Issue Date October 31, 2005
Audit Report Number 2006-LA-1001

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

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: Ryland Mortgage Company, Tempe Arizona, Did Not Follow HUD Requirements in the Origination of Insured Loans

HIGHLIGHTS

What We Audited and Why

In response to a recommendation from the Department of Housing and Urban Development's (HUD) Santa Ana Homeownership Center Quality Assurance Division and Ryland Mortgage Company's (Ryland) high default rate for its branch office, we audited Ryland's loan origination activities for its Tempe, Arizona, branch office. The audit objectives were to determine whether Ryland acted in a prudent manner and complied with HUD regulations, procedures, and instructions in its approval of Federal Housing Administration-insured mortgages and whether it adequately implemented its quality control plan.

What We Found

Although most of Ryland's loans are performing, Ryland failed to originate 23 of the 24 loans in our sample in compliance with HUD requirements and regulations. All 23 loans involved multiple origination deficiencies that should have precluded their approval. The deficiencies included false employment data; questionable/false Social Security numbers; improper treatment of downpayment gifts, service fees, and/or buydowns, resulting in inflated sales prices; unsupported/overstated income; insufficient income and employment documentation; an understated liability; an unacceptable credit history; inaccurate or excessive qualifying ratios without adequate compensating factors; an unallowable fee; and unsupported sources of deposits. In addition, Ryland did not adequately implement its quality control plan. We attribute these problems to Ryland's failure to fully implement its quality control plan and its aggressive position on approving loans over more prudent lending practices. As a result, Ryland placed HUD's single-family insurance fund at risk for 23 unacceptable loans with original mortgages totaling $3,085,094. HUD remains at risk of losses totaling $2,730,099 related to 20 of the 24 loans.

What We Recommend

We recommend that HUD take appropriate administrative action against Ryland by seeking recovery for 14 of the loans totaling $85,741 in partial claims, loan modification, special forbearance, and inflated sales prices; indemnification of $2,730,099 against future losses on 20 of the loans; and requiring Ryland to reimburse the borrowers for $4,000 in unallowable fees on one of the loans.

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

Auditee's Response

We provided Ryland the draft report on September 20, 2005, and held an exit conference with Ryland officials on September 27, 2005. Ryland provided written comments on October 14, 2005. Ryland generally disagreed with our report findings.

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

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BACKGROUND AND OBJECTIVES

The National Housing Act, as amended, established the Federal Housing Administration, an organizational unit within the Department of Housing and Urban Development (HUD). The Federal Housing Administration provides insurance to private borrowers against loss on mortgages financing homes. The basic home borrower insurance program is authorized under title II, section 203(b) of the National Housing Act and governed by regulations in 24 CFR [*Code of Federal Regulations*] Part 203.

Before 1983, HUD performed most underwriting of Federal Housing Administration-insured loans. In 1983, HUD implemented the direct endorsement program, which authorized approved lenders to underwrite loans without HUD's prior review and approval. Regulations governing this program are contained in 24 CFR [*Code of Federal Regulations*] Parts 202 and 203. The vast majority of Federal Housing Administration-insured single-family loans are processed through the direct endorsement program.

Ryland was approved in 1979 as a nonsupervised lender, with its home office headquartered in Woodland Hills, California. According to HUD's Neighborhood Watch system, Ryland has 24 active branches throughout the country, including the Tempe, Arizona, branch office. Ryland is an authorized agent for two principal lenders: Coastal Mortgage Services Inc., and Virginia Housing Development. Ryland's primary business is to originate loans for new homes built by its parent company, Ryland Group, Inc. All loan applications are initially received at the branch offices or online through Ryland's Web site and then routed to the Ryland Operations Center in Scottsdale, Arizona, for underwriting and closing. The loans are initially underwritten by Loan Prospector, a software program which evaluates the borrowers' creditworthiness and indicates the level of underwriting and documentation that is necessary to determine the loan's eligibility for insurance by Federal Housing Administration. If Loan Prospector gives an accept status on the loan, then the loan officer underwrites the loan. However, if the loan is given a refer status, then it is routed to the Ryland Operations Center for a more thorough review and underwriting. Pursuant to a written agreement, Ryland sells Federal Housing Administration loans to Countrywide Funding Corporation shortly after closing, if the loans meet Countrywide's contract requirements.

The audit objectives were to determine whether Ryland acted in a prudent manner and complied with HUD regulations, procedures, and instructions in its approval of the Federal Housing Administration-insured mortgages and whether it adequately implemented its quality control plan.

RESULTS OF AUDIT

Finding 1: Ryland Did Not Originate Insured Loans in Accordance with HUD Requirements and Prudent Lending Practices

Ryland did not comply with HUD's requirements for prudent lending practices in the origination and underwriting of the 23 loans we reviewed in our sample totaling $3,085,094. It did not exercise due diligence in (1) detecting false employment data and invalid Social Security numbers, (2) identifying inflated sales prices and inappropriate use of gift funds and buydowns, (3) verifying borrowers' income and employment, (4) assessing borrowers' ability to pay through meticulous evaluation of liabilities and credit deficiencies, (5) precluding charging unearned or unallowable fees, and (6) verifying borrowers' source of funds for deposits. We attribute this problem to Ryland's disregard for HUD requirements and in the failure to adequately implement its quality control plan. As a result, HUD remains at a risk of loss on 20 of the loans, valued at $2,730,099, and incurred other actual losses of $85,741. In addition, one borrower was charged an unallowable fee of $4,000.

HUD Handbook and Requirements

Lenders must follow the statutory and regulatory requirements of the National Housing Act and HUD requirements, instructions, guidelines, and regulations when originating insured loans. HUD Handbook 4060.1, REV-1, "Mortgagee Approval Handbook," requires that lenders conform to generally accepted practices of prudent lenders and demonstrate responsibility to maintain approval for participation in Federal Housing Administration insurance programs.

HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, "Mortgagee Credit Analysis for Mortgagee Insurance," describes the basic mortgage credit underwriting requirements for single-family mortgage loans insured under the National Housing Act. The lender must establish the ability and willingness of the borrower to repay the mortgage debt. This decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout the handbook and must be supported by sufficient documentation.

Summary of Findings

We reviewed 24 Federal Housing Administration-insured loans originated between November 30, 2001, and November 30, 2004, and found that Ryland did not comply with HUD requirements and prudent lending practices in 23 of 24 loans totaling $3.1 million. All 23 loans contained multiple loan origination deficiencies that should have precluded their approval. During the audit, 3 of the 24 loans were sold without a loss to HUD, while 21 of the 24 loans equaling $2.8 million are still active and 20 of those loans continue to be a risk to HUD. We identified the following loan deficiencies during our review (see appendix C):

Questionable Documentation Deficiencies
- False or altered Internal Revenue Service W-2 forms, pay stubs, and verification of employment forms and false loan officer cerification (3 of 24 loans) and
- Questionable/false borrowers' Social Security numbers (3 of 24 loans).

Loan Origination Deficiencies
- Inflated sales prices without justification (13 of 24 loans); and
- Improper use of buydown rate (8 of 24 loans).

Income Deficiencies
- Unsupported/overstated income (7 of 24 loans); and
- Insufficient employment documentation (14 of 24 loans).

Debt or Credit Deficiencies
- Understated liabilities (1 of 24 loans);
- Unacceptable credit history (1 of 24 loans); and
- Inaccurate or excessive qualifying ratios without adequate compensating factors (5 of 24 loans).

Unallowable Fees
- Unallowable fees (1 of 24 loans).

Inadequate Documentation
- Unsupported sources of deposits (8 of 24 loans).

Details of deficiencies are discussed separately below. In addition, narrative case summaries for each of the cases are in appendix D.

False Employment Data and False Loan Officer Certifications (3 of 24 Cases)

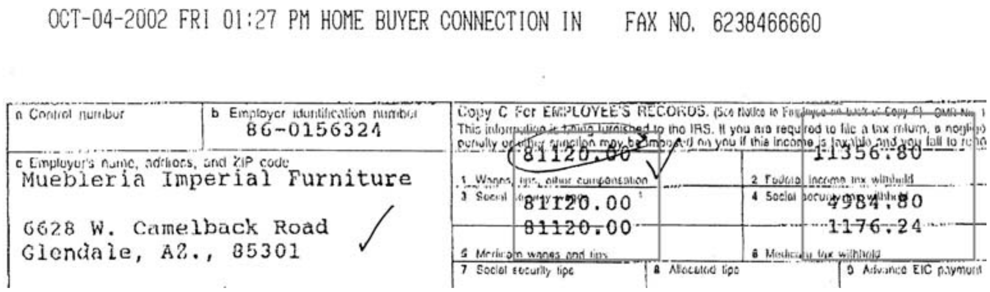
We determined that 3 of the 24 cases contained false employment documents that should have been detected by Ryland. These documents included fabricated or altered Internal Revenue Service W-2 forms, borrower pay stubs, and verification of employment forms. We confirmed the false employment data by reviewing the documents in the file, interviewing the borrower and employer, and obtaining supplemental verification documentation from the borrower's employer.

In one case (023-0990733), the borrower's employer, G-Unlimited, did not exist. We visited the address listed on the loan application to conduct an interview with the employer. The lot the employer purportedly occupied belonged to another business, Grand Canyon Pump and Supply Company, which has operated at that location for more than 15 years without affiliation with G-Unlimited. We contacted the property owner of the area, who confirmed that G-Unlimited has never operated at the address, nor has it ever occupied any of its properties. It appears that the business is fictitious, and income earned by the borrower while supposedly working there is false.

The borrower's pay stubs and W-2 form appear to have been fabricated. We noticed that the Social Security insurance tax and healthcare tax amounts were incorrectly presented on both pay stubs and the W-2 form. Contrary to HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-16, the loan officer certified the faxed copies of the borrower's W-2 form and pay stubs as true and correct copies of the originals without noticing the discrepancy of the tax withholding calculations. The W-2 form calculated a 9 percent Social Security tax (a variance of 2.8 percent from the standard 6.2 percent), and a 2 percent Medicare tax (a variance of 0.65 percent from the standard 1.45 percent). All four pay stubs calculated a 4.84 percent Social Security tax (a variance of 1.36 percent), and a 1.60 percent Medicare tax (a variance of 0.15 percent). When we questioned the borrower about these inconsistencies, she could not verify her employment at G-Unlimited, yet Ryland's telephone verification of employment showed that the borrower's employment was verified for two years.

In another case (023-1451488), false employment documents included faxed copies of the W-2 form and pay stubs, contrary to HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. The W-2 form, shown in figure 1 below, shows the type set was printed outside of the text box margins. Additionally, a handwritten number was superimposed on the first number of the Social Security prefix on the pay stub (see figure 2 below). The borrower was able to verify the employer's name; however, she could not explain the altered state of her pay stubs, furnish supportive documentation to corroborate the pay stubs' authenticity, or contact her former employer since it had gone out of business. The Department of Economic Security wage reports did not show the borrower ever worked for Muebleria Imperial, which signifies that either the employment was false or the borrower's income was unreported, yet the telephone verification of employment confirmed borrower's two years of service at Muebleria.

Figure 1: W-2 form, case 023-1451488



OCT-04-2002 FRI 01:27 PM HOME BUYER CONNECTION IN FAX NO. 6238466660

a Control number

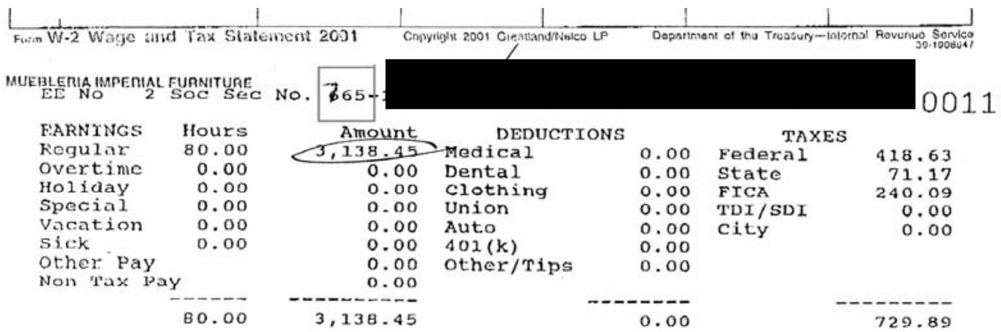
b Employer identification number 86-0156324

c Employer's name, address, and ZIP code
Muebleria Imperial Furniture
6628 W. Camelback Road
Glendale, AZ., 85301

Copy C For EMPLOYEE'S RECORDS. This information is being furnished to the IRS. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable and you fail to report it.

1 Wages, tips, other compensation 81120.00
2 Federal income tax withheld 11356.80
3 Social security wages 81120.00
4 Social security tax withheld 4984.80
5 Medicare wages and tips 81120.00
6 Medicare tax withheld 1176.24
7 Social security tips
8 Allocated tips
9 Advance EIC payment

Figure 2: Pay stub, case 023-1451488



Form W-2 Wage and Tax Statement 2001 Copyright 2001 Greatland/Nelco LP Department of the Treasury—Internal Revenue Service

MUEBLERIA IMPERIAL FURNITURE
EE No 2 Soc Sec No. 765-[redacted] 00116

EARNINGS	Hours	Amount	DEDUCTIONS		TAXES	
Regular	80.00	3,138.45	Medical	0.00	Federal	418.63
Overtime	0.00	0.00	Dental	0.00	State	71.17
Holiday	0.00	0.00	Clothing	0.00	FICA	240.09
Special	0.00	0.00	Union	0.00	TDI/SDI	0.00
Vacation	0.00	0.00	Auto	0.00	City	0.00
Sick	0.00	0.00	401(k)	0.00		
Other Pay		0.00	Other/Tips	0.00		
Non Tax Pay		0.00				
	80.00	3,138.45		0.00		729.89

In the third case (023-1932092), three of the most recent pay stubs in the loan file were manufactured and altered to increase the borrower's monthly income. We were able to contact the borrower's employer, Pioneer Ford, which provided the borrower's payment history for the period of April through September 2003. The two pay stubs coinciding with the payment history showed a deviation of $2,000 and $1,300 from the amount reported on Pioneer Ford's records. In addition, one of the pay stubs was missing a check number, and the font sizes on all three pay stubs were different. Ryland failed to detect this violation and approved the loan.

Questionable/False Social Security Numbers (3 of 24 Cases)

We tested the validity of all borrowers' and coborrowers' Social Security numbers by querying Lexis Nexis and performing a Social Security number validity test from an in-house database. We determined that 3 of the 24 cases contained invalid Social Security numbers that went unnoticed by Ryland. These borrowers' Social Security numbers were issued within two years of the application-received date.

- Our Lexis Nexis query showed one borrower had more than one Social Security number (see appendix D, case 023-1073648). Ryland's only documentation of verification of the borrower's Social Security number was the individual's tax returns (1999-2001), which appeared questionable since they lacked the borrower's signature, and his name was misspelled. The credit report for the borrower showed no activity. However, the accounts that were used to analyze his liabilities were listed under his spouse's Social Security number.
- Lexis Nexis reported that the second borrower's Social Security number belonged to another individual (see appendix D, case 023-1932092). Moreover, Ryland required that the borrower provide a clearer copy of his Social Security card; however, the loan was underwritten without either the card or a documented explanation in the Ryland case file.
- The third borrower's Social Security number was altered on the pay stubs to show "765" rather than the printed "665" (see appendix D, case 023-1451488).

Inflated Sales Prices and Improper Treatment of Downpayment Gifts and Buydowns (13 of 24 Cases)

Ryland generally offers an incentive to new home buyers if they use Ryland as their lender to finance the purchase of a home. Through the Nehemiah or OWN program, the buyer is offered gift funds, which go toward financing the downpayment and closing costs. In exchange for supplying the homebuyers with this gift, Ryland agrees to make a contribution in the amount of the gift, along with a $300, $385, $500, or $800 service fee to the gift provider (Nehemiah or OWN). We found that 13 of the 21 cases we reviewed included this type of situation. While this is an accepted practice, Ryland inappropriately made price adjustments to the original base sales price to recover part or all of the amount it provided to the Nehemiah or OWN program, service fees, and buydown.

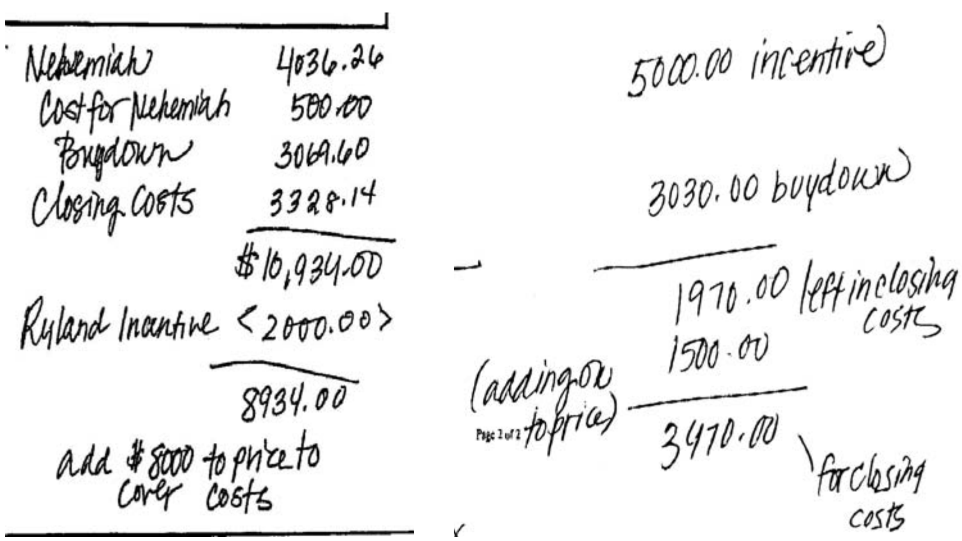
Contrary to HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-10 C, the borrowers were essentially unaware that they were repaying the gift funds through their monthly mortgage payments. The increase in sales price caused the payments to be inflated for 13 of the 24 cases by part or all of the amount of the gift, service fee, and/or buydown.

A former Ryland loan officer claimed that Ryland management's aggressive position on approving loans led its employees to circumvent more prudent loan approval practices. For instance, if the borrower's income was insufficient to qualify for a loan, the two-to-one buydown would be offered to the borrower to bypass the qualification cap. The Nehemiah program was offered in the event that the borrower had no funds saved for closing. In the scenario in which the borrower receives the gift fund, the operations manager would instruct the loan processor to increase the sales price of the home to cover the expense of funding the gift. The manager would also request this transaction's anonymity by making sure that the contract addendums did not state "sales price increase." A Ryland underwriter confirmed these practices.

Figure 3 below shows two examples of documents which a Ryland employee had written, illustrating the increase in sales price due to the Nehemiah gift fund, service fee, and buydown.

<u>Figure 3: Sales price increase, cases 023-1293230 and 023-1449064</u>

Sales price increased by $8,000 in the first case and $5,500 in the second.



Nehemiah 4036.26
Cost for Nehemiah 500.00
Buydown 3069.60
Closing Costs 3328.14
$10,934.00
Ryland Incentive <2000.00>
8934.00
add $8000 to price to cover costs

5000.00 incentive
3030.00 buydown
1970.00 left in closing costs
1500.00 (adding on to price)
3470.00 for closing costs

Inappropriate Use of Buydown Rate (8 of 24 Cases)

Contrary to HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14, and REV-5, paragraph 3-1 C, Ryland qualified 8 of the 24 loans with a buydown rate but failed to document that the eventual increase in mortgage payments would not adversely affect the borrower or increase the chance of default. On seven of the eight loans, the borrowers defaulted after making from 3 to 15 payments.

Two Ryland homebuyers attested that Ryland offered them the two-to-one buydown without adequately explaining the process or warning them of the eventual monthly mortgage payment increase. One of the borrowers believed she was offered the buydown because her income would not qualify her for the loan.

A former Ryland loan officer indicated that this was common practice when the borrower did not have sufficient income to qualify. As a result, both borrowers struggled in meeting their payments, which could have resulted in the loss of their homes.

Overstated Income (7 of 24 Cases)

Contrary to HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraphs 2-7 and 2-7 A, Ryland overstated the borrowers' income in 7 of the 24 cases. This problem is attributable to the inclusion of false or discrepant employment income and unsupported/incorrect calculations of income.

Third-Party Verifications Not Conducted (14 of 24 Cases)

Ryland failed to obtain adequate employment documentation as required by HUD Handbook 4155.1, REV-4, paragraph 4-4, and REV-5, paragraphs 2-6 and 3-1 E, in 14 of 24 cases. Ryland failed to verify borrower's employment for two years, obtain a copy of the borrowers' pay stubs covering the most recent 30-day period, and/or obtain a copy of the previous two years' Internal Revenue Service W-2 forms. Details are contained in the individual narrative case summaries (appendix D) and in finding 2.

Understated Liabilities (1 of 24 Cases)

Ryland did not include all outstanding liabilities as required by HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3 and 2-4, and REV-5, paragraph 2-11 in 1 of the 24 loans. In case 023-1073648, Ryland understated the borrower's liabilities by not including a personal line of credit account that held a balance of $184

Unacceptable Credit History (1 of 24 Cases)

In 1 of 24 cases (023-1493862) , the borrower's credit history was unsatisfactory and did not meet the provisions stated in HUD Handbook 4155.1, REV-4, CHG-

1, paragraph 2-3. The credit report indicated collection and charge-off accounts older than two years. Ryland obtained explanation letters from the borrower regarding the charge-offs but not the collection accounts.

Inaccurate/Excessive Qualifying Ratios without Adequate Compensating Factors (5 of 24 Cases)

Ryland's calculated borrower debt-to-income ratios as required by HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-12 exceeded guidelines in 4 of the 24 case files. Yet, Ryland approved the loans and submitted them for insurance endorsement without acceptable compensating factors.

After we adjusted the calculations for unsupported/overstated income and understated liabilities that Ryland should have included, the ratios exceeded HUD guidelines for 5 of the 24 cases. The ratios calculated for the 5 loans are shown below in figure 4.

Figure 4: Qualifying ratios

		Ryland calculated		OIG calculated	
		Mortgage payment-to-income ratio	Total fixed payment-to-income ratio	Mortgage payment-to-income ratio	Total fixed payment-to-income ratio
HUD case number		29%	41%	29%	41%
1	023-1057152	26.75%	46.25%	26.94%	46.43%
2	023-1129379	28.77%	43.26%	30.96%	46.56%
3	023-1592011	18.59%	46.53%	18.82%	47.11%
4	023-1653270	35.79%	40.17%	37.38%	41.76%
5	023-1932092	22.65%	35.42%	48.99%	76.60%
Cases with excessive debt-to-income ratios		2	4	4	5

Unallowable Fee (1 of 24 Cases)

In 1 of the 24 loans (023-1493852), we determined that the borrower was charged an unallowable fee. The borrower's accrued rent equity with her stay at an Equity Residential apartment was used to offset an unjustified adjustment in the sales price of her home. Ryland allowed a total of $4,000 in unallowable fees to be charged to the borrower.

Inadequate Documentation for Verification of Deposit (8 of 24 Cases)

Ryland failed to obtain a standard verification of deposit or original bank statements for the most recent three-month period for 8 of the 24 cases as required by HUD Handbook 4155.1, REV-4, CHG-1 and REV-5, paragraph 3-1 F. If the document itself is not more than 180 days old when the loan closes, there is no need to acquire an updated application or original bank statements.

Prudent Underwriting and Required Quality Control Practices Circumvented

According to a former Ryland national underwriting manager, Ryland's upper management circumvented underwriting policies and procedures to increase loan approval turnovers. This included allowing branch managers to underwrite refer[1] loans and then instructing direct endorsement underwriters to sign off on the mortgage credit analysis worksheets and certifications. She also claimed many of the loan processors were not properly trained and were heavily dependent on the instruction of the senior managers, whose primary goal was to increase loan approvals as quickly as possible.

A former loan officer confirmed those facts. She stated that "she had no formal Federal Housing Administration training and received assistance with completing her duties from an operations manager, who stressed quantity rather than quality. The same operations manager allegedly pressured other loan officers to falsify borrower income in order to meet requirements. If the loan officers did not comply, their continued employment at Ryland was doubtful."

[1] Refer loans are those that were not initially qualified to be approved in Loan Prospector.

Another former underwriter stated that the managers did everything possible to ensure a loan was not rejected. This notion, she stated, was what Ryland headquarters dictated to the Ryland Operations Center.

Conclusion

Based on our review and discussions with borrowers, their employers, and former Ryland employees, we believe that Ryland upper management's failure to fully implement its quality control plan (see finding 2 below) and its aggressive philosophy on approving loans over adhering to more prudent lending practices caused the improper loan approvals. Consequently, Ryland unnecessarily increased the risk to the Federal Housing Administration insurance fund by approving loans that did not comply with HUD requirements and remains at risk of losses on 20 of the loans totaling $2,730,099.

Recommendations

We recommend that HUD's assistant secretary for housing-federal housing commissioner require Ryland to

1A. Indemnify HUD's Federal Housing Administration against future losses on the 20 active loans totaling $2,730,099 and reimburse HUD for losses already incurred of $85,741 (see appendix A).

1B. Reimburse the borrower $4,000 for an unallowable fee.

1C. Contact the servicing lenders regarding the inflated sales prices and pay the increased amounts to reduce the corresponding loan amounts.

RESULTS OF AUDIT

Finding 2: Ryland Did Not Adequately Implement Its Quality Control Plan as Required

Contrary to HUD requirements, Ryland did not fully implement its quality control plan as required. Our review disclosed that while Ryland had established a written quality control plan that met HUD requirements, it failed to conduct the required quality control and early payment default reviews. Ryland also neglected to follow established quality control plan procedures relating to third-party verifications of income and employment. We attribute these deficiencies to Ryland's disregard of its responsibilities to assure the reviews were conducted in a timely manner and that deficiencies were promptly addressed. This unnecessarily increased the risk to the Federal Housing Administration insurance fund.

HUD Requirements

HUD Handbook 4060.1, REV-1, "Mortgagee Approval Handbook," chapter 6, provides that as a condition of HUD-Federal Housing Administration approval, lenders, including loan correspondents, must have and maintain a quality control plan for the origination and servicing of insured mortgages. The quality control plan must be a prescribed function of the lender's operations and assure that the lender maintains compliance with HUD-Federal Housing Administration requirements and its own policies and procedures. It must be sufficient in scope to enable the lender to evaluate the accuracy, validity, and completeness of its loan origination and servicing operations. It must provide for independent evaluation of the significant information gathered for use in the mortgage credit decision making and loan servicing process for all loans originated or serviced by the lender. The quality control plan must enable the lender to initiate immediate corrective action where discrepancies are found.

Quality Control Plan Reviews Not Conducted

Ryland's quality control plan states that quality control reviews will be conducted on 10 percent of its loans within 90 days of closing. However, we found that did not occur.

As of January 2005,

- Ryland's November 2003 to July 2004 monthly audit reviews were complete but were done late. According to Ryland's vice president of the Quality Assurance Division, these were late because of the extended leave of one of its auditors beginning in June 2004 and the retirement of another senior auditor on December 31, 2003.

- Although the November 2003 to July 2004 reviews were performed and completed, they were conducted over 90 days after closing and occurred before Ryland's auditor took leave, indicating that the work was not completed in a timely manner with a full staff on board.

- Our review of the November 2003 report showed about 70 percent of the reviews (or 71 of the 103 loans) were completed after the 90-day period. This delayed Ryland from notifying senior and middle management personnel to promptly initiate remedial action and from directing corrective measures to all loan origination, underwriting, and service personnel.

As of May 2005,

- Ryland's August 2004 to November 2004 monthly audit reviews were complete but late.

- Ryland anticipated it would catch up with its reviews by the end of July 2005.

- Our review of Ryland's November 2004 report showed 100 percent of its 110 reviews were conducted and completed after the required timeframe, which contributed in the delay of management's actions and notification of remedial action to loan origination, underwriting, and service personnel.

- A few of the deficiencies identified in Ryland's November 2004 review reflected what we found during ours and mirrored findings in HUD's August 2003 monitoring. Those deficiencies included the following:

    1. The qualifying ratios were not calculated correctly;
    2. Some of the income used to qualify was unstable and/or not properly identified;
    3. All underwriting requirements were not met;
    4. The qualifying ratios were not always acceptable, and the underwriter did not always state the compensating factors on the mortgage credit analysis worksheet;

5. A pay stub covering the most recent 30-day period was not found in the file and/or did not meet all of the requirements for this type of loan; and

Early Payment Default Reviews Not Conducted

Our evaluation of Ryland's early payment default reviews was inconsistent with the work completed by one of Ryland's internal auditors. When we discussed the reviews with her, she assured us that all defaults with six payments or fewer were conducted monthly. We recreated her selection procedures by obtaining a hard copy of her Neighborhood Watch default list for the periods between December 1, 2002, and March 31, 2005. We determined that 122 loans went into default, with 66 (more than 50 percent) defaulting in six payments or fewer. Only 32 (48 percent) of the 66 loans were properly reviewed, while the remaining 34 were not. We also noted that several reviews were conducted for loans that went into default with more than six payments. The time expended for these reviews should have been allocated to those loans that defaulted in fewer than six payments.

Third-Party Verifications Not Conducted (14 of 24 Cases)

In our review of 24 loans, we found 14 instances in which Ryland did not follow the established quality control plan procedures and HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraphs 2-6 and 3-1 E, relating to third-party verifications of income and employment used as a basis for approving the loans. Ryland's quality control plan provides that employment documents, such as verification of employment, pay stubs, Internal Revenue Service W-2 forms, tax returns, and bank statements, will be reviewed for accuracy and completeness. HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraphs 2-6 and 3-1 E, provides more stringent requirements for verifying employment; as an alternative to obtaining a written verification of employment, the lender may choose to obtain from the borrower original pay stubs covering the most recent 30-day period, along with original copies of the previous two years' Internal Revenue Service W-2 forms. The lender must also verify by telephone all employment for the past two years.

One case (023-1188456) did not contain a written or telephone verification of employment, indicating that no verification of the borrower's employment was performed for the past two years. Another case (023-1592011) did not contain the borrower's and coborrower's original pay stubs covering the most recent 30-day period, while the telephone verification of employment verified only one year and five months of the borrower's employment and one year and six months of the coborrower's employment.

Conclusion

We attribute these deficiencies to Ryland management's disregard of its responsibilities to assure the reviews were conducted and in a timely manner. Ryland's vice president of quality assurance explained that there was insufficient staff to perform the work. We believe Ryland's disregard stems from management's aggressive position on approving loans as quickly as possible over more prudent lending practices. As a result, as discussed in finding 1, Ryland unnecessarily increased the risk to the Federal Housing Administration insurance fund by approving loans that did not comply with HUD requirements.

Recommendations

We recommend that HUD's assistant secretary for housing-federal housing commissioner

2A. Require Ryland to take the necessary actions to ensure that the required quality control plan and early payment default reviews are conducted in a timely manner and that corrective action is taken and documented for all reported deficiencies.

2B. Require Ryland to take the necessary actions to ensure that it complies with HUD's Federal Housing Administration requirements relating to third-party verifications of income and employment.

SCOPE AND METHODOLOGY

Our review generally covered the period from November 30, 2001, through November 30, 2004.

We made a nonrepresentative selection of 24 loan files originated by Ryland's Tempe, Arizona, branch office from a population of 390 loans. We made our selection based on the number of payments before first default; loans in claim; and several risk factors, including miscellaneous "price adjustments" found in the agreement of sale, questionable Social Security numbers, inadequate qualifying ratios, unsupported income, unsupported assets, understated liabilities, inadequate documentation, and questionable/unearned fees.

To accomplish our objectives, we

- Reviewed relevant HUD rules, regulations, and guidance regarding mortgage underwriting and quality assurance.
- Reviewed Ryland and HUD case files for the 24 sample loans, 12 LandAmerica Transnation escrow files, and 7 Ryland title escrow files.
- Obtained Arizona Department of Economic Security wage reports on borrowers and coborrowers for all 24 loans.
- Distributed postal tracers to verify borrowers' home/mailing addresses.
- Reviewed Ryland's fiscal year end 2003 quality control plan to determine whether the plan complied with HUD requirements and whether Ryland fully implemented the plan.
- Queried the Social Security numbers for the 390 borrowers and 214 coborrowers in our audit universe to determine their validity.
- Queried electronic/Internet database systems, including Lexis Nexis, Real Quest, Neighborhood Watch, and Single Family Data Warehouse to determine the validity of loan information.
- Interviewed 10 borrowers and 10 current or former borrowers' employers.
- Interviewed former Ryland employees: national underwriting manager, underwriter, and loan officer.
- Interviewed current Ryland employees, including the vice president of the Quality Assurance Division and vice president of production.

The audit fieldwork was performed during the period January through July 2005. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

We determined the following internal control was relevant to our audit objectives:

- Policies and procedures that management has in place to reasonably ensure that the loan underwriting process complies with HUD program requirements.

We assessed the relevant control 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:

- Ryland did not have adequate internal controls to reasonably ensure that originations complied with all applicable HUD requirements (see findings 1 and 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A (see below)	$85,741	$2,730,099
1B (finding 1)	$4,000	

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.

HUD case no.		Mortgage amount	Claim amount	Partial claim	Loan modification	Special forebearance	Inflated sales price	Recovered amount (resale)	Net loss (ineligible)	Indemnification amount (funds put to better use)
1	023-0990733	$ 100,261	$ -	$ -	$ -	$ -	$ 2,264	$ -	$ 2,264	$ 100,261
2	023-1057152	95,460	95,460	-	-	-	2,363	95,460	$ 2,363	-
3	023-1073648	137,857	-	-	-	-	-	-	$ -	137,857
4	023-1113543	134,995	-	-	-	-	3,352	-	$ 3,352	134,995
5	023-1129379	123,068	-	-	-	-	4,696	-	$ 4,696	123,068
6	023-1188456	143,470	-	-	650	-	985	-	$ 1,635	143,470
7	023-1293230	132,457	132,457	26,216	650	-	7,876	132,457	$ 34,742	-
8	023-1318434	107,488	-	-	-	100	3,136	-	$ 3,236	107,488
9	023-1449064	131,239	-	-	650	-	5,413	-	$ 6,063	131,239
10	023-1451488	150,575	-	-	-	-	-	-	$ -	150,575
11	023-1453913	151,265	-	-	-	-	-	-	$ -	151,265
12	023-1487584	127,078	127,078	-	650	-	5,270	127,078	$ 5,920	-
13	023-1493862	118,805	-	6,170	-	-	2,985	-	$ 2,985	118,805
14	023-1576678	128,905	-	9,145	-	-	5,907	-	$ 5,907	128,905
15	023-1592011	153,772	-		1,300	100	-	-	$ 1,400	153,772
16	023-1646394	130,833	-	-	-	-	-	-	$ -	130,833
17	023-1646660	148,291	-	-	-	-	-	-	$ -	148,291
18	023-1653270	136,010	-	-	-	-	3,150	-	$ 3,150	136,010
19	023-1736086	140,628	-	5,094	-	-	2,934	-	$ 8,028	140,628
20	023-1811657	155,173	-	-	-	-	-	-	$ -	155,173
21	023-1932092	119,516	-	-	-	-	-	-	$ -	119,516
22	023-1965223	157,172	-	-	-	-	-	-	$ -	157,172
23	023-2133833	137,025	-	-	-	-	-	-	$ -	
24	023-2177719	160,776	-	-	-	-	-	-	$ -	160,776
Subtotal (without		$ 3,085,094	$354,995	$46,625	$ 3,900	$ 200	$ 50,331	$ 354,995	$ 85,741	$ 2,730,099
Total		$ 3,222,119								
Recommendation 1A sanction total									$	2,815,840
		Loans are still active. We are requesting indemnification for amount not partial claims amount								

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

RYLAND

Memorandum

The Ryland Group, Inc.

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To: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

From: Eric Menyuk

Date: October 15, 2005

Subject: Response by Ryland Mortgage Company to Draft Discussion Report dated September 26, 2005 Regarding Audit by Office of Inspector General

INTRODUCTION

This memo provides comments by Ryland Mortgage Company (Ryland) in response to the Discussion Draft Audit Report prepared by your office dated September 26, 2005 (Report). We appreciate this opportunity to comment on the Report and appreciate the time and consideration given by you and your staff.

Ryland takes the issues raised in the report extremely seriously, and has attempted to conduct as complete a review of all of the findings in the short amount of time given. When the Ryland's President learned of the result of the audit, he immediately convened a committee to review the findings in the Report to respond fully. The Committee consisted of the top executives of Ryland who were involved in the origination process. The Committee consisted of the following executives:

President, Ryland Mortgage Company
Senior Vice President and CFO
Senior Vice President, Production
Vice President, National Production
Manager, National Underwriting
Vice President, Quality Assurance
Eric Menyuk, Assistant General Counsel

The committee was tasked with reviewing the Report as well as the 21 files reported in Appendix D. Ryland's President would also like the opportunity to meet with you and the other auditors to go over the findings, the recommendations as well as Ryland's response contained herein.

The Results – An Overview.

With regard to the Report, the Committee found:

- The OIG interviewed both former and current employees, but the Report almost exclusively quotes two former Ryland employees, without providing any documentation to support their claims;
- Both of the former employees had personal reasons to criticize Ryland unjustifiably;
- There was a great deal of misinformation given to the auditors without substantiation, or an opportunity for rebuttal;
- Although charges were made against Ryland's "upper management" no senior executive was sought for interviews or to respond to the allegations prior to issuing the Report
- There is a basic misunderstanding throughout the Report regarding the relationship between Ryland and the home sales division from which Ryland receives its mortgage loans, as well as a lack of recognition of the nature of the "new construction" business, which is The Ryland Group's core business.

With regard to the 390 files in the original pool, which was boiled down to 21 non-representative files, the Committee found:

- Of the 92 findings, Ryland agrees with 7 without reservation, agrees with 8 others, but has reservations, and disagrees with 77
- Of the 21 files, Ryland found that 12 had no deficiencies whatsoever
- Of the 9 that had deficiencies, 5 had only 1, 2 had 2, and 2 had 3
- Only 2 cases had deficiencies that were serious enough to cause a risk to HUD's insurance fund, and that had issues that should have been detected by a reasonably prudent underwriter.

With regard to the specific deficiencies identified

<u>Questionable Documentation</u>

- False Loan Officer Certifications (0 of 21 loans).
- False employment (1 with and 1 without reservations out of 21 loans)
- Questionable/false Social Security # (1 out of 21 loans)

<u>Loan origination</u>

- Inflated sales prices (0 out of 21 loans)
- Inappropriate use of buydown rate (1 with reservations out of 21 loans)

<u>Income</u>

- Unsupported/overstated income (1 with reservations out of 21 loans)

Comment 1

- Missing verification of employment, written or telephonic; employment of 2 years not verified (2 with reservations out of 21 loans)
- Missing W-2 forms (2 with and 1 without reservations out of 21 loans)
- Missing pay stubs covering most recent 30-day period (1 with and 1 without reservations out of 21 loans).

Debt/credit
- Understated liabilities (0 out of 21 loans)
- Unacceptable credit history (0 out of 21 loans)
- Inaccurate/excessive qualifying ratios without inadequate compensating factors (1 with and 1 without reservations out of 21 loans)

Unearned/unallowable fees
- Excessive home ownership association fees (0 out of 21 loans)
- Working capital (0 out of 21 loans)
- Rent equity (0 out of 21 loans)

Inadequate documentation
- Missing verification of deposit/3 months bank statements (1 with and 2 without reservations out of 21 loans)

The Audit

The Reason for the Audit is Unclear

At the exit conference, a question was raised as to why an OIG audit had been requested of Ryland by the Santa Ana HOC given the low default record for the Tempe, Arizona branch office. We were informed that even though the default record was currently low, this was not the case at the time when the audit was being considered.

However, Ryland had pulled the default data as of November 30, 2004 from Neighborhood Watch:

Single Lender - Originator by Branch
RYLAND MORTGAGE CO - 3831400137
Lender Branch Originations by Counties
Default Choice - Current Defaults
Performance Period - 11/30/2004
Sort Order by Percent of Defaults and Claims in Descending Order

Active - Terminated - Merged Originating Branches
Data shown includes all insured single family loans with beginning amortization date between December 01, 2002 and November 30, 2004

			Compare Ratio	Total Orig.	Total in Default	Total Claims	Total in Default and Claim	% in Default and Claim	County Total Orig	County Total in Default	County Total Claims	County Total in Default and Claim	County % in Default and Claim
1	MARICOPA	AZ	**47%**	378	4	0	4	1.06	57,969	1,086	222	1,308	2.26

As shown above, Ryland's default rate was less than half of other lenders originating in Maricopa County a couple of months before this audit began.

The Report itself does not contend or indicate that Ryland has a high default rate. In fact, the only statement about the performance of Ryland's loans is the first clause of the second paragraph: "Although most of Ryland's loans are performing, …" and then nothing further is said about the overall performance of the loans until Appendix D.

From a pool of 390 FHA loan files, the OIG chose 24 loans that already had indications of problems:

> We made our selection based on the number of payments before first default; loans in claim; and several risk factors, including miscellaneous "price adjustments" found in the agreement of sale, questionable Social Security numbers, inadequate qualifying ratios, unsupported income, unsupported assets, understated liabilities, inadequate documentation, and questionable/unearned fees.

So, these were the worst of the worst Ryland loans. What is the status of these loans? Based on the Narrative findings in Appendix D of the Report:

- 3 loans have paid off with no loss
- For 9 loans: "mortgage payments current"
- 8 loans are "not currently in default"; and
- 4 loans are currently "in default"

So, from an initial pool of 390 loans, 4 of the loans – or approximately 1.03% are currently not performing, which closely matches the percentage of default from Neighborhood Watch.

The lack of reference to the performance of Ryland's loans is particularly surprising if one reviews a small sample of audit reports from the OIG. For example, the day prior to our exit conference, the OIG issued a report that started:

> We audited KB Home Mortgage Company (KB) insured loan origination in the Phoenix, Arizona, metropolitan area because the KB default and claim rate under the Department of Housing and Urban Development's (HUD) Phoenix office jurisdiction was almost triple the average for that office.

From another recent OIG audit:

> Of the 609 loans submitted with unacceptable payment histories, 126 (20.69 percent) have defaulted since insurance endorsement, compared to approximately 4 percent for all Washington Mutual loans.

Comment 2

Therefore, the lack of any reference to default rates in the Report seems to be in direct contrast to OIG's usual procedure. Ryland, therefore, respectfully requests that the OIG provide it with information as to why the Santa Ana HOC requested the audit, as it appears to have not been warranted.

Ryland Objects to the Tenor of the Report, Especially With Regard to Unsupported Allegations

As noted at the exit conference, the employees who had contact with the OIG auditors all stated that it was a very positive experience, and that the auditors appeared to be truly interested in understanding Ryland's business and processes in a fair and impartial manner. All were therefore dismayed when reviewing the Report to find such a one-sided characterization of Ryland's business.

This was most apparent on page 14 of the Report under a section entitled, "Prudent Underwriting and Required Quality Control Practices Circumvented." The section begins with non-specific, derogatory allegations from a former national underwriting manager. Contrary to her assertions, Ryland does not measure production from underwriters by approvals, but by decisions. This should have been apparent had any senior manager been interviewed, or any production report been reviewed. Therefore, her assertion that management circumvented policies and procedures to increase loan approvals is without merit.

Ryland acknowledges that this manager was not happy at Ryland due, in part, to the pressure she felt from upper management to increase the decision rate by her team. However, at no time would any underwriter be pressured to approve a loan. Since Ryland sells all of its loans, it loses money on early payment defaults as it is required under its contracts with its investors to repurchase such loans. In fact, this was the case with the loan this national underwriter obtained from Ryland, as she defaulted on her first payment. Shortly thereafter, she resigned.

Similarly, Ryland strongly objects to her second baseless assertion that branch managers issued loan decisions, instructing direct endorsement (DE) underwriters to sign off on them. None of the loans audited support this allegation, and it is only confirmed by a former loan officer who was written up for submitting false information to underwriting and then was terminated after being discovered going through other people's e-mails. Interestingly, it appears that this terminated loan officer wrote the two notes that appear on page 10 of the report.

Branch Managers Do Have Underwriting Authority

Of the 28 active branch managers and assistant branch managers, six managers and 1 assistant branch manager are designated "Fully Delegated" which indicates they are authorized to make credit decisions on refer loans. The overwhelming majority of loans used under this delegation are conventional loans. A phone survey of these seven management employees reveals that only one branch manager has used such authority on approximately 4 loans and only after discussion, and with the approval and concurrence of the national underwriting manager, who ultimately approved the loans.

These 6 branches originated a total of approximately 906 FHA loans in the last two years. Two of these branches (Chicago and Houston) originated 816 of these loans or more than 90%. All but one of the branches involved has a default compare ratio significantly below the baseline default rate for its associated HUD field office area. The only exception is the San Diego Branch, which experienced one default (not underwritten by the branch manager) out of a total of three FHA originations. In addition, every one of the fully-delegated branch managers is a long term Ryland employee with management tenure of at least 5 years and 2 are vice presidents with the company. These are ethical, well informed employees that as indicated by the above, do not take the approval of FHA refer loans lightly and strongly prefer that refer loan files be evaluated by the DE underwriter.

Loan Processors Do Not Have Underwriting Authority

The statement by the former employee that loan processors were pressured to increase loan approvals misrepresents Ryland's loan approval process. Loan processors do not have the authority to approve or deny loans. Because risk assessment is the most important aspect of loan origination, Ryland has adopted a method that provides for loan approval before the file is released to a loan processor. This means that the loan files will be presented to the processor conditionally approved by a delegated underwriter with a list of conditions that must be released prior to final approval. The processor's job is to collect the necessary documentation to release the conditions. However, if the there are changes to the ratios, loan amount, credit rating, debt levels, down payment source or any other factor associated with underwriting, the processor must resubmit the file to the underwriting department or to the Operations Manager who is also DE approved. Therefore, the assertion that loan processors are pressured to approve loans cannot stand, as it is patently false.

The Assertion That There is No Formal Training is Equally Baseless

Both ex-employees contend that Ryland employees lacked training. Another false assertion easily contradicted by facts. Below is a sample list of training sessions that were held at the Regional Operating Center (ROC) in Phoenix for 2004:

Training Session	Date	Time	Duration	# of Attendees
Withdrawn & Denied Loan Procedures	28-Jan	1:00	30 minutes	11
Withdrawn & Denied Loan Procedures	28-Jan	2:00	30 minutes	4
Withdrawn & Denied Loan Procedures	28-Jan	10:00	30 minutes	32

Training Session	Date	Time	Duration	# of Attendees
Withdrawn & Denied Loan Procedures	28-Jan	11:00	30 minutes	15
Appraisal, Flood and RIS Changes	2-Feb	10:00	60 minutes	24
Appraisal, Flood and RIS Changes	2-Feb	11:00	60 minutes	24
Landsafe Credit Changes - How to Order a Supplement	3-Feb	1:00	30 minutes	12
Landsafe Credit Changes - How to Order a Supplement	3-Feb	2:00	30 minutes	29
Landsafe Flood, Appraisal & RIS Changes	4-Feb	10:00	30 minutes	27
FHA & VA Accept Loans, Resubmissions and Case Binders	5-Feb	9:00	60 minutes	27
FHA & VA Accept Loans, Resubmissions and Case Binders	5-Feb	11:00	60 minutes	29
Landsafe Credit, FHA/VA Accept Loans & Case Binder Makeup Session	23-Feb	1:30	60 minutes	5
Brokered Loan Procedures for NC, SC & GA	24-Feb	8:30	90 minutes	7
Brokered Loan Procedures for TX & S.CA	24-Feb	10:30	90 minutes	7
Brokered Loan Procedures for FL	24-Feb	1:30	90 minutes	9
Brokered Loan Procedures for CA	1-Mar	9:00	60 minutes	2
Brokered Loan Procedures for AZ	2-Mar	9:30	60 minutes	4
How to Review an Appraisal	7-Apr	10:00	1 hour	12
MATCH	4/22 &4/23	8:00	16 hrs	16
New Underwriter Training	3-May	9:30	2 hours	1
Analysis of the Self Employed Borrower	4-May	8:30	3.5 hrs	18
Analysis of the Self Employed Borrower	4-May	1:00	3.5 hrs	27
New Loan Counselor Training	5-May	1:00	1.5 hours	2
New Processor Training	10-May	8:00	4 hours	2
New Processor Training	11-May	8:00	4 hours	2
HELOCs	12-May	10:00	30 minutes	20
HELOCs	12-May	10:45	30 minutes	16
HELOCs	12-May	11:30	30 minutes	18
HELOCs	12-May	1:15	30 minutes	10
How to Review an Appraisal	18-May	2:00	30 minutes	6
How to Review an Appraisal	20-May	9:00	30 minutes	3
New Processor Training	8-Jun	10:00	2 hours	1
New Processor Training	9-Jun	8:30	2 hours	1
New Processor Training	10-Jun	10:00	2 hours	1
ARM Loans - Ordering MI Online	15-Jun	8:30	30 minutes	12
ARM Loans - Ordering MI Online	15-Jun	9:00	30 minutes	13
ARM Loans - Ordering MI Online	15-Jun	9:30	30 minutes	14
New Contract UW Training	16-Jun	10:00	2 hrs	1
New Management Trainee Training	17-Jun	9:00	3 hrs	1
New Management Trainee Training	18-Jun	9:00	3 hrs	1

Training Session	Date	Time	Duration	# of Attendees
New Processor Training	28-Jun	9:00	4 hrs	1
New LC Training	29-Jun	10:00	1 hr	2
New Processor Training	30-Jun	9:00	6 hrs	2
New Processor Training	1-Jul	9:00	3 hours	3
New Processor Training	2-Jul	9:00	4 hours	3
New Processor Training	6-Jul	9:00	4 hours	2
Benefits of Using RIS	7-Jul	10:00	30 minutes	13
New Processor Training	7-Jul	10:30	1.5 hours	1
New Processor Training	8-Jul	11:00	1 hr	1
Resubmissions	9-Aug	900	30 minutes	13
Resubmissions	9-Aug	10:00	30 minutes	14
New Processor Training	23-Aug	8:00	4 hrs	1
New Processor Training	24-Aug	8:00	4 hrs	1
New LC & LO Training	25-Aug	1:00	3 hrs	4
New LC Training	27-Aug	9:30	6 hrs	2
New Processor Training	31-Aug	8:30	4 hrs	2
New UW Training	1-Sep	10:00	2 hrs	1
Lump Sum Training	3-Sep	9:00	30 minutes	6
Lump Sum Training	3-Sep	9:30	30 minutes	13
Lump Sum Training	3-Sep	10:00	30 minutes	19
Lump Sum Training	3-Sep	11:00	30 minutes	8
Lump Sum Training	3-Sep	1:00	30 minutes	15
Lump Sum Training	3-Sep	2:00	30 minutes	15
Closing Coordinator Training	8-Sep	8:30	3 hours	1
Closing Coordinator Training	9-Sep	9:00	3 hours	1
Credit Supplement Training	14-Sep	11:00	30 minutes	9
Credit Supplement Training	14-Sep	2:00	30 minutes	12
New Las Vegas Loan Officer Training via Phone	17-Sep	8:30	90 minutes	1
FHA Loans	20-Sep	8:30	60 minutes	3
FLAME Training	11-Oct	8:00	20 hours	19
MATCH	14-Oct	8:00	16 hours	18
New Closer Training	4-Nov	8:00	8 hours	1
New Underwriter Training	10-Nov	8:00	8 hours	1
New Loan Officer	16-Nov	8:00	4 hours	1
New Loan Counselor Training	29-Nov	10:00	90 minutes	1

FLAME is a two and one half day class covering all aspects of loan origination at Ryland including:

- Overview of Ryland corporate structure and policies
- Ryland Homes operational overview
- Underwriting process
- Loan validation process

- Title insurance
- Homeowners insurance
- Mortgage insurance
- In-depth loan origination system training (UniFi or Empower)
- Quality assurance
- Credit reports
- Pricing (quoting and disclosing interest rates)
- In-depth loan program review
- Professional development/goal setting
- Customer communication
- Using Allregs (added to most recent class curriculum)

MATCH is a two-day class covering all aspects of loan processing at Ryland including:

- Overview of Ryland corporate structure and policies
- Title process
- Underwriting process
- Loan program review
- Credit reports
- Customer communication
- Quality assurance
- In-depth loan origination system training (UniFi or Empower)
- Homeowners insurance
- Professional development/goal setting
- Mortgage insurance, FHA insurance, and VA funding fees

In addition to the above training, Ryland encourages managers and other employees to attend relevant outside training. For example, our Vice President of Quality Assurance attended the following conferences during the audited period:

- FHA Annual Mortgagee Conference
- MBA Conference: "Avoiding and Detecting Mortgage Fraud"
- MBA Annual Quality Assurance Conference
- MBA Annual Regulatory Compliance Conference

Thus, the allegation that Ryland does not provide adequate training for all of its employees, including its underwriters and loan processors does not hold up against the facts.

It appears that the OIG was mislead by these disgruntled, ex-employees, and Ryland's President and Senior Executives would welcome the opportunity to meet with you and the rest of the audit team to openly and candidly discuss these accusations as

Comment 3

well as the other findings in the Report. Regardless, Ryland respectfully requests that any and all baseless accusations, unsupported by documentation, be stricken from any final report.

Ryland Also Objects to the Misrepresentation Regarding Changes in Sales Pricing and Treatment of Downpayment Gift

This is another area where Ryland would respectfully request the OIG consider the source of their information. It is true that in new construction, the price of a home will invariably fluctuate from the time a buyer signs the purchase agreement and applies for a mortgage until the time the buyer closes on the home. However, the scenario described by the same ex-employee cited above is not only erroneous, it is easily shown as false by the facts.

First, the contention that downpayment assistance programs such as Nehemiah or OWN (DPA) would be used for borrowers whose income was insufficient to qualify makes no sense. If a borrower did not have sufficient income to qualify, then the source of the downpayment would have no effect on the underwriting decision. The second contention that such programs might be offered to a borrower who did not have sufficient funds to close is the very reason these programs were created. Therefore, Ryland does not understand how such statements support an allegation that it improperly treated such funds.

The ex-employee continues with the misrepresentation, however, by stating that when, "the borrower receives the gift funds, the operations manager would instruct the loan processor to increase the sales price of the home to cover the expenses of funding the gift." The veracity of this allegation is completely undermined by its complete misrepresentation of Ryland's processes and the processes of its affiliated home-selling divisions. Ryland is a separate entity from any of The Ryland Group's home selling subsidiaries. Therefore, neither Ryland, nor any of its employees have the ability to "increase" the sales price of any home sold by the home selling divisions. This was explained to the auditors in an interview and subsequent statement from the Vice President of Production.

He also explained that due to the nature of the homebuilding business, a buyer may sign a sales agreement and apply for a loan many months prior to the closing. In that time there may be numerous changes to the sales price. He continued: "a buyer may receive up to an $8 to $10 thousand incentive, which could be used for option upgrades, closing costs, or a reduction in the sale price of the home. In the time between signing the purchase contract and closing the home, a buyer frequently makes changes in the application of the incentive, which may cause the bottom line to fluctuate …."

The ex-loan officer's statement that such price fluctuations could be made anonymous by not including "sales price increase" in an addendum is equally specious.

In preparing for this response, the Committee requested and reviewed the 10 files containing the contracts, addendums, riders and all other documents related to the sale of the homes (Sales Files). All of the Sales Files contain numerous riders and amendments to the original purchase agreement that reflect increases and decreases to the total sales price. As expanded in more detail in Appendix B to this response, any one file may contain numerous riders and amendments that may increase the price due to added options or decrease the price due to added incentives. Amendments have such statements as: "Price Adjustment" or "Incentive Change" or, for a change order, the rider would list options added and the cost of such options. All amendments and riders would list the "Total Sales Price" as of the date of such document and all would be signed and dated by the buyer.

In Appendix D of the Report, there were a couple of borrowers who stated that they did not know what the price change was for. While I understand that a buyer may not remember transactions that took place 2 to 4 years ago, it is hard to imagine that a buyer would sign such a document without asking the reason. In one case, a borrower complained that he was given the documents at closing. However, the documents he signed and dated were a week before the closing. Again, Ryland does not believe that these borrowers are being less than truthful; but it is difficult to remember the details of any transaction, even one as large as buying a home, 4 years later.

It is also important to note that all of the documents in the Sales File are signed by the buyers and by employees of the home sales divisions. None are executed by mortgage company employees. This is not to say that Ryland employees would not talk with sales division personnel to determine how best to serve the needs of a particular customer. As indicated by the production manager:

> Although, as noted above, I do not have any authority to increase the price of the home, in my capacity as VP of Production, I work with our mortgage personnel when issues arise with borrowers. For example, if a borrower had a financial issue after contracting and no longer had sufficient funds to close, one suggestion I would make would be for the loan officer to talk with the home sales staff to see if any incentives could be applied to assist the borrower with closing costs. If the customer wanted to apply an incentive to closing costs, prior to December 2002 the net effect could have been an increase in the contract price. However, at no time would I – or could I – advise anyone to increase the sale price of homes for borrowers receiving non-profit gifts.

Ryland Also Challenges The Legal Basis Cited In The Report For Finding That It Improperly Treated The Downpayment Assistance

The Report states that "Ryland inappropriately made price adjustments to the original bases sales price to recover part or all of the amount it provided to Nehemiah or OWN program, service fees, and buydown." The only support given for this allegation is

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C and HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-10 C.

Paragraphs 1-6 and 1-7 of HUD Handbook 4155.1 (the "Handbook") specify limits for the mortgage amount based upon loan-to-value ratios. Neither the report, nor any of the documents in the file indicate that the LTV for any of the loans exceeded the limits specified in the Handbook. The amount of the loan for all the files cited were less than or equal to the maximum loan amounts required. The values of the homes were not just based upon the sales price, but were supported by appraisals by FHA-Approved Appraisers. Finally, in reviewing the overall sales for the homes in the communities in which the borrowers purchased, the homes were not consistently sold for more than similar homes sold at about the same time. Below is a sampling of 4 of the cases cited from The Ryland Group's Heritage Point Community:

Sales Price	% of Audited File	Plan #	Model Name	Sale Date	Case Number
118,890	**108.9%**	H12R	DESERT ROSE	Aug-02	
117,971	**108.0%**	H12R	DESERT ROSE	Aug-02	
116,509	**106.7%**	H12R	DESERT ROSE	Sep-02	
111,591	**102.2%**	H12R	DESERT ROSE	Sep-02	
109,190		**H12R**	**DESERT ROSE**	**Aug-02**	**023-1188456**
108,151	**99.0%**	H12R	DESERT ROSE	Sep-02	
134,542	**107.6%**	HD17	OCOTILLO	**May-02**	
130,290	**104.2%**	HD17	OCOTILLO	Apr-02	
129,000	**103.2%**	HD17	OCOTILLO	Jun-02	
125,000		**HD17**	**OCOTILLO**	**May-02**	**023-1129379**
176,797	**126.5%**	HD24	YUCCA	Apr-02	
152,920	**109.4%**	HD24	YUCCA	Feb-02	
143,000	**102.3%**	HD24	YUCCA	Mar-02	
139,780		**HD24**	**YUCCA**	**Jan-02**	**023-1073648**
117,524	**105.2%**	H12R	DESERT ROSE	Mar-02	
115,000	**102.9%**	H12R	DESERT ROSE	Mar-02	
113,000	**101.1%**	H12R	DESERT ROSE	Mar-02	
111,916	**100.1%**	H12R	DESERT ROSE	Mar-02	
111,766			**DESERT ROSE**	**Mar-02**	**023-1113543**
111,131	**99.4%**	H12R	DESERT ROSE	Mar-02	
111,104	**99.4%**	H12R	DESERT ROSE	Mar-02	
111,000	**99.3%**	H12R	DESERT ROSE	Mar-02	
109,868	**98.3%**	H12R	DESERT ROSE	Mar-02	
107,870	**96.5%**	H12R	DESERT ROSE	Mar-02	
107,448	**96.1%**	H12R	DESERT ROSE	Mar-02	

Similarly, Ryland was not in violation of paragraph 2-10 C, which specifically relates to "Gift Funds." This section specifically provides from what types of organizations such gift funds may be received and documentation requirements for such funds. The audit report does not suggest that Nehemiah or OWN are not appropriate sources for such funds. Nor does the report suggest that Ryland making a donation to Nehemiah or OWN is inappropriate. In fact, the report notes, "this is an accepted practice." Therefore, even if the sales price of the homes were increased, there is no legal basis for finding that such a practice violates any HUD regulations or guidelines as long as the sales price does not exceed the market value of the house. As noted above, both the appraisals in the files and the prices of comparable houses in the same community support the sales prices of the homes for ALL OF THE FILES CITED.

Ryland Has Always Been Extremely Cautious With Regard to Downpayment Programs Due, in Part, to a Lack of Concise Guidance from HUD

Ryland has always been wary of using DPA's due, in part, to a lack of specific direction or commitment from HUD as to how and when mortgage companies and homebuilders could or could not make contributions. Out Senior Vice President of Production has an extensive history at Ryland and provided the following timeline of Ryland's dilemma in offering to originate loans for homebuyers who would use such programs.

When these programs first appeared in the mid '90's, neither Ryland, nor the home selling divisions would use them due to unresolved questions, and because at that time, HUD had not agreed to allow FHA guarantees for such mortgages. However, in 1998 when HUD finally agreed, many homebuilders and mortgage companies had to start offering the programs or they could not compete in certain markets.

Then in 1999, there was a huge debate when HUD reconsidered its position and issued a proposal to no longer allow FHA to guarantee such loans. However, the proposal was never adopted. Ryland at that time monitored and continues to monitor its default rates very closely to ensure that we don't have the issues that concerned HUD at the time – namely, higher default rates on when such programs are used.

Then, in September 2002, the OIG issued its report on the high default rates for borrowers who used the DPA's. At that time, Ryland conducted another investigation, this time to determine if the The Ryland Group's sales divisions were, in fact, selling homes at a higher price to homebuyers who were using DPA programs. What it discovered was that while the ultimate price would not be higher for such buyers, that if a buyer chose to use incentives at the outset to decrease the cost of the home, but chose later to use such incentives for the DPA or for other closing costs, the home price would be adjusted up from the discounted price.

Therefore, even though there was still no specific guidance from HUD, Ryland made the decision to issue a directive to both mortgage personnel as well as to its affiliated home selling divisions that the price of the home could no longer be adjusted to accommodate the DPA'; that the selling price had to be set for the entire community at the outset. This was the memo provided to you at the exit conference. This is also explained in the statement provided to your auditor by Ryland's operations manager.

This was a decision that was made by Ryland executives, based upon a desire to take the high road, not based on any law, regulation or directive from HUD or from any other agency. If you believe that Ryland is mistaken is this assessment, once again our Executive Managers and President would welcome the opportunity to discuss this issue with you. However, based upon the rules and regulations today, Ryland believes that both it and its home selling affiliates were acting well within the law and within HUD guidelines in how it treated and administered its DPA programs.

Based upon the above, and upon the facts as detailed in the responses to the case narratives:

- Ryland is a separate entity from The Ryland Group's home selling divisions;
- Ryland is not responsible for the sales price, or for incentives offered to homebuyers for using the mortgage company; that is the responsibility of the home selling divisions;
- Although Ryland employees may work with the home selling divisions and with its borrowers for the benefit of all, it will not do so if the risk is too great for either. No one benefits when a borrower defaults – least of all, Ryland.
- Ryland has, and will continue to monitor default rates closely, especially with regard to FHA insured mortgages, and will take any and all actions necessary to lower the risk on such loans
- Therefore, Ryland does not believe that it, or its home selling affiliates "inflated" sales prices or treated downpayment gifts improperly for any of the loans cited in the Report.

Ryland would welcome a discussion with you if you believe otherwise.

FINDING 1: RYLAND ORIGINATED INSURED LOANS IN ACCORDANCE WITH HUD REQUIREMENTS AND PRUDENT LENDING PRACTICES

In addition to the above, Ryland respectfully submits the following responses to the issues raised in the Report:

False Employment Data and False Loan Officer Certifications

Comment 4

OIG: (3 of 21 Cases); Ryland: (1 of 21 Cases). Ryland has only found one case in which we believe the underwriter should have detected fraud. In one case, the basis of the fraud assertion is that the Soc Security/Medicare taxes were not correct, the auditor asserted that the business does not exist because the employer cannot be located, and cannot be verified now, almost four years later.

The pay stubs appear normal with the exception of slight variances in the Social Security and Medicare withholding, which were small and would not have alerted even the most prudent underwriter. The W-2 in the file appears normal and the bank statements reflect deposits exactly equal to the net pay on the pay stubs.

In another fraud detected by this audit the auditor confirmed the employment fraud with the state of Arizona. There was no such statement for this file. Additionally, the auditor noted that the Loan Officer certified the pay stubs and W-2 from a fax source, which the auditor could not determine. In our review, we can read that the fax originated from Ryland and there was also a bank printout in the file that was certified by the customer's bank.

In another file, the OIG is recommending indemnification even though its own narrative indicates that Ryland verified employment using an acceptable alternative method. Moreover, there is a notation in the file that the borrowers could not locate their 2000 W-2's for the prior year and were providing signed tax returns as a substitute. Ryland does not believe substituting signed tax returns for the W-2's added any significant risk to this loan and therefore, does not feel indemnification is appropriate or necessary in this case.

Questionable/False Social Security Numbers

OIG: 3 of 21 Cases; Ryland: 1 of 21 Cases.

Comment 5

Ryland only has found one case in which we believe the underwriter should have detected the questionable Social Security Number. In the first instance cited (023-1073648), the tax returns and bank statements all shared the same social security number. Although, the auditor determined that there was an "immigration issue with the buyer" the Arizona Federal Credit Union bank statement not only shows the same Social Security Number, but also indicates "N" under "Foreign Status". The credit report from Landsafe Credit shows the same social security number and indicates it passed a validity test. It is not expected that a reasonably prudent underwriter would perform further due diligence given the documentation in the file. Additionally, in conducting the review, Ryland spoke with the tax-preparer for the borrowers' 2001 and 2002 tax returns, and he not only verified the social security number, but also confirmed that there was a spelling difference between our file and his file.

In the second case cited, 023-1932092, the pay stubs, W-2's, tax returns, application and credit report all list the same social security number. The FHA compliant, tri-merged credit report states the Social Security number passed a validity test. A review of the copy of the social security in the file, while of poor quality, supports the social security on the loan application. Per HUD Handbook 4155.1 CH-3, Section 3-2, a lender may obtain evidence of a social security number from any of the above sources, and the actual social security card is not required. In addition, a review of HUD Handbook 4330, Appendix 60: Manual Checks of Social Security Numbers (9/94) reveals the prefix for the borrower's number to be valid and issued in California, which is not unusual for an Arizona purchaser. Therefore, it is not reasonable to expect that a prudent underwriter should or would have detected a false social security in this case.

Inappropriate Use of Buydown

OIG: 6 of 21 Cases; Ryland: 1 of 21 Cases.

Comment 6

The report notes that 5 of the 6 cases reviewed defaulted from 3 to 15 payments. Moreover, the finding is not that Ryland did not qualify the borrowers properly, but that it failed to document how the eventual increase would effect the borrower's ability to repay. If most of the borrower's defaulted in the first year, then it cannot be shown that it was the increase that caused the default.

In fact, in reviewing the files, in all but one case, Ryland found that there was ample evidence supporting each borrower's ability to manage the increase. In one file, for instance, the VOE shows increases in hourly wages for subsequent years that are more than sufficient to cover the increased rates (023-1129379).

In another file the borrower showed an increase in salary over two years and had overtime pay that was not used in qualifying for the buydown rate (023-1449064). Under HUD Handbook 4155.1, REV-5, paragraph 2-14 B 2, one of the criteria for establishing that the eventual increase will not affect the borrower adversely is, "The borrower has a potential for increased income that would offset the scheduled payment increases…." Thus, while the underwriter may not have sufficiently documented the criteria for the buydown, a review of the file indicates that it was appropriate and did not cause HUD undue risk.

Overstated Income

OIG: 9 of 21 Cases; Ryland: 0 of 21 Cases.

Comment 7

There are numerous reasons why Ryland does not believe that it overstated income in any of the cases cited. While one was because the auditor discounted all employment for fraud (where we dispute whether the fraud should reasonably have been detected), others appear to be due to documents that may have been missed during the audit, or a different interpretation of HUD guidelines. Ryland has always taken a conservative approach to questions regarding interpretation of guidelines and often calls the Homeownership Center in Santa Ana (HOC) for guidance. Thus, in one case where the auditor found Ryland had not sufficiently documented income by accepting a facsimile directly from an applicant, the HOC indicated that a faxed paycheck from the borrower was acceptable as long as the lender examined the paycheck for validity and the loan processor must certify it to be true and correct copy of the original, which was done (023-1592011).

Third Party Verifications Not Conducted

OIG: 10 of 21 Cases; Ryland: 2 of 21 Cases

Comment 8

This is also cited in Finding #2 for Quality Control even though the alleged issue is that Ryland did not sufficiently verify income, deposits and/or employment as it related to approving loans. However, in all but two cases, Ryland's review found adequate verifications in the loan files. In one case, we were cited for not providing bank statements for three months, but the file contained a letter explaining that the borrower had been raised not to rely on banks or credit, and therefore did not have a bank account until just prior to settlement (023-0990733). In another file, the auditor cited Ryland for not verifying a past employer (023-1188456). However, pursuant to HUD Handbook 4155.5, REV-5, paragraph 3-1 E provides, "The lender also must verify by telephone all ***current*** employers." The file contains VOEs for all current employers. Finally, while Ryland accepts that in two cases the underwriters did not obtain sufficient documentation regarding deposits and that this must be stressed in future trainings, both these loans are current (032-1073648 & 023-1646394).

Understated Liabilities

OIG: 3 of 21 Cases; Ryland: 0 of 21 Cases

Comment 9

These findings appear to be factual immaterial as well as do not appear to be supported by HUD Guidelines. In one case Ryland is cited for not including a borrower's loan balance for his retirement plan (023-1965223). In the first case, there was a $184.00 debt in an overdraft protection account. While Ryland agrees that this should have been counted, such accounts are usually paid off in the next month and, even if considered, the minimum payment of $20.00 on this debt would not have increased the DTI ratios, or effected any underwriting decision (023-1073648).

In another finding, Ryland's underwriter was cited for not considering a borrower's 401K loan obligations (023-1965223), which is exactly what the underwriter should have done:

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

HUD Handbook, REV 5, 4155.1, 2-11 D (emphasis added).

Unacceptable Credit History

OIG: 1 of 21 Cases; Ryland: 0 of 21 Cases

Comment 10

As in the last case, the report cites a violation of HUD guidelines that were, in fact, followed. Under HUD Handbook, REV 5, 4155.1, 2-11 D, "*minor* derogatory information occurring two or more years in the past does not require explanation...." Most of the debts referred to in the report occurred four to six years prior to the closing, with the highest collection balance of $424.00. Therefore, the underwriter correctly deemed these debts to be minor derogatory information that did not require explanation.

Unacceptable Qualifying Ratios

OIG: 12 of 21 Cases; Ryland: 2 of 21 Cases

Comment 11

With most of these findings, the report is calculating ratios based upon non-energy efficient home standards. All Ryland homes meet energy efficient mortgage standards. Therefore, under HUD Handbook REV 5, 4155.1, 2-19, the benchmark ratios are 31% for mortgage payment-to-income and 43% for debt-to-income.

Unearned or Unallowable Fees

OIG: 14 of 21 Cases; Ryland 0 of 21 Cases

Comment 12

Ryland has received notice from the OIG that it will be removing its findings with regard to the HOA dues and the Working Capital; therefore Ryland will not address those issues. However, the OIG also cites Ryland for the following: "In another case (023-1493852), the borrower's accrued rent equity with her stay at an Equity Residential apartment was used to offset an unjustified adjustment in the sales price of her home." Other than the word "unjustified" there is no indication as to what law, regulation or guideline Ryland has violated. Or even what fee was charged to the borrower?

Having said that, it appear from a review of the Sales File that there was a note from the same ex-loan officer used by the OIG for many of its cites in this Report to adjust the incentive due to "Rent/Equity." Because this is against Ryland policy, Ryland will work with the home selling division to investigate the matter and will, if appropriate, reimburse the borrower for any wrongfully charged fees.

Inadequate Documentation for Verification of Deposit

OIG: 13 of 21 Cases; Ryland: 3 of 21 Cases

Ryland is cited for failing to obtain a standard verification of deposit or original bank statements for the most recent three-month period, when according to HUD Handbook 4155.1 REV-5, 3-1F provides:

Comment 13

> ***Alternative Documentation.*** *As an alternative to obtaining a VOD, the lender may obtain from the borrower original bank statement(s) covering the most recent three-month period.* ***Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements.***

Thus, in one case, it appears that the guideline was misquoted, and Ryland was wrongfully cited for only obtaining two consecutive statements stating: "Original bank statements covering the most recent three-month period are required…." (023-1451488). In other cases, the narrative declares that the "handbook requires that the application be updated so as not to more than 120 days old when the loan closes." (023-1493862, 023-1811657 & 023-1965223). Although appropriate for most purchases, the handbook's actual requirement for new construction: "Provided the document is not more than 120 days old when the loan closes (***180 days old on new construction***), it does not have to be updated. Ryland only originates loans on Ryland homes, and all Ryland homes are new construction.

The Report Provides No Reason For The Inclusion of 3 Loans as "Ineligible Costs"

Comment 14

Appendix "A" lists the 24 loans, for which OIG has made the recommendations for Ryland to reimburse HUD for "losses already incurred of $85,741. However, 3 of the loans are not included in the Narrative Case Summaries in Appendix D, or elsewhere in the Report. Therefore, the OIG gives no rationale for including these 3 in its recommendations. The case numbers are (as numbered on Appendix A):

HUD Case Number		Net loss
2	023-1057152	$2,363.00
7	023-1293230	$34,742.00
12	023-1487584	$5,920.00
Total		**$43,025.00**

CONCLUSION

Comment 15

For the reasons set forth above, and based upon our review of the files as set forth in Appendix B, Ryland believes that it has originated insured loans in accordance with HUD requirements and prudent lending practices. Ryland does, however, agree with the OIG's findings as it relates to two cases (023-1932092 & 023-1451488) in that Ryland underwriters did not detect fraud, Ryland agrees with the recommendation to indemnify HUD for all costs incurred due to any default, forbearance or modification of these loans.

Ryland also does agree that it will provide additional retraining for its underwriting and loan processing staff with regard to detecting fraud and with regard to strict adherence to FHA documentation guidelines.

Ryland does not agree, however, with the recommendations with regard to the reimbursement to HUD for losses, partial claims or for forbearance or to borrowers for fees, or to the servicing lender to pay down the loan amounts.

Comment 16

FINDING 2: RYLAND ADEQUATELY IMPLEMENTED ITS QUALITY CONTROL PLAN AS REQUIRED

Ryland at no time disregarded its responsibilities to assure the Quality Assurance reviews were conducted in a timely manner and never intended not to comply with its written Quality Control plan and HUD guidelines.

The audit reviews were completed within the 90-day required deadline during the timeframe covered in the audit with the exception of the period from October 2003 to April 2005:

RYLAND MORTGAGE COMPANY
SCHEDULE OF CLOSED LOAN AUDIT FILE COMPLETIONS

MONTH/YEAR	COMPLETED
November 2001	2/19/2002-79 Days
December 2001	4/2/2001 - 90 Days
January 2002	4/25/2002-90 Days
February 2002	5/7/2002 - 67 Days
March 2002	6/17/2002 - 77 Days
April 2002	7/8/2002 - 68 Days
May 2002	7/25/2002 - 55 Days
June 2002	8/19/2002 - 49 Days
July 2002	9/6/2002 - 66 Days
August 2002	10/7/2002 - 38 Days
September 2002	10/31/2002 - 30 Days
October 2002	1/9/2003 - 69 Days
November 2002	2/4/2003 - 64 Days
December 2002	3/5/2003 - 65 Days
January 2003	4/1/2003-61 Days
February 2003	4/9/2003 - 39 Days
March 2003	5/19/2003 -49 Days
April 2003	6/3/2003 - 34 Days
May 2003	7/21/2003-51 Days
June 2003	8/22/2003 - 52 Days
July 2003	10/21/2003 - 81 Days
August 2003	11/18/2003 - 78 Days
September 2003	12/30/2003 - 90 Days
October 2003	2/20/2004 - 110 Days
November 2003	3/19/2004 - 109 Days
December 2004	5/28/2004- 148 Days
January 2004	6/10/1004 - 130 Days
February 2004	6/28/2004 - 118 Days
March 2004	7/28/2004 - 118 Days
April 2004	9/1/2004 - 121 Days
May 2004	9/29/2004 - 120 Days
June 2004	11/12/2004- 132 Days

July 2004	12/22/2004 - 132 Days
August 2004	2/9/2005 - 159 Days
September 2004	3/15/2005 - 165 Days
October 2004	3/31/2004 - 150 Days
November	4/28/2005 - 148 Days
December 2004	6/3/2005 - 153 Days
January 2005	6/14/2005 - 134 Days
February 2005	6/24/2005 - 114 Days
March 2005	7/15/2005 - 105 Days
April 2005	8/2/2005 -92 Days
May 2005	8/29/2005 - 90 Days
June 2005	9/27/2005 - 90 Days

The late reports were due to two unexpected occurrences:

1. In December of 2003 the Senior Auditor in the department retired. She spent the month of December completing the initial training of the newly hired auditor. The new employee had to come up to speed on Ryland's audit software; and
2. In June of 2004 the other Senior Auditor and Team Lead went out on leave. The nature of this leave was such that her return appeared imminent for several months. The anticipation of her return led the Vice President of Quality Assurance to determine that this was a short-term situation and would be rectified when there was full staffing.

During this time period, mortgage origination volume nationally was at an all-time high, resulting in severe restrictions on the pool of qualified employees within the mortgage industry. We found limited opportunities to engage capable temporary employees or hire qualified permanent employees to supplement the absent staff. The department was ultimately fully-staffed again, although it took longer than initially planned. These were isolated instances as evidenced by the attached Schedule A, which reflects that prior to these instances, Ryland was within the required 90-day period for the completion of file audits and all audits are currently on time.

The Quality Assurance Department takes this responsibility very seriously. In further support of the importance that Ryland places on the Quality Assurance function, Ryland can provide you with the professional resumes of the Vice President of Quality Assurance and the department's staff, if you do not already have them. She has over 30 years in the industry. In an earlier section, we provided a list of professional seminars attended by the Vice President of Quality Assurance, to ensure that Ryland stayed abreast of the latest developments in mortgage compliance.

To further assert Ryland's commitment to a strong Quality Assurance Program, we have follow-up procedures that Quality Assurance maintains for audit exception items. The Quality Assurance department distributes the individual exceptions to applicable staff at the Operations Center for response. These responses are reviewed by Operations Center Managers to monitor the quality of work and determine training needs of the individual employees. They are then reviewed by Quality Assurance to also determine if the response was appropriate and what the training needs might be. Examples of such memoranda that are distributed detailing these procedures should have been provided to you in the course of your audit. If not, we would be more then happy to provide these to you. Branches, or origination exceptions, are distributed to the Branch Managers. Examples of these may also be provided. These require Branch Managers to respond, detailing his actions on the exceptions. This process exhibits our efforts to address the exceptions found in internal audits in a meaningful way and to utilize these to enhance our staff training.

An earlier section provided details of training sessions previously held for our staff. Ongoing training has been a priority and all staff are included in the sessions that pertain to their function within the company. They also participate in training to provide additional exposure to other functions that give them a broader view of the processes. This training is an integral process in Ryland's Quality Assurance program. We can also provide you with program materials used in Ryland's training sessions.

The auditor also asserts on page 17 of the Report that a review of Ryland's November 2004 file audit did not reflect the mirrored findings in HUD's August 2003 monitoring. We believe the auditor is referencing FHA Case 023-2190013796. We assert that the file audit findings were accurate and appropriate. We address the auditor's assertions as follows and can provide supporting documentation:.

1. Qualifying ratios were not calculated correctly. **The auditor utilized a higher tax base than the underwriter, which accounted for the 1.08% variance in ratios. This variance was not significant enough to impact the AUS "accept" rating on this file.**
2. Some of the income used to qualify was unstable and/or not properly identified. **There is a verbal employment verification from the Work Line in the file in addition to two pay stubs that were current at loan approval that evidence the income and a YTD total. The borrower has been in this field for 4 years and this was the only income evidenced on the 1003 Loan Application and the MCAW.**
3. All Underwriting Conditions were not met. **The Underwriting Condition not met was the certification of the alternative documentation which was a requirement but not critical to the quality of the loan.**
4. The Underwriter did not state compensating factors on the MCAW. **This is correct although it should be noted that this loan was an AUS Accept.**
5. A pay stub covering the most recent 30-day period was not found in the file and/or did not meet all requirements for this type of loan. **The file was approved on 11/10/04 and closed on 11/18/04. There are two pay stubs in the file that evidence 30 days earnings dated 8/30/04 and 9/15/04 which appear to have been current at the time and do meet all the requirements for this type of loan.**

6. The borrower was charged an unallowable fee. **This refers to the working capital HOA fee on the HUD 1. It has been determined that these fees are disclosed in the CC&Rs to the applicants and are part of the contractual sales agreement. They are also not "escrowed" and would not fall under HUD's restriction of 2 months collected at closing. See email from HUD attached.**

Contrary to the Report's Assertion, Early Payment Default Reviews Were Conducted in a Timely Fashion

Comment 17

A review of the EPD Audit records reveals that the files prior to December 2003 were always done within the required deadline. From January 2003 to August 2004, the files were done late and were not within compliance. All files since August 2004 have been completed monthly from the Neighborhood Watch printout. This isolated instance caused by a mistake on the part of a new employee. Once found by the Quality Assurance manager, this was corrected. The department is current with the Early Payment Default files. This was an isolated occurrence and not in keeping with the department's normal operating procedures. We are very aware of our responsibility to keep this function current and in adherence with Ryland's Quality Control Plan and HUD guidelines.

The Report states that several reviews were conducted for loans that went into default with more than six payments, which is not required. A previous HUD Auditor had advised the Manager of Quality Assurance that files going into default within the first 12 months had to be audited. Our policy has been revised to audit files going into default as evidenced on Neighborhood Watch within the first six months.

As further evidence of our awareness of our responsibilities regarding the Early Payment Default files, we can provide you with copies of correspondence forwarded to the applicable HOC offices regarding fraud or misrepresentations found in several files.

Third-Party Verifications Were Conducted

Comment 18

This issue was addressed in the earlier section, and in the individual Narrative Case Summary Responses. The auditor asserts that 14 instances were found in which Ryland did not follow the established quality control plan procedures and HUD Handbook 4155.1, REV-4, paragraph 3-1E, and REV-5, paragraph, paragraph 3-1 E, relating to third-party verifications of income and employment used as a basis for approving the loans.

The auditor states that "HUD Handbook 4155.1, REV-4, paragraph 3-1 E, and REV-5, paragraph 3-1 E, provide more stringent requirements for verifying employment; as an alternative to obtaining a written verification of employment, the lender may choose to obtain from the borrower original pay stubs covering the most recent 30-day period, along with original copies of the previous two years' Internal Revenue Service W-2 forms. The lender must also verify by telephone all employment for the past two years."

Per HUD Handbook 4155.1, REV-4, paragraph 3-1 E, and REV-5, paragraph 3-1 E, "Alternative Documentation…The lender must also verify by telephone all current employers…", not all employment for the past two years.

The specific responses to these 14 findings are included in Appendix B of this report. Of the 14, Ryland disputes and rejects 10 instances, and has provided the supporting documentation in explanation. Ryland accepts 4 instances, with explanations that alternative, compensating documentation was provided, which resulted in no significant additional risk on the loans.

The auditor sited two specific cases, which are discussed further in Appendix B In case 023-1188456, alternative documentation was obtained and telephone verification was obtained on the current employer, as required. In case 023-1592011, telephone verification was obtained on the current employer, as required. Faxed pay stubs, were obtained as alternative documentation. As noted in Appendix B, we assert that faxed pay stubs were appropriate documentation in this situation.

CONCLUSION REGARDING FINDING 2

Comment 19

The late audit reviews were isolated instances, which never happened before and will not happen again. It has always been Ryland's intention to comply with all agency, state, and federal regulations and guidelines. We take this responsibility very seriously and recognize the importance of adherence to the required deadlines. We strongly maintain that Ryland has created an environment in which compliance is of utmost importance.

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Appendix A

COMPARISON OF LOAN DEFICIENCY FINDINGS

	023-0990733[redacted]	023-1073648[redacted]	023-1113543[redacted]	023-1129379[redacted]	023-1188456[redacted]	023-1318434[redacted]	023-1449064[redacted]	023-1451488[redacted]	023-1453913[redacted]	023-1493862[redacted]	023-1576678[redacted]	023-1592011[redacted]	023-1646394[redacted]	023-1646660[redacted]	023-1653270[redacted]	023-1736086[redacted]	023-1811657[redacted]	023-1932092[redacted]	023-1965223[redacted]	023-2133633[redacted]	023-2177719[redacted]	Total Deficiencies	Ryland Total Deficiencies
Questionable documentation indicators																							
False loan officer certification																						2	0
False employment								x										x				3	2
Questionable/false Social Security #								x														3	1
Loan origination																							
Inflated sales prices																						10	0
Inappropriate use of buy down rate															x							6	1
Income																							
Unsupported/overstated income																		x				9	1
Missing verification of employment, written or telephonic; employment of 2 yrs not verified									x													7	1
Missing W2 forms	x						x		x													3	3
Missing pay stubs covering most recent 30-day period								x														4	1
Debt/credit																							
Understated liabilities																						3	0
Unacceptable credit history																						1	0
Inaccurate/excessive qualifying ratios without inadequate compensating factors															x			x				12	2
Unearned/unallowable fees																							
Excessive home ownership association fees																						5	0
Working capital																						10	0
Rent equity																						1	0
Inadequate documentation																							
Missing verification of deposit/3 months bank statements		x				x							x									13	3
Total deficiencies per loan	6	5	2	4	6	3	5	7	2	7	3	5	3	4	5	2	4	4	3	5	5	92	15
Ryland Total Deficiences	1	1	0	0	0	1	1	3	2	0	0	0	1	0	2	0	0	3	0	0	0	15	

Disagree
Agree
Agree with reservations

Names redacted for privacy

Comment 20

Appendix B

NARRATIVE CASE SUMMARY RESPONSES

Case Number 023-0990733
Loan No. 715987
Borrower [redacted]
Status: Mortgage Payment Current

A. False Employment – Ryland Response: Disagree

We do not believe that it is reasonable for Ryland Mortgage to have detected this fraud. We are not even sure that this loan was in fact fraudulent. The basis of the fraud assertion is that the Social Security/Medicare taxes were not correct, that the employer, G-Unlimited does not exist, and that the address of the employer can not be verified now, almost four years later. The pay stubs appear normal with the exception of the variances in the Social Security and Medicare withholding, which were small and would not have alerted the underwriter. The W-2 in the file appears normal. In another fraud detected by this audit, the auditor confirmed the employment fraud with the state of Arizona. There was no such statement for this file. The bank statements reflect deposits exactly equal to the net pay on the pay stubs. The auditor noted that the Loan Officer certified the pay stubs and W-2 from a fax, but could not identify the source. We can read that the fax originated from Ryland. Also of note is that the bank printout was certified by the customer's bank. Finally, we found two Dun and Bradstreet listings for G-Unlimited. So while the business may not exist today, it did exist at some point.

B. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, the Sales File for this borrower contains a Rider to the original agreement setting forth the incentive ($6,300) and that the appraised value of the property will not be less than $101,840. Moreover, contrary to the audit report, there is another rider, signed by the borrower, documenting the price adjustment of $2,300.

C. Overstated Income – Ryland Response: Disagree

The auditor asserts the income was overstated because the auditor claims employment fraud and has removed her income.

D. Insufficient Employment Documentation – Ryland Response: Agree

Ryland did not obtain 1999 tax returns. But we did have the 2000 W-2 and pay stubs for period ending 11/23/01. As a result, we were one month short of 2 years employment documentation. We will retrain our processing staff in October 2005 on FHA documentation standards as part of our ongoing training.

E. Inaccurate/Excessive Debt-to-Income Ratios – Ryland Response: Disagree

The builder cert confirms that all new construction (box 6) builders must comply with the Energy Code. All Ryland Homes meet Energy Efficient Mortgage Standards and as such, the allowed ratios are 31/43.

F. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV 5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

G. Unverified Sources Of Deposit – Ryland Response: Disagree

Borrower had no bank account until November 30, 2001. Borrower provided a letter explaining she had organized her affairs in a way not to need a bank account and that she had been raised not to rely on bank and credit. We are not aware of any FHA requirement that a borrower is required to have a bank account.

Response to Recommendations:

- Ryland will retrain processing staff to ensure compliance with FHA Documentation requirements
- Because Ryland did not find evidence of fraud, Ryland does not believe it should be required to indemnify HUD for this loan.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 21

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Case Number 023-1073648
Loan No. 718797
Borrower [redacted]
Status: Mortgage payments current

A. Questionable/ False Social Security Number - Ryland Response: Disagree

We believe that our due diligence verifying the borrower's Social Security number was acceptable. The tax returns and bank statements all shared the same social. Please note that the auditor determined that there was an "immigration issue with the buyer" but the Arizona Federal Credit Union bank statement not only shows the same Social Security Number but also indicates "N" under "Foreign Status". The credit report from Landsafe Credit shows the same social and indicates it passed a validity test. We accept that the name was misspelled on the tax returns but the address and social security numbers all matched and it was assumed to be a typographical error. It is not expected that an underwriter would require further checks based on the documentation in the file. We spoke with the tax preparer of their 2001 and 2000 tax returns and he verified the social security number but also indicated that the name on the tax return was correct.

B. Unsupported Source of Income – Ryland Response: Agree

We accept that we should have questioned why the tax returns for two years were both filed the same day. We should also have asked the buyer to explain why the name on the tax returns was different and ran credit under the AKA. We will retrain our underwriting staff and processing staff in October 2005 on document discrepancies and use this case an example.

C. Overstated Income – Ryland Response: Disagree

We agree that the underwriter added back the self-employment tax to borrowers Adjusted Gross Income. We support this decision by HUD Handbook 4155.1, REV-5, 2-9, C, 1, g, "*Individual Tax Returns ... the amount shown on the IRS Form 1040 as "adjusted gross income" either must be increased or decreased, based on lenders analysis of the individual tax return.*'" In addition, HUD Handbook 4155.1 REV-5, 2-1 D provides further guidance: "*Obligations not to be considered debt (or subtracted from gross income) include federal, state and local taxes...*" When we determine this borrower's Schedule C self-employed income, we took a two-year average of their Schedule C gain/loss plus any depletion and depreciation. Further, even if we removed the self-employment tax, it would have resulted in qualifying ratios of 25.5/32.5%, which is still well within the allowed ratios.

D. Understated Liability – Ryland Response: Disagree

We accept that we missed the overdraft protection account. The auditor described the overdraft protection in a negative manner that we do not accept. Overdraft protection accounts are widely used debt/asset management tools in place for over 15 years and used by millions of Americans. Further, adding a 5% minimum payment of $20.00 on this debt of $184.00 would not have increased the debt to income ratios.

E. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

F. Unverified Source of Deposit - Ryland Response: Agree

We accept that we only obtained a one-month bank statement for the account maintained at Arizona Federal Credit Union. The customer changed banks and we have older bank statements from the previous Bank Wells Fargo but not consecutive to the Arizona Federal Credit Union. We will retrain our processing staff in October 2005 on FHA asset documentation.

Response to Recommendations:

- Ryland will retrain processing staff to ensure compliance with FHA Documentation requirements
- Because Ryland did not find evidence of fraud, Ryland does not believe it should be required to indemnify HUD for this loan.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 22

Case Number 023-1113543
Loan No. 715167
Borrower [redacted]
Status: Not currently in default (partial reinstatement)

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, contrary to the audit report, there is a rider, signed by the borrower, documenting the price adjustment of $3,400.

B. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

Response to Recommendations:

- Because Ryland did not find evidence of fraud, Ryland does not believe it should be required to indemnify HUD for this loan.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 23

Case Number 023-1129379
Loan No. 726348
Borrower [redacted]
Status: Not currently in default

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, contrary to the audit report, there is a rider, signed by the borrower, documenting their acknowledgment and consent to a price adjustment of $4,770.00.

B. Inappropriate Use of Buydown Rate – Ryland Response: Disagree

Although the underwriter did not comment as to the borrower's ability to manage the buydown payment increases, a review of the file supports that he will be able to manage this increase. The VOE dated 07/13/02 in file shows a $.50 increase per hour in 01/2/02 with another scheduled increase in 1/2/03 for $1.00 per hour. Per the VOE, 17 months of overtime averaged $368.00 per month. The 17 months of overtime was averaged over 24 months and only $191 per month was used. The VOE indicates the overtime is likely to continue. Ratios with the correct overtime of $368 per month reduce the ratios at the initial bought down rate to 27/40.61. The scheduled 01/2003 wage increase alone of $173 per month would offset all buydown increases of $76.70 in year 2 and an additional $81.00 in year three.

C. Inaccurate Excessive Debt to Income Ratios – Ryland Response: Disagree

See "B" above. Ratios are not excessive with the correct overtime included, and as this property is Energy Efficient the allowed ratios are 31/43, and there is a significant compensating factor of the scheduled salary increase in Jan 03.

D. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost, Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting, Ryland does not believe it should be required to indemnify HUD for this loan.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 24

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Case Number 023-1188456
Loan No. 715987
Borrower [redacted]
Status: Mortgage payments current

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, contrary to the audit report, there is a rider, signed by the borrowers, documenting their acknowledgment and consent to a price adjustment of $1,000.00.

B. Unsupported Source of Income – Ryland Response: Disagree

The file clearly supports the co-borrowers income. The co-borrower has been employed with the Roosevelt School District for three years. There is a 2000 W-2 with $20,843 earnings, a 2001 W-2 with $21,058 ($1,750 per month avg.) earnings and year-to-date (YTD) pay stubs earnings through May 2002 of $12,067. The 29-month average is $1,786 per month, which is $5 per month more than the MCAW indicates. The school district operates under a fiscal year that corresponds to the school year, but the pay stub also shows the calendar year for YTD calculations. The pay stub clearly shows YTD earnings of $12,067 are for May 2003.

C. Insufficient Employment Documentation – Ryland Response: Disagree

On Semiconductor, the employer for the borrower noted by the auditor as not verified, is a previous employment. Per the HUD Handbook 4155.1, REV-5, 3-1 E, *"Alternative Documentation. ... The lender must also verify by* ***telephone all current employers****...."* All current employers were verified.

D. Excessive Debt to Income Ratios – Ryland Response: Disagree

The builder cert confirms that all new construction (box 6) builders must comply with the Energy Code. All Ryland Homes meet Energy Efficient Mortgage Standards and as such the allowed ratios are 31/43.

E. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

F. Unverified Source of Deposit - Ryland Response: Disagree

In the file is one complete bank statement along with a bank activity printout for a full 30-day period that clearly shows the borrower name and account number and is consecutive to the previous bank statement and shows a beginning and ending balance. Per the HUD Handbook 4155.1, REV-5, 3-1 F " *Alternative Documentation. As an alternative to obtaining a VOD, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous months balance, this requirement is met by obtaining the two most recent, consecutive months".*

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for the loan modification.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 25

Case Number 023-1318434
Loan No. 729610
Borrower [redacted]
Status: In default as of June 30, 2005

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, contrary to the audit report, there is a amendment to the purchase contract, signed by the borrowers, documenting their acknowledgment and consent to a price adjustment of $3,200.00.

B. Insufficient Employment Documentation – Ryland Response: Disagree

The application was taken 09/02 and one pay stub containing YTD information was obtained from both borrowers. Per HUD Handbook 4155.1, REV-5, 3-1 E, "*Alternative Documentation. As an alternative to obtaining a VOE the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with the original IRS W-2 Forms from the previous two years. The pay stub(s) must show the borrowers name, social security number, and year to date earnings....*" We have obtained consistent guidance from the HOC over the last 5 years that 3-1 E means that one pay stub is sufficient as long as the pay stub covers a minimum of 30 days worth of earnings and if the file is submitted to an FHA approved AUS. The 2000 & 2002 LP Documentation Matrix states, "*FHA Accept ... Obtain the most recent pay stub documenting 1 full month of earnings and a verbal VOE.... FHA Refer ... Same as Accept.*" The 12/2004 Total Scorecard reiterates this long standing requirement as, "*Current employment - The Lender must obtain the single most recent pay stub (showing year to date earnings of at least one month...*"). This loan was submitted to Loan Prospector, an FHA-approved AUS, for an AUS decision.

C. Unverified Source of Deposit – Ryland Response: Agree with reservation

We agree that we should have obtained two months consecutive bank statements. We believe the processor did not obtain the statements because no funds to close came from the borrower's bank. The down payment was a DPA gift and the seller paid all closing costs. A review of the HUD-1 evidences that the borrower was refunded their initial deposit at closing. Because of this, we do not believe this oversight added to the loan risk. We will retrain our processing staff in October 2005 that all listed assets must be documented in the file as required by FHA.

Response to Recommendations:

- Ryland will retrain processing staff to ensure compliance with FHA Documentation requirements

- Because Ryland did not find evidence of fraud or of improper underwriting, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for the special forbearance amount.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.

Comment 26

Case Number 023-1449064
Loan No. 728847
Borrower [redacted]
Status: Not currently in default

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, the Sales File contains several riders and contract amendments that, contrary to the audit report, document changes in the original sales price due to added options as well as changes to the application of the incentives. Both the buyer and the seller signed all of these amendments and riders, acknowledging and consenting to the price adjustments. Therefore, while the borrower may not recall changes to the price for her home that occurred three years ago, at the time she agreed to all of them.

B. Inappropriate Use of Buydown Rate - Ryland Response: Disagree

We believe that this file contains appropriate documentation that supports the borrower's ability to handle the buy down payment increases. HUD Handbook 4155.1, REV-5, 2-14 states 4 methods to establish that the buy down will not lead to default. Although the underwriter did not document the criteria, it is evident in the file that the borrower had the potential for increased income that would offset the increase. Only base pay was used to qualify. Deducting base pay from total gross income on the 11/18/2002 pay stub, and as documented on other pay stubs in the file, the borrower has earned an average of $173 per month in overtime. In addition the borrower has a documented history of increased wages. We direct you to the 2002 annualized base pay of $31,278 as supported by the pay stub in the file that is 19% greater than 2001 gross income. 2001 gross income of $26,323 is 3% greater than 2000 gross income. So not only did the borrower have overtime income not used in qualifying, but her income increased each year from the prior year. Both of these items would indicate that the borrower would be able to handle the increases.

As a side note, the auditor's note that the borrower defaulted after three payments does not support the contention of the improper use of a buydown, since at the time the borrower was paying the reduced amount. Now, three years later, after the increases have taken effect, the borrower is not currently in default.

C. Insufficient Employment Documentation – Ryland Response: Agree with reservation

We agree that we are missing the 2000 W2 from the file because the borrower could not locate it, but feel that the alternative documentation in the file supports two years employment. The borrower provided 2000 tax returns as a substitute, which are in the file and certified to be true and correct copies. The borrower also provided a current pay stub with year to date earnings for pay period ending 11/15/2002. As a result the file documents 22.5 months plus the 2000 tax returns. We do not believe that failure to obtain a W-2, which would have "filled in" the missing 1.5 months added any significant risk to this loan. We will retrain our processing staff in October 2005 on FHA documentation requirements.

D. Inaccurate/ Excessive Debt to Income Ratios - Ryland Response: Disagree

The builder cert confirms that all new construction (box 6) builders must comply with the Energy Code. All Ryland Homes meet Energy Efficient Mortgage Standards and as such the allowed ratios are 31/43. In addition, three years of the borrower's residency were rated and the previous landlord represented that two of those three years the borrower paid rent during that period almost equal to the proposed PITI. We believe the rental history was a valid compensating factor even though it was one year in the past.

E. Unallowable fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

Response to Recommendations:

- Ryland will retrain processing staff to ensure compliance with FHA Documentation requirements
- Because Ryland did not find evidence of fraud, improper underwriting or improper use of the buydown, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for the loan modification.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.

Comment 27

Case Number 023-1451488
Loan No. 732128
Borrower [redacted]
Status: Mortgage payments current

A. False Employment – Ryland Response: Agree

We accept that this customer committed fraud for purchase and was not detected by our underwriter or processing staff

B. Questionable/False Social Security Number - Ryland Response: Agree

We accept that this customer committed fraud for purchase and it appears that the borrower and her employer provided invalid pay stubs and W-2's that were not detected by our underwriting or processing staff. A review of the file indicates that the employer address and phone number were independently verified through the local phone company internet business listing, but the verbal verification was made to the phone number on our loan application, not the phone number indicated on the internet listing. We will retrain our DE Underwriters and Loan Processors in Fraud Detection in October 2005 using this file (purged of buyer references) as an example as part of our ongoing fraud training.

C. Insufficient Employment – Ryland Response: Agree

We accept that the pay stubs did not meet FHA documentation standards and will retrain our DE Underwriters and Loan Processors in Fraud Detection in October 2005.

D. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

E. Unverified Source of Deposit - Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 3.1 paragraph F Bank statements will expire within 180 days for new construction not the 120 days for existing as noted by auditor. In addition only two months bank statements are required (not the three stated in the audit) if they are consecutive and each bank statement shows the previous months ending balance.

Response to Recommendations:

- Ryland will retrain processing and underwriting staff to ensure compliance with FHA Documentation and fraud detection requirements.

- Because Ryland accepts that it did not detect evidence of fraud, and should have, it will agree to indemnify HUD for any and all actual costs incurred due to any default, forbearance or modification of this loan.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 28

Case Number 023-1453913
Loan No. 726137
Borrower [redacted]
Status: Mortgage payments current

A. Insufficient Employment – Ryland Response: Agree with reservation

A review of the file reveals that both borrowers' employment was verified by a supplement to the credit report that satisfies the verbal verification of employment requirement. The borrowers could not locate their 2000 W-2's for the prior year and as a substitute provided signed tax returns. While we agree that this did not conform with the letter of HUD Guidelines, we do not believe that substituting signed 2002 tax returns for 2000 W-2's added any significant risk to this loan. We will retrain our processing staff in October 2005 on FHA documentation requirements.

Response to Recommendations:

- Ryland will retrain processing and underwriting staff to ensure compliance with FHA Documentation requirements.
- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 29

Case Number 023-1493862
Loan No. 725239
Borrower [redacted]
Status: Not currently in default

A. Inflated Sales Price -- Ryland Response: Disagree

In addition to the general notes, the Sales File contains several riders and contract amendments that, contrary to the audit report, document changes in the original sales price due to added options as well as changes to the application of the incentives. Both the buyer and the seller signed all of these amendments and riders, acknowledging and consenting to the price adjustments. Therefore, while the borrower may not recall changes to the price for her home that occurred three years ago, at the time she agreed to all of them.

That said, a review of the Sales File indicates that a loan officer, in violation of Ryland policy, did request an amendment to the sales agreement to decrease the incentive amount with a notation "rent w/equity." This is the same loan officer terminated for cause by Ryland and on whose testimony the findings of this audit are largely based. Because of this violation of policy, Ryland will be conducting an investigation and will be meeting with the sales division to determine if it would be appropriate, as the auditor recommends, for the sales division to reimburse the buyer for the amount of the increase.

B. Inappropriate use of Buydown – Ryland Response: Disagree

Although the underwriter did not document the borrower's ability to handle the increases, a review of the file indicates the buyer would be able to support the increased payment. 2001 full year W-2 Earnings of $26,812 were 13% higher than 2000 W-2 earnings of $23,268. The buyer had 4 jobs in 2002 so at this time we cannot determine 2002 full year earnings, but the borrower's pay stub from her new job, which began in Jan 03 shows an annualized pay of approximately $31,000, which is a 15.5% increase over 2001. These factors well support the borrower's ability to adjust to the increased housing payment. In addition the ratios are within FHA EEM ratio guidelines of 31/43.

C. Insufficient Employment Verification – Ryland Response: Disagree

The auditor cites for not verifying prior employers. Per the HUD Handbook 4155.1, REV-5, 3-1 E, "*Alternative Documentation. ... The lender must also verify by telephone all current employers....*". All current employers were verified.

D. Unacceptable Credit History – Ryland Response: Disagree

A review of the borrower's credit report indicates that two years prior to closing the only adverse credit shown is a paid Cox Communication debt (the cable company) in 2002. All student loans reported deferred and satisfactory. The adverse credit referred to by the auditors totaled, by their own calculation, $902.00 with a highest collection balance of $424.00 and all occurred at least two years prior to closing with most debts being spread over 4 to 6 years prior to closing. As such the underwriter per the HUD Handbook 4155.1, REV-5, 2-3 judged the credit as instructed *"..minor derog credit occurring two or more years in the past does not require explanation..."*

E. Inaccurate Excessive Debt to Income Ratios – Ryland Response: Disagree

The builder cert confirms that all new construction (box 6) builders must comply with the Energy Code. All Ryland Homes meet Energy Efficient Mortgage Standards and as such the allowed ratios are 31/43.

F. Unverified Source of Deposit - Ryland Response: Disagree

The auditors noted that when the bank statements were updated we did not obtain two months bank statements but only one additional bank statement. We believe that obtaining an additional bank statement from the borrower would not have served any useful purpose, as the funds were not material to the transaction. Three months of deposit amounts were well represented by the borrower's 401K statement, which reflected three months of activity from 09/28/02 through 12/31/02. The bank statements provided at application and the updated bank statement showed minimal balance differences (one bank statement showed a balance at application of $101.83 and the updated bank statement showed a balance of $405.00, the other bank accounts also contained small balance of $100 - $300 and both time periods showed substantially the same balances and activity. Therefore, the lack of a second updated statement would have not provided any material information that would have effected the underwriting decision.

Response to Recommendations:

- Because Ryland did not find evidence of fraud, improper underwriting or improper use of the buydown, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for partial claims paid.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Ryland will conduct an investigation regarding its ex-employee's violation of policy regarding the adjustment made due to the buyer's participation in a rent with equity program. If appropriate, Ryland will recommend that the sales division reimburse the buyer for the amount of any unauthorized increase.

Comment 30

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Case Number 023-1576678
Loan No. 731932
Borrower [redacted]
Status: In default; partial claim

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, the Sales File contains several riders and contract amendments that, contrary to the audit report, document changes in the original sales price due to added options as well as changes to the application of the incentives. Both the buyer and the seller signed all of these amendments and riders, acknowledging and consenting to the price adjustments.

B. Inappropriate use of Buydown – Ryland Response: Disagree

Although it was not noted on the MCAW, a review of the borrower's historical earnings support that her income should increase as the buy down decreases. Her 2002 full year W-2 earnings of $26,856 were 18.5% higher than her 2001 full year W-2 earnings of $22,616. Her annualized 2003 earnings (base hourly rate of $13.50 per hour x 40 hours x 52 weeks) of $28,596 are 6.5% higher than 2002. The buy down subsidy run off will increase her monthly payment about $80.00 per month. Assuming 6.5% income increases, the lower of the historical increases indicates her income could go up $145.00 per month, which would more than compensate for the buy down increases. Ryland will emphasize the necessity of proper documentation by underwriters at future trainings.

C. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

Response to Recommendations:

- Because Ryland did not find evidence of fraud, improper underwriting or improper use of the buydown, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for partial claims paid.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 31

Case Number 023-1592011
Loan No. 731020
Borrower [redacted]
Status: Not currently in default

A. Overstated Income – Ryland Response: Disagree

This income is substantiated. The $70.00 per month income used for the co-borrower is seasonal second job income she earns from H&R Block. Reviews of her W-2's indicate that in 2000 she earned $4,288, in 2001 she earned $845 and in 2002 she earned $1,972. Disregarding the overly large earnings in 2000, an average of 2001 and 2002 results in average monthly earnings of $117.00 per month, which is greater than the $70.00 used by the underwriter. Because the income was only $70.00 per month, inclusion or exclusion would not have changed the qualifying ratios.

B. Insufficient Income Documentation – Ryland Response: Disagree

We agree that the pay stubs were faxed from the co-borrower's place of employment and that the loan processor certified them as true and correct copies. We have confirmed with the Santa Ana HOC on Friday October 7, that a faxed paycheck direct from the borrower was acceptable but that the lender must closely examine the paycheck for validity and the loan processor must certify it to be true and correct copy of the original. A close examination of the faxed documents provide no reason to suspect the pay stubs were altered in any way or contributed in any way to the borrowers default. We often rely on guidance from our HOC and there are times when the guidance provided appears to vary from the guide or clarifies an unclear guide item.

C. Inaccurate/Excessive Debt to Income Ratios - Ryland Response: Disagree

This borrower did have approx. 4.70 months reserves after the close of escrow, which is an allowed compensating factor. In addition the qualifying ratios were 18/46 and compared to the allowed for EEM ratios of 31/43 are not significantly excessive. We also note that the recent increase of ratios with EEM to 33/45 would today effectively remove this as a finding. We will retrain the underwriter staff in October on the standard for documenting compensating factors.

D. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting, Ryland does not believe it should be required to indemnify HUD for this loan or reimburse HUD for the special forbearance or for the loan modification.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 32

Case Number 023-1646394
Loan No. 731932
Borrower [redacted]
Status: Mortgage payments current

A. Overstated Income – Ryland Response: Disagree

We agree that the underwriter added back the self-employment tax to borrowers Adjusted Gross Income. We support this decision by HUD Handbook 4155.1, REV-5, 2-9 1 9 "*Individual Tax Returns ... the amount shown on the IRS Form 1040 as "adjusted gross income" either must be increased or decreased, based on lenders analysis of the individual tax retu...*" In addition, HUD Handbook 4155.1, REV-5, 2-1 D provides further guidance "*.... Obligations not to be considered debt (or subtracted from gross income) include federal, state and local taxes....*" When we determined this borrower's Schedule C self-employed income we took a two-year average of their Schedule C gain/loss plus any depletion and depreciation. We also note that FNMA allows net Schedule C Income plus depreciation and depletion to be used as qualifying income without regard to taxes.

B. Inaccurate/Excessive Debt to Income Ratio – Ryland Response: Disagree

We do not agree with finding "A" above which caused this finding. The ratios were within guidelines when based upon Schedule C earnings.

C. Unverified Source of Deposit – Ryland Response: Agree

We agree that only one-month bank statement was obtained on this loan. We will retrain our all loan processors in October 2005 on FHA documentation requirements.

Response to Recommendations:

- Ryland will retrain processing and underwriting staff to ensure compliance with FHA Documentation requirements.
- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 33

Case Number 023-1646660
Loan No. 741778
Borrower [redacted]
Status: Mortgage payments current

A. Inappropriate use of Buydown – Ryland Response: Disagree

Ratios per the MCAW are 25.5/38.7, well below EEM allowed ratios of 31/43. In year 2, the ratios would increase to 28/41 still within EEM allowed ratios. In year 3, the ratios would increase to 30.7/43.9; only slightly over EEM allowed ratios of 31/43. These ratios are based upon NO CHANGE in the borrowers income. The method used to determine borrower income was conservative. There is extensive documentation in the file from the borrower and the borrower's employer indicating that, with the employers consent, beginning 09/2002 and ending 04/2003 the borrower reduced his hours by one day a week to attend soccer school. In addition, we received, a pay stub that reflected a wage increase of $1.00 per hour, which the employer confirmed. We used an average of 2003 YTD earnings plus 2002 earnings to arrive at our qualifying income for the borrower of $1,368 per month. We did not use 2001 earnings because they were greater than 2002 and YTD (because the borrower was working full time that year). We do not see any more conservative method of calculating this income. This was the income on the MCAW and the income used by the FHA-approved AUS that issued an "Accept" on this loan.

B. Unsupported Source of Income – Ryland Response: Disagree

We believe the auditor confused the initial application in the file with the final application and therefore made erroneous conclusions. The loan officer took the final application at our office, while the initial application was produced from our Loan Operating System (LOS). The initial application was dated April 10, 2003, which is the date our LOS records as the application date. This transaction closed on May 13, 2004 and the final typed application reflects lower income due to the conservative method we adopted in approving the loan. Both the MCAW and the FHA-Approved AUS system all used the lower qualifying income of $1,368 per month, not the $1,684 per month reported by the auditor.

C. Insufficient Employment Documentation – Ryland Response: Disagree

A review of the file reveals a copy of the co-borrowers employment letter, a verbal verification of employment, two years W-2's and a pay stub which reflects current and YTD earnings through 3/21/2003. Per the HUD Handbook 4155.1, REV-5, 3-1 E, "*Alternative Documentation. As an alternative to obtaining a VOE the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with the original IRS W-2 Forms from the previous two years. The pay stub(s) must show the borrowers name, social security number, and year to date earnings.*"

Even more compelling is that this loan was submitted to Loan Prospector® (LP) for underwriting, and FHA-approved AUS. We have obtained consistent guidance from the HOC over the last 5 years that paragraph 3-1 E above means that one paystub is sufficient as long as the paystub covers a minimum of 30 days worth of earnings and if the file is submitted to an FHA-approved AUS. The 2000 & 2002 Loan Prospector® FHA and VA Documentation Matrix (Matrix) states that for either "FHA Accept" or "FHA Refer": *"Obtain most recent paystub documenting 1 full month's earnings and a verbal VOE."* The 12/2004 TOTAL Mortgage Users Guide reiterates this long standing requirement for AUS "Accept/Approve" or "Refer": "**Current employment** - The Lender must obtain the single most recent pay stub (showing year to date earnings of at least one month." Therefore, based on past and present guidelines, there was sufficient employment documentation in this file.

D. Unverified Source of Deposit - Ryland Response: Disagree

Per the HUD Handbook 4155.1, REV-5,.1, 3-1 F, "***Alternative Documentation**. As an alternative to obtaining a VOD, the lender may obtain from the borrower original bank statements covering the most recent three-month period. Provided the bank statement shows the previous months balance, this requirement is met by obtaining the two most recent, consecutive months*." By the auditor's own statement, this is what is contained in the loan file.

Response to Recommendations:

- Because Ryland did not find evidence of fraud, improper underwriting or improper use of a buydown that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 34

023-1653270 023-1653270
Loan No. 742642
Borrower [redacted]
Status: In default

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, the Sales File contains several riders and contract amendments that, contrary to the audit report, document changes in the original sales price due to added options as well as changes to the application of the incentives. Both the buyer and the seller signed all of these amendments and riders, acknowledging and consenting to the price adjustments. The last such amendment was signed by the borrower on April 23, 2003, one week before closing. Therefore, while the borrower may believe that he didn't see the changes at closing, but the documents do not support that recollection. Moreover, while the settlement agent cannot recollect what occurred at this particular closing, the Settlement Statement in the file shows that the sales division did, indeed, provide incentives, including paying for certain closing costs, insurance, etc.

B. Inappropriate Use of Buydown – Ryland Response: Agree with reservation

The auditor stated that the borrower defaulted after making seven payments. We believe that the buydown was not the reason for the default because the default occurred prior to any payment change. One of the compensating factors for this loan was that the borrower's current rent of $646 per month was generally equal to the proposed payment of $777.51 on an after tax basis. So for the first 12 payments there was little payment shock. A review of the file indicates that this borrower did not have the adequate compensating factors for a buydown. Because buyers now qualify at the note rate on temporary buydowns, we will not encounter this issue in the future.

C. Inaccurate/Excessive Debt to Income Ratios – Ryland Response: Agree

We accept that ratios exceeded allowable ratios. We will retrain the underwriter staff in October 2005 on the need to conform to allowable ratios of 33/45 when there are not compensating factors that justify the high ratio loan.

D. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

E. Unverified sources of deposit - Ryland Response: Disagree

The borrower did not use a bank account for his financial affairs and only opened an account because of the pending home purchase. We accept that the bank statement was for only one month but that was due to the recent opening.

Response to Recommendations:

- Ryland will retrain processing and underwriting staff to ensure compliance with FHA Ration and Documentation requirements.
- Although Ryland disputes that the buydown was the cause of this borrower's default, Ryland accepts that this borrower did not qualify for the loan program. Therefore, it will agree to indemnify HUD for any and all actual costs incurred due to any default, forbearance or modification of this loan.
- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments prior to closing, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

Comment 35

Case Number 023-1736086
Loan No.
Borrower [redacted]
Status: Not currently in default; partial claim

A. Inflated Sales Price – Ryland Response: Disagree

In addition to the general notes, the Sales File contains several riders and contract amendments that, contrary to the audit report, document changes in the original sales price due to added options as well as changes to the application of the incentives. Both the buyer and the seller signed all of these amendments and riders, acknowledging and consenting to the price adjustments. In addition, the buyer in this case was represented by a real estate agent throughout the home buying process.

B. Insufficient Employment Documentation – Ryland Response: Disagree

The employer noted by the auditor is previous employment. Per the HUD Handbook 4155.1, REV-5, 3-1 E, "*Alternative Documentation. ... The lender must also verify by telephone all current employers....*" All current employers were verified.

Response to Recommendations:

- Because the value of the property is supported by a HUD-approved appraisal and other similar properties in the area, and because both the buyer and the seller agreed to all price adjustments prior to closing, Ryland does not believe it should be required to pay any amount to the servicing lender to reduce the loan amount.
- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 36

Case Number 023-1811657
Loan No. 740592
Borrower [redacted]

A. Insufficient Employment Documentation – Ryland Response: Disagree

The employer noted by the auditor is previous employment. Per the HUD Handbook 4155.1, REV-5, 3-1 E, *"Alternative Documentation. ... The lender must also verify by telephone all current employers…."* All current employers were verified.

B. Inaccurate/Excessive Debt to Income Ratios - Ryland Response: Disagree

This file was an LP Accept decision approved with Ratios of 38/39. The lender is not required to justify ratios when a valid LP Accept decision is received.

C. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

D. Unverified Source of Deposit - Ryland Response: Disagree

The application was taken by phone on 3/25/05 and signed by the borrowers on 3/30/2003. Per the HUD Handbook 4155.1, REV-5,.1 3-1 "*... All documents may be up to 120 days old at the time the loan closes (180 days for new construction)...*". The auditor erroneously used the 120 day existing construction documentation standard when the 180 day for new construction standard should have been used. Based on 180 days the file should have been updated September 25, 2003 the loan closed on August 13, 2003. All the bank statements in the file are internet bank statements. The internet statements all contain the URL as required by FHA and we have further assured ourselves that the statements belong to the customer by verifying bank deposits of their paychecks in the file match to the penny. They support balances as follows:

Bank of America regular savings xx0372 with an ending balance of $6,579.78 covers an entire period from 01/22/03 through 07/17/2003. All activity is shown for a 6.5-month period. Bank of America Checking 101-529XXX with an ending balance of $2,149.81 covers an entire period from 01/16/2003-07/17/2003. All Activity shown is for a 7-month period. And finally Bank of America My Access Checking 5318 with an ending balance of $1,971.52 covers an entire period from 02/05/2003-07/18/2003. All activity is shown for 6.5-month period. These funds total $10,699 and per the HUD1 the borrowers funds to close were $7,187. So we verified all funds to close plus about 3 months reserves.

Comment 37

Case Number 023-1932092
Loan No. 747121
Borrower [redacted]

A. False Employment – Ryland Response: Agree with reservation

We accept that this customer committed fraud for purchase. We disagree that we should have found a discrepancy in the FICA withholding. The pay stub with base pay of $3,360 should have carried $208.32 and 48.72 FICA and Medicare the paycheck provided shows $183.12 and 19.488. Another check with 3,633 gross should have had 225.46 and 52.67 FICA and MC and the pay stub actually showed 213.36 and 33.53. We believe these differences are not of a scale that would trigger further interest from the underwriter.

B. Questionable/False Social Security Number – Ryland Response: Disagree

A review of the file indicate that that it would not be reasonable to expect Ryland Mortgage to detect the Social Security number was not valid. Per HUD Handbook 4155.1, REV-5, 3-2, a lender must obtain evidence of a social security number. The pay stubs, W2's, tax returns, application and credit report all list the same social security number. The FHA compliant tri-merged credit report states the Social Security number passed a validity test. A review of the copy of the social security in the file, while of poor quality, supports the social security on the loan application. A review of 4330, Appendix 60: Manual Checks of Social Security Numbers (9/94) reveals the SS prefix to be valid and issued in California, which is not unusual for an Arizona purchaser.

C. Unsupported Source of Income – Ryland Response: Agree with reservation

We accept that this borrower may have committed fraud for purchase and to that end provided Ryland Mortgage with falsified/altered pay stubs, W-2 Earnings Statements and Tax Returns. We do not have access to the Arizona Department of Economic Security data and must rely on the documentation provided by the borrower. As an indicator of fraud the auditor states the FICA & Medicare were incorrect for the April and May pay stubs and that one pay stub was missing a check number. We agree with those findings in the context of our response above but would note that the Underwriter approved this loan on 10/21/03 and that updated pay stubs covering 09/01/03 – 09/30/03 were used by the underwriter in her evaluation. A review of those paychecks shows that Medicare & SS withholdings are correct (based on gross income less pretax dental plan). Either the borrower corrected a previous falsification or, more likely, the employer had previously withheld incorrectly.

As further defense, we believe that the paychecks deemed by the auditor to be false must have been manufactured using the employer's own payroll system. We refer you to the paycheck with no check number. In retrospect we can see there is no check number on the check but we also note additional printing at the bottom left side of the check. Computer characters **1201F91300** are repeated twice. This leads us to believe the borrower generated these check stubs from the employer and not manufactured independently. Fraud assisted by person(s) inside the employer would have made detection very difficult. Given the above, however, we will be using this borrower as an example of fraud when we retrain our underwriters in October 2005.

D. Inaccurate/excessive Debt to Income Ratios - Ryland Response: Agree with reservation

Ratios were judged excessive because the auditor removed all false income

Response to Recommendations:

- Ryland will retrain processing and underwriting staff to ensure compliance with FHA Documentation and fraud detection requirements.
- Because Ryland accepts that it did not detect evidence of fraud, and should have, it will agree to indemnify HUD for any and all actual costs incurred due to any default, forbearance or modification of this loan.

Comment 38

Case Number 023-1965223
Loan No. 746897
Borrower [redacted]
Status: In default

A. Insufficient Employment Documentation – Ryland Response: Disagree

The auditor invalidated the telephone verification of employment simply because the "probability of continued employment" was blank. It does not indicate "Not probable". This was an oversight of the processor to write "refused" or "will not provide" If the employer refused to provide we would have still judged this employment as stable. This borrower was employed with the same employer for 4 years. Most employers do not stated probability of continued employment at the time of telephone verification of employment. We agree that we did not fill in the box but reject the assertion that this failure did not document the stability and sufficiency of income. Continuous employment of 4 years with the same employer is itself such an indicator. We are changing our verbal verification of employment form to provide three check boxes on the form for "Yes" "No" "Refused to state" to make it clear to the processor that a response is required.

B. Understated Liabilities – Ryland Response: Disagree

The auditor used a 401K loan that was not used by the underwriter and per HUD Handbook 4155.1, REV-5,, 2-11 D retirement loan obligations are not considered obligations used in qualifying the borrower.

C. Inaccurate/excessive Debt to Income Ratios - Ryland Response: Disagree

A review of the file reveals a letter from the borrower indicating that he currently lived in a company apartment and that when he left the company provided housing his rate of pay would increase. We have an updated pay stub in the file date 10/10/03 that shows a new rate of pay of 21.36 per hour or $3,771 per month versus the $2,866 used by the underwriter. This rate increase, which is documented, lowers the qualifying ratios to 31/31 or is a well-supported compensating factor that would justify higher ratios. Regardless, the qualifying ratios of 31/31 are less then the maximum ratios of 31/43 as an EEM.

D. Unverified Source of Deposit - Ryland Response: Disagree

Per the HUD Handbook 4155.1, REV-5, 3-1, "All documents may be up to 120 days old at the time the loan closes (180 days for new construction)…." The auditor erroneously used the 120-day existing construction documentation standard when the 180-day for new construction standard that should have been used. Based on 180 days the file should have been updated December 10, the note was drawn and dated December 8.

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 39

Case Number 023-2133833
Loan No. 768518
Borrower [redacted]

A. Overstated Income – Ryland Response: Disagree

Per the HUD Handbook 4155.1, REV-5, 2-11 D, "*Obligations not to be considered debt (or subtracted from gross income) include federal, state and local income taxes; FICA or other retirement contributions such as 401(k) accounts (including repayment of debt secured by these funds.".* The auditor cited this section to support a finding that Ryland did not consider contributions to a 401K account as debt. In fact, this citation supports and describes how Ryland appropriately handled the 401K obligation and the 401K Loan. In addition, the auditor noted another deduction to the paycheck which in fact is a separate payroll deduction to Truwest Savings as an automatic savings deposit.

B. Understated Liabilities – Ryland Response: Disagree

There is no substantiation in the file for a new unidentified loan of $75.00 per month. The HELOC payment to Wells Fargo for $93.00 per month was not omitted in error but our Loan Origination System did not print data correctly on the MCAW. The ratios were correct but the debts were understated (only on the printed MCAW not in the calculations) due to the borrowers existing house payment. The borrower was selling their current home on Wildcat but the property did not sell in time for the closing. As a result the expense of the house in the amount of $262.00 per month was used in qualifying the borrower. To confirm that the MCAW was calculating the ratios correctly we tested it as follows: New Proposed Housing Payment = 1,026.40 + recurring debts 1,967 + Existing House Payment 262.16 (Wells Fargo Loan $93 + R.E. Taxes 140.00 + Hazard Insurance of $29.16) divided by Monthly effective Income of $6,511 = Qualifying Ratios of 15.6/49.9 which equals the MCAW ratios.

C. Inaccurate/excessive Debt to Income Ratios - Ryland Response: Disagree

We reference our response to finding A above. The auditor erroneously reduced income by 401K loan and deferral. There is no obligation on the underwriter part to confirm the borrower has reduced or eliminated their 401k deductions. In addition this loan was approved with high ratios by the HUD approved AUS System LP.

D. Unverified Source of Deposit - Ryland Response: Disagree

Our records show that this loan application was taken over the telephone on 02/24/05 and a copy signed and dated by the loan officer is in the file but evidently never returned by the customer. The Bank statements provided are from December 03 and Jan 04 with a cutoff date of the end of month. As a result the bank statements in the file were the most recent at the time of application and as they showed the beginning balance and the ending balance, under alternative documentation standards only two months were required and are valid for 180 days.

The concurrent bank statements in the file would have expired on July 30 and this loan closed July 23, 2004.

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.

Comment 40

Case Number 023-2177719
Loan No. 774489
Borrower [redacted]

A. Unsupported Source of Income – Ryland Response: Disagree

The borrower started employment with his current employer 11/27/02 and closed this loan on 10/19/2004. The W-2 earnings for this employer in 2002 were $3,109, the W-2 Earnings for 2003 were $46,326 and the YTD earnings for 2004 were $13,128. That period equals 16 months and results in an average monthly earning of $3,910, which is similar to the $3,798 used by the underwriter. Average Monthly Income is also increasing: $3,109 in 2002, $3,860 in 2003, and $4,376 per month in 2004. Although this period is shorter than the two years normally used when averaging income we believe it is prudent because the income is historically increasing, the income used for qualifying is substantially less then actual year to date earnings, and an letter from the employer dated 9/17/2004 supports the fact that OT is continuing by stating the gross pay for July and August 2004 and stating that he earns $15.00 per hour. Deriving OT from his base pay indicates the customer earned at least $2,400 per month in OT for those months. As a final justification, if the OT was removed from income, and only base pay used, the ratios would be 29/31 well within FHA guidelines of 31/43 for EEM homes.

B. Insufficient Employment Verification -- Ryland Response: Disagree

The auditor noted prior employers were not verified.. Per the HUD Handbook 4155.1, REV-5, 3-1 E, *"Alternative Documentation. ... The lender must also verify by telephone all current employers…."* All current employers were verified.

C. Unallowable Fees – Ryland Response: Disagree

Per HUD Handbook 4155.1, REV-5, 2-15 this is an allowable closing cost. Ryland did not charge transfer fees to the borrower, no HOA fees were considered as financed closing costs, and Ryland Mortgage did not collect any HOA fee or charge as part of an escrow account.

D. Unverified Source of Deposit - Ryland Response: Disagree

We agree that the loan processor neglected to remove the "Saving funds to close" but a review of the settlement statement shows the borrower needed $7,656 to close. The Desert School Credit Union checking account contained $8,300 and we do have two full months bank statements in the file for this account. Per the HUD Handbook 4155.1, REV-5, 3-1 F when using alternative documentation only two months bank statements are required if the bank statements show a beginning and ending balance.

Response to Recommendations:

- Because Ryland did not find evidence of fraud or improper underwriting that created any greater risk for HUD, Ryland does not believe it should be required to indemnify HUD for this loan.
- Because the fees are allowable, Ryland does not believe it should refund any amount to the borrower.

OIG Evaluation of Auditee Comments

Comment 1 OIG has the authority to audit any HUD-funded program activities and does not need a specific justification for its selection. Nevertheless, as previously discussed with Ryland at the exit conference, OIG initiated the audit of Ryland based on the fact that the Tempe branch office's three year default rate of 9.2 percent for loans closed during the audit period (November 1, 2001 and November 30, 2004) was significantly high. The confusion in Ryland's comments lies in the time period, loans that were in default for the two year performance period ending November 30, 2004, used when querying Neighborhood Watch. Further, we felt an audit of Ryland was warranted based on a HUD recommendation stemming from concerns outlined in a November 2003 monitoring report.

Comment 2 We interviewed the former Ryland employees to obtain a better understanding of the loan process and origination practices that occurred at the time the sampled loan transactions took place. Subsequent to the interviews, we discussed the results with Ryland's vice president of production in order to ensure accuracy and fairness in our audit report conclusions. The vice president was unable to provide us with any evidence to dispute the statements and claims by the former Ryland employees. Our interpretations of former Ryland employee allegations are addressed below:

- The former Ryland national underwriting manager's contention does not question the branch manager's authority to underwrite loans, but questions whether the branch manager acted in accordance with underwriting policies and procedures. Ryland's response stated "a phone survey of these seven management employees reveals that only one branch manager has used such authority on approximately four loans and only after discussion, and with <u>the approval and concurrence of the national underwriting manager, who ultimately approved the loans</u>." The former national underwriting manager's claim implies she did not concur with the approval of the loans, yet the loans were approved based on the sole authority of the branch manager. As a result, we feel that Ryland did not successfully invalidate the former employee's allegation.

- The former loan officer was not speaking about <u>loan processors</u>; she was speaking about other <u>loan officers</u>. Further, she did not state that loan processors were pressured <u>to approve loans</u>. She stated that loan officers were pressured <u>to falsify borrower income</u> in order to meet requirements. There is a great distinction between <u>falsifying borrower income</u> and <u>approving loans</u>. As a result, we feel that Ryland did not successfully invalidate the former employee's allegation.

- The former Ryland employees did not assert that all of its employees lacked training. The underwriting manager stated that many of the loan processors were not properly trained, not that they were not trained at all. And, because they were not properly trained, they relied heavily on the assistance of higher managers. Similarly, the former loan officer stated that she had no formal Federal Housing Administration training and as a result, relied heavily on the assistance of someone above her. As a result, we feel that Ryland did not successfully invalidate the former employees' allegation.

Comment 3 We agree with Ryland's assertion found two paragraphs down after the section "Ryland Also Objects to the Misrepresentation Regarding Changes in Sales Pricing and Treatment of Downpayment Gift." and understand how the message was misconstrued. We revised the section to clarify the statement.

We also agree with the contention that Ryland employees do not have the ability to "increase" the sales price. We are fully aware that Ryland is a separate entity from any of The Ryland Group's home selling subsidiaries and Ryland receives its mortgage loans from the home sales division. It is, however, apparent that both entities have business associations with each other. We believe that the decisions to "increase" the sales price of homes are made at Ryland Mortgage and communicated and directed to The Ryland Group's home selling subsidiary. This assertion is evidenced by an email we obtained from a Ryland Mortgage file between a Ryland Mortgage loan processor and a Ryland Home employee, who we presume to be the seller since her name appears on the Rider to Agreement of Sale as the document's preparer. The email requests a price adjustment be made to cover the cost of a buydown and to adjust what is reported on the finance addendum by a proportionate amount. The email continues to say "put in the comments in clear 'price adjustment' cause we've had people put in other things like – to cover buy down or for Nehemiah – and we don't want the appraiser to know that." The message alludes that this procedure of increasing the sales price to conceal the recovery of Nehemiah fund, service fee, and buydown is not an isolated occurrence, but is common and accepted at Ryland Mortgage. Furthermore, we recently received a memo directing Ryland managers and their respective departments to cease increasing sales prices when offering downpayment assistance. The memo went on to state that if there was any resistance, contact the Regional President or the writer of the memo. This suggests that prior to its dissemination in December of 2002, increasing the sales price to regain the downpayment assistance funds was commonly exercised.

We reviewed the 24 borrower contracts, included in that number are the three cases that were omitted from the narrative case summary, and determined that 13 cases contained unjustified price adjustments. Of the 13 cases, nine were in effect and dated before Ryland sent out the directive (see chart below). It is safe to say that these nine cases had inflated sales prices. We believe the four remaining cases, signed by buyer between January 11, 2003 and April 17, 2003, were handled the same way and no changes to cease this practice were ever implemented.

	Case number	Settlement date	Price adjustment amount	Price adjustment date based on buyer's signature
1	023-0990733	12/14/01	$ 2,300	12/5/2001
2	023-1113543	04/30/02	3,400	3/2/2002
3	023-1057152	05/16/02	2,400	4/2/2002
4	023-1188456	06/14/02	1,000	6/5/2002
5	023-1129379	07/30/02	4,770	7/14/2002
6	023-1293230	09/27/02	8,000	8/23/2002
7	023-1449064	12/27/02	5,500	8/31/02 & 10/10/02
8	023-1318434	09/25/02	3,200	9/8/2002
9	023-1576678	03/26/03	6,000	11/11/2002
10	023-1487584	02/12/03	5,277	1/11/2003
11	023-1493862	01/28/03	3,032	1/11/2003
12	023-1736086	06/24/03	2,980	2/6/2003
13	023-1653270	04/30/03	3,200	4/17/2003
		Not signed by borrower, date of fax		
		3 loans not included in draft report		

Mortgagee Letter 96-18 states "the source of funds for a gift to the borrower must be totally unrelated to the loan transaction." HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-10 C, states that "no repayment of the gift may be expected or implied." Therefore, if the sales price of the homes were increased to recoup the gift, there is a violation of both Mortgagee Letter 96-18 and HUD Handbook, regardless of whether this increase in sales price is below the market value of the house.

Other than briefly mentioning that the terminated loan officer wrote the two notes appearing on page 10 of the report, Ryland did not provide any documentation or support to negate these notes. Nor did Ryland sufficiently explain the option identification numbers attached to these sales price increases during our audit. Therefore, we did not make any changes to the report relating to the inflated sales prices.

Comment 4 We reviewed the loan file documentation again, but stand by our conclusion that all three cases contained false employment data that should have been detected by Ryland and/or false loan officer certification. It appears that Ryland may have confused the facts between two cases. The first two paragraphs on page 15 of their comments seem to refer to case number 023-0990733, while the third paragraph seems to refer to case number 023-1451488. However, we never mentioned that a loan officer certified the pay stubs and W-2 from a fax source for case number 023-1451488, but rather directed that deficiency to case number 023-0990733. In light of Ryland's observation, we noticed that we overlooked the fact that the pay stubs and W-2s were also falsely certified for case number 023-1451488. As a result, we have included that deficiency in the narrative case summary and will appear on the final version of the report. In order to reduce redundancy, we chose to direct Ryland to the comments of the narrative case summaries, unless Ryland agrees with a deficiency but chose to comment on it. Please see comment 20 for our response.

- <u>Case No. 023-1451488</u> HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-16 states when a duly designated official of a mortgage certifies a document, they are endorsing that the document is accurate and complete to the best of their knowledge. The text typewritten on the year 2001 W-2 form overlaps the surrounding textbox and text descriptions, while the Social Security numbers on two pay stubs were altered; before the change, the Social Security prefix showed "665," and after the change, it showed "765." The loan officer certified W-2 statements for the years 2000 and 2001, as well as the two altered pay stubs for the periods August 24 to September 6, 2002 and September 7 to 20, 2002. Clearly, this loan officer acted in violation of the HUD Handbook. Also, these items contained the fax header from "PM Home Buyer Connection In," with the fax number 623-846-6660. HUD Handbook 4155.1 REV-4, CHG-1, paragraph 3-1 E requires that the <u>original</u> pay stubs be obtained. Further, there were also pay stubs for the borrower's husband included in the file, which were faxed by Ryland; however, because the husband is not a borrower those items are irrelevant. The bank statement certification bears no consequence to false employment.

- <u>Case No. 023-1932092</u> OIG agrees that Ryland verified employment using an acceptable alternative method. However, employment verification is not in question for this borrower. Moreover, we do not believe substituting signed tax returns for the missing W-2 form added significant risk to the loan. The issue at hand concerns false pay stubs. The most recent pay stubs in the loan file were fabricated and altered to increase the borrower's monthly income. One of the pay stubs was missing a check number and the font size on all three pay stubs was different. This was very apparent at first inspection of the documents. Ryland failed to detect this discrepancy. We noted that Ryland agreed with the OIG to indemnify this loan; their statement can be found on page 20 and 55 of their comments.

Comment 5 We reviewed the loan file documentation again but stand by our position that all three cases contained false Social Security numbers that should have been detected by Ryland. Ryland found one case in which they believe the underwriter should have detected the false Social Security numbers (case number 023-1451488) and they chose to indemnify another case (023-1932092), but disagreed with OIG's evaluation. Our response is shown below. Please see comment 21 for our response on the third case (023-1073648).

- Case No. 023-1932092 Even though borrower's Social Security number was the same on pay stubs, W-2 forms, tax returns, application, and credit report, there was still an issue with the number. As noted on the file, a Ryland employee wanted a clearer copy of the Social Security card. This is not necessary; however, due diligence should have dictated. We feel that the employee who noted the request was unsure of the validity of the Social Security number. As discussed in the exit conference, Ryland has access to Lexis Nexis, a research database where the OIG found other names associated with the Social Security number in question. We noted that Ryland agreed with the OIG to indemnify this loan; their statement can be found on page 20 and 55 of their comments.

Comment 6 Our contention in the 'inappropriate use of buydown' section was twofold; one, to satisfy the documentation requirement mandated by HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14 and two, to show the improper use of the buydown. This is illustrated by the statement concerning borrowers who defaulted in 3 to 15 payments. We are suggesting that these borrowers should not have received a loan because their incomes were insufficient to handle the monthly mortgage payments, yet Ryland qualified them by offering the two to one buydown. We stand by our position that all six cases contained inappropriate use of a buydown. Also, we included in the total count the three other cases we did not include in the narrative case summaries; note that we cite two of those cases contained inappropriate use of buydown. Please see comments 23, 26, 29, 30, and 33 for our response.

Comment 7 We agree to remove two deficiencies with regard to overstated income for case numbers 023-1188456 and 023-2133833 from the report, but maintain that the other five cases are valid and remain deficient. Please see comments 20, 21, 31, 32, and 40 for our response.

Comment 8 We agree to remove one deficiency concerning case number 023-1965223 from the report, but maintain that the remaining twelve are valid and remain deficient. Included in our total count are the three cases we did not include in the narrative case summaries; note that we cite two of those cases contained a third party verification deficiency. In addition, we added in the criteria HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-6, which requires that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. Please see comments 24, 25, 29, 31, 33, 35, 36, & 40 for our response.

Comment 9 We agree to remove two deficiencies with regard to understated liabilities for case numbers 023-1965223 and 023-2133833 from the report, but maintain that the other one case is valid and remains deficient. Please see comment 21 for our response.

Comment 10 We stand by our position that this one case has an unacceptable credit history. Please see comment 29 for our response.

Comment 11 We agree to remove eight deficiencies with regard to inaccurate/excessive qualifying ratios without adequate compensating factors for case numbers 023-0990733, 023-1188456, 023-1449064, 023-1493862, 023-1646394, 023-1811657, 023-1965223, and 023-2133833 from the report, but maintain that the remaining four were valid and remain deficient. Included in our total count are the three other cases we did not include in the narrative case summaries; note that we cite one other case that contained inaccurate/excessive qualifying ratios without adequate compensating factors. Please see comments 23 and 31 for our response.

Comment 12 We agreed not to pursue the home ownership association fees as improper charges. However, we stand by our position that the $4,000 in rent equity be refunded as an overcharge to the borrower in case number 023-1493862.

Comment 13 We agree to remove five deficiencies with regard to inadequate documentation for verification of deposit for case numbers 023-118456, 023-1451488, 023-1646660, 023-2133833, and 023-2177719 from the report, but maintain that the remaining five were valid and remain deficient. Please see comments 20, 29, 34, 36, and 38 for our responses.

Comment 14 The missing three loans are also included in the narrative case summaries of appendix D. In addition, we readjusted our case totals to include the three loans, bringing us up to 24 instead of the original 21 we had reported in the draft.

Comment 15 Ryland agrees to indemnify loans relating to case numbers 023-1932092 and 023-1451488. We agree not to pursue indemnification for case number 023-2133833; however, we believe that Ryland did not originate insured loans in accordance with HUD requirements and prudent lending practices in the other 23 cases. We believe that Ryland should reimburse HUD for losses, partial claims, or forbearance relating to 23 cases. In addition, we believe that Ryland should reimburse the servicing lender to pay down the loan amounts and refund any overcharges to the borrowers.

Comment 16 Contrary to Ryland's claim, failing to perform timely audit reviews for a period of about a year and a half clearly shows that Ryland disregarded its responsibilities. Considering the importance of these monthly audit reviews to internal controls, this relatively long instance was not rectified immediately thereby delaying corrective action by middle and upper management.

Comment 17 According to HUD Handbook 4060.1 REV-1 & REV-1 CHG-1, Chapter 6, an analysis of all loans which go into default within the first six months are required to be conducted as part of the lender's quality control. We took a conservative approach to testing early payment defaults. Rather than relying on data that we directly pulled from Neighborhood Watch, we opted on reproducing a Ryland auditor's work to understand the series of actions or events leading to her results. As stated in the report, 66 or over 50% of the 122 defaulted loans between December 1, 2002 and March 31, 2005 were not properly reviewed; i.e., no documentation was in the binders to substantiate that a review was done. While we acknowledge that the department is current with its early payment default files; at the time of our review in May of 2005, we found several instances when the files were still not reviewed. Between September 2004 and March 2005, 28 loans defaulted within six payments or less. While 21 of the required reviews were conducted, seven or 25 percent were not; disproving Ryland's statement that 'all files since August 2004 have been completed monthly.'

Comment 18 The purpose of third-party verifications is to evaluate the stability of the borrower's income. According to HUD Handbook 4155.l, REV-4, CHG-1, and REV-5, paragraph 2-6, the lender must verify the borrower's employment for <u>the most recent two full years</u>. If the borrower indicates he or she was in school or in military during any of this time, the borrower must provide evidence supporting this. <u>The borrower must also explain any gaps in employment of a month or more.</u> This criterion indicates that two years of employment must be verified and not just <u>current</u> employment. We will include this Handbook citation in the main body, criteria, and narrative case summaries of the report for clarification.

Comment 19 While Ryland may have intended to comply with agency, state, and federal regulations, our review shows otherwise. For the reasons stated above, we maintain our position that Ryland did not adequately implement its quality control plan as required and unnecessarily increased the risk to the Federal Housing Administration insurance fund.

Comment 20 Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree to remove one deficiency relating to case number 023-0990733.

- <u>False Employment</u> We are unsure whether Ryland agrees or disagrees with this deficiency. On page 15 of the report, Ryland found one case in which they believe that the underwriter should have detected fraud; however, in the narrative case summary on page 27, Ryland stated that it was not reasonable to detect this fraud. Nonetheless we wanted to make clear that the address listed on the loan application for borrower's employer actually belonged to Grand Canyon Pump and Supply Company, which has operated at that location for over 15 years without any affiliations with G-Limited. Further, no wages from the employer in question appeared for the borrower's Social Security number with the Arizona Department of Economic Security.

- <u>Inflated Sales Price</u> The original purchase price was listed as $99,540 on the Sales Agreement signed on October 19, 2001 by the borrower. This amount included options with a total of $6,500, a lot premium of $1,500, and a base price of $91,490. On a December 5, 2001 faxed copy of a rider to Agreement of Sale, $2,300 was added to the final sales price as a 'Price Adjustment.' The final sales price as a result of this adjustment was $101,840. There was no description or explanation of the $2,300. Moreover, the original agreement states that the appraised value of the property will not be less than $99,540. There was an additional rider included in the file that states the appraised value of the property will not be less than $101, 840. However, after the price adjustment of $2,300 was added to the sales price.

- Overstated Income The borrower's monthly income of $2,600 earned at G-Unlimited on the mortgage credit analysis worksheet was overstated. Since the borrower's place of employment was false, the purported income from this employment must be deducted. We do not know whether the borrower had any income at all. Aside from her bank statement, covering a two-week period, there was no evidence in the file that leads us to believe that borrower has a stable income and can afford to pay her monthly premiums.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Unverified Sources of Deposit While we agree that borrower is not required to have a bank account, HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-10 B states that if the account was recently opened an explanation and evidence of source of funds must be obtained by the lender. Other than the letter explaining her lack of a bank account, no evidence of source of funds was ever provided.

- Recommendations
  - Indemnify HUD the mortgage amount of $100,261.
  - Pay the servicing lender $2,264 to reduce the loan amount.

Comment 21 Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree on removing any deficiencies relating to case number 023-1073648.

- Questionable/False Social Security number We reviewed Ryland's objections and do not concur with Ryland's assessment. The tax records may have had the Social Security number listed, but with all the discrepancies on the forms; i.e., forms not signed, misspelled name, multiple year filings, and the tax preparer did not submit the tax return to the Internal Revenue Service, (he turned them over to the filer for him to submit to the Internal Revenue Service) we have considerable doubt whether the records were actually used to declare the individual's income and tax liability, in-turn have not been validated by the IRS. We reviewed the borrower's Arizona Federal Credit Union bank statements and found no reference to the borrower's Social Security number other than the words "on file." The document Ryland speaks of which indicates the borrower's Social Security number and "N" under "Foreign Status" does not appear authentic and does not contain the Arizona Federal Credit Union's header. The borrower's file did not have a verification of deposit for the Arizona Federal Credit Union so it is assumed the statement was used as an alternative to the standard verification of deposit sheet. No documentation was in the file to show that a contact was ever made with the bank concerning the borrower. Therefore, we cannot see how the statement can validate the borrower's Social Security number. We agree that the Landsafe Credit report does show the same Social Security number; however, the credit report also generated more than one variation of the borrower's name attached to that same Social Security number. Trans Union credit bureau indicated the one variation to the borrower's name was 0 years old, while Experian credit bureau indicated the other name variation to be 21 years of age, yet both hold the same Social Security number. This should have raised a red flag towards the borrower's identity/Social Security number. When we interviewed the borrower, he stated that the last name listed on the loan application was not his surname, but was the variant that was reported on the credit report. Further, the Landsafe credit report does not show any activity for the borrower. All activity is for the borrower's wife, who is not a borrower/co-borrower. As stated at the exit conference by both the Vice President of Quality Assurance and Ryland's Assistant General Counsel, this is a red flag and further verification is required.

- <u>Overstated Income</u> The borrower's monthly income of $4,518 on the mortgage credit analysis worksheet was overstated by $293 per month. Assuming that the borrower's self-employed income was appropriate, Ryland improperly calculated the income by using business income rather than adjusted gross income as required by HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-9 C. 1.

- <u>Understated Liability</u> We agree that this liability would not have increased the debt to income ratios; however, it was not appropriate to omit it from the loan application. Also as a debt management tool for an individual, who has approximately 16 overdrafts in one month, this paints a poor picture of the borrower's ability to live within his income.

- <u>Unallowable Fees</u> As discussed, we agreed to remove this deficiency from the report.

- <u>Recommendations</u>
  - ❑ Indemnify HUD for the mortgage amount of $137,857.

Comment 22 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree on removing any deficiencies relating to case number 023-1113543.

- Inflated Sales Price The original purchase price was listed as $131,640 on the Sales Agreement signed on October 27, 2001 by the borrower. This amount included options with totaling negative $10, a lot premium of $750, and a base price of $130,900. On a Rider to Agreement of Sale, signed by the borrower on October 27, 2001, $1,796 worth of options was added to the final sales price, increasing it to $133,436. Additionally, a second Rider to Agreement of sale, signed by the borrower on October 27, 2001, shows an option of $95.00 added to the final sales price, increasing it to $133,531. On a Rider to Agreement of Sale, signed by the borrower on March 2, 2002, $3,400 was added to the final sales price as a 'Price Adjustment.' The final sales price as a result of this adjustment was $136,931. There was no description or explanation of the $3,400.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $134,995.
  - Pay the servicing lender $3,352 to reduce the loan amount.

Comment 23 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree on removing any deficiencies relating to case number 023-1129379.

- Inflated Sales Price The original purchase price was listed as $120,230 on the Sales Agreement signed on May 25, 2002 by the borrower. This amount included options with a total of $1,740, a lot premium of $1,000, and a base price of $117,490. On July 14, 2002, the borrower signed an amendment to agreement of sale, which added $4,770 to the final sales price. The description of this transaction was listed as a "Price Adjustment." The final sales price as a result of this adjustment was $125,000. There was no description or explanation of the $4,770.

- Inappropriate Use of Buydown Rate HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-14 requires that the underwriter specifically state which four criteria the borrower meets and documentation of job training or education in the borrower’s profession or a history of the borrower’s career advancement along with increases in earnings, all of which Ryland failed to do. Also, note that one pay stub included in the file for the period ended May 19, 2002, the year to date overtime hours were 44. These hours are a significant difference from the prior year's, which was stated on the verification of employment as 191.50 hours. HUD Handbook 4155.1, REV-4, CHG-1, chapter 2, section, 2-7 requires that "an earnings trend must be also established" for overtime income. In addition, if this type of income shows a continual decline, the lender must provide rationalization for inclusion of such income, where none was provided. Therefore, we disagree with Ryland's evaluation of the borrower's potential for increased earnings and feel that this borrower was inappropriately given a buydown to qualify for the loan. Interestingly enough, Ryland did not notice that the verifier of the employment verification form was signed by someone holding a position as 'foreman.' When we spoke to the employer, they notified us that this person was not authorized to verify employment.

- <u>Inaccurate/Excessive Debt-to-Income Ratios</u> The recalculated overtime income is incorrect and therefore cannot be included as income in the calculation of qualifying ratios. Further, the Debt-to-Income ratio remains at 46.6 percent, which is considerably higher than the 43 percent benchmark for Energy Efficient Mortgage Standards.

- <u>Unallowable Fees</u> As discussed, we agreed to remove this deficiency from the report.

- <u>Recommendations</u>
  - ❑ Indemnify HUD the mortgage amount of $123,068.
  - ❑ Pay the servicing lender $4,696 to reduce the loan amount.

Comment 24 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree to remove three deficiencies relating to case number 023-1188456.

- <u>Inflated Sales Price</u> The $1,000 price adjustment was listed on the Rider to the Agreement contract with an unidentifiable code beside it, not indicating what the legitimate purpose was for the adjustment. When we asked Ryland what it was for (i.e. additional options), we did not get a straight answer. Further, when we interviewed the borrower, they could not verify what it was for, yet they were able to name the option upgrades they requested and an approximate price they were charged.

- <u>Unsupported Source of Income</u> We agree to remove this deficiency from the report.

- <u>Insufficient Employment Documentation</u> HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The telephone verification of employment was scarcely complete when verifying borrower's employment at On Semiconductor. The years of employment of January 1, 1992 thru December 30, 2001were written on the sheet; however, no name, phone number, or date of verification was filled out. "W-2's" was handwritten on the verification of employment, possibly indicating that the loan processor did not contact anyone to verify this income and merely relied on the paper document for verification.

- <u>Inaccurate/Excessive Debt-to-Income Ratios</u> We agree to remove this deficiency from the report.

- <u>Unallowable Fees</u> As discussed, we agreed to remove this deficiency from the report.

- <u>Unverified Source of Deposit</u> We agree to remove this deficiency from the report.

- <u>Recommendations</u>
  - Indemnify HUD the mortgage amount of $143,470.
  - Reimburse HUD for the loan modification amount of $650.
  - Pay the servicing lender $985 to reduce the loan amount.

Comment 25 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We disagree with removing any deficiencies relating to case number 023-1318434.

- <u>Inflated Sales Price</u> The original purchase price was listed as $105,990 on the Sales Agreement signed on August 9, 2002 by the borrowers. This amount included no options, no lot premium, and a base price of $105,990. On September 8, 2002, the borrowers signed an amendment to agreement of sale, which added $3,200 to the final sales price. The description of this transaction was listed as a "Price Adjustment." The final sales price as a result of this adjustment was $109,190. There was no description or explanation of the $3,200.

- <u>Insufficient Employment Documentation</u> We understand that one pay stub is sufficient to satisfy this requirement, so long as it covers the **most recent 30-day period, i.e., one month's worth of income prior to the signing of the initial/final application**. Ryland did not obtain the original pay stubs covering the most recent 30-day period from both borrowers. The last pay stub included in the file for borrower and coborrower were for the periods ended August 3, 2002 and August 10, 2002, respectively. We presumed that the application signed by both borrowers on September 10, 2002 is the initial application since no other applications preceded it on file. Therefore, the necessary **most recent 30-day** pay stubs must cover the date August 10 thru September 10, 2002 because Ryland chose to verify the borrowers' employment via telephone**.** HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E states "verification of employment (VOE) and **most recent pay stub**" are required for each borrower. Additionally, the lender may choose an alternate form of verification where they must "obtain from the borrower original pay stub(s) covering the most recent thirty-day period, along with original copies of the previous two years' IRS W-2 forms."

- <u>Recommendations</u>
  - ❑ Indemnify HUD the mortgage amount of $107,488.
  - ❑ Reimburse HUD for the special forbearance of $100.
  - ❑ Pay the servicing lender $3,136 to reduce the loan amount.

Comment 26 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-1449064.

- <u>Inflated Sales Price</u> On October 10, 2002, the borrower signed an amendment to agreement of sale included in the file that adds $7,856 in options and $5,500 to the final sales price. The description of this transaction was listed as an 'incentive.' The final sales price as a result of this adjustment was $133,346. There was no description or explanation for the $5,500.

- <u>Inappropriate Use of Buydown Rate</u> HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14 requires the lender must establish and document that the eventual increase in mortgage payments will not adversely affect the borrower and likely lead to default. This requirement was not met. We disagree with Ryland's evaluation of the borrower's potential for increased earnings.

  When we interviewed the borrower, she claimed that she was unaware of how the buydown worked and that Ryland failed to explain the eventual increase in her mortgage payment. The last we heard, this borrower not only defaulted on her payments again, but she's had to sell her home. Clearly, the borrower defaulted after three payments, yet Ryland provided her with a buydown to meet the qualification requirement, Ryland improperly assessed the borrower's ability to pay and improperly used the buydown.

- <u>Inaccurate/Excessive Debt-to-Income Ratios</u> We agree to remove this deficiency from the report.

- <u>Unallowable Fees</u> As discussed, we agreed to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $131,239.
  - Reimburse HUD for the loan modification amount of $650.
  - Pay the servicing lender $5,413 to reduce the loan amount.

Comment 27 Ryland agreed to indemnify HUD for any and all actual costs incurred due to any default, forbearance or modification of this loan. We agree on removing one deficiency relating to case number 023-1451488.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Unverified Source of Deposit We agree to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $150,575.

Comment 28 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify case number 023-1453913.

- Recommendations
  - Indemnify HUD the mortgage amount of $151,265.

Comment 29 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-1493862.

- Inflated Sales Price On January 11, 2003, the borrower signed an amendment to agreement of sale, which reduced the sales price by $3,968. The description of this transaction was listed as a "Price Adjustment Rent w/ equity per xxxx."[2] There was an additional amendment to agreement of sale not signed by the borrower, which added $7,000 to the sales price with the description "Correcting Price Adjustment and Adding Additional Financing." There was no other description or explanation of the $7,000 increase.

- Inappropriate Use of Buydown HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14 requires the lender must establish and document that the eventual increase in mortgage payments will not adversely affect the borrower and likely lead to default. This requirement was not met. We disagree with Ryland's evaluation of the borrower's potential for increased earnings.

[2] Name redacted for privacy.

While the borrower's W-2 earnings show a $3,000 increase from 2000 to 2001 and an increase in annualized pay in 2002, the borrower's January 2003 credit report shows several deferments of educational loans amounting to approximately over $60,000. Payments are to begin between June and December of 2004, which is one year into the buydown. In addition, borrower has several pending liabilities that were deferred to June of 2004, amounting to approximately $18,000. Clearly, her income would not be sufficient to pay the monthly payments of a home and pay for student loans as well as other liabilities. Therefore, we believe Ryland inappropriately used the buydown.

- Insufficient Employment Verification HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The VOE was done by telephone and employment was only verified for four months. Therefore, the lender failed to verify the most recent two full years of employment.

- Unacceptable Credit History HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3 & 2-5 states the lender is required to examine the overall pattern of credit behavior, which it failed to do. Moreover, they also failed to explain numerous returned checks on the bank statement, which leads us to believe the borrower to be a high credit risk.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Unverified Source of Deposit HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F requires original bank statements covering the most recent three-month period where two must be consecutive statements if no verification of deposit is done by the lender. Only one applicable bank statement was found in the file.

- Recommendations
  - Indemnify HUD for the mortgage amount of $118,805.
  - Reimburse HUD for partial claims paid of $6,170.
  - Refund $4,000 in overcharges to the borrower.
  - Pay the servicing lender $2,985 to reduce the loan amount.

Comment 30 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree on removing any deficiencies relating to case number 023-1576678.

- Inflated Sales Price The original purchase price was listed as $120,555 on the Sales Agreement signed on September 29, 2002 by the borrower. This amount included options with a total of $5,565, no lot premium, and a base price of $114,990. On an amendment to agreement of sale, signed by the borrower on October 12, 2002, added additional options of $505, which increased the sales price to $121,060. On an amendment to agreement of sale dated November 1, 2002, signed by the borrower on November 02, 2002, options of $3,870 were added and increased the sales price to $124,930. On November 11, 2002, the borrower signed an amendment to agreement of sale, which added $6,000 to the final sales price. The description of this transaction was listed as a "Financing." The final sales price as a result of this adjustment was $130,930. There was no description or explanation of the $6,000.

- Inappropriate Use of Buydown To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase as required by HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14, which Ryland failed to do. In addition, we noted that the borrower defaulted after making seven payments. Therefore, a buydown was used to initially qualify the borrower. Further, Ryland claims borrower's income could go up $145 per month; however, the mortgage payment will increase $157.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $128,905.
  - Reimburse HUD for partial claims paid of $9,145.
  - Pay the servicing lender $5,907 to reduce the loan amount.

Comment 31 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree on removing any deficiencies relating to case number 023-1592011.

- Overstated Income The coborrower's monthly income of $2,462 on the loan application and mortgage credit analysis worksheet is overstated by $70 per month. We were unable to determine the basis of $70 listed as other income. There was no evidence in the file to support the continuance of this income as required in HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-7 & 2-7 A. Further, no faxed paycheck from the borrower was found in the file documenting the additional $70 in monthly income.

- Insufficient Employment Documentation HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The VOE was done by telephone and borrower's employment was only verified for one year and five months. Coborrower's employment was verified for one year and six months, also done by telephone. Therefore, the lender failed to verify the most recent two full years of employment for both borrowers. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E states "verification of employment (VOE) and most recent pay stub" are required for each borrower. Additionally, the lender may choose an alternate form of verification where they must "obtain from the borrower original pay stub(s) covering the most recent thirty-day period, along with original copies of the previous two years' IRS W-2 forms." Ryland did not obtain an original pay stub covering the most recent 30-day period from both borrower and coborrower. The last pay stub included in the file for the borrower was for the period ended March 7, 2003. However, the pay stub was faxed from the coborrower's place of employment. Additionally, there is a stamp bearing "certified to be a true and correct copy of the original" signed by a Ryland employee. The only original copies of pay stubs found in the file for the borrower were for the periods ended August 9, 2002, August 2, 2002, July 26, 2002, and July 19, 2002. The last pay stub included in the file for the coborrower was for the period ended March 14, 2003. This pay stub was also faxed from the coborrower's place of employment and bears the stamp "certified to be a true and correct copy of the original" signed by a Ryland employee. Without actually examining the original the Ryland employee is unable to certify that the document at hand is true and correct.

- <u>Inaccurate/Excessive Debt-to-Income Ratios</u> HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12 requires lenders to list compensating factors that justify qualifying ratios that exceed guidelines. The only compensating factors listed on the Mortgage Credit Analysis Worksheet were "minimal increase in housing." Where the borrower's verification of rent shows a monthly rent payment of $659, whereas the estimated mortgage payment is $1,062. This increased monthly home payment expenditures by $403. Additional compensating factors assured that "both borrowers have been in the same line of work for 5 and 2 yrs, borrower's have paid off some credit," yet borrowers defaulted their loans after three payments. We agree that borrower's had approx. 4.70 months reserves during loan process; nonetheless, was not listed as a compensating factor.

- <u>Unallowable Fees</u> As discussed, we agreed to remove this deficiency from the report.

- <u>Recommendations</u>
  - Indemnify HUD the mortgage amount of $153,772.
  - Reimburse HUD for the special forbearance ($100) and loan modification ($1,300) paid of $1,400.

Comment 32 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-1646394.

- Overstated Income The borrower's monthly income of $2,523 on the mortgage credit analysis worksheet was overstated by $178 per month. Assuming that the borrower's self-employed income was appropriate, Ryland improperly calculated the income by using business income rather than adjusted gross income as required by HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-9 C,1. We disagree with your analysis on the grounds that first, the mortgage was executed April 2003 and required the use of 4155.1 REV-4, CHG-1. Second, Ryland's interpretation of REV-5 appears flawed; the paragraph quoted intended the analyzer not to deduct these taxes from gross income, and third, this is in the liability section of the HUD Handbook regulation allowing these debts not to be used as a liability against the borrower, not gross income analysis.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $130,833.

Comment 33 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-1646660.

- Inappropriate Use of Buydown HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14 requires the lender must establish and document that the eventual increase in mortgage payments will not adversely affect the borrower and likely lead to default. This requirement was not met.

- Unsupported Source of Income Income from any source that cannot be verified, is not stable, or will not continue may not be used in calculating the borrower's income ratios as stated in HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E. Borrower's verification of employment reported gross income earned through April 24, 2003 of $5,374. Borrower's hourly pay prior to his May 9, 2003 pay raise of $10.11 per hour was $9.82. The combined income of $5,374 and calculated hourly income of $10.11 per hour, equaled a monthly income of $1,526, resulting in an overstatement and deviance from the $1,684 income reported on the MCAW of $158.

- Insufficient Employment Documentation HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E states "verification of employment (VOE) and most recent pay stub" are required for each borrower. Additionally, the lender may choose an alternate form of verification where they must "obtain from the borrower original pay stub(s) covering the most recent thirty-day period, along with original copies of the previous two years' IRS W-2 forms." Ryland did not obtain the original pay stubs covering the most recent 30-day period from coborrower, yet coborrower's income was incorporated in the calculation of income. Only one pay stub was included in file for the pay period ending March 21, 2003, showing a gross amount of $964. The most recent 30-day period pay stub is required because Ryland chose to verify the coborrower's employment via telephone.

- Unverified Source of Deposit We agree to remove this deficiency from the report.

- Recommendation
  - Indemnify HUD the mortgage amount of $148,291.

Comment 34 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree to remove any deficiencies relating to case number 023-1653270.

- Inflated Sales Price There is only one amendment to Agreement of Sale included in the file that adds $3,200 to the final sales price. The description of this transaction was listed as an "Incentive to be used towards closing". Yet an incentive to be used towards closing would not increase the sales price. There was no other explanation or description in the file to support the increase.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Unverified Sources of Deposit HUD Handbook 4155.1 REV-4, CHG-1, paragraph 2-10 B states a verification of deposit or copies of the most recent bank statements must be included in the file. If the account was recently opened, an explanation and evidence of source of funds must be obtained by the lender. There was no such explanation found in the file.

- Recommendations
  - Indemnify HUD the mortgage amount of $136,010.
  - Pay the servicing lender $3,150 to reduce the loan amount.

Comment 35 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We do not agree to remove any deficiencies relating to case number 023-1736086.

- Inflated Sales Price We agree that there were two riders and contract amendments that document changes in the original sales price due to added options. However, there is a third amendment to agreement of sale signed by the borrower on February 6, 2003, which added $2,980 to the sales price. The description of this transaction was listed as an "off base price off house/options." This increase was not substantiated by any documentation or explanation.

- Insufficient Employment Documentation HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The VOE was done by telephone and borrower's employment was only verified for one year.

- Recommendations
  - Indemnify HUD the mortgage amount of $140,628.
  - Reimburse HUD for a claim paid of $5,094.
  - Pay the servicing lender $2,934 to reduce the loan amount.

Comment 36 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-1811657.

- Insufficient Employment Documentation HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The VOE only verified borrower's employment for one year and seven months.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Unverified Source of Deposit We do not contest the dates of the bank statements provided in the file. The issue we found is there are several copies of online bank account statements - each corresponding to the account numbers provided on the URLA. However, we cannot be sure that these accounts belong to the borrower and co-borrower since the statements do not have names of the account holders. Therefore, HUD Handbook 4155.1, REV-

4, CHG-1, paragraph 3-1 F requirement that original bank statements covering the most recent three-month period are required where two must be consecutive statements if no verification of deposit is done by the lender was not met.

- Recommendations
  - Indemnify HUD the mortgage amount of $155,173.

Comment 37 Ryland agreed to indemnify HUD for any and all actual costs incurred due to any default, forbearance or modification of this loan. We do not agree on removing any deficiencies relating to case number 023-1932092.

- Recommendation
  - Indemnify HUD the mortgage amount of $119,516.

Comment 38 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing three deficiencies relating to case number 023-1965223.

- Insufficient Employment Documentation We agree to remove this deficiency from the report.

- Understated Liabilities We agree to remove this deficiency from the report.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Unverified Source of Deposit Ryland contends that the statement meets the 180-day requirement for new construction. OIG agrees with this part, but the bank statements failed to meet the rule concerning three consecutive bank statements, two if beginning and ending balance are listed. Our file showed two different bank accounts for the period June 6 through July 8 and September 24 through October 24; these documents have a gap between July 9 and September 23.

- Recommendation
  - Indemnify HUD the mortgage amount of $157,172.

Comment 39 There was no finding of fraud found in this case and therefore, no such claim is made on the report. In addition, we agree with Ryland this loan did not create any greater risk to HUD. For that reason, we will not recommend that case number 023-2133833 to be indemnified.

- Overstated Income We agree to remove this deficiency from the report.

- Understated Liabilities We agree to remove this deficiency from the report.

- Inaccurate/Excessive Debt-to-Income Ratios We agree to remove this deficiency from the report.

- Unverified Source of Deposit We agree to remove this deficiency from the report.

Comment 40 There was no finding of fraud found in this case and no such claim is made on the report. Based on the underwriting deficiencies found in the file we recommend that Ryland indemnify this loan. We agree on removing one deficiency relating to case number 023-2177719.

- Unsupported Source of Income A copy of the borrower's 2004 W-2 was not in file; therefore, we cannot verify the YTD earnings of $13,128. Our position still remains that Ryland failed to authenticate the borrower's source of $813 overtime income as required in HUD Handbook 4155.1, REV-5, paragraph 2-7. We could not determine the basis for borrower's income through recalculation. Additional documentation to support the $813 on MCAW was not available in file.

- Insufficient Employment Verification HUD Handbook 4155.1, REV-5, paragraph 2-6 states that the borrower must explain any gaps in employment spanning one month or more. Additionally, the lender must verify the borrower's employment for the most recent two years. The VOE was done by telephone and borrower's employment was only verified for one year and ten months.

- Unallowable Fees As discussed, we agreed to remove this deficiency from the report.

- Unverified Source of Deposit We agree to remove this deficiency from the report.

- Recommendations
  - Indemnify HUD the mortgage amount of $160,766.

Appendix C

SCHEDULE OF LOAN DEFICIENCIES

	023-0990733	023-1057152	023-1073648	023-1113543	023-1129379	023-1188456	023-1293230	023-1318434	023-1449064	023-1451488	023-1453913	023-1487584	023-1493862	023-1576678	023-1592011	023-1646394	023-1646660	023-1653270	023-1736086	023-1811657	023-1932092	023-1965223	023-2133883	023-2177719	Total deficiencies	Percentage of 24 loans
Questionable documentation indicators																										
False loan officer certification	X									X															2	8%
False employment	X									X											X				3	13%
Questionable/false Social Security number			X							X											X				3	13%
Loan origination																										
Inflated sales prices	X	X		X	X	X	X	X	X			X	X	X				X	X						13	54%
Inappropriate use of buydown rate		X			X		X		X				X	X			X	X							8	33%
Income																										
Unsupported/overstated income	X		X												X	X	X				X			X	7	29%
Missing verification of employment, written or telephonic; employment of 2 years not verified						X					X	X	X		X				X	X				X	8	33%
Missing W2 forms	X	X							X		X	X													5	21%
Missing paystubs covering most recent 30-day period		X						X		X					X		X								5	21%
Debt/credit																										
Understated liabilities			X																						1	4%
Unacceptable credit history													X												1	4%
Inaccurate/excessive qualifying ratios without inadequate compensating factors		X			X										X			X			X				5	21%
Unearned/unallowable fees																										
Rent equity													X												1	4%
Inadequate documentation																										
Missing verification of deposit/ 3 months of bank statements	X		X					X					X			X		X		X		X			8	33%
Total deficiencies per loan	6	5	4	1	3	2	2	3	3	4	2	3	6	2	4	2	3	4	2	2	4	1	0	2	70	

Loan files that were paid in full and sold by borrower as of end of fieldwork, July of 2005 (shaded columns: 023-1057152, 023-1293230, 023-1487584)

Appendix D

NARRATIVE CASE SUMMARIES

HUD case number:	023-0990733
Loan amount:	$100,261
Settlement date:	December 14, 2001
Status:	Mortgage payments current
Indemnification:	$100,261

Ryland underwrote and approved the loan based on false employment, overstated income, insufficient employment documentation, excessive debt-to-income ratio without adequate compensating factors, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $2,264.

A. <u>False Employment</u>

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E; HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-16. Ryland used falsified employment documents to qualify the borrower for the loan. The false documents include a verification of employment, a W-2 form, and four pay stubs. During the audit, we established that the borrower's place of employment, G-Unlimited, does not exist, yet the telephone verification of employment, dated December 14, 2001, falsely confirmed two years with the fictitious employer. Also, the recalculated Social Security and Medicare taxes on both the W-2 form and pay stubs do not compute to the appropriate 6.2 and 1.45 percent, respectively. The W-2 form calculated a 9 percent Social Security tax (a variance of 2.8 percent) and a 2 percent Medicare tax (a variance of about .55 percent). All four pay stubs calculated a 4.84 percent Social Security tax (variance of 1.36 percent) and a 1.60 percent Medicare tax (variance of .15 percent). Ryland's loan officer falsely certified that all supporting documents were accurate and complete to the best of the signer's knowledge. In light of the miscalculations, the W-2 form and four pay stubs were not adequately reviewed for their authenticity, yet the loan officer certified the documents to be a true and correct copy of the originals. We noted that the W-2 form and pay stubs were faxed in, but we could not determine the source since the header was unreadable. This loan was underwritten, approved, and insured without the underwriter's due diligence.

B. <u>Inflated Sales Price</u>

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6 and 1-7; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $2,264. Ryland increased the sales price from $99,540 to $101,840, a difference of $2,300, without documentation or justification to substantiate the increase. When we asked the borrower about the increase, she stated that she was unsure what the price adjustment represented and that Ryland told her no downpayment was necessary if it increased the price of the property. We believe the adjustment was made to cover part or all of the Nehemiah gift of $3,055 and/or a service fee of $800.

C. Overstated Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-7 and 2-7 A; HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3. The borrower's monthly income of $2,600 earned at G-Unlimited on the mortgage credit analysis worksheet was overstated. Since the borrower's place of employment was false, the purported income from this employment must be deducted. We do not know whether the borrower had any income. Aside from her bank statement, covering a two-week period, there was no evidence in the file that leads us to believe the borrower has a stable income and can afford to pay her monthly premiums.

D. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland failed to obtain original copies of the previous year's W-2 forms. Only the W-2 form for 2000 was in the file. The last two years' W-2 forms are required because Ryland chose to verify the borrower's employment via telephone.

G. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. The borrower provided a one-month bank statement, covering the two-week period of November 30, 2001, through December 12, 2001. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if the lender does not obtain a verification of deposit.

Recommendations

- Indemnify HUD the mortgage amount of $100,261.
- Pay the servicing lender $2,264 to reduce the loan amount.

HUD case number:	023-1057152
Loan amount:	$95,460
Settlement date:	May 16, 2002
Status:	Paid in full on March 01, 2005; property sold by borrower
Indemnification:	None

Ryland underwrote and approved the loan based on inappropriate use of buydown rate, insufficient employment documentation, and excessive debt-to-income ratio without adequate compensating factors. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $2,363.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C. Ryland inflated the sales price by $2,363. Ryland increased the sales price from $94,562 to $96,962, a difference of $2,400, without any documentation or justification to substantiate the increase. According to a note found in the Ryland file, this amount was used to cover the buydown agreement of $2,322.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown agreement for $2,322. Ryland qualified the borrower using the buydown interest rate; however, they failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. We noted that the borrower defaulted after making seven payments.

C. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain the original pay stubs covering the most recent 30-day period from borrower. We found a loan application signed by borrower on May 2, 2001, which we presume to be the initial application, and the final application signed on May 16, 2002, coinciding with the loan settlement date. According to the Handbook, if the initial application lapsed 180 days before the loan closes, it and its supporting documentation must be updated. Since no other applications were found in the file, we relied on the date of the final application and expected to find the April 16 through May 16, 2002 pay stubs. However, the last pay stub included in file was for March 24, 2002. Additionally, Ryland failed to obtain original copies of the previous two years' W-2 forms. There was only a W-2 form for the year 2001 in the file. Both a most recent 30-day period pay stub and the last two years' W-2 forms are required because Ryland chose to verify the borrower's employment via telephone.

D. Inaccurate/Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12. We recalculated the qualifying ratios using the correct monthly hazard insurance premium. Our ratios were very close to those calculated by Ryland. The recalculated mortgage payment-to-income ratio of 26.94 percent does not exceed the HUD requirement; however, the total fixed payments-to-income ratio of 46.43 percent exceeds the HUD requirement by 5.43 percentage points. The compensating factor listed by Ryland was "buydown offers payments less than rent." However, there was no verification of rent included in the loan file. The loan application lists $0 for present monthly housing expense. The total increase in the monthly housing payment was $687. Therefore, the compensating factor did not make sense and was unacceptable in explaining the high ratio.

Recommendations

- Pay the servicing lender $2,363 to reduce the loan amount.

HUD case number:	023-1073648
Loan amount:	$137,857
Settlement date:	June 28, 2002
Status:	Mortgage payments current
Indemnification:	$137,857

Ryland underwrote and approved the mortgage based on a questionable/false Social Security number, an unsupported source of income, overstated income, understated liability, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Questionable/False Social Security Number

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-2 C. We performed a Social Security number query of our in-house database and determined that the borrower was using a Social Security number issued within two years of the application-received date. In addition, Lexis Nexis reported that the borrower's name was associated with a second Social Security number. Based on our interview with the borrower, we determined there was an immigration issue with the borrower. Ryland's only documentation of verification of borrower's Social Security number was the individual's tax returns (1999-2000), which appear questionable since they were without the borrower's signature and his name was misspelled. The credit report for the borrower showed no activity. However, the accounts that were used to analyze his liabilities were listed under his spouse's Social Security number.

B. Unsupported Source of Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-9 C. Ryland failed to authenticate the borrower's self-employed source of income. During our interview with the borrower's tax preparer, we determined that the borrower filed his 1999 and 2000 tax returns in January of 2002, while his 2001 tax return was filed later in the year (March 2002) and used to substantiate his income. No additional documents or information was obtained to explain why all three individual tax returns were filed or received in 2002. Additionally, these income tax documents showed the borrower's name was misspelled.

C. Overstated Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-9 C. The borrower's monthly income of $4,518 on the mortgage credit analysis worksheet was overstated by $293 per month. Assuming that the borrower's self-employed income was appropriate, Ryland improperly calculated the income by using business income rather than adjusted gross income.

D. Understated Liability

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3 and 2-4. Ryland failed to list an overdraft protection (loan) account for $184 that was established by the bank for the borrower to cover the excessive nonsufficient funds checks the borrower wrote.

E. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. The borrower provided one bank statement covering only the month of May. Since the lender did not obtain a verification of deposit, original bank statements covering the most recent three-month period are required, two of which must be consecutive statements.

Recommendations

- Indemnify HUD for the mortgage amount of $137,857.

HUD case number:	023-1113543
Loan amount:	$134,995
Settlement date:	April 30, 2002
Status:	Borrower retains ownership; not currently in default (partial reinstatement)
Indemnification:	$134,995

HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $3,352.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6 and 1-7; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $3,352. It increased the sales price from $133,531 to $136,931, a difference of $3,400, without documentation or justification to substantiate the increase. This adjustment was made to cover part of the Nehemiah gift of $4,108 and a service fee of $500.

Recommendations

- Indemnify HUD the mortgage amount of $134,995.
- Pay the servicing lender $3,352 to reduce the loan amount.

HUD case number:	023-1129379
Loan amount:	$123,068
Settlement date:	July 30, 2002
Status:	Borrower retains ownership; not currently in default
Indemnification:	$123,068

Ryland underwrote and approved the loan based on inappropriate use of a buydown rate and an excessive debt-to-income ratio without adequate compensating factors. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales by $4,696.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $4,696. It increased the sales price from $120,230 to $125,000, a difference of $4,770, without documentation or justification to substantiate the increase. By increasing the sales price, Ryland recouped part or all of the $3,750 Nehemiah gift, a $500 service fee, and/or a $2,852 buydown at the expense of the borrower.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown of $2,852. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. The borrower defaulted after making five payments.

C. Inaccurate/Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12. We recalculated the qualifying ratios using the correct monthly income. The recalculated mortgage payment-to-income ratio of 30.96 percent exceeds the HUD requirement by 1.96 percentage points; the total fixed payments-to-income ratio of 46.56 percent exceeds the HUD requirement by 5.56 percentage points. Compensating factors listed by Ryland were "minimal increase in housing/borrower in the same line of work for 5 years/the collection accounts are old." The difference between the rental payment of $639 listed on loan application and estimated mortgage payment with buydown interest of $778 on the mortgage credit analysis worksheet was $139. Without the buydown agreement, the increase would have been from $639 to $935, constituting a significant $296 difference. Therefore, the compensating factor was insufficient to explain the high ratios.

Recommendations

- Indemnify HUD the mortgage amount of $123,068.
- Pay the servicing lender $4,696 to reduce the loan amount.

HUD case number:	023-1188456
Loan amount:	$143,470
Settlement date:	June 14, 2002
Status:	Mortgage payments current
Indemnification:	$144,400 ($143,470 + $650 loan modification)

Ryland underwrote and approved the loan based on an unsupported source of income, insufficient employment documentation, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $985.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6 and 1-7. Ryland inflated the sales price by $985. It increased the sales price from $144,765 to $145,765, a difference of $1,000, without documentation or justification to substantiate the increase. When we questioned the borrowers about the price adjustment, they stated that they were unaware of the increase and what it could possibly have gone toward.

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland failed to verify the borrower's employment for the past two years. The telephone verification of employment was not complete when verifying borrower's employment at On Semiconductor. The years of employment of January 1, 1992, through December 30, 2001, were written on the sheet; however, no name, telephone number, or date of verification was filled out. "W-2's" was handwritten on the verification of employment, possibly indicating that the loan processor did not contact anyone to verify this income and merely relied on the paper document for verification.

Recommendations

- Indemnify HUD the mortgage amount of $143,470.
- Reimburse HUD for the loan modification amount of $650.
- Pay the servicing lender $985 to reduce the loan amount.

HUD case number:	023-1293230
Loan amount:	$132,457
Settlement date:	September 27, 2002
Status:	Preforeclosure sale completed, January 21, 2005
Indemnification:	$26,866 ($26,216 partial claims + $650 loan modification)

Ryland underwrote and approved the mortgage based on inappropriate use of buydown rate and excessive debt-to-income ratio without adequate compensating factors. Additionally, Ryland failed to verify the borrower's verification of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $7,876.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7 and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $7,876. Ryland increased the sales price from $126,542 to $134,542, a difference of $8,000, without any documentation or justification to substantiate the increase. This adjustment was made to cover the $4,036 Nehemiah gift, a $500 service fee, and a $3,033 buydown agreement.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown agreement in the amount of $3,033. Ryland qualified the borrower using the buydown interest rate; however, failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. We noted that the borrower defaulted after making six payments.

Recommendations

- Reimburse HUD for partial claims paid of $26,216.
- Reimburse HUD for loan modification amount of $650.
- Pay the servicing lender $7,876 to reduce the loan amount.

HUD case number:	023-1318434
Loan amount:	$107,488
Settlement date:	September 25, 2002
Status:	In default as of June 30, 2005
Indemnification:	$107,588 ($107,488 + $100 special forbearance)

Ryland underwrote and approved the mortgage based on insufficient employment documentation. In addition, it failed to verify the borrowers' deposit came from a legitimate source. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $3,136.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $3,136. It increased the sales price from $105,990 to $109,190, a difference of $3,200, without documentation or justification to substantiate the increase. This adjustment was made to cover part or all of the Nehemiah gift of $3,276 and/or a $500 service fee.

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain the original pay stubs covering the most recent 30-day period from both borrowers. The last pay stub included in the file for the borrower and coborrower were for the periods ending August 3, 2002, and August 10, 2002, respectively. We presumed that the application signed by the borrower on September 10, 2002, was the initial application since no other applications preceded it on file and, therefore, was based on the most recent 30-day pay stub on that date. The necessary pay stubs should cover the dates August 10 through September 10, 2002, because Ryland chose to verify the borrowers' employment via telephone.

C. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if no verification of deposit is done by the lender. The borrowers signed the presumed initial loan application on September 10, 2002; therefore, the bank statements should generally cover the period June 10 through September 10, 2002. The bank statement provided was a printout from the borrower's financial institution's Web site only covering the period between August 2 through August 23, 2002. Therefore, the handbook requirement was not met.

Recommendations

- Indemnify HUD the mortgage amount of $107,488.
- Reimburse HUD for the special forbearance of $100.
- Pay the servicing lender $3,136 to reduce the loan amount.

HUD case number:	023-1449064
Loan amount:	$131,239
Settlement date:	December 27, 2002
Status:	Borrower retains ownership; not currently in default
Indemnification:	$131,889 ($131,239 + $650 loan modification)

Ryland underwrote and approved the mortgage based on an inappropriate use of a buydown rate, insufficient employment documentation, and excessive qualifying ratios. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $5,413.

A. <u>Inflated Sales Price</u>

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $5,413. It increased the sales price from $127,846 to $133,346, a difference of $5,500, without documentation or justification to substantiate the increase. When we questioned the borrower concerning this price adjustment, she stated that she was not aware of the increase and did not know what costs it went toward. This adjustment was made to cover part or all of the Nehemiah gift of $4,000, a service fee of $500, and/or a buydown of $3,023.

B. <u>Inappropriate Use of Buydown Rate</u>

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown agreement in the amount of $3,023. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. We noted that the borrower defaulted after making three payments.

C. <u>Insufficient Employment Documentation</u>

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland failed to obtain original copies of the previous two years' W-2 forms for the borrower. Only a W-2 form for year 2000 was included in the file. The last two years' W-2 forms are required because Ryland chose to verify the borrower's employment via telephone.

<u>Recommendations</u>

- Indemnify HUD the mortgage amount of $131,239.
- Reimburse HUD for the loan modification amount of $650.
- Pay the servicing lender $5,413 to reduce the loan amount.

HUD case number: 023-1451488
Loan amount: $150,575
Settlement date: December 19, 2002
Status: Mortgage payments current
Indemnification: $150,575

Ryland underwrote and approved the loan based on false employment, a questionable/false Social Security number, insufficient employment documentation, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. False Employment

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E; HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-16. Ryland used falsified employment documents to qualify the borrower for the loan. The false documents include a faxed copy of the W-2 form and two pay stubs from employer Muebleria Imperial Furniture. The text typewritten on the year 2001 W-2 form overlaps the surrounding textbox and text descriptions, while the Social Security numbers on two pay stubs were altered; before the change, the Social Security prefix showed "665," and after the change, it showed "765." The discrepancies should have alerted Ryland that there was a problem with the purported employment. Also, the loan officer certified W-2 statements for the years 2000 and 2001, as well as the two altered pay stubs for the periods August 24 to September 6, 2002 and September 7 to 20, 2002. Clearly, this loan officer acted in violation of the HUD Handbook.

B. Questionable/False Social Security Number

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-2 C; 24 *Code of Federal Regulations* 202.5(j)(4). We performed a Social Security number query of our in-house database and determined that Ryland qualified the borrower using a Social Security number that was issued within two years of the application-received date. Also, as shown in section A, the Social Security number on two of borrower pay stubs were altered to show "765," rather than the printed "665." The discrepancies should have alerted Ryland that there was a problem with the Social Security number.

C. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain the original pay stubs covering the most recent 30-day period from borrower. The last pay stub was sent to Ryland via fax and covered the period ending September 20, 2002. Since the only loan application in the file is dated December 19, 2002, pay stubs covering November 19 through December 19, 2002, must be in the file. The original pay stub covering the most recent 30-day period was required because Ryland chose to verify the borrower's employment via telephone.

Recommendations

- Indemnify HUD the mortgage amount of $150,575.

HUD case number:	023-1453913
Loan amount:	$151,265
Settlement date:	December 27, 2002
Status:	Mortgage payments current
Indemnification:	$151,265

Ryland underwrote and approved the loan based on insufficient employment documentation. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain a standard or telephone verification of employment for both the borrower and coborrower. Additionally, a year of the borrower's and coborrower's W-2 forms were missing from the file. Because the borrower provided sufficient pay stubs, it appeared that Ryland was verifying employment through the alternative method; i.e., telephone verification of employment.

Recommendation

- Indemnify HUD the mortgage amount of $151,265.

HUD case number: 023-1487584
Loan amount: $127,078
Settlement date: February 12, 2003
Status: Paid in full on March 31, 2005; property sold by borrowers
Indemnification: $650 loan modification

Ryland underwrote and approved the mortgage based on insufficient employment documentation. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrowers met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $5,270.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7 and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $5,270. Ryland increased the sales price from $123,723 to $129,000, a difference of $5,277, without any documentation or justification to substantiate the increase. This adjustment was made to cover the Nehemiah gift of $3,870 and a service fee of $500

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland failed to obtain original copies of the previous two years' W-2 forms for borrower and coborrower. Included in the file were the year 2001 W-2 forms for borrower and coborrower. Furthermore, Ryland failed to verify employment for the coborrower. A most recent 30-day period pay stub, last two years' W-2 forms, and verification of employment are required. Without the required documentation, Ryland would not have been able to determine the income stability and/or likelihood of income continuance.

Recommendations

- Reimburse HUD for loan modification paid of $650.
- Pay the servicing lender $5,270 to reduce the loan amount.

HUD case number:	023-1493862
Loan amount:	$118,805
Settlement date:	January 28, 2003
Status:	Borrower retains ownership; not currently in default; partial claim
Indemnification:	$124,975 ($118,805 + $6,170 partial claim)

Ryland underwrote and approved the mortgage based on inappropriate use of a buydown rate and insufficient employment documentation, unacceptable credit history, and excessive debt-to-income ratio. In addition, Ryland failed to verify that the borrower's deposit came from a legitimate source. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland overcharged the borrower $4,000 in equity credits and inflated the sales price by $2,985.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-10 C. Ryland inflated the sales price by $2,985. It increased the sales price from $117,643 to $120,675, a difference of $3,032, without documentation or justification to substantiate the increase. The borrower also accrued $4,000 from her participation in a program enabling renters to earn credits toward the purchase of a new home. Initially, Ryland adjusted the property sales price by $7,000, but the $4,000 in equity credits had offset that amount and reduced it to $3,032. When we questioned the borrower concerning this price adjustment, she stated that she was not aware of the increase and did not know what cost it went toward. We believe the after-equity difference was made to cover part or all of the Nehemiah gift of $3,620, a service fee of $500, and/or a buydown of $2,704.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown in the amount of $2,704. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. The borrower defaulted after making 15 payments.

C. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not verify all of the borrower's employment for the past two years. Ryland verified, via telephone, employment for only four months.

D. Unacceptable Credit History

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3. The borrower's credit history was unsatisfactory. The credit report indicated six collection accounts and two charge-offs, which are older than two years, for a balance of $902. However, the lender was required to examine the overall pattern of credit behavior. The lender failed to document in the file whether these items were "based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower," as stated in the HUD handbook. There was only an explanation included in the file by the borrower regarding one charge-off account and a judgment. The remaining six items are unaccounted for by both the borrower and the lender.

F. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if no verification of deposit is done by the lender. The borrower signed the initial loan application on September 3, 2002, and handbook requires that the application be updated so it was not more than 180 days old when the loan closes. The loan should have been updated in February 3, 2002; however, no document found in file was signed by borrower around that date. Instead, a January 21, 2003, application was on file, on which we relied; therefore, the bank statements should cover the period October 21, 2002, through January 21, 2003. The loan file contained more than one bank statement from three different banks; five of the seven provided were not submitted within the acceptable three-month period. The two statements fell within the required timeframe but covered generally the same period. Two more statements were necessary so the handbook requirement was not met.

Recommendations

- Indemnify HUD the mortgage amount of $118,805.
- Reimburse HUD for partial claims paid of $6,170.
- Refund $4,000 in overcharges to the borrower.
- Pay the servicing lender $2,985 to reduce the loan amount.

HUD case number: 023-1576678
Loan amount: $128,905
Settlement date: March 26, 2003
Status: In default as of June 30, 2005; partial claim
Indemnification: $138,050 ($128,905 + $9,145 partial claim)

Ryland underwrote and approved the mortgage based on inappropriate use of a buydown rate. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $5,907.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $5,907. It increased the sales price from $124,930 to $130,930, a difference of $6,000, without documentation or justification to substantiate the increase. This adjustment was made to cover part or all of the Nehemiah gift of $3,928, a service fee of $385, and/or a buydown of $2,860.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown in the amount of $2,860. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. The borrower defaulted after making seven payments.

Recommendations

- Indemnify HUD the mortgage amount of $128,905.
- Reimburse HUD for partial claims paid of $9,145.
- Pay the servicing lender $5,907 to reduce the loan amount.

HUD case number:	023-1592011
Loan amount:	$153,772
Settlement date:	March 31, 2003
Status:	Borrower retains ownership; not currently in default
Indemnification:	$155,172 ($153,772 + $100 special forbearance + $1,300 loan modification)

Ryland underwrote and approved the mortgage based on overstated income, insufficient employment documentation, and excessive debt-to-income ratio without adequate compensating factors. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Overstated Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-7 and 2-7 A. The coborrower's monthly income of $2,462 on the loan application and mortgage credit analysis worksheet was overstated by $70 per month. Ryland failed to verify and provide documentation to substantiate this amount.

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain an original pay stub covering the most recent 30-day period from either the borrower or coborrower. The last pay stub included in the file for the borrower was for the period ending March 7, 2003. However, the pay stub was faxed from the coborrower's place of employment. Additionally, there was a stamp bearing "certified to be a true and correct copy of the original" signed by a Ryland employee. The only original copies of pay stubs found in the file for the borrower were for the periods ending August 9, August 2, July 26, and July 19, 2002. The last pay stub included in the file for the coborrower was for the period ending March 14, 2003. This pay stub was also faxed from the coborrower's place of employment and bears the stamp "certified to be a true and correct copy of the original" signed by a Ryland employee. The only original copies of pay stubs found in the file for the coborrower were for periods ending August 15, July 31, and July 15, 2002, and were not the most updated documents in the file. Additionally, Ryland failed to verify employment for two full years for either the borrower or coborrower. Ryland verified the borrower's employment for one year and five months and verified the coborrower's employment for one year and six months. A most recent 30-day period pay stub and verification of employment for two full years are required. Without the required documentation, Ryland would not have been able to determine the income stability and/or likelihood of income continuance.

C. Inaccurate/Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12. The calculated total fixed payments-to-income ratio of 47.11 percent exceeds the HUD requirement by 6.11 percentage points. The compensating factor listed by Ryland stated "minimal increase in housing." This was not adequate justification for approving the loan with excessive ratios. The borrower's verification of rent shows a monthly rent payment of $659, whereas the estimated mortgage payment was $1,062. This increased monthly home payment expenditures by $403. Additional compensating factors assured that "both borrowers have been in the same line of work for 5 and 2 years, borrowers have paid off some credit," yet the borrowers defaulted on their loans after three payments.

Recommendations

- Indemnify HUD the mortgage amount of $153,772.
- Reimburse HUD for the special forbearance ($100) and loan modification ($1,300) paid of $1,400.

HUD case number:	023-1646394
Loan amount:	$130,833
Settlement date:	April 30, 2003
Status:	Mortgage payments current
Indemnification:	$130,833

Ryland underwrote and approved the loan based on overstated income, an excessive debt-to-income ratio without adequate compensating factors, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Overstated Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-9 C; HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3. The borrower's monthly income of $2,523 on the mortgage credit analysis worksheet was overstated by $178 per month. Based on the borrower's self-employed income on the 2001 and 2002 tax returns, Ryland improperly calculated the income by using business income rather than adjusted gross income.

B. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. The borrower provided a one-month bank statement, covering the period December 20, 2002, through January 22, 2003. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if the lender does not obtain a verification of deposit.

Recommendation

- Indemnify HUD the mortgage amount of $130,833.

HUD case number:	023-1646660
Loan amount:	$148,291
Settlement date:	May 13, 2003
Status:	Mortgage payments current
Indemnification:	$148,291

Ryland underwrote and approved the loan based on unsupported income, insufficient employment documentation, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown agreement in the amount of $3,290. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase.

B. Unsupported Source of Income

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E. Income from any source that cannot be verified, is not stable, or will not continue may not be used in calculating the borrower's income ratios. The borrower's verification of employment reported gross income earned through April 24, 2003, of $5,374. The borrower's hourly pay before his May 9, 2003, pay raise of $10.11 per hour was $9.82. The combined income of $5,374 and calculated hourly income of $10.11 per hour equaled a monthly income of $1,526, resulting in an overstatement and deviation from the $1,684 income reported on the mortgage credit analysis worksheet of $158.

C. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not obtain the original pay stubs covering the most recent 30-day period from the coborrower, yet the coborrower's income was incorporated in the calculation of income. Only one pay stub was included in the file for the pay period ending March 21, 2003, showing a gross amount of $964. The most recent 30-day period pay stub was required because Ryland chose to verify the borrower's employment via telephone.

Recommendation

- Indemnify HUD the mortgage amount of $148,291.

HUD case number:	023-1653270
Loan amount:	$136,010
Settlement date:	April 30, 2003
Status:	In default as of June 30, 2005
Indemnification:	$136,010

Ryland underwrote and approved the mortgage based on inappropriate use of a buydown rate and excessive qualifying ratios. In addition, Ryland failed to verify that the borrower's deposit came from a legitimate source. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $3,150.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $3,150. It increased the sales price from $134,953 to $138,153, a difference of $3,200, without documentation or justification to substantiate the increase. When we questioned the borrower, he stated that he was shocked to see the price increase at closing because he did not know what it went toward. He further stated that he was overwhelmed with the paper work, and the closer assured him that he would be receiving an incentive; therefore, he did not question the increase. We believe this adjustment was made to cover part or all of the OWN gift of $4,145, a service fee of $300, and/or a buydown agreement of $3,017.

B. Inappropriate Use of Buydown Rate

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-14. The borrower agreed to a buydown of $3,017. Ryland qualified the borrower using the buydown interest rate but failed to show that the scheduled mortgage payment increase would not adversely affect the borrower and likely lead to default. To use the buydown interest rate to qualify, the underwriter must document the borrower's ability to handle the scheduled mortgage payment increase. The borrower defaulted after making seven payments.

C. Inaccurate/Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-12. The mortgage payment-to-income ratio of 37.38 percent exceeds HUD guidelines by 8.38 percentage points; the total fixed payments-to-income ratio of 41.76 percent exceeds the HUD requirement by 0.76 percentage points. The compensating factor on the mortgage credit analysis worksheet stated "borrower paying the same in housing as rent." However, the borrower's rent, according to the verification of rent, was $646, and the new mortgage payment was $778, including the buydown of $166. The total increase in the monthly housing payment was $131, which was not the same amount as rent payment. Therefore, the compensating factor does not justify excessive ratio.

D. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if no verification of deposit is done by the lender. The borrower signed the initial loan application on April 10, 2003, and the final application on April 29, 2003; since no more than 180 days had lapsed since the settlement date of April 30, 2003, bank statements should generally cover the period January 10 through April 10, 2003. The two bank statements provided covered February 17 through March 25, 2003. As a result, the HUD handbook requirement was not met.

Recommendations

- Indemnify HUD the mortgage amount of $136,010.
- Pay the servicing lender $3,150 to reduce the loan amount.

HUD case number:	023-1736086
Loan amount:	$140,628
Settlement date:	June 24, 2003
Status:	Borrower retains ownership; not currently in default; partial claim
Indemnification:	$145,722 ($140,628 + $5,094 partial claim)

Ryland underwrote and approved the mortgage based on insufficient verification of employment. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines. Moreover, Ryland inflated the sales price by $2,934.

A. Inflated Sales Price

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 1-6, 1-7, and 1-7 C; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10 C. Ryland inflated the sales price by $2,934. It increased the sales price from $139,861 to $142,841, a difference of $2,980, without documentation or justification to substantiate the increase. This adjustment was made to cover part or all of the OWN gift of $4,285 and/or a service fee of $300.

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not verify all of the borrower's employment for the past two years. It verified employment for only one year.

Recommendations

- Indemnify HUD the mortgage amount of $140,628.
- Reimburse HUD for a claim paid of $5,094.
- Pay the servicing lender $2,934 to reduce the loan amount.

HUD case number:	023-1811657
Loan amount:	$155,173
Settlement date:	August 13, 2003
Status:	Borrower retains ownership; not currently in default
Indemnification:	$155,173

Ryland underwrote and approved the mortgage based on insufficient verification of employment, excessive debt-to-income ratio without adequate compensating factors, and insufficient verification of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrowers met HUD qualifying guidelines.

A. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-6 and 3-1 E. Ryland did not verify all of borrowers' employment for the past two years. It verified employment for only one year and seven months.

B. Unverified Source of Deposit

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if no verification of deposit is done by the lender. The borrowers signed the initial loan application on March 30, 2003, and the handbook requires that the application be updated so as not to be more than 180 days old when the loan closes. The loan should have been updated September 30, 2003; however, no document on file was signed by the borrowers around that date. We relied on the final application, dated August 12, 2003; therefore, the bank statements should cover the period May 12 through August 12, 2003. There were four deposit accounts, as well as an investment account, listed on the loan application. The account statements included in the file were copies of statements downloaded from the borrowers' financial institution's Web site. There were eight statements included in the file:

- **Account 5318,** February 5 through March 28, 2003, and May 27 through July 18, 2003.
- **Account 0372**, January 22 through March 20, 2003, and April 21 through July 17, 2003.
- **Account 9984,** January 16 through March 28, 2003, and May 15 through July 18, 2003.
- **Account 3967,** the two statements provided do not contain date coverage.

None of these statements contained account holder names. There was no statement found for the investment account listed on the loan application. Ryland would not have been able to verify that these accounts belonged to the borrowers. As a result, the HUD handbook requirement was not met.

Recommendations

- Indemnify HUD the mortgage amount of $155,173.

HUD case number:	023-1932092
Loan amount:	$119,516
Settlement date:	November 4, 2003
Status:	Mortgage payments current
Indemnification:	$119,516

Ryland underwrote and approved the loan based on false employment, a questionable/false Social Security number, an unsupported source of income, and an excessive debt-to-income ratio without adequate compensating factors. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. False Employment

HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3; HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 E. Ryland used falsified employment documents to qualify the borrower for the loan. The false documents include two pay stubs (April through May 2003) from employer Pioneer Ford. The following deficiencies were found:

- Social Security and Medicare taxes did not calculate to 6.2 percent and 1.45 percent, respectively; rather, Social Security calculated to 5.45 percent and Medicare to 0.58 percent on April 2003 pay stub and Social Security calculated to 5.87 percent and Medicare to .92 percent on May 2003 pay stub.
- The April 2003 pay stubs did not have a check number printed on the top right hand corner, as did the May 2003 pay stub.
- We requested a wage history for borrower from Pioneer Ford and found inconsistent wage information. The April 2003 wages were inflated by $2,000, and the May 2003 wages were inflated by $1,300.

The borrower was unaware of the inflation or other inconsistencies found on the pay stubs.

B. Questionable/False Social Security Number

HUD Handbook 4155.1, REV-5, paragraph 3-1 C; 24 *Code of Federal Regulations* 202.5(j)(4). We performed a Social Security number query of our in-house database and determined that Ryland qualified the borrower using a Social Security number that was issued before the borrower's birthdate. Lexis Nexis reported that the Social Security number belonged to another individual. Moreover, Ryland required that the borrower provide a clearer copy of his Social Security card; however, the loan was underwritten without the card or a documented explanation in the Ryland case file.

C. Unsupported Source of Income

HUD Handbook 4155.1, REV-5, paragraph 2-7 C. Ryland failed to authenticate the borrower's source of income. We could not determine the basis for borrower's income of $3,876 through recalculation. Instead, we recalculated the borrower's income based on the amount reported on the Department of Economic Security wage reports. Monthly income based on our calculation was $1,792, an overstatement of $2,084 from the income reported on the mortgage credit analysis worksheet.

D. Inaccurate/Excessive Debt-to-Income Ratios

HUD Handbook 4155.1, REV-5, paragraph 2-12. We recalculated the qualifying ratios using the income based on the figure reported on the Department of Economic Security wage statements. The recalculated mortgage payment-to-income ratio was 48.99 percent and exceeds HUD requirements by 19.99 percentage points, while the total fixed payments-to-income ratio of 76.60 percent exceeds the HUD requirements by 35.60 percentage points. Compensating factors stated the borrower had worked in the same line for three years, ratios were in line, and maximum loan to value was 90 percent. Due to the large variance of these ratios, the compensating factors were not adequate to justify approving the loan.

Recommendation

- Indemnify HUD the mortgage amount of $119,516.

HUD case number:	023-1965223
Loan amount:	$157,172
Settlement date:	December 22, 2003
Status:	In default; first legal action to commence foreclosure on January 1, 2005
Indemnification:	$157,172

Ryland underwrote and approved the mortgage based on insufficient employment documentation, understated liabilities, excessive debt-to-income ratios without adequate compensating factors, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrowers met HUD qualifying guidelines.

A. Unverified Source of Deposit

HUD Handbook 4155.1, REV-5, paragraph 3-1 F. Original bank statements covering the most recent three-month period are required, two of which must be consecutive statements, if no verification of deposit is done by the lender. The borrowers signed the initial loan application on June 10, 2003, and the handbook requires that the application be updated so as not to be more than 180 days old when the loan closes. The loan should have been updated December 10, 2003. We relied on the final application, dated December 15, 2003; therefore, the bank statements should cover the period September 15 through December 15, 2003. The two bank statements provided covered June 6 through July 8, 2003, and September 24 through October 24, 2003. As a result, the HUD handbook requirement was not met.

Recommendation

- Indemnify HUD the mortgage amount of $157,172.

HUD case number:	023-2177719
Loan amount:	$160,766
Settlement date:	October 19, 2004
Status:	Mortgage payments current
Indemnification:	$160,766

Ryland underwrote and approved the loan based on an unsupported source of income, insufficient employment documentation, and an unverified source of deposit. Therefore, HUD insured the loan based on Ryland's inaccurate representation that the borrower met HUD qualifying guidelines.

A. Unsupported Source of Income

HUD Handbook 4155.1, REV-5, paragraph 2-7. Ryland failed to authenticate the borrower's source of $813 in overtime income. We could not determine the basis for borrower's income through recalculation. Additional documentation to support the $813 on the mortgage credit analysis worksheet was not available in file.

B. Insufficient Employment Documentation

HUD Handbook 4155.1, REV-5, paragraphs 2-6 and 3-1 E. Ryland failed to verify the borrower's employment for two years. A telephone verification of employment was on file, which verified employment for one year and ten months.

Recommendations

- Indemnify HUD the mortgage amount of $160,766.

Appendix E

Criteria

A. **HUD Handbook 4000.4, REV-1, CHG-2, paragraph 5-3,** defines a level three deficiency as one, which involves an action by the lender to misrepresent the financial capacity either of the applicant-borrower or the condition of the property offered as security for the mortgage.

B. **HUD Handbook 4000.4, REV-1, CHG-2, paragraph 3-16,** states the underwriter should certify the legitimacy of the insurance application and all supporting documents are accurate and complete to the best of the signer's knowledge.

C. **HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1 F,** requires the lender to obtain original and not faxed pay stubs from the borrower covering the most recent 30-day period. In addition, lenders should obtain original copies of the previous two years' Internal Revenue Service W-2 forms in the event that a telephone verification of employment is used, which is concurrent with this situation.

D. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-10 C,** state that no repayment of the gift may be expected or implied.

E. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-14,** state that the lender must establish that the eventual increase in mortgage payments after the buydown term ends will not adversely affect the borrower and likely lead to default. The underwriter must document which of the following criteria the borrower meets:

(a) Potential for increased income that would offset the scheduled payment increases, as indicated by job training or education in the borrower's profession or by a history of advancement in the borrower's career with attendant increases in earnings.

(b) A demonstrated ability to manage financial obligations in such a way that a greater portion of income may be devoted to housing expense. This may also include borrowers whose long-term debt, if any, will not extend beyond the term of the buydown agreement.

(c) The borrowers have substantial assets available to cushion the effect of the increased payments.

(d) The cash investment made by the borrower substantially exceeds the minimum required.

F. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraphs 2-7 and 2-7 A,** provide that the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. In most cases, borrower income will be limited to salaries or wages. Income from most other sources, provided it is properly verified by the lender, can be included as effective income.

G. **HUD Handbook 4155.1, REV-4, CHG-1 and REV-5, paragraphs 2-6 and 3-1 E,** require that in lieu of obtaining a standard verification of employment, the lender may obtain the borrower's original pay stubs covering the most recent 30-day period, along with the original copies of the previous two years' Internal Revenue Service W-2 forms. The lender must also verify employment by telephone for the past two years. Ryland failed to verify borrower's employment for two years, obtain a copy of the borrowers' pay stubs covering the most recent 30-day period, and/or obtain a copy of the previous two years' Internal Revenue Service W-2 forms. Moreover, the borrower must explain any gaps in employment spanning one month or more. The lender must verify the borrower's employment for the most recent two years.

H. **HUD Handbook 4155.1, REV-4, CHG-1, paragraphs 2-3 and 2-4, and REV-5, paragraph 2-11,** require lenders to consider all installment loans, contingent liabilities, and projected obligations when assessing the loan application. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other recurring charges, including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending 10 months or more. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing; this is especially true if the borrower will have limited or no cash assets after loan closing.

I. **HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3,** serves as a guide in determining the attitude toward credit obligations that will govern the borrower's future actions. A borrower who has made payments on previous or 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 offsetting factors will be necessary to approve the loan.

J. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-12,** state that ratios are used to determine whether the borrower can reasonably be expected to meet the expenses involved in homeownership and otherwise provide for the family. The mortgage payment expense to effective income (front ratio) may not exceed 29 percent of gross effective income, and the total fixed payment to effective income (back ratio) may not exceed 41 percent of gross effective income, unless significant compensating factors are presented.

K. **Chapter 2, page 2-15, of the HUD Homeownership Guide** lists a group of closing costs and fees that can be collected by the lender from the borrower, subject to a maximum limitation. Whenever "actual costs" are permitted, it is expected that they do not exceed what is reasonable and customary for the area.

An unallowable fee is one that has been identified by the local HUD office as not being a necessary/normal part of the loan origination process. An unearned fee is a closing cost that does not have an actual service or thing of value attached to it. An excessive fee is a closing cost charged to the borrower beyond the amount allowed by HUD.

L. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 3-1 F,** requires the lender to obtain the borrower's verification of deposit. As an alternate to obtaining a verification of deposit, the lender may choose to obtain from the borrower original bank statements for the most recent three-month period, two of which must be consecutive statements. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent consecutive statements.

M. **HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-9 C & C, 1**, requires the lender must establish the borrower's earnings trend over the previous two years, but may average the income over three years if all three years' tax returns are provided. If the borrower provides quarterly tax returns, then the analysis can include income through the period covered by the tax filings. If the borrower is not subject to quarterly tax filings or does not file quarterly returns (form IRS 1040 ES), the income shown on the P&L may be included in the analysis provided the income stream based on the P&L is consistent with the previous years' earnings. If the P&L statements submitted for the current year show an income stream considerably greater than what is supported by the previous years' tax returns, the analysis of income must be predicated solely on the income verified through the tax returns. Lenders must carefully analyze the individual business's financial strength, the source of its income, and the general economic outlook for similar businesses in that area to determine if the business can be expected to continue to generate sufficient income for the borrower's needs. Annual earnings that are stable or increasing are acceptable. Conversely, a borrower whose business shows a significant decline in income over the period analyzed may not be acceptable even if current income and debt ratios meet our guidelines**. Business income or loss (from Schedule C).** The sole proprietorship income calculated on Schedule C is business income. Depreciation or depletion may be added back to adjusted gross income.

N. **HUD Handbook 4155.1, REV-4, CHG-1, and REV-5, paragraph 2-10 B** states that a verification of deposit (VOD) may be used to verify these accounts, along with the most recent bank statement. If there is a large increase in an account, or the account was opened recently, an explanation and evidence of source of funds must be obtained by the lender.