
CHAPTER 7. FHA-APPROVED LENDERS AUDIT GUIDANCE

7-1 Program Objective. The U.S. Department of Housing and Urban Development (HUD) insures loans and mortgages made by private and governmental, financial, and mortgage lending institutions to finance the purchase, refinancing, or construction of single-family homes and multifamily projects. HUD approves such institutions for participation in the Federal Housing Administration (FHA) insurance programs for Title I property improvement and manufactured housing loans and for Title II single-family and multifamily mortgages. After initial approval, institutions are required to recertify annually to maintain their FHA-approved status.

As defined in 24 CFR (Code of Federal Regulations) Part 202, a “lender” or “Title I lender” is a financial institution that (a) holds a valid Title I contract of insurance and is approved by the HUD Secretary or (b) is under suspension or held a Title I contract that has been terminated but remains responsible for servicing or selling Title I loans that it holds and is authorized to file insurance claims on such loans. A “mortgagee” or “Title II mortgagee” is a mortgage lender that is approved to participate in the Title II programs.

As it revises its various requirements, FHA is adopting a common industry practice of using the terms “lender” and “borrower” for all of its programs and discontinue the use of the terms “mortgagee” and “mortgagor.” Throughout this guide, we use the terms “lender” and “borrower” to include “mortgagee” and “mortgagor,” respectively. Auditors should be aware that existing guidance and Federal regulations may continue to use both sets of terminology.

7-2 Lender Approval Types. HUD has four types of lenders that are approved for participation (refer to 24 CFR 202.6 through 202.10).

A. Supervised Lenders. Supervised lenders are financial institutions that are members of the Federal Reserve System (FRS) or institutions with accounts insured by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), or the National Credit Union Administration (NCUA). Supervised lenders may originate, underwrite, purchase, hold, service, or sell FHA-insured loans.

- 1. Small Supervised Lenders.** Small supervised lenders are members of FRS or regulated by FDIC, OCC, or NCUA, the consolidated assets of which do not meet the threshold required by those agencies for submitting audited financial statements (delineated at 12 CFR 363.1(a), 562.4(b)(2), and 715.4(c)).
- 2. Large Supervised Lenders.** Large supervised lenders are those lenders that are members of FRS or regulated by FDIC, OCC, or NCUA, the consolidated

assets of which are equal to or greater than the prevailing threshold required by those agencies for submitting audited financial statements (delineated at 12 CFR 363.1(a), 562.4(b)(2), and 715.4(c)).

- B. Non-supervised Lenders.** Non-supervised lenders are lending institutions that have as their principal activity the lending or investing of funds in real estate mortgages, consumer installment notes, or similar advances of credit or the purchase of consumer installment contracts and are not approved as supervised, as described in paragraph A above, or as government lenders, as described in paragraph D below. A non-supervised lender may originate, purchase, hold, service, or sell all types of FHA-insured loans, including multifamily loans.
- C. Investing Lenders.** Investing lenders may purchase, hold, or sell FHA-insured loans but may not originate FHA-insured loans in their own name or submit applications for the insurance of mortgages. An investing lender may not service FHA-insured loans without prior approval of the HUD Secretary. Investing lenders are generally required to provide only audited financial statements and a computation of adjusted net worth. Those investing lenders that are authorized to service FHA-insured mortgages are also required to submit a report on internal controls and a report on compliance.
- D. Governmental Lenders.** Government lenders are Federal, State, or municipal governmental agencies; a Federal Reserve bank, a Federal home loan bank, the Federal Home Loan Mortgage Corporation (Freddie Mac), or the Federal National Mortgage Association (Fannie Mae). A government lender may originate, purchase, service, or sell FHA-insured loans, including multifamily loans. No financial reporting is required.

Lenders with Title I authority are approved to process or service loans for property improvements and the purchase of manufactured housing. Lenders with Title II authority are approved to process or service loans for single-family homes and multifamily projects. A lender may be approved for both Title I and Title II programs.

These institutions are approved on the basis of their financial capacity, experience, facilities, and other criteria as specified in HUD Handbook 4060.1, Mortgagee Approval Handbook, HUD Handbook 4700.2, Title I Lender Approval Handbook, and subsequent mortgagee letters and Title I letters.

- 7-3 Audit and Reporting Requirements.** The following chart is a summary of the financial reporting requirements for supervised and non-supervised lenders. A more detailed explanation of the financial reporting requirements is also provided below.

Scenario	Level of financial statements	Audited consolidating schedules	Financial data templates, including net worth schedule	Net worth schedule (audited)
Supervised lenders				
Stand-alone bank	Bank	N/A	Bank	Bank
Bank \geq 40% of consolidated entity; no guarantee by parent	Consolidated	Not required	Consolidated	Bank
Bank <40% of consolidated entity; guarantee by parent	Consolidated	Not required	Consolidated	Bank
Bank <40% of consolidated entity; no guarantee by parent	Consolidated	Required	Bank	Bank
Multiple banks, each <40% of consolidated entity; no guarantee by parent	Consolidated	Required	Each Bank	Each Bank
Non-supervised lenders				
Stand-alone lender	Lender	Lender	Lender	Lender
Lender in a parent/subsidiary structure	Lender	Required	Lender	Lender

Except for governmental¹ and small supervised lenders, all FHA-approved lenders are required to have an annual audit in accordance with this guide **regardless of the number of loans originated or serviced**. All required audits are to be submitted within 90 days of the close of the lender's fiscal year. Audits must be performed in accordance with the most currently effective Government Accountability Office generally accepted government auditing standards (GAGAS, also referred to as the "Yellow Book"), auditing standards generally accepted in the United States of America (GAAS) as issued by the American Institute of Certified Public Accountants (AICPA),² and this guide.

If the supervised or non-supervised lender is also a Government National Mortgage Association (Ginnie Mae) approved issuer and wants to have the same audited financial

¹ Governmental lenders follow the audit requirements of the Single Audit Act as set forth in 24 CFR 44.

² The Public Company Accounting Oversight Board (PCAOB) has established professional standards that apply to financial audits of publicly traded companies with a reporting obligation under the Securities Exchange Act of 1934. As noted in the "Yellow Book," auditors may elect to use the PCAOB standards in conjunction with GAGAS.

statements satisfy both FHA and Ginnie Mae, the financials will also have to be prepared in accordance with Ginnie Mae's requirements (See chapter 6 of this guide).

Unqualified opinions in the audit report on the financial statements and compliance are acceptable for recertification. If either opinion is qualified, HUD will determine, on a case-by-case basis, whether a report with a qualification is acceptable for recertification purposes. In addition to the detailed description of the reason for the qualification in the audit report, an appropriate finding may need to be included by the auditor in the schedule of findings and recommendations. When findings are reported, a corrective action plan prepared by the lender must accompany the audit findings. For additional information on the required audit reports and suggested wording, please refer to chapter 2 of this guide, which contains examples.

In some instances, a HUD-approved lender may enter into arrangements whereby the responsibility for performing certain required procedures transfers to another HUD-approved entity. A common example is when a lender originates a loan and later sells the loan and the related servicing to another HUD-approved entity. In these situations, the lender must comply with any required activities for the period during which it is legally obligated to perform those services, and the independent auditor would report on the lender's compliance during that period. After the transfer of responsibility to another party, the independent auditor for the entity acquiring those responsibilities would report on that party's compliance with HUD requirements.

A. General Audit Requirements. The audit reporting package must include:

1. Audit of the Financial Statements and Supplementary Information.

- a. The basic financial statements prepared in accordance with generally accepted accounting principles (GAAP) and the independent auditor's report thereon in accordance with GAAS and GAGAS.
- b. The independent auditor's report must cover the lender's computation of its adjusted net worth, the hardcopy of the electronic submission, and if applicable, consolidating schedules. The auditor's reporting on this information should be done in accordance with GAAS relating to "Supplementary Information in Relation to the Financial Statements as a Whole."

2. Internal Control Report.

The internal control reports, which do not include the expression of the independent auditor's opinion, must include

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- a. An independent auditor's report on internal control over financial reporting based on an audit of financial statements. If the lender engages the auditor to provide an opinion on internal control over financial reporting, as required either by FDIC or under the standards of the Public Company Accounting Oversight Board, such reporting may be submitted for this requirement.
 - b. An independent auditor's report on internal control over compliance with HUD-assisted programs. This report may be combined with the independent auditor's report on internal control over financial reporting.

Alternatively, auditors may issue combined reports (1) on internal control over financial reporting and compliance based on the audit of the financial statements under GAGAS and (2) on compliance and internal control over compliance with major HUD programs.

3. Compliance Report.

The compliance report relating to major HUD programs must include

- a. A listing of compliance areas tested.
 - b. An independent auditor's opinion on compliance with specific program requirements that could have a direct and material effect on each major HUD-assisted program.³
4. **Schedule of Findings and Questioned Costs.** This is required for all material instances of noncompliance, and significant deficiencies and material weaknesses in internal control identified by the auditor (including those cases in which corrective action was taken by the lender on the finding after the end of the fiscal year). Refer to section 7-9 of this chapter for information on reporting findings. A management letter reporting all immaterial instances of noncompliance should accompany the compliance report.
 5. **Corrective Action Plan.** This is prepared by the lender using the lender's letterhead, in which the lender describes the corrective action taken or planned in response to the findings identified by the auditor. The plan should also include comments on the corrective action taken on prior findings resulting

³ A major program is defined as an individual assistance program or a group of programs in a category of Federal financial expenditures, which is equal to or exceeds the amount shown in the threshold table in chapter 1 of this guide during the applicable year or a project that has an outstanding HUD-insured or HUD-guaranteed loan balance, which is equal to or exceeds the amount shown in the table as of the reporting date.

from relevant HUD, Office of Inspector General audits and HUD program reviews.

B. Reporting Requirements for Lenders in Parent-Subsidiary Structures

1. **Non-supervised Lenders.** For non-supervised lenders, HUD will accept the audits of the consolidated financial statements of the parent if they include consolidating schedules that distinguish the balance sheets and operating statements of each FHA-approved subsidiary and the computation of adjusted net worth of each FHA-approved subsidiary. Such information must be subjected to audit procedures in accordance with GAAS relating to “Supplementary Information in Relation to the Financial Statements as a Whole.”
2. **Large Supervised Lenders.** Supervised lenders in parent-subsidiary structures (i.e., subsidiaries) are permitted to submit the audited consolidated financial statements of a parent company, without audited or unaudited consolidating schedules if one of the following conditions is met:
 - a. The FHA-approved subsidiary owns at least 40 percent of the assets on the consolidated balance sheet or
 - b. The FHA-approved subsidiary provides FHA with an executed copy of a corporate guaranty agreement between it and the parent company in which the parent company guarantees the ongoing net worth and liquidity compliance of the FHA-approved subsidiary. At the time of the revision of this chapter, FHA was finalizing a standardized agreement (see attachment E) and will require lenders to use this agreement or obtain prior approval to use a different agreement.

A supervised FHA-approved lender electing to submit audited consolidated financial statements pursuant to one of the above-mentioned conditions must submit its fourth quarter call report as an attachment to its electronic submission. Additionally, the reports on internal control and compliance at the FHA-approved subsidiary’s level must be included as an attachment to the FHA-approved lender’s electronic submission.

3. **Investing Lender.** Investing lenders in parent-subsidiary structures are permitted to submit the audited consolidated financial status of the parent as allowed in paragraphs B.1 and B.2 above.

Investing lenders are required to submit audited financial statements and an audited computation of adjusted net worth. Investing lenders that have been

approved to service FHA loans must also submit reports on internal control and compliance.

C. Reporting Requirements for Small Supervised Lenders. Small supervised lenders are not required to submit audited financial statements to FHA or an audited computation of adjusted net worth. Such lenders must submit a copy of their unaudited regulatory report (i.e., report of condition and income, also known as the “call report” and submitted on the Federal Financial Institutions Examination Council forms 031 and 041, or a consolidated or fourth quarter NCUA call report, submitted on NCUA Form 5300 or 5310), signed by an officer, that aligns with their fiscal yearend.

7-4 Electronic Submission of Audited Financial Statements and Compliance Data.

All FHA-approved lenders are required to electronically submit their financial and compliance data to the Lender Approval and Recertification Division through FHA’s electronic data system within 90 days of the close of the end of their fiscal year. The submission must be based on the signed issued paper copy of the audit of the lender’s financial statements, supplemental information, and the signed independent auditor’s report containing the auditor’s opinion. A copy of the issued signed hardcopy of the financial statements, supplemental information, and the signed independent auditor’s report(s) must be submitted electronically.

Lenders that are approved by both FHA and Ginnie Mae must complete the electronic submission of their financial and compliance data through FHA’s electronic system and submit their audited financial statements to Ginnie Mae in accordance with the Ginnie Mae Mortgage-Backed Securities Guide.

A. Auditor Involvement in the Electronic Submission Process. The responsibility for the electronic submission of the lender’s financial and compliance data rests with the lender; however, the auditor is required to perform a separate agreed-upon procedures engagement to determine whether the financial data entered into HUD’s electronic system by the lender are accurate and reconcile with the data on the lender’s hardcopy audited financial statements that are contained in the issued signed audit report. In general, the auditor must compare the electronic data transmitted to HUD to the hardcopy of the basic financial statements, supplemental information, footnotes, the signed independent auditor’s reports, the computation of adjusted net worth, and financial data templates. This procedure should be performed under the current AICPA Statements on Standards for Attestation Engagements for Agreed Upon Procedures Engagements.

B. Extension Requests. A request for a 30-day extension must be submitted to HUD management, through the electronic system, no earlier than 45 days before the

electronic submission due date and no later than 15 days before the submission due date.

- C. Operating Loss Reporting.** Approved lenders must submit either audited or unaudited financial statements to HUD, within 30 days of the end of each fiscal quarter in which the lender experiences an operating loss of 20 percent or greater of its net worth and must continue to make submissions until the lender demonstrates an operating profit for two consecutive quarters or until the next annual recertification by FHA, whichever is the longer period (24 CFR 202.5(m)(1)). The submission should be emailed to LEAPRecert@hud.gov.

7-5 Compliance Requirements and Suggested Audit Procedures Applicable to Lenders with Both Title I and Title II Authorities.

A. Quality Control Plan.

- 1. Compliance Requirement.** The adoption and implementation of a quality control plan is a required element of a lender's application for approval to participate in FHA programs. FHA-approved lenders are required to
 - a.** Originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending and comply with all relevant HUD rules and regulations.
 - b.** Maintain quality control plans consistent with the requirements of chapter 7 of HUD Handbook 4060.1 (Title II) or chapter 6 of HUD Handbook 4700.2 (Title I) as applicable.
 - c.** If they use third-party originators (TPO), ensure that the direct endorsement lender has a quality control plan that requires the review of loans that are originated by the TPO.
 - d.** Review all loans that are originated or underwritten by their company or originated by a sponsored TPO that go into default within the first six payments (referred to as early payment default).
 - e.** Review a sampling of rejected applications (see suggested audit procedure below in 7-5.D.2.d.).
 - f.** Immediately report to HUD, via Neighborhood Watch, fraud or material violations of FHA requirements that, based on the auditor's judgment, represent a significant risk to the FHA insurance fund (paragraph 7-3(J), HUD Handbook 4060.1, REV-2).

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2. **Implementation.** FHA-approved lenders must implement a quality control plan consistent with their needs and the above-referenced guidance to assist corporate management in determining whether their personnel are following HUD requirements and corporate policies and procedures. Lenders must ensure the following:
- a. Quality control reviews are performed on a regular and timely basis. Depending on a lender's production volume, origination reviews may be performed weekly, monthly, or quarterly. The review of a specific mortgage should be completed within 90 days of closing.
 - b. Reviews of different aspects of servicing will vary in frequency; however, delinquent servicing and loss mitigation activities should be reviewed monthly. Timing and frequency of quality control reviews is addressed in the Origination and Servicing sections of HUD Handbook 4060.1.
 - c. The quality control function must be independent of the origination and servicing functions.

The quality control procedures may be conducted by the entity itself internally, by personnel not involved in any aspect of loan origination or servicing, or by an external reviewer (see 24 CFR 202.5(h)).

3. **Suggested Audit Procedures.**

- a. Obtain a copy of the lender's quality control plan and compare it to the general and specific requirements contained in chapter 7 of HUD Handbook 4060.1 or chapter 6 of HUD Handbook 4700.2 as applicable.
- b. Determine whether the lender has a procedure in place to disseminate quality control policies and procedures to all employees involved in loan origination and servicing.
- c. Determine whether the lender has guidelines to revise its procedures in a timely manner to accurately reflect changes in HUD requirements, that personnel are informed of the changes, and that employees are held accountable for performance failures and errors.
- d. Determine whether the lender has procedures for reviewing and monitoring its sponsored third-party originators. At a minimum, these procedures must include the requirements outlined in "Basic Requirements for Quality Control of Single Family Production" in chapter 7 of HUD Handbook 4060.1 and Mortgage Letter 2011-02.

- e. Determine whether the quality control plan requires that all mortgage change records be reviewed for accuracy of sale, transfer of loans, and terminations of insurance.
 - (1) For cases involving the transfer of legal rights to service FHA-insured loans,
 - (a) The transferee is required to report the “change of legal rights to service” to HUD.
 - (b) The transferor is required to verify that the “change of legal rights to service” has been reported and that all of the details contained in the report are accurate.
 - (2) For cases involving the holder’s sale of loans,
 - (a) The holder (seller) is required to report the “sale of loans” to HUD within 15 calendar days, and
 - (b) The buyer is required to confirm that the “sale of loans” has been reported and that all of the details contained in the report are accurate.
- f. Determine whether the lender has a procedure for expanding the scope of quality control reviews as required by chapter 7, paragraph 7-3.F of HUD Handbook 4060.1 when fraudulent activity or patterns of deficiencies are identified.
- g. Inquire into whether the lender relies on an internal or external quality control review of its origination, underwriting, and servicing functions.
 - (1) If the lender relies on an internal review,
 - (a) Verify that the quality control system is separate and apart from the loan processing and underwriting process and is carried out by knowledgeable personnel not involved in loan processing and underwriting.
 - i. Check the employee or contractor listing or organization chart and loan production report provided by the lender to ensure that the personnel are not involved in the day-to-day processes that they are reviewing and

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- (2) Determine whether the sponsor retained the documents and methodologies used in making that determination and the results of the review.
- (3) Review the documentation for compliance with HUD requirements and determine whether the findings were reported and followed up in accordance with the lender's policies and procedures.
- m.** In addition to the loans selected by the lender for routine quality control reviews, select a sample of early payment defaulted loans and determine whether the lender performed a review of such loans within 45 days from the end of the month in which the loan was reported as 60 days past due. Determine whether the early payment default review report and follow-up, including review findings and any actions taken along with procedural information as specified in chapter 7 of HUD Handbook 4060.1, are retained for a period of 2 years.
- n.** Review the supporting documentation of the most recent review to determine whether all of the required general and specific elements included in chapter 7 of HUD Handbook 4060.1 or chapter 6 of HUD Handbook 4700.2 were included in the quality control review. The quality control plan must provide for the written reverification of the borrower's employment, deposits, gift letter, or other sources of funds.
- o.** Obtain a written copy of the latest quality control review report and determine whether senior management officials also received a copy that included any deficiencies identified during the review.
- p.** Determine whether management is monitoring its default and claims rate in accordance with FHA's Credit Watch Program. Copies of Neighborhood Watch reports may be obtained to determine whether the client is using such reports to meet the monitoring requirement.
- q.** Determine whether the lender notified the Office of Lender Activities and Program Compliance of any violations, false statements, or program abuses that were documented in the quality control review report within 60 days of the initial discovery.
- r.** Determine whether senior management officials promptly initiated corrective action for all deficiencies noted in the quality control review report.
- s.** Determine whether the files evidenced the actions taken by senior management to correct the deficiencies.
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- t. Determine whether the files contain evidence that the appropriate employees were notified of the deficiencies and provided instructions to correct the deficiencies and prevent recurrence.

B. Sponsor Responsibility for Third-Party Originators.

1. **Compliance Requirement.** HUD does not monitor sponsored TPOs for the purpose of the origination of loans submitted for FHA insurance. FHA-approved lenders are responsible for performing quality control reviews of their sponsored TPOs. Such reviews include but are not limited to performing a review of loans originated and sold to the lender by each of its sponsored TPOs (Mortgagee Letter 2011-02). The lender must determine the appropriate sample amount of each sponsored TPO's loans to review based on volume, past experience, and other factors specified in chapter 7 of HUD Handbook 4060.1.
2. **Suggested Audit Procedures.**
 - a. Determine whether the sponsoring lender has issued an annual written communication to each TPO under its sponsorship indicating its intent to assume the responsibility of ensuring the TPO's compliance.
 - b. Test the documentation supporting the reviews and the reports of the TPOs and determine the accuracy and reliability of the reviews and reports.

C. Branch Office Operations.

1. **Compliance Requirement.** A lender may maintain one or more branch offices for the origination of loans and submission of applications for mortgage insurance. A lender may originate or service FHA-insured loans from branches that meet FHA requirements (chapter 2 of HUD Handbook 4060.1 or HUD Handbook 4700.2 and Mortgagee Letter 2011-34). Each branch office where a lender's FHA origination personnel are assigned must be registered with FHA, and its facilities must meet State originating requirements. It must also meet FHA's staffing and manager requirements in chapter 2 of HUD Handbook 4060.1 or HUD Handbook 4700.2.

The direct lending branch office is a branch that will be used for the sole purpose of direct lending. Its facilities must meet State originating requirements. It must also meet FHA's staffing and operating requirements in HUD Handbook 4060.1.

2. Suggested Audit Procedures.

- a. Determine whether all branches that manage a lender's FHA origination personnel are registered with HUD by reviewing the appropriate form or screen printout from FHA's Lender Electronic Assessment Portal (LEAP).
- b. Through inquiry or physical observation, determine whether the branches are true branches and are not subsidiaries, independent contractors, agents of the lender, or separate entities. A lender with a separate tax identification number is required to have approval in its own right. A branch must have at least one employee including a branch manager. The branch manager may manage more than one branch except in the case of a direct lending branch, which must have its own manager. Branch office expenses must be paid by the lender.
- c. Review the lender's payroll records for indications of any branch office personnel, except the receptionist, who are not employed exclusively by the lender at any given time. Inquire of personnel to determine whether branch employees conduct only the business affairs of the lender during normal business hours.
- d. Determine whether the branch office facilities meet State mortgage lending licensing requirements.
- e. Review company records for evidence that:
 - (1) The present branch office managers are corporate officers or employees authorized to bind the corporation in matters involving loan origination and servicing and whether the branch office manager of each direct lending branch office manages only that one branch.
 - (2) Branch compensation and contractual relationships comply with the requirements set forth in chapter 2, paragraph 2-14 of HUD handbook 4060.1.

D. Loan Origination.

1. **Compliance Requirement.** HUD requires lenders to originate loans in accordance with HUD requirements. They must obtain and verify information with at least the same care that would be exercised in originating a loan in which the mortgage would be entirely dependent on the property as security to protect their investment.

Information on the lender's copy of form HUD-92900, "HUD/FHA Application for Commitment for Insurance under the National Housing Act," must be supported by documents in the lender's files (HUD Handbook 4155.1).

Lenders may not require, as a condition of providing an insured loan, the principal amount of the loan to exceed a minimum amount established by the lender (24 CFR 203.18d).

Regulations at 24 CFR 202.12 prohibit lenders from originating insured mortgages if it is the customary practice of the lender to engage in "tiered pricing" of its loans (for discount points, origination fee, and other such fees) of more than 2 percent in an area (metropolitan statistical area or county in rural areas). The regulation further requires HUD to ensure that any variations in mortgage charge rates be based only on the actual variations in costs to the lender to make the loan. The 2 percent limitation on variation in "mortgage charge rates" must be applied to all Section 203 mortgages by loan type.

For Title I loans, HUD expects that the lender will exercise prudence and diligence in determining whether the borrower is solvent and an acceptable credit risk with a reasonable ability to make payments on the loan obligation. All documentation supporting this determination of credit worthiness must be retained in the loan file (24 CFR 201.22).

2. Suggested Audit Procedures.

- a.** Obtain an understanding of the lender's procedures for processing loan applications. Determine whether the lender's procedures provide for the applicant's credit report, employment verification, and verification of deposits to be sent directly to the lender and not passed through any interested third party (e.g., real estate agent).
- b.** Obtain a sample of files for Title II loans originated during the audit period to perform the following tests. These files should include loans originated at the lender's branch offices and by its sponsored TPOs as well as its central office.
 - (1)** Review loan file documentation for evidence that the loan applicant had an opportunity for a face-to-face interview. If the loan applicant opted not to have a face-to-face interview, determine whether the lender asked sufficient questions to elicit a complete picture of the borrower's (i) financial situation, (ii) source of funds for the transaction, and (iii) intended use of the property. Verification of all of this information, as well as the identity of the loan applicant, must be documented in the

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- loan file. In addition, determine whether a home equity conversion mortgage (HECM) loan applicant completed the required counseling.
- (2) Review all files in the sample to determine whether any forms have been signed by the lender but not completed by the applicant.
 - (3) Determine whether all employment and income data are supported by a verification of employment or other sources, especially for self-employed applicants and applicants with nonemployment income. Review loan file documentation for evidence that the lender reconciled any conflicting information before submitting the application package to the appropriate HUD Homeownership Center for endorsement or insuring the loan under the lender insurance procedure.
 - (4) Determine whether the applicant's cash assets, source of funds, and liabilities are supported by documentation such as verifications of deposit, gift letters, credit reports, etc.
- c. Obtain a sample of files for Title 1 loans originated during the audit period to be examined for the documentation required by the regulations. The sample should include loans originated at the lender's branch offices as well as the home office.
- (1) Determine whether the lender obtained a separate dated credit application on the HUD-approved form from the borrower, any co-maker, or cosigner and verified the validity of the borrower's Social Security number in accordance with Title I Letter TI-414.
 - (2) Determine whether all income and employment data are supported by written verification or other documentation, especially for self-employed applicants and those with nonemployment income.
 - (3) Determine whether the lender obtained a complete and current consumer credit report on the borrower, any co-maker, or cosigner and checked on any credit inquiries reported within the previous 90 days.
 - (4) Determine whether the lender obtained written verification of the borrower's payment status on any senior mortgages or deeds of trust on the property to be improved.
 - (5) For each person on the credit application, determine whether the lender checked HUD's Credit Alert System to verify whether the borrower is in default or a claim has been paid on behalf of the borrower on any federally insured or guaranteed loan and whether the lender recorded the

borrower's "credit alert response code" on the application for each person listed.

- (6) When the principal balance of the loan exceeds \$5,000 and the initial payment exceeds 5 percent of the loan amount, determine whether the lender obtained written verification of the source of these funds through verifications of deposit, bank statements, gift letters, or other methods or evidence.
 - (7) Review the loan file documentation for evidence that the lender conducted a face-to-face or telephone interview with the borrower before making a final determination of the borrower's credit worthiness.
 - (8) For dealer loans with a credit application date of December 12, 2001, or later, review the file documentation to determine whether a telephone interview occurred before loan disbursement was made. Lenders are required to conduct a telephone interview before disbursing the loan in addition to the credit underwriting telephone interview.
- d. Obtain a sample of files for rejected loans during the audit period and perform the following review:
- (1) Determine whether individual reviews were conducted for all sampled rejected applications that were denied due to a statistical category or score (e.g., credit score, debt-to-income ratio). Determine whether the score accurately reflected the financial status (e.g., loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.
 - (2) Determine whether the rejections were made based on established criteria and the reasons for the rejections were provided to the applicant. Determine whether procedures for accepting and processing the loans were followed.

E. Loan Servicing.

1. **Compliance Requirement.** Lenders that service FHA-insured loans are permitted to collect certain fees from the borrowers in accordance with HUD rules (HUD Handbook 4330.1, chapter 4). Sponsored TPOs are not allowed to service loans.

Lenders that service insured HECMs with adjustable rate mortgages are responsible for adjusting those rates in accordance with the annual and lifetime caps as established by HUD Handbook 4235.1.

Loan servicing procedures are to be followed consistently and should not vary. The lender must have an organized means of periodically identifying the payment status of delinquent loans to enable personnel to initiate and follow up on collection activities and must document its records to reflect its collection activities regarding delinquent loans. The lender must accept partial payments under an executed modification agreement or an acceptable repayment plan (refer to 24 CFR 201.41 for details). A modification agreement may be used to increase or reduce monthly payments but not to increase the term or the interest rate to ensure that the delinquent or defaulted loan is brought current before or by the end of the loan term. A modification agreement may also be used to effect a reduction in the interest rate and monthly payment for current loans (24 CFR 203.500).

2. Suggested Audit Procedures.

- a. Obtain an understanding of the lender's procedures for servicing loans.
- b. Select a sample of delinquent and defaulted loans, including loans in foreclosure, for testing the lender's loan servicing procedures.
- c. Review the loan file documentation for evidence that the lender documents its records to reflect its servicing on delinquent and defaulted mortgages.
 - (1) Determine whether the lender maintains individual servicing records documenting collection (loan servicing) activities.
 - (2) Review the servicing records to determine whether they contain information on collection contacts attempted and completed.
- d. Review selected loan file documents for evidence that the lender communicates with the borrower or makes a reasonable effort to do so to determine the cause of default.
 - (1) Review the individual loan servicing records for recorded collection contacts of more than one type (i.e., telephone, letter, face-to-face interview, etc.) if one type of contact effort is unsuccessful.
 - (2) Review the individual loan servicing records for borrower explanations of defaults and documented attempts by loan servicing personnel to contact the borrowers.
 - (3) Based on the review of the individual loan servicing records, when the cause of delinquency appears to be temporary (i.e., illness,

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- unemployment), test whether the lender offers reasonable repayment plans.
- e. Review selected receipts for evidence that the lender accepts partial or late payments offered by borrowers.
 - (1) Review the lender's procedures for the handling of partial payments. Obtain a representation letter from the lender concerning such procedures.
 - (2) Review the servicing records for the recording of partial payments accepted, held in a pending file, or rejected. (Note: The decision to reject a late or partial payment must be a decision based on the individual circumstances.)
 - (3) Review the payment records of selected borrowers to determine whether
 - (a) The amount of the late charge, if any, was computed correctly.
 - (b) The late charge was assessed after 15 days of delinquency or the 17th day of the month.
 - f. Determine whether the lender has implemented steps to comply with the provisions of HUD's loss mitigation program. Servicing lenders should use the following six tools to mitigate losses to the insurance fund: special forbearance, mortgage modification, partial claim, FHA home modification, preforeclosure sale, and deed in lieu of foreclosure. HUD requires that all loss mitigation tools be considered, and the servicing lender is required to document its loss mitigation efforts. Review selected servicing and claim files for evidence that such relief measures were considered (refer to Mortgagee Letters 2000-05, 2002-17, 2003-19, 2008-23, and 2009-23).
 - g. Determine whether the lender sends notices to advise the borrower about HUD's foreclosure relief program once it has decided to foreclose. Review the loan files selected for evidence that such letters were sent before the initiation of foreclosure proceedings.
 - h. Compare charges assessed to borrowers for servicing activities to allowable amounts (refer to 24 CFR 203.552, 24 CFR 203.25, and chapter 4 of HUD Handbook 4330.1). For the loans selected:
 - (1) Review charges to borrowers for checks returned due to insufficient funds.
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- (2) Review charges to borrowers for attorney's fees and determine whether
- (a) The charges were for services performed by someone other than salaried members of the lender's staff and
 - (b) The charges were made only in those cases in which the lender decided to foreclose and referred the loan to an attorney for initiation of foreclosure proceedings.
- i. Obtain an understanding of the lender's procedures for paying insurance premiums to HUD. Determine whether the lender follows one of the two acceptable methods of making insurance premium payments (electronic payment through pay.gov or bank check) and that its practices comply with HUD regulations. Review a representative sample of insurance claims submitted to HUD. Recalculate the net claim amount on the Single Family Application for Insurance Benefits (form HUD-27011) and compare the claim amount information to the accounting records. Test the amounts included in the claim for preservation and protection expenses to determine whether they are supported by documentation.
 - j. Select a sample of adjustable rate HECMs and determine whether the lender is exceeding the limitations of the 2 percent annual and 5 percent lifetime caps.
 - k. Select a sample of HECMs and determine whether the disbursements have been made in accordance with the mortgage note.

F. Federal Financial and Activity Reports.

1. **Compliance Requirement.** Lenders participating in HUD-assisted Title I and Title II programs are required to ensure that financial status, single-family default monitoring, and reports required under the Home Mortgage Disclosure Act (HMDA) contain reliable data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements, handbooks, and mortgagee letters contain the specific reporting requirements that the lender is to follow. Refer to HMDA reporting requirements at: <http://www.ffiec.gov/hmda/guide.htm>.

In addition to the specific reporting requirements referenced above, lenders originating Title I loans are required to submit annual HMDA reports by March 1 of each year pursuant to Title I Letter TI-479. All lenders with Title I authority are required to report any noncompliance by borrowers, contractors, or other parties related to a Title I-insured loan pursuant to Title I Letter TI-447.

2. Suggested Audit Procedures.

- a. Obtain a list from management of the HUD programs participated in during the reporting period, along with all related guidance and reference materials addressing reporting requirements for each program listed.
- b. Obtain an understanding of the lender's procedures for preparing and reviewing the required reports.
- c. Select a sample of financial reports, other than those that are included in the audited financial statements, and determine whether the reports selected are prepared in accordance with HUD instructions.
- d. Select a sample of activity reports and determine whether the reports selected are prepared in accordance with HUD requirements and are filed in a timely manner.
- e. For the sample, trace significant data to supporting documentation; i.e., worksheets, ledgers, etc. Report all material differences between selected reports and lender records.
- f. Review adjustments made to the general ledger accounts having a material effect on the HUD program activity and evaluate the propriety of those adjustments.

G. Lender Annual Recertification, Adjusted Net Worth, Liquidity and Licensing.

To help strengthen FHA's oversight of approved lenders and better manage program risks, Section 203 of the Helping Families Save Their Homes Act of 2009 (Public Law 111-22) provides limitations on those eligible to participate in FHA programs. This Act directs that lenders not be and not have any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator of the applicant lender who is currently (1) suspended; (2) debarred; (3) under a limited denial of participation; (4) under indictment for or has been convicted of an offense that reflects adversely upon the applicant's integrity, competence, or fitness to meet the responsibilities of an approved lender; (5) subject to unresolved findings contained in HUD or other governmental audit, investigation, or review; (6) engaged in business practices that do not conform to generally accepted practices of prudent lenders or that demonstrate irresponsibility; (7) convicted of or who has pled guilty to a felony related to participation in the real estate or mortgage loan industry; or (8) in violation of any other requirement as established by the HUD Secretary. The timeframes associated with criminal activity and clarification of the term "unresolved findings" is further outlined in Mortgagee Letter 2010-38.

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1. **Compliance Requirements.** All lenders must maintain both fidelity bond and errors and omissions insurance of at least \$300,000 each (24 CFR 7(b)(5)). HUD does not require that it be the beneficiary of such coverage. A fidelity bond that is generally acceptable to the secondary market agencies, such as Ginnie Mae, Fannie Mae, or Freddie Mac, will meet FHA's requirement. An applicant must provide evidence of such coverage.

In compliance with Mortgagee Letter 2010-38, FHA-approved lenders must complete the online annual certification (formerly known as the yearly verification report) before electronically submitting the annual renewal fee and audited financial statements. The annual recertification process must be completed within 90 days of the lender's fiscal year end. There are three steps to FHA's annual recertification process; namely, (1) the completion of the online annual certification, (2) electronic payment of the annual renewal fee, and (3) electronic submission of acceptable audited financial statements and other required documents that have been received as acceptable by HUD. On April 20, 2010, HUD made changes to the net worth requirements (24 CFR 202.5(n)). The following net worth requirements are effective May 20, 2010, for all approved supervised and non-supervised lenders and all approved investing lenders with FHA approval as of May 20, 2010.

- Existing non-small-business-approved lenders. An applicant for FHA-approved lender that exceeds the size standards for its industry classification as established by the Small Business Administration (SBA) at 13 CFR 121.201, section 52 (Finance and Insurance), subsector 522 (Credit Intermediation and Related Activities), must have a net worth of not less than \$1 million, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable⁴ to the HUD Secretary.
- Existing small-business-approved lenders. An approved lender that meets the SBA size standards for its industry classification must have a net worth of not less than \$500,000, of which no less than 20 percent must be liquid assets consisting of cash or its equivalent acceptable to the HUD Secretary. The net worth requirements for small business lenders remain applicable as long as the lender continues to meet the SBA size standard for small business. If a small business lender no longer meets the SBA size standard of a small business, as evidenced by the audited financial statements

⁴ Cash and cash equivalents constitute liquid assets. Cash includes cash on hand, checking accounts, savings accounts, and certificates of deposit. Cash equivalents are readily marketable investments; e.g., securities readily convertible into cash. To be considered a liquid asset, the cash or cash equivalent must not be restricted or otherwise reserved for any purpose other than the payment of a current liability. FHA does not consider a line of credit or loans or mortgages held for resale by the lender to be liquid assets.

provided to HUD 90 days after the end of a fiscal year, the lender must meet the net worth requirements for a non-small-business lender by the last day of the fiscal year in which the audited financial statements were submitted.

In addition, the following net worth requirements are effective on May 20, 2013, for new applicants for FHA approval to participate in FHA single-family and multifamily programs, for all approved supervised and non-supervised lenders, and for all FHA-approved investing lenders:

- **Single-family lenders.** Irrespective of size, each applicant and each approved lender, for participation solely under the FHA single-family programs, shall have a net worth of not less than \$1 million, plus an additional net worth of 1 percent of the total volume in excess of \$25 million of FHA single-family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. No less than 20 percent of the applicant's or approved lender's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the HUD Secretary.
- **Multifamily lenders.** Irrespective of size, each applicant for approval and each approved lender for participation solely under the FHA multifamily programs must have a minimum net worth of not less than \$1 million. For those multifamily approved lenders that also engage in mortgage servicing, an additional net worth of 1 percent of the total volume in excess of \$25 million in FHA multifamily mortgages originated, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million, is required. For multifamily approved lenders that do not perform mortgage servicing, an additional net worth of one half of 1 percent of the total volume in excess of \$25 million in FHA multifamily mortgages originated during the prior fiscal year, up to a maximum required net worth of \$2.5 million, is required. No less than 20 percent of the applicant's or approved lender's required net worth must be liquid assets consisting of cash or its equivalent acceptable to the HUD Secretary.

An FHA computation of adjusted net worth is required for all lenders even if there were no loans originated or serviced during the audit period. The required amount, which must be maintained throughout the year, varies by program participant type and approval date. When the lender is a parent or a subsidiary of a parent, the adjusted net worth computation must focus on the assets and equities of the individual FHA-approved entity.

Included in this chapter are examples of adjusted net worth computation schedules, which are shown in attachments A and B.

The following are unacceptable assets and are not to be used in the computation of adjusted net worth:

- a.** Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community or to the government regulator. These pledged assets are acceptable for supervised institutions only.
- b.** An asset due from an officer or stockholder of the lender or from a related entity, except for:
 - (1)** A construction loan receivable, secured by a first mortgage, from a related entity.
 - (2)** A mortgage loan receivable established in the normal course of business in an arm's length transaction and secured by a first mortgage on the related property.
 - (3)** A receivable from a related party when the affected parties have executed a cross-default agreement⁵ or corporate guarantee agreement⁶ with Ginnie Mae.
 - (4)** A receivable from an officer or stockholders of a publicly traded supervised institution that owns less than 5 percent of the shares outstanding or issued.
- c.** An investment in a related entity in which any officer or stockholder of the lender has a personal interest⁷ unrelated to that person's position as an officer or stockholder of the lender.
- d.** Any intangible asset, including but not limited to goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals aside from mortgage servicing rights referenced below.

⁵ A cross-default agreement is an agreement between related affiliated Ginnie Mae issuers, which provides for the default of all affiliated issuers in the event of a default by any one of them.

⁶ A corporate guarantee agreement is an agreement in which the issuer's parent guarantees the performance of the issuer.

⁷ "Personal interest" as used here indicates a relationship between the lender and a person or entity in which that specified person (e.g., spouse, parent, grandparent, child, brother, sister, aunt, uncle, or in-law) has a financial interest in or is employed in a management position by the lender.

- e. The value of any servicing contract not determined in accordance with Financial Accounting Standards Board Accounting Standards Codification 860-50 – Transfers and Servicing – Servicing Assets and Liabilities or revisions thereto.
- f. Any asset unrelated to the lending business and not readily marketable and for which appraised values are highly subjective. Examples include but are not limited to antiques, artwork, and gemstones.
- g. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost, including unrealized gains on “available for sale” securities.
- h. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.
- i. Any asset, which is principally used⁸ for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes motor vehicles and personal residences.
- j. “Other assets” unless the financial statements are accompanied by a schedule covered by the audit opinion or a schedule prepared by the issuer or lender and signed by an officer of the issuer or lender.
- k. That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution, determined by an independent appraisal. If property is contributed but the related mortgage or debt is not also transferred to the company, the value of the contributed property should be reduced by that obligation.

Beginning in 2011, mortgage lenders were required to file their annual licensing requirements with the National Mortgage Licensing System (NMLS). The lender must also file a quarterly call report on loan information that also includes selected financial data. The detail required depends on the size of the lender. The link to the NMLS website can be found below:

<http://mortgage.nationwidelicencingsystem.org/Pages/default.aspx>

⁸ “Principally used” means that any other use of the property must be solely incidental.

2. Suggested Audit Procedures.

- a. As of the financial statement date and additional representative points of time during the audit period, test whether the lender meets the required levels for adjusted net worth, liquidity, fidelity bond coverage, and errors and omissions bond according to HUD Handbook 4060.1. If the lender does not meet the requirement, report the deficiency in the report on compliance and in a written audit finding. Determine whether there are internal control deficiencies related to the noncompliance that should be reported in the report on internal controls and in a written audit finding.
- b. Ensure that the lender has filed the annual certification, paid the annual renewal fee, and submitted audited financial statements for the prior year.
- c. Determine the lender's compliance in reporting any quarterly net operating loss, calculated based on GAAP, in excess of 20 percent of net worth (refer to HUD Handbook 4060.1).
- d. Determine the lender's compliance with the liquidity requirements as outlined above (refer to HUD Handbook 4060.1).
- e. Review the lender's filings with NMLS to ensure that the required filings were made. Review the yearend filing to ensure that the financial data filed agree with the audited financial statement data.

7-6 Compliance Requirements and Suggested Audit Procedures Applicable to Lenders with Title I Authority.**A. Loan Disbursement.**

1. **Compliance Requirement.** The lender has certain responsibilities to be carried out in connection with the disbursement of loan proceeds (24 CFR 201.26 and 201.40). These responsibilities vary widely, depending upon whether the loan is a property improvement or manufactured home loan and whether the disbursement is made directly to the borrower or to a dealer. The disbursement of loan proceeds must be adequately documented in the lender's file. When dealer loans are involved, the lender must also maintain separate dealer files, which reflect compliance with HUD's requirements concerning the dealer's approval and supervision (24 CFR 201.27).
2. **Suggested Audit Procedures.**
 - a. Review the lender's procedures for determining borrower eligibility and evaluating whether the loan proceeds are being used for eligible purposes

(24 CFR 201.20 or 201.21 as appropriate). Also, review the lender's procedures for documenting that the property improvements have been completed or the manufactured home has been satisfactorily delivered and installed (24 CFR 201.26(a) or (b) as appropriate).

- b.** Select a representative sample of property improvement loan files and determine whether each file contains the following:
 - (1)** The note, security instrument if any, credit application, completion certificate, and notice of HUD's role in the loan transaction required by 24 CFR 201.26(b)(7) for manufactured home loans and 24 CFR 201.26(a)(8) for property improvement loans.
 - (2)** A contract or contract proposal between the borrower and a dealer or contractor or a detailed written description of the work with a materials list and estimated costs if the borrower is carrying out the work without a dealer or contractor.
 - (3)** Evidence of an onsite inspection to determine that the improvements were completed if the loan is for \$7,500 or more.
- c.** Select a representative sample of manufactured home loan files. Review the files to determine whether each file contains the following documents:
 - (1)** The note, security instrument, credit application, purchase contract, manufacturer's invoice, itemized statements of other costs, and fees or charges.
 - (2)** Evidence of the borrower's initial payment, a placement certificate signed by the borrower and dealer, and the notice of HUD's role in the loan transaction required by 24 CFR 201.26(b)(7).
- d.** For each file reviewed under A.2.c above, determine whether the lender has documented a site-of-placement inspection within 60 days after disbursement of the loan proceeds.
- e.** When the lender approves dealer loans, determine whether
 - (1)** The lender supervised and monitored each dealer and visited the dealer periodically.
 - (2)** Each dealer's approval is documented on a HUD-approved form, signed and dated by both parties.

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- (3) Each dealer's file contained the dealer's current financial statement, including a determination that the dealer met the minimum adjusted net worth requirements of 24 CFR 201.27(a)(1) and credit reports on the dealership and its owners, principals, and officers.
 - (4) The file contained documentation of the lender's experience with the dealer's Title I loans, including information on borrower defaults and borrowers' complaints and evidence of the resolution of those complaints.

B. Eligible Fees and Charges.

1. **Compliance Requirement.** Title I Letters TI-440, dated May 2, 1996, and TI-440-S, dated July 3, 1996, list all fees and charges allowed in the program.
2. **Suggested Audit Procedures.** Obtain the lender's general ledger, cash journal, canceled checks, and supporting invoices for at least 2 months of the audit period and based on review of a representative sample, determine whether
 - a. The fees and charges were within the allowable amounts contained in Title I Letters TI-440 and TI-440-S and report amounts paid in excess of the allowable amounts.
 - b. Disbursements are supported by invoices and were for eligible amounts in return for goods or services actually provided in connection with a Title I loan. Review and report on any differences.
 - c. Referral fees are being paid. During the review of loan origination and loan settlement documents, the auditor should be alert for any fees or other types of payments that show evidence of being referral fees. If the auditor notes any such referral fees, they must be reported as a finding.
 - d. Points and closing costs are accurate.

7-7 Compliance Requirements and Suggested Audit Procedures Applicable to Lenders with Title II Authority.

A. Loan Settlement.

1. **Compliance Requirement.** The loan origination fee should normally compensate the lender for the required loan settlement services. As a result of regulatory changes to 24 CFR 203.27, FHA no longer limits the origination fee to 1 percent of the mortgage amount for its standard mortgage insurance programs. HUD has specified the types and amount of additional charges and

fees that the lender may collect from the borrower. Additionally, the lender is responsible for promptly submitting upfront mortgage insurance premiums to HUD following loan settlement, disbursing the funds, and completing the transaction in accordance with the closing documents without undue delay (24 CFR 203.284).

2. Suggested Audit Procedures.

- a.** Obtain an understanding of the lender's procedures for settling and completing loan transactions.
- b.** Select a representative sample of HUD loans for testing from those settled during the audit period.
 - (1)** Examine the signed settlement statement (form HUD-1). Prove the mathematical accuracy of the HUD-1. Compare amounts listed on the HUD-1 to other authentic loan documents, including the good faith estimate.
 - (2)** Review the fees and charges collected from the borrowers as shown on loan settlement statements.
 - (a)** Determine whether they are equal to the lender's actual out-of-pocket costs for the related service or the maximum charge allowed by HUD, whichever is lower (refer to 24 CFR 203.24, 24 CFR 203.26, chapter 6 of HUD Handbook 4155.2, and chapter 4 of HUD Handbook 4330.1).
 - (b)** Determine whether all such fees were disclosed in the good faith estimate.
 - (3)** Review the points and closing costs to determine whether those costs were the costs that the borrower agreed to.
 - (4)** Review computations and supporting data for amounts collected to establish escrow accounts for taxes and hazard insurance. Determine whether the amounts charged are in accordance with the supporting data. Report any differences.
 - (5)** Review computations and supporting data for interest collected from the borrower at loan closing. Reconcile and report on any differences.
 - (6)** Compare the amount of the insured mortgage to the acquisition costs to determine whether the borrower made the required minimum

investment. The form HUD-92900 contains the acquisition cost of the property. The HUD-1 contains the amount of the insured mortgage.

- (7) Examine the canceled check or other supporting documentation for evidence that the lender submitted the mortgage insurance premium to HUD in accordance with HUD policy at the time of closing. Determine whether payment reached HUD's depository within 10 calendar days of closing (Mortgage Letter 2005-28, dated June 20, 2005).
- (8) Compare the purchase contract and the HUD-1 for agreement as to sales price, earnest money deposit, and any seller concessions.

B. Escrow Accounts.

1. **Compliance Requirement.** HUD requires that lenders establish escrow accounts and borrowers make monthly payments thereto to ensure that funds will be available to pay taxes and insurance premiums. Each month, the lender must collect from the borrower an amount that the lender estimates will be sufficient to enable it to accumulate funds to pay all escrow obligations before delinquency; i.e., (a) mortgage insurance premiums; (b) taxes, special assessments, and ground rents if any; (c) hazard insurance premiums if any; and (d) flood insurance premiums when required. The lender should analyze the escrow account at least annually to determine whether projected escrow balances will be sufficient to fund escrow disbursements. Any projected escrow shortage should be collected by either (a) lump sum payment or (b) allocating the shortage over a 12-month period. The mortgage instrument provides the authority for the lender to accumulate sufficient escrow funds with which to pay the borrower's tax and insurance bills 30 days before the bills become delinquent (HUD Handbook 4330.1, chapter 2).

Lenders may not use borrower escrow funds for any purpose other than that for which they were received, and lenders may not report escrows as their own assets. If a lender reports its escrow funds on its balance sheet, such funds must be fully offset by a corresponding liability and must be segregated on the balance sheet.

2. Suggested Audit Procedures.

- a. Obtain an understanding of the policies and procedures for reconciling escrow accounts.
- b. Determine whether escrows are reported on the balance sheet. If so, determine whether the proper liability account is established and reported and the accounts are segregated as required.

- c. Obtain trial balances of individual escrow accounts and reconcile or review the reconciliation of the total with the lender's control account and the related bank account. Select a sample and test to determine whether the lender used escrow funds to pay late charges, assumption fees, or any other expense that are not allowable expenses as specified above.
- d. For selected mortgages, obtain the most recent escrow analysis and note whether it was prepared not more than 1 year previously and whether monthly deposits appear adequate to provide for payments of taxes, insurance, etc., by review of actual payments or other evidence of amounts due (e.g., tax assessment notices or prospective rate adjustment notices from insurance companies). Also, determine whether the most recent real estate tax bills for each account were paid. If not paid within the discount period, inquire as to reasons for the delay and test to determine whether the borrower retained the benefit of the discount and any late charges assessed were borne by the lender at its expense. Determine whether the borrower was furnished a statement of interest paid during the preceding calendar year within 60 days after the end of that calendar year.
- e. On accounts selected for review, inspect supporting documents for escrow disbursements such as receipts, invoices, tax bills, and canceled checks. Determine whether the funds were used only for the intended purpose and the proper amount was disbursed.
- f. Determine whether escrow funds have been deposited into accounts fully insured by FDIC or NCUA and whether the lender covered any overdrafts on selected accounts by advancing its own funds to custodial accounts so that FDIC or NCUA insurance protection was not impaired. HUD regulations neither require nor forbid escrow accounts to bear interest. However, in those cases in which accounts are interest bearing, determine whether interest earned, net of any bank account fees, is passed on to the borrower.
- g. Determine whether the lender advises the borrower of the amount of any surplus escrow funds in accordance with HUD requirements.
- h. Review the policies and procedures that the lender has established to ensure that bills payable from the escrow fund or the information needed to pay such bills is obtained in advance of the due date.
- i. For any bills paid late by the lender, determine whether any late charges or penalties assessed are paid out of the lender's funds and not the borrower's funds.

- j. Determine whether the lender requires the borrower to purchase hazard insurance coverage from the lender or from a specific company.
- k. Review selected loan payoffs for evidence that the lender returns to the borrower the amounts held in escrow for taxes and hazard insurance within 30 days of receipt by the lender of payoff funds.
- l. Determine whether the lender has notified HUD within 15 calendar days of the sale or transfer of an FHA-insured loan to another FHA-approved lender, pursuant to Mortgagee Letter 2011-33.

C. Kickbacks.

- 1. **Compliance Requirement.** HUD regulations and the Real Estate Settlement Procedures Act prohibit lenders from paying any fee, kickback, compensation, or thing of value, including a fee representing all or part of the lender's origination fee, to any person or entity other than for services actually performed or to any person or entity for referral of the loan or as a finder's fee (HUD Handbook 4155.2, chapter 6).
- 2. **Suggested Audit Procedures.**
 - a. Obtain the general ledger; the cash journal; and a representative sample of canceled checks, check vouchers, and supporting invoices for at least 2 months of the audit period and determine whether
 - (1) Disbursements are supported by an invoice and were not for an unreasonable amount in return for goods or services actually performed. Reconcile and report on any differences.
 - (2) Any funds were advanced to real estate agents, real estate brokers, mortgage brokers, or packagers as an advance of anticipated commissions on sales to be financed with an FHA-insured mortgage.
 - b. Determine whether any no-interest loans or loans at less than prevailing rates were made to a real estate broker, real estate agent, mortgage broker, packager, builder, or any other party from whom, based on available evidence, the lender accepts proposals involving FHA-insured mortgages.
 - c. From a sample of payments, determine whether any payment was made for a gratuity or for a gift valued above items that are customarily distributed in the normal course of advertising or public relations or as a general promotion device to any person or entity involved in FHA-insured mortgage transactions of the lender.

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- d. From a sample of payments, determine whether any fees or compensation was paid that is prohibited by the Real Estate Settlement Procedures Act.
 - e. During the review of loan origination and loan settlement documents, the auditor should be alert for any fees or other types of payments that may represent kickbacks. If the auditor notes any kickbacks or indications of kickbacks, these should be reported in an audit finding.

7-8 Multifamily Insured Loans Reporting Requirement - Loan Fees for Multifamily Mortgages

- A. Compliance Requirement.** Lenders participating in FHA multifamily programs are now required by Mortgagee Letter 2011-05 to report total loan fees earned that exceed 5 percent of the insured loan amount on each FHA-insured loan of more than \$2 million endorsed during the lender's fiscal year period covered in its audited financial statements.

Loan fees include

1. Origination and placement fees as permitted by the Multifamily Accelerated Processing Guide,
2. **Plus** trade profit, trade premium, or marketing gain earned on the sale of the Ginnie Mae security at a value above par, even if the security sale is delayed until after endorsement,
3. **Minus** loan fees applied by the lender to its legal expenses incurred in connection with loan closing.

Loan fees should be reported on a separate schedule included as supplemental information with the lender's annual audited financial statements submitted to HUD (see example format below). For each loan in which the lender earned total loan fees of more than 5 percent, the schedule must list (1) the FHA loan number, (2) the loan amount at initial or final endorsement, and (3) the amount of total loan fees earned above 5 percent, both in dollar amount and as a percentage of the FHA-insured loan amount.

**Schedule of loan fees for
multifamily lenders**

FHA loan number	Dollar amount of endorsed loan	Loan fees earned that exceed 5% of insured loan amount	
		Percentage of insured loan amount	Amount in dollars

Lenders are not required to separately report on total loan fees that do not exceed 5 percent.

If, on a single loan endorsement, the trade profit, trade premium, or marketing gain earned on the sale of the Ginnie Mae security is received by the lender during a fiscal year reporting period that is after the period in which the origination and placement fees were received and if the total of the fees earned requires reporting under Mortgagee Letter 2011-05, the lender must disclose the total loan fees it earned that are above 5 percent of the loan amount on the schedule filed during the next fiscal year.

Mortgagee Letter 2011-05 also states that that lenders' annual audited financial statements are not subject to Freedom of Information Act requests.

B. Suggested Audit Procedures.

1. Review insured loans of more than \$2 million that closed during the reporting period and determine whether the total loan fees earned exceeded 5 percent of the loan amount.
2. Review the report and determine whether all of the fees earned that exceeded 5 percent of the loan amount were listed in the report.
3. Determine whether the report included all of the required information and whether that information was accurate based on information in the loan file.
4. Determine whether (1) any trade profit, trade premium, or marketing gain fees earned on the sale of the Ginnie Mae security were received by the lender during a fiscal year reporting period that was after the period in which the origination and placement fees were received, (2) the total of the fees earned requires reporting under Mortgagee Letter 2011-05, and (3) the lender disclosed

the total loan fees it earned that were above 5 percent on the schedule filed during the next fiscal year.

7-9 Audit Finding Reporting.

All material instances of noncompliance with any HUD requirement or regulation, significant deficiencies and material weaknesses in internal controls, instances of fraud or illegal acts, or contract violations that were disclosed during the audit process must be reported as findings in the audit report. All nonmaterial instances of noncompliance, deficiencies in internal control, instances of fraud or illegal acts, or contract violations relating to HUD programs disclosed during the audit process may be reported to management in a separate communication outside of the audit report. Such reporting must be in writing in a management letter or other type of written auditor communication and must be mentioned in the independent auditor's report, including the date of the management letter or other written communication. The management letter or other communication should accompany the electronic submission. Noncompliance, deficiencies, or instances of violations, which were corrected during the audit process or after the fiscal year under audit or disclosed as a part of the audit process before the end of the fiscal year under audit and before the issuance of the audit report, must be included in the report as resolved findings or in a management letter, depending on their materiality, regardless of whether they were found to be material or immaterial FHA compliance issues.

A. Content of Finding.

Findings are to be presented in accordance with the standards and requirements of the Government Auditing Standards, "Yellow Book." A finding should be supported by sufficient, competent, and relevant evidence; be presented in a manner to promote adequate understanding of the matters reported; and provide convincing but fair presentations in proper perspective. Each finding is to be accompanied by a corrective action plan prepared by the lender.

Please refer to chapter 2 for the information that is to be included in a finding.

B. Corrective Action in Process.

Many times when lenders are presented with draft findings, they will start to take action to correct the deficient condition. When this action is underway and the auditor has completed his or her fieldwork, the lender may include the action completed and the action remaining to be taken in the lender's comments and in the corrective action plan. Regardless of whether the lender is in the process of correcting the finding, the auditor is to include the finding in the report with all required elements.

C. Corrective Action Completed.

Many times when the lender is presented with draft findings, it will start to take action and complete that action, correcting the deficient condition before the completion of the fieldwork. When this action occurs, the finding is still to be included in the audit report with all required elements. The action taken or completed should be included in the lender's comment section and should be validated by the auditor. The recommendation section should follow the lender's comment section, and the auditor should indicate whether any of the information is inconsistent with or in conflict with the report's findings. In addition, the auditor could include any additional recommendations he or she believes are necessary based on the testing of that action.

- 7-10 Reference Material.** The following is the reference material that was in effect at the time this handbook chapter was issued. It is the auditors' responsibility to use the appropriate reference material that was in effect during the period covered by their audit.

Throughout this chapter, except in this paragraph, reference is made to handbooks using only the base handbook number without the revision number (i.e., REV-1, REV-6, etc.). In this section only, we are citing the revision numbers that were current on the date of publication since it was those documents we used in establishing the requirements of this audit guide. Also, the auditor should ensure that the updated references or the reference materials that were in effect during the period of the audit are used for performing the audits. Auditors should make any needed modifications or updates to the material used to perform their audits. If reference to the handbook is needed in the audit report findings or in any other part of their audit report, auditors should ensure that the entire updated reference (including the revision number) is used.

The information collection requirements contained in this handbook have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. (United States Code) 3501-3520) and assigned the following OMB approval numbers: 2502-0328, 2502-0551, and 2502-0005.

Document	Title
24 CFR Part 5	General HUD Program Requirements: Waivers
24 CFR Part 201	Title I Property Improvement and Manufactured Home Loans
24 CFR Part 202	Approval of Lending Institutions and Mortgagees

Document	Title
Mortgagee letters	Various
Forms	Various
HUD Handbook 4060.1, REV-2	FHA Title II Mortgagee Approval Handbook
HUD Handbook 4145.1	Architectural Processing and Inspections for Home Mortgage Insurance
HUD Handbook 4150.1, REV-1	Valuation Analysis for Home Mortgage Insurance ⁹
HUD Handbook 4150.2	Valuation Analysis for Single Family One-to-Four-Unit Dwellings
HUD Handbook 4155.1	Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties
HUD Handbook 4155.2	Lender's Guide to the Single Family Mortgage Insurance Process
HUD Handbook 4235.1, REV-1	Home Equity Conversion Mortgages
HUD Handbook 4240.2, REV	The Graduated Payment Mortgage Program
HUD Handbook 4240.4, REV-2	203K Handbook Rehabilitation Home Mortgage Insurance
HUD Handbook 4330.1, REV-5	Administration of Insured Home Mortgages
HUD Handbook 4330.4, REV-1	FHA Single Family Insurance Claims
HUD Handbook 4350.4	Insured Multifamily Mortgagee Servicing and Field Office
HUD Handbook 4700.2	Title I Lender Approval Handbook
LEAP User Manual	LEAP User Manual

⁹ The 1999 transmittal pages for HUD Handbook 4150.2 specified that most of 4150.1 was being incorporated into the new 4150.2 except for several chapters and paragraphs. The inclusion of 4150.1 in this listing of applicable handbooks may give the mistaken impression that all of 4150.1 is applicable, when it is not.

If the program participant does not have this reference material, it may be obtained by accessing HUD's Client Information and Policy System (HUDCLIPS) at <http://www.hud.gov/offices/adm/hudclips/index.cfm>, or it may be ordered from HUD's Direct Distribution System by telephone at (800) 767-7468; in a letter addressed to HUD, Customer Service Center, Room B-100, 451 Seventh St., SW, Washington, DC 20410; or by fax at (202) 708-2313.

7-11 Technical Assistance.

On behalf of the HUD Secretary, the Lender Approval and Recertification Division determines the acceptability of all audited financial statements submitted by FHA-approved lenders. Therefore, it is important that such submissions meet the requirements delineated in this chapter and HUD Handbook 4060.1, REV-2. If a program participant has questions related to HUD's audited financial statements' requirements, the participant may contact the helpline at 202-755-7400 or submit an email to LEAPRecert@hud.gov.

Attachment A**FHA Lenders with Title I Authority - Adjusted Net Worth Computation***

Stockholders; equity (net worth) Per balance sheet	\$_____ (a)
Less unacceptable assets	\$_____ (b)
Adjusted net worth for HUD purposes (c) = (a)-(b)	\$_____ (c)
Less minimum net worth required	<u>\$1,000,000</u> (d)
Adjusted net worth above/below minimum net worth required (e) = (c)-(d)	\$_____ (e)

*FHA loan activity is not required.

Attachment B**FHA Lenders with Title II Authority - Adjusted Net Worth Computation***

Stockholders; equity (net worth) Per balance sheet	\$_____ (a)
Less unacceptable assets	\$_____ (b)
Adjusted net worth for HUD purposes <i>(c) = (a)-(b)</i>	\$_____ (c)
Less minimum net worth required	<u>\$1,000,000</u> (d)
Adjusted net worth above/(below) minimum net worth required <i>(e) = (c)-(d)</i>	\$_____ (e)

*Schedule is effective immediately. Lenders with Title II authority without any FHA loan activity may continue to use this computation after May 20, 2013.

Attachment C

Title II Single Family Program Lenders' Adjusted Net Worth Computation
(Effective After May 20, 2013)

FHA servicing portfolio* at (end of fiscal year under audit)	_____ (a)
*HUD-FHA-insured single-family mortgages only. Include HECMs at maximum claim amount.	
FHA originations – FHA-insured Title II loan originations during the fiscal year	_____ (b)
FHA purchases – FHA-insured Title II third-party originator purchases during the fiscal year	_____ (c)
Total FHA loan activity [(d) = (a)+(b)+(c)]	_____ (d)
FHA-insured Title II loan originations retained at the fiscal yearend	_____ (e)
FHA-insured Title II third-party originator purchases retained at the end of fiscal year	_____ (f)
Adjustments [(g) = (e)+(f)]	_____ (g)
Total adjusted FHA loan activity [(h) = (d)-(g)]	_____ (h)
Net worth required	<u>\$1,000,000</u> (i)
If (h) ≤ \$25 million, skip lines (j) and (k) and insert (i) on line (o).	
Additional net worth required	_____ (j)
If (h) > \$25,000,000, then (j) = (h)-(25,000,000)*(1%).	
Total net worth [(k)** = (i)+(j)]	_____ (k)
If line (k) < \$2,500,000, insert line (k) on line (o).	
If line (k) > \$2,500,000, insert \$2,500,000 on line (o).	
** After May 20, 2013, the maximum net worth required will be \$2.5 million.	
Stockholders' equity (net worth) per balance sheet	_____ (l)
Less unacceptable assets	_____ (m)
Adjusted net worth [(n) = (l)-(m)]	_____ (n)
Minimum net worth required	_____ (o)
Adjusted net worth above/(below) required minimum amount [(p) = (n) – (o)]	_____ (p)

Attachment D

Title II Multifamily Program Servicers - Adjusted Net Worth Computation
(Effective After May 20, 2013)

FHA servicing portfolio* at (end of fiscal year under audit)	_____	(a)
*HUD-FHA-insured single-family mortgages only. Include HECMs at maximum claim amount.		
FHA originations – FHA-insured Title II loan originations during the fiscal year	_____	(b)
FHA purchases – FHA-insured Title II third-party originator purchases during the fiscal year	_____	(c)
Total FHA loan activity [(d) = (a)+(b)+(c)]	_____	(d)
FHA-insured Title II loan originations retained at the fiscal yearend	_____	(e)
FHA-insured Title II third-party originator purchases retained at the end of fiscal year	_____	(f)
Adjustments [(g) = (e)+(f)]	_____	(g)
Total adjusted FHA loan activity [(h) = (d)-(g)]	_____	(h)
Net worth required	<u>\$1,000,000</u>	(i)
If (h) ≤ \$25 million, skip lines (j) and (k) and insert (i) on line (o).		
Additional net worth required	_____	(j)
If (h) > \$25,000,000, then (j) = (h)-(25,000,000)*(0.5%).		
Total net worth [(k)** = (i)+(j)]	_____	(k)
If line (k) < \$2,500,000, insert line (k) on line (o).		
If line (k) > \$2,500,000, insert \$2,500,000 on line (o).		
** After May 20, 2013, the maximum net worth required will be \$2.5 million.		
Stockholders' equity (net worth) per balance sheet	_____	(l)
Less unacceptable assets	_____	(m)
Adjusted net worth [(n) = (l)-(m)]	_____	(n)
Minimum net worth required	_____	(o)
Adjusted net worth above (below) required minimum amount [(p) = (n) – (o)]	_____	(p)

ILLUSTRATIVE CORPORATE GUARANTY AGREEMENT

**U.S. Department of Housing and Urban Development
Federal Housing Administration**

Whereas, _____ (“Parent”) is the parent company of
_____ (the “Subsidiary”), an institution with FHA lender identification
number _____ ; and

Whereas, the Subsidiary is currently a Lender in good standing and approved by the Federal Housing Administration (“FHA”) to participate in FHA programs; and

Whereas, the Subsidiary accounts for less than forty percent (40%) of the Parent’s assets; and

Whereas, as a condition precedent to FHA allowing the Subsidiary to continue to participate in FHA programs, FHA requires that the Parent promises the performance by it of actions necessary for the Subsidiary to meet the obligations required to maintain approval for participation in FHA programs (“Corporate Guaranty”);

Now, therefore, in consideration of FHA allowing the Subsidiary to continue to participate in FHA programs, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parent agrees as follows:

1. Guaranty. The Parent hereby irrevocably promises to FHA the prompt and unconditional performance of any actions necessary for the Subsidiary to meet the obligations required to maintain approval for participation in FHA programs (“Approval Obligations”) in accordance with the requirements of 24 CFR Part 202 et seq. and the FHA Title II Mortgagee Approval Handbook 4060.1, REV-2, as amended, modified, or supplemented from time to time (the “Handbook”). The obligations of the Subsidiary include but are not limited to the obligation of FHA-approved participants to meet ongoing net worth and liquidity requirements.

In the event that FHA determines that the Subsidiary has failed to meet or maintain Approval Obligations, the Parent shall be liable for any sanctions, fees, debts, or damages so ordered by FHA relating to such failure. Except to the extent that actions taken by FHA against the Subsidiary cause the promises made by Parent with respect to the Subsidiary to be satisfied, in the event FHA terminates the Subsidiary’s approval to participate in FHA programs, the Parent hereby agrees to reimburse FHA for any and all actual and direct losses, damages, costs and expenses (including, without limitation, reasonable attorney’s fees) resulting from the nonperformance or nonfulfillment of the Subsidiary of FHA program requirements and all legal and other expenses of or for the collection of payments due to the Subsidiary.

In the event that any payment to FHA in respect of the obligations promised by the Parent pursuant to this Corporate Guaranty is rescinded or must otherwise be returned for any reason whatsoever, the Parent shall remain liable with respect of such obligations as if such payment

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- had not been made. During the term of this Corporate Guaranty, the Parent shall not be discharged or released hereunder by reason of the discharge or release of the Subsidiary from its obligations under the Handbook and related agreements for any reason, including surrender by the Subsidiary of its FHA lender approval; a discharge in bankruptcy, receivership, or other proceeding; a stay or other enforcement restriction; or any other reduction, modification, impairment, or limitation of the liability of the Subsidiary. FHA shall not be obligated to file any claim relating to the obligations promised by the Parent pursuant to this Corporate Guaranty in the event that the Subsidiary becomes subject to a bankruptcy or reorganization or similar proceeding, and the failure of FHA to so file shall not affect the Parent's obligations hereunder.
2. Make Well Agreement. If Subsidiary fails to meet ongoing net worth and liquidity requirements set forth in the regulations at 24 CFR part 202 and the Handbook, the Parent shall make or cause to be made cash payments to Subsidiary in such amount as is required to meet such requirements. Parent shall make the cash payments required by this Section not later than thirty (30) Business Days following the date on which Subsidiary's net worth and liquidity amounts fall below HUD's minimum requirements.
 3. Independent Obligation. The obligation of the Parent under this Corporate Guaranty shall be, in each instance, absolute, irrevocable, and unconditional and independent of the obligations of the Subsidiary. Parent may not assign its rights or delegate its obligations under this Corporate Guaranty without FHA's prior written consent. FHA may proceed directly against the Parent to enforce its rights under this Corporate Guaranty without proceeding against or joining the Subsidiary. The Parent hereby waives any rights it may have to compel FHA to proceed first against the Subsidiary. Neither the exercise of any remedies against the Subsidiary nor the sale, enforcement, or realization of any of the servicing rights shall (except to the extent that such actions cause the obligations guaranteed by the Parent to be satisfied) in any way affect the Parent's obligations hereunder, even though any rights which the Parent may have against such Subsidiary or others may be extinguished, diminished, or otherwise affected by such action.
 4. No Waiver; Cumulative Rights. FHA may grant any extension of time or indulgence to the Subsidiary for the payment of any sums due or take any note or other obligation or any security for the payment of any sum or sums due or to become due without notice to the Parent and without thereby in any releasing or affecting the liability of the Parent under this Corporate Guaranty. No failure on the part of FHA to exercise and no delay in exercising any right, remedy, or power hereunder shall operate as a waiver thereof, nor shall any single or partial exercise by FHA of any right, remedy, or power hereunder preclude any other or future exercise of any right, remedy, or power. Each and every right, remedy, and power hereby granted to FHA or allowed it by law or other agreement shall be cumulative and not exclusive of any other and may be exercised by FHA at any time or from time to time.
 5. Cost of Enforcement. The Parent agrees to indemnify FHA for all out-of-pocket third-party costs and expenses, including but not limited to reasonable attorneys' fees incurred or paid by FHA in enforcing this Corporate Guaranty, whether or not litigation is commenced, if the Parent defaults in any payment owing by it hereunder.
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6. Governing Law and Consent to Jurisdiction. This Corporate Guaranty shall be governed by and construed in accordance with the Federal law of the United States of America. To the extent that Federal law does not apply, the laws of the State of New York shall apply. The Parent agrees that the United States of America District Court for the District of Columbia shall have exclusive jurisdiction to hear and determine any claims or disputes pertaining directly or indirectly to this Corporate Guaranty or to any matter arising here from or related hereto. The Parent hereby expressly submits and consents in advance to such jurisdiction and venue in any action or proceeding either commenced by FHA or brought against the Parent in such court.
 7. No Oral Change. This Corporate Guaranty may not be changed or amended except by a writing signed by the party against whom enforcement of such change or amendment is sought, and no obligation of the Parent shall be released or waived except by a writing signed by FHA.
 8. Parent's Representations and Warranties. The Parent hereby represents and warrants to FHA as follows:
 - a. The Parent is duly organized, validly existing, and in good standing under the laws of the jurisdiction of its organization and has all requisite power and capacity to enter into this Corporate Guaranty and to perform its obligations hereunder. The Parent's execution and delivery of this Corporate Guaranty and any related agreements or instruments and the consummation of the transactions contemplated hereby has been duly authorized by all requisite action, and no further action or approval is required in order to constitute this Corporate Guaranty as a binding and enforceable obligation of the Parent;
 - b. The Parent's execution and delivery of this Corporate Guaranty does not violate any provision of law or regulation or any order or any court or other agency or instrumentality or government (including but not limited to a supervisory agreement, memorandum of understanding, cease and desist order, capital directive, supervisory directive, or consent decree);
 - c. The execution, delivery, and performance of this Corporate Guaranty and any related agreements or instruments by the Parent, its compliance with the terms hereof and thereof, and consummation of the transactions contemplated hereby and thereby will not violate, conflict with, result in any material breach of, constitute a material default under, be prohibited by, or require any additional approval under its by-laws or any instrument or agreement to which it is a party or by which it is bound;
 - d. All consents, licenses, clearances, authorizations and approvals of, and registrations and declarations with any governmental authority or regulatory body necessary for the due execution, delivery, and performance of this Corporate Guaranty have been obtained and remain in full force and effect, and all conditions thereof have been duly complied with, and no other action by and no notice to or filing with any governmental authority or regulatory body is required in connection with the execution, delivery, or performance of this Corporate Guaranty; and
 - e. This Corporate Guaranty constitutes a legal, valid, and binding obligation of the Parent enforceable against the Parent in accordance with its terms, subject to bankruptcy,
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insolvency, reorganization, moratorium, and other laws of general applicability relating to or affecting creditors' rights and to general equity principles.

9. Termination. This Corporate Guaranty shall be terminated if and when the Subsidiary has relinquished its FHA lender approval, has transferred its FHA mortgages to an approved FHA lender with FHA's consent, and has satisfied all outstanding obligations to FHA. This Corporate Guaranty shall not terminate, and this section shall in no way limit FHA's rights in the event FHA is entitled to proceed against the Parent under Section 1 above.
10. Notices. All notices or demands on the Parent shall be deemed effective when received, shall be in writing, and shall be delivered by hand or by registered mail or by facsimile transmission promptly confirmed by registered mail, addressed to the Parent at:

Parent Address:

Parent Fax #:

or to such other address or fax number as the Parent shall have notified FHA in a written notice delivered to FHA in accordance with the related Guaranty Agreements.

In witness whereof, the undersigned has caused this Corporate Guaranty to be executed by a duly authorized officer and its corporate seal to be affixed and attested by its Secretary in accordance with express authority of its Board of Directors.

Dated:

Attest:

(Secretary)

(Seal)

By:

(Authorized Officer)