent limitation is \$7,500. The contract to purchase the home included \$15,856 in seller contributions or concessions.
  - c. The subject property has 6.67 acres of land that cost \$20,805. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had 10 acres and was adjusted down by \$1,000;
    - Comparable two had 3 acres and was adjusted up by \$1,000; and
    - Comparable three had 5 acres and was not adjusted.
  - d. Comparable one and three are manufactured homes like the subject; however, comparable two is a traditional site built home and was adjusted down by \$10,000.
  - e. The subject has a living area of 2,240 square feet and the appraiser computed a \$57 price per square foot. The comparables' price per square foot ranged from \$59 to \$80; however, the appraiser used approximately \$10 per square foot to adjust the comparables:
    - Comparable one had 640 feet less living area and was adjusted up by \$6,400;
    - Comparable two had 330 feet less living area and was adjusted up by \$3,300; and
    - Comparable three had 192 feet less living area, and was adjusted up by \$1,900.
  - f. The appraiser's adjustment for age does not appear reasonable or consistent, and is not adequately explained.
    - Comparable one is 6 years older and was adjusted up by \$6,000.
    - Comparable two is one year older and was adjusted up by \$1,000.
    - Comparable three is 9 years older than the subject, and it was only adjusted up by \$10,000.
  - g. The appraiser made upward adjustments of \$1,000 to all the comparables for condition without adequate explanations.
  - h. The subject property did not have a garage or carport. The appraiser's adjustments for this were not adequately explained and do not appear consistent:
    - Comparables one and two had a 2-car garage/carport and was adjusted down by \$1,000 and \$2,000, respectively.
    - Comparable three had a 3-car garage/carport and was adjusted down by \$4,500.
  - i. The final values of the comparables ranged from \$121,900 to \$144,300. The values of the comparables should be closer to the value established by the subject.
3. The lender did not adequately evaluate the borrower's credit. The borrower has a poor credit history with major unexplained derogatory credit accounts, including delinquent federal debts. Specifically, the borrower did not adequately explain the major derogatory credit that included 29 accounts, totaling \$22,043 that were placed for collection or written off. In addition, there were 41 payments past due totaling \$5,099, and five accounts showing defaulted federal student loans. The borrower should not be eligible until the federal student loans are brought current, paid, or otherwise satisfied. A satisfactory repayment plan should have been made between the borrower and the federal agency, and then verified in writing.



4. The borrower did not appear to have the necessary funds to close. The borrower did not have any cash reserves. Also, the borrower did not appear able to save the amount of money indicated on the budget plan. The lender did not report any assets, or savings or checking accounts. The lender used a budget plan to show that the borrower could save \$2,105 every month; however, any cash savings were not verified. In addition, the budget plan was not realistic because the plan only included rent, utilities, food, gas, and telephone. It did not include many ordinary expenses such as car insurance or the \$87 in loan or credit card payments that were on the Mortgage Credit Analysis Worksheet and the Loan Application.

**FHA Case Number:** 495-6505803  
**Lender Number:** 3021785  
**Loan Amount:** \$128,483  
**Contract Sales Price:** \$84,000  
**Endorsement Date:** July 18, 2003  
**Current Loan Status:** Repayment December 1, 2004

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$83,993.31 and the sales price shown on the HUD-1 Settlement Statement was \$84,000. If the lender staff had reviewed the closing, they would have found the seller added \$11,986 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$4,718 in closing costs, \$1,063 for the title policy, \$1,250 for FHA non-allowables, \$4,463 for the gift and fee used as the downpayment, and an unidentified price increase of \$512.
2. The seller's contribution for downpayment assistance was used to fund the closing. The seller's proceeds from the sale were reduced by the downpayment assistance contribution to a nonprofit as shown by the settlement statement. The closing was held March 28, 2003 and funded on March 31, 2003. The closer disbursed the funds on April 1, 2003. The "gift" funds from the nonprofit were not received until April 4, 2003. The "gift" and fee were returned to the nonprofit on April 8, 2003.
3. The lender did not adequately review the appraisal. According to the local appraisal district, the appraiser overvalued the property by \$53,320 (\$105,000 mortgagee appraisal less \$51,680 local appraisal district). Several of these discrepancies indicate a lower value:
  - a. Comparable one is 5 miles away, and comparables two and three are 10 miles from the subject.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$84,000 and the 6 percent limitation is \$5,040. The contract to purchase the home included \$11,474 in seller contributions or concessions.

- c. The subject had 1.25 acres of land that cost \$23,393.31. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had 10 acres and was adjusted down by \$5000;
    - Comparable three had 5 acres and was adjusted down by \$5000; and
    - Comparable two had 1.8 acres and was not adjusted.
  - d. Comparable two and three were manufactured homes like the subject; however, comparable one is a traditional site built home and was not adjusted.
  - e. The subject has a living area of 1,792 square feet and the appraiser computed a \$44 price per square foot. The comparables' price per square foot range from \$49 to \$68, however, the appraiser used approximately \$10 per square foot to adjust the comparables:
    - Comparable one had 192 feet less living area and was adjusted up by \$1,900;
    - Comparable two had 336 feet more living area and was adjusted down by \$3,400; and
    - Comparable three had 256 feet less living area and was adjusted down by \$2,600.
  - f. The appraiser's adjustment for age does not appear reasonable or consistent, and was not adequately explained. Comparable one is six years older and was adjusted up by \$6,000. Comparable two is three years older and was adjusted up by \$2,000. Comparable three is nine years older than the subject and was only adjusted up by \$10,000.
  - g. All the comparables were adjusted up by \$1,000 for condition without adequate explanations.
  - h. The subject property did not have a garage or carport and the appraiser's adjustments for this were not adequately explained, and do not appear consistent:
    - Comparable one had a 2-car garage\carport and was adjusted down by \$1,000; and,
    - Comparable three had a 3-car garage\carport and was adjusted down by \$4,500.
  - i. The subject's appraised value was \$105,000. The final values of the comparables range from \$103,100 to \$118,900. The values of the comparables should be closer to the subject's value.
3. The lender did not adequately evaluate the borrower's credit. The borrower has a poor credit history and the lender did not consider all the current debts nor did they obtain explanations for the borrower' numerous collection accounts. The lender should have included an additional \$62 per month in current debts listed on the Credit Report. The current debt payments should have been \$653 instead of \$591. The additional debt payment would cause the debt to income ratio to increase from 46 percent to 48 percent. This exceeds HUD guidelines of 41 percent. The borrower had 16 accounts with a \$7,455 balance that were recently placed for collection or were charged off.

**FHA Case Number:** 495-6037036  
**Lender Number:** 32646  
**Loan Amount:** \$128,483  
**Contract Sales Price:** \$130,500  
**Endorsement Date:** February 3, 2003  
**Current Loan Status:** Modification December 1, 2003  
**Claims Paid:** \$500 Modification

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$21,418 in unsupported costs to the sales price, including costs the seller agreed to pay on the buyer's behalf. The seller added \$7,830 in closing costs, \$1,400 for the title policy, \$1,100 for FHA non-allowables, \$5,931 for the gift and fee used as the downpayment, a \$1,000 gift certificate, and an unidentified price increase of \$4,157.
2. The lender did not adequately review the appraisal that valued the property at \$132,000, whereas the local appraisal district valued the property at \$100,670. The appraiser overvalued the property by \$31,330. Several discrepancies indicate a lower value:
  - a. Comparables one and three are 5 miles away, and comparable two is 8 miles from the subject property.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$130,500. The 6 percent limitation is \$7,830. The contract to purchase the home included \$16,261 in seller contributions or concessions.
  - c. The subject property has 1.04 acres that cost \$27,400. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had 3.3 acres and was adjusted down by \$2,000;
    - Comparable two had 21 acres and was adjusted down by \$18,000; and
    - Comparable three had .267 acres and was adjusted up by \$2,000.
  - d. The subject has a living area of 2,368 square feet and the appraiser did not compute the price per square foot. The comparables price per square foot range from \$59 to \$71; however, the appraiser used approximately \$20 per square foot to adjust the comparables:
    - Comparable one had 240 feet less living area and was adjusted up by \$4,800;
    - Comparable two had 588 feet less living area and was adjusted up by \$11,800; and,
    - Comparable three had 448 feet less living area and was adjusted up by \$9,000.
  - e. The appraiser's adjustment for age does not appear reasonable or consistent and is not adequately explained. Comparable one is eight years older than the subject property and was adjusted up by \$1,200, and comparable two is five years older and was only adjusted up by \$600.
  - f. The appraiser's adjustment for condition does not appear reasonable or consistent, and is not adequately explained. Comparable one was adjusted up by \$6,000 for good condition.

- g. The subject property's appraised value was \$132,000. The final values of the comparables ranged from \$121,500 to \$134,000. The values of the comparables should be closer to the subject property's value.

**FHA Case Number:** 495-6114990  
**Lender Number:** 90203023  
**Loan Amount:** \$125,352  
**Contract Sales Price:** \$130,000  
**Endorsement Date:** August 7, 2002  
**Current Loan Status:** Foreclosed April 1, 2005  
**Claims Paid:** \$132,997

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$15,434 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$7,800 in closing costs, \$1,375 for the title policy, \$1,100 for FHA non-allowables, \$7,015 for the gift and fee used as the downpayment, a \$1,000 referral fee, and an unidentified credit of \$2,856.
2. The lender did not adequately review the appraisal that valued the property at \$137,000, whereas local appraisal district valued the property at \$108,637. The appraiser overvalued the property by \$28,393. Several discrepancies indicate a lower value:
  - a. Comparable three is seven miles from the subject property.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$130,000. The 6 percent limitation is \$7,800. The contract to purchase the home included \$17,290 in seller contributions or concessions.
  - c. The subject property has a living area of 1,536 square feet and the price per square foot was not computed. The appraiser's adjustments do not appear reasonable. The comparables price per square foot range from \$86 to \$95; however, the appraiser used approximately \$20 per square foot to adjust the comparables:
    - Comparable two had 48 feet less living area and was adjusted up by \$960; and
    - Comparable three had 192 feet less living area and was adjusted up by \$3,840.
  - d. The appraiser made upward adjustments of \$3,000 to all comparables for not having an FHA foundation, but did not explain the adjustments.
  - e. The appraiser made upward adjustments of \$2,500 to all the comparables for the porch and patio, but did not explain these adjustments.

**FHA Case Number:** 495-6285316  
**Lender Number:** 31345  
**Loan Amount:** \$132,094  
**Contract Sales Price:** \$136,992  
**Endorsement Date:** January 10, 2003  
**Current Loan Status:** Reinstatement March 1, 2005

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$17,645 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$7,600 in closing costs, \$1,600 for the title policy, \$1,100 for FHA non-allowables, and \$7,345 for the gift and fee used for downpayment assistance.
2. The lender did not adequately review the appraisal that valued the property at \$137,000, whereas the local appraisal district valued the property at \$90,865. The appraiser overvalued the subject property by \$46,135. Several discrepancies indicate a lower value:
  - a. Comparable three was four miles from the subject property.
  - b. The sales date for comparable three was over nine months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$136,992 and the 6 percent limitation is \$8,220. The contract to purchase the home included \$17,645 in seller contributions or concessions.
  - d. The subject property has 1.86 acres of land that cost \$48,500. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had 2.28 acres and was not adjusted;
    - Comparable two had 3.568 acres and was adjusted down by \$3,000; and
    - Comparable three had 1.205 acres and was not adjusted.
  - e. The subject property has a living area of 1,944 square feet and the appraiser did not compute the price per square foot. The comparables price per square foot range from \$66 to \$74; however, the appraiser used approximately \$20 per square foot to adjust the comparables which does not appear reasonable:
    - Comparable one had 104 feet more living area and was adjusted down by \$2,100;
    - Comparable two had 152 feet less living area and was adjusted up by \$3,000; and,
    - Comparable three had 264 feet less living area and was adjusted up by \$5,300.
  - f. The subject's appraised value was \$137,000 however; the final values of the comparables range from \$130,300 to \$140,000. The values of the comparables should be closer.

**FHA Case Number:** 495-6295517  
**Lender Number:** 32121  
**Loan Amount:** \$79,748  
**Contract Sales Price:** \$81,000  
**Endorsement Date:** March 21, 2003  
**Current Loan Status:** Repayment July 1, 2005  
**Claims Paid:** \$500 Modification

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. We found that the seller added \$8,049 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$4,860 in closing costs, \$1,035 for the title policy, \$1,100 for FHA non-allowables, and \$1,054 for the gift and fee used as the downpayment.
2. The lender did not adequately review the appraisal. Several discrepancies indicate a lower value:
  - a. Comparables one, two, and three are over 5 miles, 15 miles, and 14 miles from the subject property, respectively.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet \$81,000 and the 6 percent limitation is \$4,860. The contract to purchase the home included \$8,049 in seller contributions or concessions.
  - c. The subject has five acres with an estimated value of \$48,000. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had one acre and was adjusted up by \$8,000;
    - Comparable two had .80 acres and was adjusted up by \$8,000; and
    - Comparable three had two acres and was adjusted up by \$6,000.
  - d. The appraiser did not adjust the comparables for age, nor was any explanation provided. Comparable one is eight years older, comparable two is four years older, and comparable three is five years older than the subject.
  - e. Comparable two was adjusted down by \$4,500 for a 2-car garage without adequate explanation.
  - f. The subject has a living area of 1,547 square feet with a price of \$52 per square foot. The comparables' price per square foot ranged from \$38 to \$54, however, the appraiser used approximately \$15 per square foot to adjust the comparables without an adequate explanation:
    - Comparable one had 273 feet more living area and was adjusted down by \$4,100;
    - Comparable two had 133 feet more living area and was adjusted down by \$2,000; and
    - Comparable three had 453 feet more living area and was adjusted down by \$6,800.
  - g. The subject's appraised value was \$81,000. The final values of the comparables range from \$75,220 to \$86,200. The values should be closer.

3. The lender did not calculate the current debt obligations and did not establish the borrower's credit worthiness. The lender did not consider all the current debts (including the non-purchasing spouse) and did not explain the derogatory credit items for both the borrower and non-purchasing spouse. The lender should have included an additional \$299 in current debts that were listed on the credit report. The current debt payments should be \$483 instead of \$185. The total debt payments of \$483 will affect the borrower's ability to make the mortgage payment after the loan closing and increase the debt to income ratio from 41 percent to 55 percent. The borrower and the non-purchasing spouse had nine recent credit accounts with a balance of \$5,532 that were placed for collection or charged off.

**FHA Case Number:** 495-6334452  
**Lender Number:** 34468  
**Loan Amount:** \$122,035  
**Contract Sales Price:** \$123,000  
**Endorsement Date:** April 30, 2003  
**Current Loan Status:** Delinquent April 1, 2004

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contracts. The sales price on the contracts (land and manufactured home) was \$122,540, whereas the sales price shown on the HUD-1 Settlement Statement was \$123,000. Closing documents also showed that the seller added \$13,223 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,763 in closing costs, \$1,100 for the title policy, \$1,285 for FHA non-allowables, \$3,715 for the gift and fee used as the downpayment, and an unidentified sales price increase of \$460.
2. The lender did not adequately review the appraisal that valued the property at \$123,000, whereas the local appraisal district valued the property at \$90,042. The appraiser overvalued the subject property by \$32,958. Several discrepancies indicate a lower value:
  - a. The closest comparable is over five miles from the subject. Comparable two is over 21 miles from the subject, and comparable one is over 18 miles from the subject.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$123,000 and the 6 percent limitation is \$7,380. The purchase memo for the home included \$12,863 in seller contributions or concessions.
  - c. The subject has 1.27 acres that costs \$17,800. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had .5 acres and was adjusted up by \$5,000; and
    - Comparable three had .5 acres and was not adjusted.
  - d. Comparable three is a site built home and not a manufactured home like the subject. It was adjusted down by \$13,000 without adequate explanation. In addition, the

- appraiser adjusted comparable three down by (1) \$3,000 for quality of construction, (2) \$3,000 for a covered patio, and (3) \$5,000 for a two-car garage.
- e. The appraiser adjusted the comparables \$1,000 per year for the age without adequate explanation. Comparable one is 6 years older than the subject property and was adjusted up \$6,000, comparable two is five years older and was adjusted up \$5,000, and comparable three is three years older and was adjusted up \$3,000.
  - f. The subject property has a living area of 2,355 square feet with a price of \$52 per square foot. The comparables price per square foot range from \$59 to \$73, however, the appraiser used approximately \$15 per square foot to adjust the comparables without adequate explanations:
    - Comparable one had 507 feet less living area and was adjusted up by \$7,500;
    - Comparable two had 639 feet less living area and was adjusted up by \$9,500; and
    - Comparable three had 536 feet less living area and was adjusted up by \$8,000.
3. The current monthly debt obligations as reported appear to be supported. However, the lender did not verify the status of four students loans noted on the credit report. The credit report states that the loans were opened on April 2001 and were placed for collection. The borrower stated that the student loans were delinquent but did not say that the loans were deferred, were in repayment, or were paid off. A current federal debt, such as a delinquent Sallie Mae- student loan, would disqualify the borrower. Although the non-purchasing spouse did not have current obligations to include in the borrower's debts, the non-purchasing spouse had a poor credit history and currently had five accounts placed for collection. The borrower would still be liable for these obligations in a community property state such as Texas.

**FHA Case Number:** 495-6394485  
**Lender Number:** 33628  
**Loan Amount:** \$72,877  
**Contract Sales Price:** \$63,896.40  
**Endorsement Date:** July 31, 2003  
**Current Loan Status:** Reinstated April 1, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$62,829. The sales price shown on the HUD-1 Settlement Statement was \$63,896. Closing documents showed that the seller added \$1,067 in unsupported costs to the sales price.
2. The lender did not adequately review the appraisal that valued the property at \$95,000, whereas local appraisal district valued the property at \$64,125. The appraiser overvalued the property by \$30,875. Several discrepancies indicate a lower value:
  - a. All the comparables are five to eleven miles from the subject;
  - b. The subject has 1.71 acres of land that the appraiser estimated the value to be \$25,500. The appraiser's adjustments do not appear reasonable.



- Comparable one had approximately five acres and was adjusted down \$5,000;
  - Comparables two and four had .5 acres and were adjusted up \$2,000; and
  - Comparable three had one acre and was adjusted up by \$1,000.
- c. The appraiser adjusted the comparables for the condition without adequate explanations. Comparables one, two, three, and five were all adjusted up by \$5,000 for inferior condition.
  - d. The appraiser adjusted the comparables for two-car garages or carports without adequate explanations. Comparables two, three, and five were adjusted down by \$7,500, and comparable one was adjusted down by \$5,000.
  - e. The appraiser did not adjust any of the comparables' age and did not provide any explanations for the lack of adjustments. Comparables one and five were 5 years older than the subject property, while comparables three and six were 6 years and 17 years older, respectively.
  - f. The appraiser, without adequate explanations, adjusted comparable four up by \$3,000 for not having a fence.
  - g. The subject property has a living area of 1,203 square feet and the appraiser did not determine the price per square foot. The comparables price per square foot ranged from \$60 to \$84; however, the appraiser's adjustments ranged from \$10 to \$25 per square foot and do not appear reasonable:
    - Comparable one had 925 more living area and was adjusted down by \$9,250;
    - Comparable two had 645 feet more living area and was adjusted down by \$6,450;
    - Comparables three and five had 83 feet less living area and were not adjusted; and
    - Comparable four had 108 feet more living area and was adjusted down by \$2,720.
  - h. The subject's appraised value was \$95,000. The final values of the comparables ranged from \$85,500 to \$128,250. The values should be closer.

<b>FHA Case Number:</b>	<b>495-6400545</b>
Lender Number:	3041553
Loan Amount:	\$112,610
Contract Sales Price:	\$113,500
Endorsement Date:	August 29, 2003
Current Loan Status:	Foreclosed May 1, 2004
Claims Paid:	\$117,005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts was \$113,500, whereas the sales price shown on the HUD-1 Settlement Statement was \$117,500. Closing documents show that the seller added \$17,400 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,725 in closing costs, \$1,250 for the title policy, \$1,250 for FHA non-allowables, \$4,175 for the gift and fee used as the downpayment, and an unidentified price increase of \$4,000.

2. The lender did not adequately review the appraisal that valued the property at \$125,000, whereas the local appraisal district valued the property at \$79,025. The appraiser overvalued the property by \$45,975. Several discrepancies indicate a lower value:
  - a. Comparables one and two are over eight miles from the subject property.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$113,500 and the 6 percent limitation is \$6,810. The purchase memo included \$13,400 in seller contributions or concessions.
  - c. The subject property has 1.65 acres that cost \$38,850 and the appraiser's adjustments do not appear reasonable:
    - Comparable three had 1.47 acres and was not adjusted;
    - Comparable one had 3.30 acres and was only adjusted down by \$3,000; and
    - Comparable two had six acres and was only adjusted down by \$5,000.
  - d. Comparables one and two were adjusted up by \$3,000 based on condition without adequate explanation.
  - e. Comparables one and two were five years older than the subject and were adjusted up by \$600 without adequate explanation.
  - f. Comparable two was adjusted down by \$3,000 for a deck.
  - g. The subject has a living area of 1,344 square feet, and the appraiser did not determine the price per square foot. The adjustments were not consistent or reasonable. The comparables' price per square foot range from \$76 to \$94; however, the appraiser used approximately \$20 per square foot to adjust comparable two and \$58 per square foot to adjust comparable three.
    - Comparable one had 51 square feet more living area. The value was not adjusted.
    - Comparable two had 112 square feet more living area. The value was adjusted down by \$2,200.
    - Comparable three had 160 feet more living area and was adjusted down by \$9,200.
  - h. The subject's appraised value was \$125,000. The final values of the comparables range from \$121,400 to \$132,718. The values should be closer.
3. The lender did not adequately verify or support the borrower's cash assets of \$1,938, as reported on the Mortgage Credit Analysis Worksheet and the loan application. There are no bank statements in the lender or HUD file to support this amount. There is a verification of deposit dated May 21, 2003 that confirmed the balance; however, the settlement date on the HUD-1 was one day before the verification of deposit was signed. In addition, two amounts or deposits needed to be verified with at least bank statements but were not. The amounts were represented as a \$1,000 gift from the borrower's mother and \$1,000 in cash saved at home, according to the budget letter.

**FHA Case Number:** 495-6419246  
**Lender Number:** 3030353  
**Loan Amount:** \$115,090  
**Contract Sales Price:** \$116,000  
**Endorsement Date:** July 7, 2003  
**Current Loan Status:** Reinstated October 1, 2004

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$12,672 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$6,700 in closing costs, \$4,375 for downpayment assistance, \$1,250 for FHA non-allowable costs, \$1,100 for the title policy and an unidentified credit of \$1,133.
2. The lender did not adequately review the appraisal that valued the property at \$123,000, whereas the local appraisal district valued the property at \$73,707. The appraiser overvalued the subject property by \$49,293. The following discrepancies indicate a lower value:
  - a. The sales dates for comparables one and two were over six months old.
  - b. The subject has one acre that cost \$42,900. The appraiser's adjustment does not appear reasonable. Comparable three had 5.92 acres of land, and the appraiser made a downward adjustment of \$10,000.
  - c. Comparables two and three were adjusted up by \$3,000 for condition without adequate explanation.
  - d. Comparable two was 18 years older than the subject and was adjusted up by \$1,800. Comparable three is 22 years older than the subject and was adjusted up by \$2,400. The appraiser made both adjustments without adequate explanation.
  - e. Comparable two was adjusted down by \$6,000 for a 2-car garage\carport without an adequate explanation.
  - f. Comparable three was adjusted down by \$3,000 for trees without an adequate explanation.
  - g. The subject property has a living area of 1,488 square feet and the appraiser determined the price per square foot at \$78. The appraiser's adjustments do not appear reasonable. The comparables price per square foot ranged from \$77 to \$92; however, the appraiser used approximately \$20 per square foot to adjust all the comparables:
    - Comparable one had 240 square feet more living area and was adjusted down by \$4,800;
    - Comparable two had 24 square feet more living area and was not adjusted; and
    - Comparable three had 188 square feet less living area and was adjusted up by \$3,800.
  - h. The subject property's appraised value was \$123,000. The final values of the comparables ranged from \$116,200 to \$129,059. The values should be closer to the subject property's value.

- i. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$116,000. The 6 percent limitation is \$6,960. The contract to purchase the home included \$13,425 in seller contributions or concessions.
3. The lender did not adequately evaluate the borrower's credit history or provide adequate explanations for derogatory credit items. The lender did not include all the current debt of the borrower or explain why they did not include all the open accounts from the credit report. The borrower would not have qualified with a 96 percent fixed payment ratio. The borrowers did not adequately explain the major derogatory credit that included seven accounts recently placed for collection or written off with a balance of \$65,866. This amount includes a \$59,092 mortgage included in a bankruptcy that was recently reported by a mortgage company. The bankruptcy was not disclosed or explained by the borrower or lender.

**FHA Case Number:** 495-6425206  
**Lender Number:** 3031708  
**Loan Amount:** \$111,617  
**Contract Sales Price:** \$112,500  
**Endorsement Date:** May 9, 2003  
**Current Loan Status:** Reinstated December 1, 2004  
**Claims Paid:** \$700 Loss Mitigation

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$10,973 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$5,730 for closing costs, \$4,125 for downpayment assistance, \$1,250 for FHA non-allowable costs, \$1,220 for the title policy, and an unidentified credit of \$1,352.

We interviewed the borrower to obtain support that shows the land and home acquisition prices are closer to our audited amount of \$101,527 and not the \$112,500 sales price on the HUD-1 Settlement Statement. The borrowers:

- a. Did not have a copy of the final purchase memo for \$99,000; however, they provided support for the cost of the mobile home, which was \$85,207.
- b. Stated that the seller never provided a breakdown or invoices showing the cost of the house and improvements.
- c. Did not understand why the final costs increased by \$13,793 (\$99,000 less \$85,207). They thought the price increased because of the closing costs they were financing.
- d. Believe the loan of \$111,617 was high because they were getting a loan with no downpayment and they were financing all the closing costs. They believed the loan would be less because they were getting \$3,472 in downpayment assistance that the seller said was available.

- e. Stated that the seller took the loan application and verified their income, bank statements, W-2 forms, and employment records.
  - f. Never met with the lender, and stated that the seller said they would pay nothing down at closing.
2. The lender did not adequately review the appraisal that valued the property at \$115,000, whereas the local appraisal district valued the property at \$89,584. The appraiser overvalued the subject property by \$25,416. Several discrepancies indicate a lower value:
- a. The subject has 1.39 acres that cost \$13,500. The appraiser's adjustments do not appear reasonable. Comparable one had .33 acres and the appraiser only adjusted it up \$2,000. Comparable two and three each had approximately .66 acres and were adjusted up by \$1,000.
  - b. Comparable two was adjusted down up by \$3,000 for the view without adequate explanation.
  - c. The appraiser's adjustment for age does not appear reasonable and is not adequately explained. Comparable one is 12 years older than the subject property and was adjusted up by \$1,200. Comparable two is six years older and was adjusted up by \$800.
  - d. The appraiser adjusted comparable one down by \$4,500 for a 2-car garage without an adequate explanation.
  - e. The subject property has a living area of 1,749 square feet and the appraiser did not determine the price per square foot. The appraiser's adjustments for living area do not appear reasonable. The comparables' price per square foot range from \$63 to \$78, however, the appraiser used approximately \$25 per square foot to adjust all the comparables:
    - Comparable one 43 square feet more living area and was adjusted down by \$1,100.
    - Comparable two had 203 square feet less living area and was adjusted up by \$5,100.
    - Comparable three had 419 square feet less living area and was adjusted up by \$10,500.
  - f. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$122,500 and the 6 percent limitation is \$6,750. The purchase contract included \$12,325 in seller contributions or concessions.

**FHA Case Number:** 495-6460736  
**Lender Number:** 39393  
**Loan Amount:** \$133,941  
**Contract Sales Price:** \$135,000  
**Endorsement Date:** July 2, 2003  
**Current Loan Status:** Foreclosed February 1, 2004  
**Claims Paid:** \$141,515

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contracts. The sales price on the contracts (land and manufactured home) was \$134,000, whereas the sales price shown on the HUD-1 Settlement Statement was \$135,000. Closing documentation showed that the seller added \$38,869 in unsupported costs to the sales price. The seller added at least \$13,704 to the sale price to pay off the trade-in and an unidentified amount of \$25,165.
2. The lender did not adequately review the appraisal that valued the property at \$138,000, whereas the local appraisal district valued the property at \$91,079. The appraiser overvalued the property by \$46,921. Several discrepancies indicate a lower value:
  - a. All the comparables are two miles away from the subject property.
  - b. The subject has 1.39 acres that cost \$18,000 and the appraiser's adjustments for land do not appear reasonable:
    - Comparable two had 1.738 acres and was not adjusted.
    - Comparable one had 2.29 acres and was only adjusted down by \$2,000.
    - Comparable three had five acres and was only adjusted down by \$4,000.
  - c. The appraiser adjusted comparable three up by \$6,000 because of condition without adequate explanation.
  - d. The appraiser adjusted comparable three up by \$6,000 because of the quality of construction without adequate explanation.
  - e. The appraiser adjusted comparable three down by \$4,000 for a 2-car detached garage without adequate explanation.
  - f. The subject has a living area of 2,077 square feet. The appraiser did not determine the price per square foot nor make reasonable adjustments to the comparables. The comparables' price per square foot ranged from \$59 to \$69, however, the appraiser used \$20 per square foot to adjust all the comparables:
    - Comparable two had 51 square feet more living area and was adjusted down by \$1,000.
    - Comparable three had 101 square feet more in living area and was adjusted down by \$2,000.
  - g. The appraiser adjusted comparable three down by \$7,500 for having fence and shop without an adequate explanation.
  - h. The subject's appraised value was \$138,000; however, the final values of the comparables ranged from \$129,000 to \$143,288. The values should be closer.

- i. The appraisal does not include a photo of comparable one. The homes in the photos of comparables two and three appear to be site built (traditional) homes and not manufactured homes as reported.

**FHA Case Number:** 495-6462585  
**Lender Number:** 3021221  
**Loan Amount:** \$121,152  
**Contract Sales Price:** \$122,110  
**Endorsement Date:** May 21, 2003  
**Current Loan Status:** Foreclosed May 1, 2004  
**Claims Paid:** \$126,317

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$12,672 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$6,022 for closing costs, \$1,270 for the title policy, \$1,250 for FHA non-allowables, \$3,780 for the gift and fee used as the downpayment, and \$350 for a rear deck.
2. The lender did not adequately review the appraisal that valued the property at \$155,000, whereas the local appraisal district valued the property at \$108,472. The appraiser overvalued the subject property by \$46,528. Several discrepancies indicate a lower value:
  - a. Comparable three is over eight miles away from the subject property.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$122,110 and the 6 percent limitation is \$7,327. The contract to purchase the home included \$12,672 in seller contributions or concessions.
  - c. The subject has five acres that cost \$52,500. The adjustments of the comparables for the land do not appear reasonable. Comparables one and two each had 1.85 acres and were only adjusted up by \$4,700. Comparable three had 19.8 acres but the appraiser only adjusted it down by \$14,800.
  - d. The appraiser made an upward adjustment of comparable three by \$5,000 based on condition without an adequate explanation.
  - e. The appraiser made an upward adjustment of comparable three by \$6,000 for being six years older than the subject without an adequate explanation.
  - f. The subject property has a living area of 2,046 square feet and the appraiser did not determine the price per square foot. The adjustments to the living area of the comparables do not appear reasonable. The comparables' price per square foot range from \$72 to \$80, however, the appraiser used \$35 per square foot to adjust all the comparables;
    - Comparable one had 82 square feet more living area and was adjusted down by \$2,870.

- Comparable two had 102 square feet less living area and was adjusted up by \$3,570.
  - Comparable three had 46 square feet less living area. The appraiser adjusted it up by \$1,610.
- g. Comparable three was adjusted down \$7,500 for having fence and shop without adequate explanation.

**FHA Case Number:** 495-6465024  
**Lender Number:** 3032125  
**Loan Amount:** \$101,200  
**Contract Sales Price:** \$102,000  
**Endorsement Date:** July 8, 2003  
**Current Loan Status:** Reinstated June 1, 2004

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$11,635 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$6,096 in closing costs, \$1,250 for unallowable closing costs, \$1,205 for the title policy, \$4068 for downpayment assistance, and an unidentified credit of \$983. We interviewed the borrower to obtain support for the cost of the home and land. The borrower:
  - a. Did not have a copy of the final purchase memo of the manufactured home for \$86,000; however, she provided a copy of a signed purchase memo for \$82,572.
  - b. Stated that the seller never broke down or explained the actual cost of the home and land. The seller told her the house and land cost \$86,000.
  - c. Believed the loan amount of \$101,200 was high because it included insurance and other costs.
  - d. Stated the house was not new. The seller told her she did not qualify for a new house and had to purchase the house as-is. The seller only allowed one modification to the master bathroom.
  - e. Stated that the seller took the loan application and verified their income, bank statements, W-2 forms, and employment records. She provided a letter from the seller to confirm that the seller processed the loan application and verified the credit, income, and employment items.
  - f. Never met with the lender and stated that the seller said the borrowers would pay nothing down at closing.
2. The lender did not adequately review the appraisal that valued the property at \$102,000, whereas the local appraisal district valued the property at \$97,920. The appraiser overvalued the subject property by \$4,080. Several discrepancies indicate a lower value:
  - a. The closest comparable is three miles from the subject property. Comparable one is eight miles and comparable two is five miles from the subject;
  - b. The sales date for comparable one was over eight months old,



- c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$102,000 and the 6 percent limitation is \$6,120. The contract to purchase the home included \$8,907 in seller contributions or concessions.
  - d. The subject has .09 acres that cost \$16,000. The appraiser's adjustments do not appear reasonable and were not adequately explained:
    - Comparable one had 1.86 acres and was adjusted down by \$10,000;
    - Comparable two had .23 acres and was not adjusted; and
    - Comparable three had .14 acres and was not adjusted.
  - e. The subject has a living area of 1,203 square feet. The appraiser did not compute the price per square foot. The appraiser's adjustments do not appear reasonable. The comparables price per square foot range from \$81 to \$92; however, the appraiser used approximately \$27 per square foot to adjust the comparables:
    - Comparable one had 205 square feet more in living area and was adjusted down by \$5,700;
    - Comparable two had 51 square feet less in living area and was adjusted up by \$1,400; and
    - Comparable three had 83 square feet less in living area and was adjusted up by \$2,300.
  - f. The appraiser adjusted the value of comparable two up by \$2,000 for quality of construction, and up by \$3,000 for average condition without adequate explanations.
  - g. The value of comparable three was adjusted up by \$400 because it is four years older than the subject, and adjusted up by \$1,000 for very good condition without adequate explanations.
  - h. Comparable one was adjusted down by \$3,000 for a 2-car carport and \$3,000 down for a large deck without adequate explanations.
3. The borrowers did not make the required minimum cash investment. The borrowers did not have any cash assets reported on the Mortgage Credit Analysis Worksheet and the loan application. The borrowers did not have assets to close. The files only have a budget plan that shows the borrowers had \$1,800 cash on hand. The lender did not verify the amount. In addition, the borrowers paid nothing at closing and did not provide any earnest money.

**FHA Case Number:** 495-6482719  
**Lender Number:** 3010236  
**Loan Amount:** \$137,837  
**Contract Sales Price:** \$110,000  
**Endorsement Date:** June 5, 2003  
**Current Loan Status:** Foreclosure Completed May 1, 2004

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$138,031, whereas the sales price

shown on the HUD-1 Settlement Statement was \$140,000. Closing documentation showed that the seller added \$16,200 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$8,394 in closing costs, \$1,393 for the title policy, \$1,250 for FHA non-allowables, \$4,842 for the gift and fee used as the downpayment, and an unidentified price increase \$321.

2. The lender did not adequately review the appraisal that valued the property at \$140,000, whereas the local appraisal district valued the property at \$102,595. The appraiser overvalued the subject property by \$37,405. Several discrepancies indicate a lower value.
  - a. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$140,000 and the 6 percent limitation is \$8,400. The contract to purchase the home included \$15,879 in seller contributions or concessions.
  - b. The subject property has 1.4 acres that cost \$38,850. The adjustment for land does not appear reasonable. Comparable two has five acres and was adjusted down by \$6,000.
  - c. The appraiser adjusted comparables two and three up by \$6,000 based on condition without an adequate explanation.
  - d. The appraiser adjusted comparable three up by \$600 based on the quality of construction and upgrades without an adequate explanation.
  - e. The appraiser's adjustment for age does not appear reasonable. Comparables two and three are five years older than the subject and were only adjusted up by \$900.
  - f. The subject has a living area of 1,798 square feet and the appraiser did not determine the price per square foot. The adjustments for living area do not appear reasonable. The comparables' price per square foot ranged from \$64 to \$87, however, the appraiser used approximately \$26 per square foot to adjust the comparables:
    - Comparable two had 348 feet less living area and was adjusted up by \$8,900.
    - Comparable three had 80 feet less living area and was adjusted up by \$2,100.
  - g. The appraiser adjusted all the comparables up by \$5,000 for a graded drive without an explanation.
  - h. The appraiser adjusted comparable three up by \$3,000 for having only average landscaping without an adequate explanation.
  - i. The subject's appraised value was \$140,000. The final values of the comparables ranged from \$133,995 to \$145,052. The values should be closer to the subject property's value.

**FHA Case Number:** 495-6483454  
**Lender Number:** 3032132  
**Loan Amount:** \$104,176  
**Contract Sales Price:** \$105,000  
**Endorsement Date:** June 25, 2003  
**Current Loan Status:** Reinstated June 1, 2005

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$12,809 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the borrower. The seller added \$6,272 for closing costs, \$4,114 for downpayment assistance, \$1,250 for FHA non-allowable costs, and \$1,173 for the title policy.
2. The lender did not adequately review the appraisal that valued the property at \$115,000, whereas the local appraisal district valued the property at \$88,747. The appraiser overvalued the subject property by \$26,253. Several discrepancies indicate a lower value:
  - a. All the comparables sales dates are seven to nine months old.
  - b. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$105,000. The 6 percent limitation is \$6,300. The contract to purchase the home included \$12,809 in seller contributions or concessions.
  - c. The subject has a living area of 1,848 square feet with a square foot price of \$57. The appraiser's adjustments for living area do not appear reasonable. The comparables price per square foot ranged from \$60 to \$95; however, the appraiser used \$20 per square to adjust all the comparables:
    - Comparable one had 390 square feet less in living area and was adjusted up by \$7,800.
    - Comparable three had 728 feet less in living area and was up by \$14,560.
    - Comparable two had 72 feet more in living area and was adjusted down by \$1,440.
  - d. The final values of the comparables ranged \$114,381 to \$120,955. The values should be closer to the subject property's value.

**FHA Case Number:** 495-6487853  
**Lender Number:** 3032127  
**Loan Amount:** \$109,137  
**Contract Sales Price:** \$110,000  
**Endorsement Date:** September 8, 2003  
**Current Loan Status:** Reinstated March 1, 2004

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$13,515 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of

the borrower. The seller added \$2,065 for closing costs, \$1,250 for FHA non-allowable costs, \$1,205 for the title policy, and an unidentified amount of \$8,995. The borrower provided documents to support the audited figures for the land and home.

We interviewed the borrower to obtain support for the cost of the home and land. The borrowers:

- a. Did not have a copy of the final purchase memo for the mobile home for \$75,341; however, they provided a copy of signed purchase memo for the mobile home for \$61,985.
  - b. Stated that the seller promised to pay the closing costs; however, at closing they had problems and the contracts and closing documents were changed.
  - c. Stated they overheard the closing agent speaking with the seller or the lender and heard the closing agent say that the seller would not be paying closing costs as agreed.
  - d. Understood that the price of the home increased by \$13,356 because the seller did not want to pay the closing costs as agreed. This was their first home and thought that that these things just happen. The borrowers had put \$8,000 down in earnest money and just wanted to finish the deal.
  - e. Stated that the seller took the loan application and verified their income, bank statements, W2 forms, and employment records.
  - f. Never met with the lender, and stated the seller said they would pay nothing down at closing.
2. The lender did not adequately review the appraisal that valued the property at \$135,000, whereas the local appraisal district valued the property at \$96,035. The appraiser overvalued the subject property by \$38,965. Several discrepancies indicate a lower value:
- a. The closest comparables are two miles from the subject property, and comparable one is ten miles away.
  - b. The sales dates of comparables two and three were over seven months old.
  - c. The appraiser's adjustment for age does not appear reasonable. Comparable three was 13 years older than the subject and was adjusted up \$1,400.
  - d. Comparable three was adjusted up by \$6,000 because of condition, and \$6000 based on quality of construction without adequate explanations.
  - e. Comparable three was adjusted down by \$4,000 for a carport without an explanation.
  - f. The subject property had 1.08 acres with a cost of \$34,500 and the appraiser's adjustment for land does not appear reasonable:
    - Comparable three had 3.92 acres more and adjusted down by \$5,000.
    - Comparable two had 1.12 acres more and adjusted down by \$3,000.
  - g. The final values of the comparables range from \$130,400 to \$140,122. The values should be closer to the subject property's value.
  - h. The appraisal does not include a photo of comparable two.

**FHA Case Number:** 495-6489197  
**Lender Number:** 3023372  
**Loan Amount:** \$113,223  
**Contract Sales Price:** \$115,000  
**Endorsement Date:** September 25, 2003  
**Current Loan Status:** Reinstated December 1, 2004

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$114,854, whereas the sales price shown on the HUD-1 Settlement Statement was \$115,000. Closing documentation showed that the seller added \$14,711 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,446 in closing costs, \$5,515 in downpayment assistance, \$1,250 in non-allowables, and \$1,500 for the title policy.
2. The lender did not adequately review the appraisal that valued the property at \$115,000, whereas the local appraisal district valued the property at \$92,275. The appraiser overvalued the property by \$22,725. Several discrepancies indicate a lower value:
  - a. Comparable one is over five miles away,
  - b. The sales dates of comparable one and three are over ten months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$115,000 and the 6 percent limitation is \$6,900. The contract to purchase the home included \$14,711 in seller contributions or concessions.
  - d. The appraiser adjusted comparable one up by \$5,000 for being five years older than the subject without an adequate explanation.
  - e. The subject has a living area of 1,782 square feet and the appraiser computed a \$63 price per square foot. The appraiser's adjustments do not appear reasonable. The comparables price per square foot range from \$54 to \$78; however, the appraiser used approximately \$25 per square foot to adjust the comparables:
    - Comparable one had 102 square feet less in living area and was adjusted up by \$2550,
    - Comparable three had 324 square feet less in living area as was adjusted up \$8,100, and
    - Comparable two had 66 square feet more in living area as was adjusted down by \$1,650.
  - f. The appraiser adjusted comparable one down by \$4,000 for two detached garage/carports without an explanation.
  - g. The final values of the comparables ranged from \$99,422 to \$122,451. The values should be closer to the subject property's value.

**FHA Case Number:** 495-8494883  
**Lender Number:** 3020038  
**Loan Amount:** \$104,165  
**Contract Sales Price:** \$105,800  
**Endorsement Date:** August 15, 2003  
**Current Loan Status:** Default - Modification June 1, 2005  
**Claims Paid:** \$950 for Special Forbearance and Modification

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$105,641, whereas the sales price shown on the HUD-1 Settlement Statement was \$105,800. Closing documentation showed that the seller added unsupported costs of \$4,876 to the sales price.
2. The lender did not adequately review the appraisal that valued the property at \$116,000, whereas the local appraisal district valued the property at \$51,386. The appraiser overvalued the subject property by \$64,614. Several discrepancies indicate a lower value:
  - a. Comparable two is 3 miles away, and comparable three is five miles away from the subject property.
  - b. The appraiser adjusted comparable three up by \$3,000 because of good condition, and comparable two up \$1,000 for excellent condition. Both adjustments were without adequate explanations.
  - c. The appraiser's adjustments for age do not appear reasonable. Comparable three is five years older than the subject property and was adjusted up \$900. Comparable two is three years older and was adjusted up by \$600.
  - d. The subject property has a living area of 1,749 square feet and the appraiser had not computed a price per square foot. The appraiser's adjustments for living area do not appear reasonable. The comparables' price per square foot ranged from \$59 to \$83; however, the appraiser used approximately \$20 per square foot to adjust the comparables:
    - Comparable one had 235 square feet more living area and it was adjusted down by \$4,700.
    - Comparable three had 211 square feet more living area. It was adjusted down by \$4,200.
    - Comparable two had 438 square feet more in living area as was adjusted up \$8,800.
  - e. The appraiser adjusted comparable three down by \$4,000 for a shop/storage building without an adequate explanation.
  - f. The appraiser's adjustments for land do not appear reasonable. The subject property had 1.03 acres that cost \$15,800.
    - Comparable three had 1.08 acres more and adjusted down by \$2,000.
    - Comparable two had 1.97 acres more and adjusted down by \$4,000.
3. The lender understated the borrower's monthly payments by \$250, thus increasing the debt to income ratio from 44 to 53percent. This ratio exceeds HUD's guidelines for loan approval.

**FHA Case Number:** 495-6521654  
**Lender Number:** 3032745  
**Loan Amount:** \$117,476  
**Contract Sales Price:** \$105,874.57  
**Endorsement Date:** June 24, 2003  
**Current Loan Status:** Property Conveyed to Insurer January 1, 2005  
**Claims Paid:** \$120,740

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$75,283, whereas the sales price shown on the HUD-1 Settlement Statement \$105,874. The land price or payoff is not supported by a contract or other documents.
2. The lender did not adequately review the appraisal that valued the property at \$129,000, whereas the local appraisal district valued the property at \$57,860. The appraiser overvalued the subject property by \$71,140. Several discrepancies indicate a lower value:
  - a. The closest comparable is three miles from the subject property and comparables two and three are ten miles away.
  - b. The sales date of comparable three was over ten months old.
  - c. Comparable three was adjusted up by \$6,000 based on the condition, without an adequate explanation.
  - d. The appraiser's adjustment for age does not appear reasonable. Comparable three is five years older than the subject and was adjusted up \$600.
  - e. The subject has a living area of 1,456 square feet. The appraiser did compute the price per square foot. The appraiser's adjustment for living area does not appear reasonable. The comparables price per square foot range from \$71 to \$91; however, the appraiser used approximately \$20 per square foot to adjust the comparables:
    - Comparable one had 336 square feet more living area. It was adjusted down by \$6,700.
    - Comparable three had 112 square feet more living area and was adjusted down by \$2,200.
  - f. The appraiser's adjustment for land does not appear reasonable. The subject property had .46 acres with an estimated value of \$25,000 and:
    - Comparable three had 4.54 acres more and adjusted down by \$6,000.
    - Comparable two had 1.48 acres more and adjusted down by \$3,000.
    - Comparable one had .56 acres more and was adjusted down by \$2,000.
  - g. The final values of the comparables ranged from \$123,258 to \$131,570. The values should be closer to the subject property's value.
  - h. The photo of the front view of the subject property is not the subject property, and the appraisal does not include a photo of comparable two.

**FHA Case Number:** 495-6556052  
**Lender Number:** 3030471  
**Loan Amount:** \$81,362  
**Contract Sales Price:** \$82,640  
**Endorsement Date:** August 21, 2003  
**Current Loan Status:** Foreclosed April 1, 2005  
**Claim Paid:** \$84,778

Deficiencies in loan origination:

1. The lender could not support the sales price on the contracts. The seller added \$10,628 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$6,700 for the title policy, survey, non-allowable costs, and construction costs, and an unidentified cost of \$3,928.
2. The lender did not adequately review the appraisal that valued the property at \$90,000, whereas the local appraisal district valued the property at \$38,880. The appraiser overvalued the subject property by \$51,120. Several discrepancies indicate a lower value:
  - a. The closest comparable is five miles from the subject and comparable three is 25 miles away.
  - b. Sale dates for comparables one and two were over eight months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contribution in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$82,640. The 6 percent limitation is \$4,958. The contract to purchase the home included \$6,700 in seller contributions or concessions.
  - d. The appraiser adjusted down comparable two by \$5,000 for finished rooms below grade, but there was no explanation.
  - e. All the comparables were adjusted up \$3,000 based on the condition, but there was no explanation.
  - f. The appraiser's adjustment for age does not appear reasonable. Comparable two is 19 years older than the subject and was adjusted up \$7,000. Comparables one and three are four years older and were adjusted up by \$1,000.
  - g. The subject's price per square foot is \$68 and the price per square foot for the comparables ranged from \$53 to \$78. The appraiser used approximately \$10 per square foot for adjustments. The adjustments for the living areas do not appear reasonable or consistent:
    - The appraiser adjusted comparable one down by \$8,600 for having 856 square feet more living area,
    - The appraiser adjusted comparable three down by \$1,800 for having 180 square feet more living area, and
    - The appraiser adjusted comparable two up by \$1,000 for having 96 square feet less living area.
  - h. The subject property has .57 acres that cost \$25,500. The adjustments made by the appraiser do not appear reasonable:



- The appraiser adjusted down both comparables one and two, which had approximately 4.43 acres more than the subject did.
  - The appraiser did not adjust comparable three, which has .55 acres more than the subject did.
- i. The final values of the comparables ranged from \$87,000 to \$98,400. The values should be closer to the subject property's value.

**FHA Case Number:** 495-6708780  
**Lender Number:** 3070989  
**Loan Amount:** \$85,271  
**Contract Sales Price:** \$86,610  
**Endorsement Date:** November 3, 2004  
**Current Loan Status:** Reinstated by Mortgagor, May 5, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$85,708, whereas the sales price shown on the HUD-1 Settlement Statement was \$86,610. Closing documentation showed that the seller added \$11,610 in unsupported costs to the sales price, including costs the seller agreed to pay in behalf of the buyer. The seller added \$5,233 in closing costs, \$1,250 for non-allowable closing costs, \$1,200 for the title policy, \$3,774 for downpayment assistance, and an unidentified cost of \$153. The borrower provided documents to support the audited acquisition amount.
2. The lender did not adequately review the appraisal that valued the property at \$90,000, whereas the local appraisal district valued the property at \$58,970. The appraiser overvalued the subject property by \$31,030. Several discrepancies indicate a lower value:
  - a. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of seller contributions in excess of 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$86,610. The 6 percent limitation is \$5,196. The contract to purchase the home included \$11,457 in seller contributions or concessions.
  - b. The closest comparable is two miles from the subject property.
  - c. Comparable three's sales date is over nine months old.
  - d. The photo of comparable one does not include the manufactured home, yet the appraiser made adjustments for the age, condition, and a deck.
  - e. Comparable three was adjusted down \$6,000 on the quality of construction and upgrades, but there was no explanation.
  - f. All the comparables were adjusted up \$3,000 based on the condition, but there was no explanation.
  - g. The appraiser's adjustment for age does not appear reasonable. All the comparables were five years older than the subject and were adjusted up \$600.
  - h. The subject property had 1.834 acres with a cost of \$25,000. The appraiser's adjustments do not appear reasonable:

- Comparable one had .406 acres more than the subject property and was not adjusted,
  - Comparable two had 1.494 acres less and was adjusted up by \$4,000, and
  - Comparable three had 1.956 acres more land, and was adjusted down by \$4,000.
- i. The subject property has a living area of 1,344 square feet. The appraiser did not list the subject's price per square foot. The appraiser's adjustment for living area does not appear reasonable. The comparables price per square feet ranged from \$56 to \$69. The appraiser used approximately \$28 per square foot to adjust down comparable three by \$9,400 for having 336 square feet more living area.
  - j. The final values of the comparables ranged from \$85,180 to \$99,700. The values should be closer to the subject property's value.

**FHA Case Number:** 495-6727274  
**Lender Number:** 3071470  
**Loan Amount:** \$112,868  
**Contract Sales Price:** \$104,424  
**Endorsement Date:** November 12, 2004  
**Current Loan Status:** Default - Repayment

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$101,424, whereas the sales price shown on the HUD-1 Settlement Statement was \$100,419. The sales price of the home is unsupported. Closing documentation showed that the seller added \$6,569 in unsupported costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$5,564 for downpayment assistance, and an unidentified cost of \$1,005.
2. The lender did not adequately review the appraisal that valued the property at \$115,000, whereas the local appraisal district valued the property at \$67,350. The appraiser overvalued the subject property by \$47,650. Several discrepancies indicate a lower value:
  - a. All the comparables are four miles away from the subject property.
  - b. The subject property has 4.69 acres that cost \$30,000. The appraiser's adjustments do not appear reasonable nor were they adequately explained:
    - Comparable one had 2.6 acres and was adjusted up by \$4,180,
    - Comparable two had 3.1 acres and was adjusted up by \$3,180, and
    - Comparable three had 2.86 acres and was adjusted up by \$3,660.
  - c. The subject property has a living area of 1,239 square feet and the price per square foot was not reported. The comparables price per square foot ranged from \$77 to \$81; however, the appraiser used approximately \$15 per square foot to adjust the comparables without adequate explanations. The adjustments do not appear reasonable:
    - Comparables one and three had 161 square feet more in living area and were adjusted down by \$2,415; and

- Comparable two had 273 square feet more in living area and was adjusted down by \$4,095.
- 3 The borrowers did not make the required minimum cash investment. The borrowers did not have any cash assets reported on the Mortgage Credit Analysis Worksheet and the loan application. The borrowers did not have assets to close. The files only have a budget plan indicating the borrowers had \$1,875 cash on hand. This amount was not verified. In addition, the borrowers paid nothing down at closing, did not receive a gift for a downpayment, and did not provide any earnest money.

**FHA Case Number:** 495-6735474  
**Lender Number:** 3080349  
**Loan Amount:** \$99,841  
**Contract Sales Price:** \$94,488  
**Endorsement Date:** March 31, 2004  
**Current Loan Status:** First Legal Action to Commence Foreclosure June 1, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contract was \$59,240 and the sales price shown on the HUD-1 Settlement Statement was \$94,488. The file does contain support for the land sales price. Closing documentation showed that the seller added at least \$40,340 in unsupported costs to the sales price, including costs the seller agreed to pay in behalf of the buyer. The seller added \$5,092 for the gift used for downpayment assistance, and an unidentified cost of \$35,248.
2. The lender did not adequately review the appraisal that valued the property at \$117,000, whereas the local appraisal district valued the property at \$63,140. The appraiser overvalued the subject property by \$53,860. The following discrepancies indicate a lower value.
  - a. The closest comparable is two miles from the subject property.
  - b. The sales dates of all comparables were over seven months old.
  - c. The appraiser made a \$6,000 downward adjustment to the value of comparable one based on quality of construction and \$2,000 based on condition without adequate explanations.
  - d. The appraiser adjusted the condition of comparable two up by \$2,000 without an adequate explanation.
  - e. The appraiser's adjustments for age are not reasonable or explained. Comparable one is five years older than the subject property and was adjusted up \$600. Comparable two is two years older than the subject and was adjusted up \$400.
  - f. The subject property has a living area of 1,344 square feet. The appraiser did not list the subject's price per square foot. The price per square foot of the comparables ranged from \$80 to \$94; however, the appraiser's adjustments ranged from \$24 to \$26 per square foot. The adjustments for the living areas do not appear reasonable or consistent. The appraiser adjusted:

- Comparable one down by \$1,300 for having 51 feet more in living area,
  - Comparable two up by \$2,900 for having 122 feet less in living area, and
  - Comparable three down by \$6,100 for having 233 feet more in living area.
- g. The subject had 1.004 acres of land. The appraiser estimated the land value to be \$48,000; however, some of the appraiser's adjustments do not appear reasonable:
- Comparable two was similar and was not adjusted.
  - Comparable one had 3.30 acres more and was adjusted down by \$4,000.
  - Comparable three had 1.308 acres more and was not adjusted.

**FHA Case Number:** 495-6748318  
**Lender Number:** 3081793  
**Loan Amount:** \$112,601  
**Contract Sales Price:** \$106,426.11  
**Endorsement Date:** December 29, 2003  
**Current Loan Status:** First Legal Action to Commence Foreclosure August 1, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$105,091, whereas the sales price shown on the HUD-1 Settlement Statement was \$106,426. Closing documentation showed that the seller added \$7,313 in unsupported and unallowable costs to the sales price, including costs the seller agreed to pay on behalf of the buyer. The seller added \$5,773 in lender fees that appear to be used for downpayment assistance, \$55 for a gift basket, \$150 in customer reimbursement liabilities, and an unidentified amount of \$1,335.
2. The lender did not adequately review the appraisal that valued the property at \$129,000, whereas the local appraisal district valued the property at \$89,100. The appraiser overvalued the subject property by \$39,900. Several discrepancies indicate a lower value:
  - a. The closest comparable is 3 miles from the subject property.
  - b. Comparable one's sales date is over six months old.
  - c. The subject property has a living area of 1,782 square feet. The appraiser did not list the subject's price per square foot. The appraiser's adjustment for living area does not appear reasonable. The comparables price per square feet ranged from \$68 to \$75; however, the appraiser used \$21 per square foot to adjust down comparable three by \$2,670 for having 178 square feet more in living area.
  - d. Comparables two and three were adjusted up by \$3,500 for FHA foundations without an adequate explanation.
  - e. The subject property had .91 acres that cost \$38,000, however, some of the adjustments made by the appraiser do not appear reasonable:
    - The appraiser adjusted comparable one down by \$2,775 for having 1.12 acres more, and
    - The appraiser adjusted comparable two down by \$1,875 for having .75 acres more.

**FHA Case Number:** 495-6593271  
**Lender Number:** 3043127  
**Loan Amount:** \$115,710  
**Contract Sales Price:** \$120,000  
**Endorsement Date:** September 16, 2003  
**Current Loan Status:** Foreclosed April 1, 2005  
**Claim Paid:** \$118,552

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$119,870, whereas the sales price shown on the HUD-1 Settlement Statement was \$120,000. Closing documentation showed that the seller added \$15,586 in unsupported costs to the sales price, including costs the seller agreed to pay in behalf of the buyer. The seller added \$6,461 in closing costs, \$1,250 for non-allowable closing costs, \$1,600 for the title policy, and \$6,275 for downpayment assistance.
2. The lender did not adequately review the appraisal that valued the property at \$120,000, whereas the local appraisal district valued the property at \$92,061. The appraiser overvalued the subject property by \$27,939. Several discrepancies indicate a lower value:
  - a. Two of the comparables were at least eight miles from the subject.
  - b. The sales date for comparable three is over six months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject by the amount of seller contributions in excess of 6 percent of the purchase price. The total contract price on the Mortgage Credit Analysis Worksheet is \$120,000. The 6 percent limitation is \$7,200. The contract to purchase the home included \$15,586 in seller contributions or concessions.
  - d. Comparable three was adjusted up \$3,000 for not having upgrades, but there was no explanation.
  - e. The appraiser did not adequately explain the adjustments for condition. Comparable one is two years older and was adjusted up \$3,000. Comparables two and three are over 4 years older and were adjusted up \$6,000 for condition.
  - f. The subject has a living area of 2,077 square feet with a price per square foot of \$58. The comparables price per square foot ranged from \$56 to \$58; however, the appraiser used approximately \$20 per square foot to adjust the comparables without adequate explanations. Comparables two and three had 229 more square feet in living area and were each adjusted up by \$4,600.
  - g. The appraiser adjustment for number of rooms does not appear reasonable and explained. All three comparables had one room less than the subject and were adjusted up \$2,000.

**FHA Case Number:** 495-6644061  
**Lender Number:** 3042272  
**Loan Amount:** \$129,228  
**Contract Sales Price:** \$130,250  
**Endorsement Date:** October 6, 2003  
**Current Loan Status:** Foreclosed August 1, 2005

Deficiencies in loan origination:

1. The lender did not insure the loan closed according to the sales contract. The sales price on the contracts (land and manufactured home) was \$130,012, whereas the sales price shown on the HUD-1 Settlement Statement was \$130,250. Closing documentation showed that the seller added \$14,575 in unsupported costs to the sales price, including costs the seller agreed to pay in behalf of the buyer. The seller added \$7,350 in closing costs, \$1,250 for non-allowable closing costs, \$1,350 for the title policy, \$4,335 for downpayment assistance, \$1,000 for a gift card, and an unidentified credit of \$710.
2. The lender did not adequately review the appraisal that valued the property at \$137,000, whereas the local appraisal district valued the property at \$91,478. The appraiser overvalued the property by \$45,522. Several discrepancies indicate a lower value:
  - a. The closest comparable is three miles from the subject property.
  - b. Comparable one's sales date is over six months old.
  - c. The lender and appraiser did not reduce the sales price or value of the subject property by the amount of excess seller contribution over 6 percent of the purchase price of the home. The total contract price on the Mortgage Credit Analysis Worksheet is \$130,250 and the 6 percent limitation is \$7,815. The contract to purchase the home included \$14,285 in seller contributions or concessions.
  - d. The subject property has a living area of 2,052 square feet and the appraiser did not compute the price per square foot. The appraiser's adjustment for living area does not appear reasonable. The comparables price per square foot range from \$67 to \$72; however, the appraiser used approximately \$18 per square foot to adjust the comparables:
    - Comparable one has 92 square feet less living area and adjusted up by \$1,656.
    - Comparables two and three had 232 square feet less living area and were adjusted up by \$4,176.
  - e. Comparables two and three were adjusted up by \$3,500 for FHA foundations without adequate explanations.
  - f. The subject property had 2.42 acres that cost \$18,000. The appraiser's adjustment for land does not appear reasonable. Comparable two has a half-acre more than the subject property and was adjusted down by \$1,350.

## Appendix D

### CRITERIA

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**Minimum Investment**, 24 CFR [*Code of Federal Regulations*] 203.19

**“(a) At the time the mortgage is insured, the mortgagor shall have paid in cash or its equivalent the following minimum amount:**

(1) In all cases (except those involving a veteran meeting the requirements of Sec. 203.18(b) or a disaster victim meeting the requirements of Sec. 203.18(e)), the minimum investment shall be at least 3 percent of the Commissioner’s estimate of the cost of acquisition (excluding the amount of any one-time mortgage insurance premium payable in accordance with Sec. 203.280) or such other larger amount as the Commissioner may determine.”

**Due Diligence**, 24 CFR [*Code of Federal Regulations*] 203.5(c)

**“(c) Underwriter due diligence. A Direct Endorsement mortgagee shall exercise the same level of care, which it would exercise in obtaining and verifying information for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment. Mortgagee procedures that evidence such due diligence shall be incorporated as part of the quality control plan required under Sec. 202.5(h) of this chapter. The Secretary shall publish guidelines for Direct Endorsement underwriting procedures in a handbook, which shall be provided to all mortgagees approved for the Direct Endorsement procedure. Compliance with these guidelines is deemed to be the minimum standard of due diligence in underwriting mortgages.”**

**Mortgage Lender Review**, HUD Handbook 4000.4, REV-1, CHG-2, “Single Family Direct Endorsement Program,” Chapter 2, Paragraph 2-5

“The lender must review all closing statements, certifications on the closing statements, legal instruments and other documents executed at closing. The lender must certify to HUD that the transaction and loan meet statutory and regulatory requirements of the National Housing Act and HUD, and that the lender closed the loan in accordance with the terms and sales price as specified in the sales contract.”

**The Complete Picture**, HUD Handbook 4155.1, “Mortgage Credit Analysis,” REV-5, Chapter 3, Introduction

“The lender is responsible for asking sufficient questions to elicit a complete picture of the borrower’s financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and documented.”

**Construction-Permanent Mortgage Program**, HUD Handbook 4155.1, “Mortgage Credit Analysis,” REV-5, Chapter 2, Paragraph 17

“The loan program combines the features of a construction loan, a short-term interim loan for financing the cost of construction, and a traditional long-term permanent residential mortgage with one closing. The borrower must secure the loan in their name, contract with a builder and provide a copy, must own or be purchasing a lot, and approve each payment before disbursement to the contractor. The lender is responsible for normal processing and underwriting plus obtaining the borrowers’ approval for contractor payments, verifying if the loan was fully drawn and if not applying any remaining funds to the loan balance, obtaining a borrower certification the property is free and clear except for the mortgage, and the final inspection.”

**Maximum Mortgage**, HUD Handbook 4155.1, “Mortgage Credit Analysis,” Chapter 1, Paragraph 1-7A and B

“A. The seller (or other interested third parties such as real estate agents, builders, developers, etc., or a combination of parties) may contribute up to six percent of the property’s sales price toward the buyer’s actual closing costs, prepaid expenses, discount points, and other financing concessions. Contributions exceeding six percent of the sales price or exceeding the actual cost of prepaid expenses, discounts points, and other financing concessions will be treated as inducements to purchase, thereby reducing the amount of the mortgage. Closing costs normally paid by the borrower are considered contributions if paid by the seller. Inducements to purchase are described in paragraph B, below.

“The six percent limitation also includes seller payment for permanent and temporary interest rate buydowns and other payment supplements, payments of mortgage interest for fixed rate mortgages and GPMs [Graduated Payment Mortgages] only (but not principal), mortgage payment protection insurance, and payment of UFMIP [Up Front Mortgage Insurance Premium].

“Fees typically paid by the seller under local or state law, or local custom, such as real estate commissions, charges for pest inspections, fees paid for trustees to release a deed of trust, etc., are not considered contributions. The dollar limit for seller contributions is calculated by using Attachment A on the HUD-92900-PUR/HUD-92900WS. Each dollar exceeding FHA’s [Federal Housing Administration] six percent limit must be subtracted from the property’s sales price before applying the appropriate LTV [Loan to Value] ratio.

“B. Certain expenses (beyond those described above) paid on behalf of the borrower, as well as other inducements to purchase, result in a dollar-for-dollar reduction to the sales price before applying the appropriate LTV [Loan to Value] ratio. These inducements include decorating allowances, repair allowances, moving costs, and other costs as determined by the appropriate HOC [Homeownership Center]. We also require dollar-for-dollar reductions to the sales price for excess rent credit (see 2-10 N), as well as for gift funds not meeting the requirements stated in Chapter 2.

“Personal property items such as cars, boats, riding lawn mowers, furniture, televisions, etc., given by the seller to consummate the sale result in a reduction to the mortgage. The value of the item(s) must be deducted from the sales price and the appraised value of the property (if



not already done so by the appraiser) before applying the LTV [Loan to Value] ratio. However, certain items, depending upon local custom or law, may be considered as part of the real estate transaction with no adjustment to the sales price or appraised value necessary. These items include ranges, refrigerators, dishwashers, washers, dryers, carpeting, window treatments, and other items as determined by the jurisdictional HOC [Homeownership Center]. That office determines if these items affect value and are considered customary. Replacement of existing equipment or other realty items by the seller before closing, such as carpeting or air conditioners, does not require a value adjustment provided no cash allowance is given to the borrower.

“In addition, if the seller or builder of the property agrees to pay any portion of the borrower’s sales commission on the sale of the borrower’s present residence, the amount paid by the seller or builder is an inducement to purchase and must be subtracted dollar for dollar from the sales price before the LTV ratio is applied. Similarly, a borrower not paying real estate commission on the sale of a present home constitutes a sales concession, if the real estate broker or agent is involved in both transactions and the seller of the property purchased by the borrower pays a real estate commission exceeding that typical for the area. In these situations, the amount paid by the seller above the normal real estate commission is considered an inducement to purchase and must be subtracted from the sales price of the property being purchased before applying the LTV [Loan to Value] ratio.”

**Building on Land Owned, Maximum Mortgage,** HUD Handbook 4155.1, “Mortgage Credit Analysis,” Chapter 1, Paragraph 1-8D

“The appropriate loan-to-value limits are applied to the lesser of:

- 1) The appraised value plus the allowable closing costs, or
- 2) The documented acquisition cost of the property, which includes the builder’s price, or sum of all the subcontractors’ bids, materials, etc.; cost of the land (if the land has been owned more than six months, or was received as an acceptable gift, the value of the land may be used instead of its cost); interest and other costs associated with any construction loan obtained by the borrower to fund construction of the property; the closing costs to be paid by the borrower; and reasonable discount points.”

**Review of the Appraisal Report,** HUD Handbook 4150.2, “Approaches to Valuation,” Chapter 9, Paragraph 9-2

“A. It is incumbent upon the reviewer to carefully analyze the report for reasonableness and a logical conclusion of value. Large adjustments should suggest that a comparable may not be suitable, and in such a case, the reviewer should check the office data for other comparables, which the appraiser could have used. The pictures of the comparables will aid the reviewer in confirming information in the appraisal report. The reviewer must also be aware of the values of central air conditioning, storm windows, and other such items which affect market value.

“B. If found to be acceptable, and the property is eligible for mortgage insurance, the reviewer signs, dates the report, and computes the maximum mortgage amount for the property.

“C. If the reviewer concludes that the appraisal report findings are inconsistent, or are otherwise unacceptable, the reviewer must contact the appraiser or return the case to the appraiser for reconsideration. The reviewer may also modify or amend the report in any manner, which can be supported by HUD valuation policy adequately documented. This includes the adjusting of value, the removal or addition of repair requirements, and the overall determinations of property approval and rejection.

“D. The reviewer must determine if the appraiser has provided a fully documented report about the subject property and if the judgments rendered by the appraiser are reasonable.

“E. The reviewer should review the front page of the appraisal report which encompasses the neighborhood, typical age, values, rents, etc. This provides a broad picture of the environment in which the subject property is located. The required photos and map help to enhance the reviewer’s understanding of the type of property being appraised. Of primary concern to the reviewer in examining this front page of the appraisal report is:

- 1) Is the information consistent?
- 2) Is the property in a “Special flood hazard area”?
- 3) Has the appraiser inserted the FEMA [Federal Emergency Management Agency] map and zone, if available?

“F. On the back page of the Appraisal Report, the reviewer should check the perimeter dimensions shown in the building sketch for consistency with the gross living area shown in the sales comparison analysis.

“G. To the right, although the appraiser is not required to complete the cost analysis for a single-family existing dwelling, the estimated site value must be shown.

“H. When reviewing the sales comparison analysis, the reviewer must carefully examine each critical area, as mentioned previously, for anything, which appears unreasonable. Taking each critical area in order, the reviewer examines:

“1) The distance between the comparables and the subject, and if one of them is a conventional sale, if available. In an urban area, ten or fifteen blocks may appear reasonable, whereas anything over that could constitute an entirely different neighborhood and environment.

“2) The comparable sales data should not be over six months old. Anything over six months may reflect a different market. If a comparable is seven or eight months old, the reviewer should expect an explanation for its use and possibly an adjustment relating to any upward or downward trend in the marketplace, if appropriate. Any comparable a year or more old is unacceptable, except in those rare cases where there are no comparables within a reasonable distance which were recent sales. This may occur in certain rural areas.

“3) The comparables should be reasonably equal to the subject in size, age and design. The reviewer must recognize that it is not always possible to find three comparables very close in similarity to the subject. If the subject is a Cape Cod, and no recent sales of Cape Cods can be found, then the reviewer would expect the appraiser to use a one and a half story home, and make the necessary adjustments. If the subject contained fifteen hundred square feet of finished living area (not including a finished basement) the reviewer would expect the comparables to range in size from twelve hundred to eighteen hundred square feet, so that a reasonable adjustment could be made.

“4) The reasonableness of the adjustments is examined. This is the most important part of the appraisal report, since the total adjusted values of the comparables bracket the market value of the subject. The reviewer must be familiar with the neighborhood and what the market is willing to pay for differences such as central air conditioning, energy-saving features, screened and unscreened porches, patios, etc. Also, an adjustment may be necessary for a larger or smaller home, or perhaps an extra bedroom, even if it is small. In reviewing these adjustments, the reviewer looks for consistency. For example, if the appraiser uses an adjustment of fifteen hundred dollars for central air conditioning for one comparable, the same amount of adjustment would be expected to be used for the other comparables in the report; or if ten dollars per square foot is used for a size adjustment, this same amount would be expected to be used for the other comparables, considering of course, that they were of approximately the same age and construction. The reviewer should calculate the dollar amount per square foot which the appraiser used to adjust for size keeping in mind what a new house of that type would cost in accordance with cost figures found in the Marshall and Swift Cost Handbook. This is an area which has been much abused. The reviewer should know what the market in a particular area is willing to pay for size difference and such figures should not be exceeded without a clear explanation from the appraiser. The reviewer should, in such cases, refer to the Marshall and Swift Cost Handbook to determine what the basic cost per square foot would be for a new, like dwelling before contacting the appraiser. Also, adjustments for very small differences are questionable.

“5) Along these same lines, the reviewer should look for consistency in land values. There should not be adjustments for lot sizes in a neighborhood of similarly sized lots. A corner lot, which may be considerably larger and more desirable, might call for some adjustment. The typical buyer does not take into consideration a few feet difference. If the location of a lot in a given subdivision were at the edge of a golf course and considered prime in the area, then a reasonable adjustment would be acceptable.

“6) The reviewer must analyze the final adjusted value of each comparable. If good comparables were used, the final adjusted value of each comparable should be very close to one another, perhaps within ten to fifteen percent. The reviewer then checks to see if the appraiser has selected the comparable most similar to the subject in arriving at the final estimate of value.”

**Credit**, HUD Handbook 4155.1, “Mortgage Credit Analysis,” Section 1

“Past credit performance serves as the most useful guide in determining a borrower’s attitude toward credit obligations and predicting a borrower’s future actions. A borrower who has made payments on previous and current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

“When analyzing a borrower’s credit history, examine the overall pattern of credit behavior, rather than isolated occurrences of unsatisfactory or slow payments. A period of financial difficulty in the past does not necessarily make the risk unacceptable if the borrower has maintained a good payment record for a considerable time period since the difficulty. When delinquent accounts are revealed, the lender must document their analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors.

“While *minor* derogatory information occurring two or more years in the past does not require explanation, *major* indications of derogatory credit—including judgments, collections, and any other recent credit problems—require sufficient written explanation from the borrower. The borrower’s explanation must make sense and be consistent with other credit information in the file.”