



**Eustis Mortgage Corporation
New Orleans, LA**

**HUD Federal Housing Administration Direct
Endorsement Lender**



Issue Date: March 21, 2013

Audit Report Number: 2013-FW-1002

TO: Charles S. Coulter
Deputy Assistant Secretary for Single Family Housing, HU

//signed//

FROM: Gerald Kirkland,
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: Eustis Mortgage Corporation, New Orleans, LA, Did Not Always Comply With
HUD-FHA Underwriting and Quality Control Program Requirements

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Eustis Mortgage Corporation's loan origination, underwriting, and quality control program policies and procedures.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 817-978-9309.



Date of Issuance March 21, 2013

Eustis Mortgage Corporation, New Orleans, LA, Did Not Always Comply With HUD-FHA Underwriting and Quality Control Program Requirements

Highlights

Audit Report 2013-FW-1002

What We Audited and Why

We audited Eustis Mortgage Corporation, a Federal Housing Administration (FHA) direct endorsement lender located in New Orleans, LA. We selected Eustis Mortgage as a result of our regional risk analysis and the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) annual audit plan goal to review single-family programs and lenders. Our objective was to determine whether Eustis Mortgage (1) complied with HUD regulations, procedures, and instructions when originating and underwriting its FHA-insured single-family mortgages and (2) had implemented a quality control program that met HUD requirements.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Eustis Mortgage to (1) indemnify four loans with unpaid principal balances of \$490,274, thereby putting an estimated \$279,456 to better use; (2) implement a quality control plan that complies with HUD requirements; and (3) provide training to its staff and contractors concerning HUD underwriting and quality control requirements.

What We Found

Eustis Mortgage did not underwrite 4 of 18 defaulted FHA-insured loans in accordance with HUD requirements. These conditions occurred because Eustis Mortgage's staff was not always aware of the applicable HUD underwriting requirements. As a result, these loans exposed HUD to unnecessary insurance risks totaling more than \$270,000.

Further, Eustis Mortgage's quality control program did not fully comply with HUD requirements. These conditions occurred because Eustis Mortgage did not (1) have adequate basic controls over its quality control program and (2) fully understand all of HUD's requirements. As a result, it increased the risk to the FHA insurance fund because it could not always ensure compliance with FHA's and its own origination requirements; guard against errors, omissions, and fraud; and ensure swift and appropriate corrective action.

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BACKGROUND AND OBJECTIVE

Eustis Mortgage Corporation is headquartered at 1100 Poydras Street, New Orleans, LA. It has seven active branches located in Deridder, LA, Baton Rouge, LA, Gulf Shores, AL, Metairie, LA, Gulfport, MS, Mandeville, LA, and Bossier City, LA. Eustis Mortgage has been a Federal Housing Administration (FHA) approved lender since 1964. It is a nonsupervised lender and was approved by the U.S. Department of Housing and Urban Development (HUD) as an unconditional direct endorsement lender on February 6, 1989. After originating loans, Eustis Mortgage sells the loans and thus does not service the loans.

HUD's direct endorsement program simplified the process for obtaining FHA mortgage insurance by allowing lenders to underwrite and close mortgage loans without prior HUD review or approval. All FHA lenders must follow all applicable statutes, regulations, and HUD's written instructions, including program handbooks and mortgagee letters. Specifically, lenders must follow HUD Handbook 4155.1, "Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans," when underwriting FHA loans. The lender is responsible for eliciting a complete picture of the borrower's financial situation, source of funds for the transaction, and intended use of the property. Its decision to approve the loan must be documented, supported, and verifiable. Lenders are protected against loan default¹ by FHA's Mutual Mortgage Insurance Fund, which is sustained by borrower premiums. The lenders bear less risk because FHA pays a claim to the lender in the event that a borrower defaults on a loan.

FHA-approved lenders are also required to implement and continuously have in place a quality control plan for the origination of insured mortgages as a condition of receiving and maintaining FHA approval.

According to HUD's Neighborhood Watch system,² Eustis Mortgage originated 762 FHA loans between July 1, 2010, and June 30, 2012, totaling more than \$116 million. Of the 762 loan originations, as of June 30, 2012, 18 loans had defaulted totaling more than \$2.5 million.

Our objective was to determine whether Eustis Mortgage (1) complied with HUD regulations, procedures, and instructions when originating and underwriting its FHA-insured single-family mortgages and (2) had implemented a quality control program that met HUD requirements.

¹ HUD defines a default as the inability to make timely mortgage payments or otherwise comply with mortgage terms. A loan is considered in default when no payment has been made 30 days after the due date. Once a loan is in default, the lender may exercise legal rights defined in the contract to begin foreclosure proceedings.

² Neighborhood Watch is Web-based software that displays loan performance data for FHA-insured single-family loans. The system is designed to highlight exceptions so that potential problems are readily identifiable.

RESULTS OF AUDIT

Finding 1: Eustis Mortgage Did Not Always Underwrite Its FHA-Insured Loans in Accordance With HUD Requirements

Eustis Mortgage did not always underwrite its FHA-insured loans in accordance with HUD requirements. This condition occurred because Eustis Mortgage's staff was not always aware of the applicable HUD underwriting requirements. As a result, these loans exposed HUD to unnecessary insurance risks totaling more than \$270,000.³

Eustis Mortgage Did Not Follow HUD-FHA Underwriting Requirements

Our review of 18 defaulted loans determined that 4 (22 percent) contained material deficiencies because the loans were not manually underwritten as required⁴ when the borrower's credit report contained disputed collection accounts. The following table summarizes the loan deficiencies.

Loan deficiencies summary	
Loan number	Disputed credit accounts
221-4549952	X
221-4642722	X
221-4603968	X
221-4528193	X

Because the borrowers for the four loans had disputed accounts on their credit reports, HUD required Eustis Mortgage to manually underwrite the loans. Instead, it processed these loans using an automated underwriting system. We performed additional analysis of the four loans to determine whether they met the manual underwriting requirements. Each loan had multiple manual underwriting deficiencies as follows:

- The files for two loans did not include all required traditional or alternative asset documentation.⁵

³ See appendix C.

⁴ FHA's Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

⁵ HUD Handbook 4155.1, paragraph 1.B.2.c

- For three loans, the files did not include a written explanation from the borrower for inquiries shown on the credit report in the last 90 days.⁶
- The files for four loans did not include a written explanation from the borrower for collection accounts occurring within the past 2 years.⁷ The files also did not contain documentation showing Eustis Mortgage's analysis of the collection accounts in dispute.⁸
- The files for three loans did not contain documentation of a 12-month rental or mortgage payment history.⁹
- The files for three loans showed that the borrowers' ratios exceeded the qualifying ratios, but Eustis Mortgage did not document the compensating factors for qualifying ratios as required.¹⁰ As an example, one borrower's front and back ratios exceeded the qualifying ratios by more than 8 and 12 percentage points, respectively.

Since Eustis Mortgage did not properly underwrite these four loans, they were not eligible for FHA insurance.

See appendix D for the case file narratives.

Eustis Mortgage Did Not Understand the Requirements

Eustis Mortgage did not always understand the requirements. According to Eustis Mortgage, it was not aware that HUD required it to review the disputed collection accounts until April 2011, after it had underwritten the loans, because it believed that HUD issued confusing guidance. Eustis Mortgage staff explained that HUD's requirements concerning the disputed accounts caused a lot of confusion with mortgage lenders nationwide. According to the staff, after HUD first issued the disputed accounts guidance in 2010, it later had to issue a mortgagee letter to clarify how the disputed accounts were to be viewed. The staff was unable to obtain clarification from HUD. Staff stated that it made the underwriting error due to the confusion regarding the requirements. Once HUD issued definitive guidance, Eustis Mortgage changed its policies to review the disputed collection accounts when applicable. However, it should have followed the HUD requirements in effect at the time the loans were underwritten and referred the loans to a direct endorsement underwriter for manual review.¹¹

⁶ HUD Handbook 4155.1, paragraph 4.C.2.c

⁷ HUD Handbook 4155.1, paragraph 4.C.2.d-e

⁸ HUD Handbook 4155.1, paragraph 4.C.1.c

⁹ HUD Handbook 4155.1, paragraph 4.C.2.b

¹⁰ HUD Handbook 4155.1, paragraphs 4.F.3.b and 4.F.2.b-c

¹¹ TOTAL Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

Conclusion

Because Eustis Mortgage was not always aware of HUD's requirements, it did not manually underwrite four loans when required. As a result, these four ineligible loans exposed HUD to unnecessary insurance risks totaling more than \$270,000.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Eustis Mortgage to

- 1A. Indemnify HUD for four insured loans with unpaid principal balances of \$490,274, thereby putting an estimated \$279,456 to better use based on the FHA insurance fund average loss rate of 57 percent of the unpaid principal balances.¹²
- 1B. Provide periodic training to ensure that origination and underwriting staff members are aware of current HUD underwriting requirements outlined in HUD Handbook 4155.1 and the TOTAL Mortgage Scorecard User Guide.

¹² Based on FHA's first quarter 2013 fiscal year-to-date loss severity rate of 57 percent, supported by the Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2012

Finding 2: Eustis Mortgage’s Quality Control Program Did Not Fully Meet HUD’s Requirements

Eustis Mortgage’s quality control program did not fully comply with HUD requirements. Specifically, Eustis Mortgage did not (1) document branch site visit compliance reviews, (2) document quality control review sample sizes and selections, (3) always maintain documentation to support that it reported review findings to its senior management within required timeframes, (4) notify HUD’s Quality Assurance Division when quality control review findings had serious violations, or (5) review loans that went into default within the first six payments. These conditions occurred because Eustis Mortgage did not (1) have adequate basic controls over its quality control program or (2) fully understand all HUD requirements. As a result, it increased the risk to the FHA insurance fund and could not provide reasonable assurance that it (1) originated loans properly; (2) guarded against errors, omissions, and fraud; and (3) ensured swift and appropriate corrective action.

Eustis Mortgage Did Not Have Documentation Supporting That It Performed Site Visits

Eustis Mortgage did not have documentation to support that it performed site reviews of its branch offices that originated FHA-insured loans. HUD required Eustis Mortgage to perform annual site visits to all of its branches to ensure that lending practices conformed to all applicable requirements.¹³ However, Eustis Mortgage did not have documentation to support that it performed the required reviews from July 1, 2010, through June 30, 2012. Eustis Mortgage had since implemented a branch visit log to document when it performed site visits. However, this log addressed only performance and did not cover a review or verification that each branch met items required by HUD Handbook 4060.1. Some of the requirements that were not met included verifying (1) proper branch registration with FHA; (2) a professional and business-like environment; (3) branch staff had access to the most current and relevant statutes, regulations, HUD issuances, and handbooks; and (4) assurance that the branch office did not employ or contract with persons under debarment or suspension.

¹³ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(G)

Eustis Mortgage Did Not Follow Quality Control Requirements

Eustis Mortgage did not always ensure that its quality control reviews followed HUD requirements. Since March of 1996, Eustis Mortgage had employed a quality control contractor, Advanced Financial Technology, Inc. (ADFITECH), to perform its quality control function. In addition, it used an independent contractor to work with ADFITECH to address the results of quality control findings and take the appropriate actions. ADFITECH performed the quality control reviews monthly as required. However, our review of 23 quality control reports, covering July 2010 through May 2012, determined that

- For all reports, Eustis Mortgage did not document how it determined the sample sizes and selections for the reviews as required¹⁴ before providing the sample selections to ADFITECH. The reports listed only the loans selected for review and the loan type.
- For four reports, Eustis Mortgage did not have documentation to support that review findings were reported to its senior management within 1 month of completion of the initial quality control report as required.¹⁵ There was no indication on the reports, via a signature, initial, or date, evidencing that management reviewed the documents.
- For three reports, Eustis Mortgage did not have documentation to support that it took corrective actions on findings cited in the quality control reviews as required.¹⁶ For instance, in the April 2011 report, two of three sampled loans did not include evidence that an issue concerning the review of a limited denial of participation list had been resolved.

HUD Was Not Notified of Serious Findings

Eustis Mortgage did not always ensure that it reported serious findings to HUD. As an additional reporting requirement, HUD required that findings of fraud or other serious violations be immediately referred, in writing, to the appropriate Quality Assurance Division Director. In lieu of submitting a paper report, HUD required Eustis Mortgage to use the lender reporting feature in the Neighborhood Watch Early Warning System.¹⁷ However, for 8 of the 23 quality control reports reviewed, we identified 13 serious findings that Eustis Mortgage did not refer to

¹⁴ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-6(C)

¹⁵ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(I)

¹⁶ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(I)

¹⁷ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(J)

HUD. According to Eustis Mortgage, it believed that as long as it resolved the items in-house, there was no need to contact HUD regarding the matter, indicating that it did not understand the requirement.

Eustis Mortgage Did Not Perform Required Reviews of Some Defaulted Loans

Eustis Mortgage did not review early payment defaults¹⁸ as required by its policies and procedures¹⁹ and by HUD.²⁰ Eustis Mortgage was required to review all loans going into default within the first six payments, in addition to loans selected for routine quality control reviews. However, it could not provide documentation showing that it met this requirement. According to Eustis Mortgage, its record keeping was lacking in this area, but it planned to begin maintaining copies of the required quality control defaulted loan reviews. As of January 2013, Eustis Mortgage had begun implementing quality control reviews of the defaulted loans.

Eustis Mortgage's Quality Control Program Was Not Adequate

Eustis Mortgage's quality control program was not adequate. HUD required Eustis Mortgage to continuously have a quality control plan for the origination of insured mortgages as a condition of receiving and maintaining FHA approval.²¹ HUD allowed Eustis Mortgage to obtain contractors to perform the quality control function but placed responsibility on Eustis Mortgage for ensuring that the contractors met HUD's requirements. In addition, any contractor arrangement required a written agreement, which stated the roles and responsibilities of each party and accessibility for review by HUD staff.²² However, we noted the following deficiencies:

Eustis Mortgage's quality control plan did not include sufficient detail – Neither Eustis Mortgage's March 2012 nor its March 1996 quality control plan included all required elements needed to ensure compliance with HUD's quality control requirements. Specifically, neither plan

¹⁸ Early payment defaults are loans that become 60 days past due within the first six payments.

¹⁹ Eustis Mortgage Corporation FHA Loan Origination Quality Control Policy, updated March 20, 2012

²⁰ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-6(D)

²¹ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-1

²² HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(B)

- (1) Addressed the timeliness and frequency of monthly reviews of delinquent loan servicing, claims, and foreclosures and the sample size of such reviews.²³ In addition, it did not clearly detail quality control requirements once Eustis Mortgage sold or transferred a loan for servicing.
- (2) Clearly stated, “review findings must be reported to the mortgagee’s senior management within one month of completion of the initial report,” as required by HUD’s guidance.

Eustis Mortgage’s contracts had deficiencies – Eustis Mortgage did not have a required written agreement with the independent contractor that performed its quality control follow-up from March through October 2012. It executed an agreement, effective November 1, 2012. The contract did not stipulate compliance with HUD’s quality control requirements or explain the ramifications for not doing so and did not address monitoring and oversight. In addition, Eustis Mortgage’s contract with ADFITECH was not dated and did not address monitoring and oversight.

Eustis Mortgage did not provide required training to contractors – Eustis Mortgage could not provide documentation showing that it provided required training to either of its quality control contractors.²⁴ While it provided documentation showing that ADFITECH had its own internal training, Eustis Mortgage did not provide evidence that it provided ADFITECH with training or access to current guidance. Eustis Mortgage did not provide training to the independent contractor that performed its quality control follow-up. To address this deficiency, in November 2012, Eustis Mortgage provided the quality control follow-up contractors with computer access to FHA guidance.

Conclusion

Because Eustis Mortgage did not have adequate basic controls over its quality control program and fully understand all HUD requirements, it did not (1) document branch site visit compliance reviews, (2) document quality control review sample sizes and selections, (3) always maintain documentation to support that it reported review findings to its senior management within required timeframes, (4) notify HUD of review findings with serious violations, and (5) review loans that went into default within the first six payments. Therefore, Eustis Mortgage increased the risk to the FHA insurance fund and could not provide reasonable assurance that (1) it protected HUD from unacceptable risk; (2) the likelihood of errors, omissions, and fraud was lessened; and (3) its loan origination and underwriting operations ensured accuracy, validity, and completeness.

²³ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-10

²⁴ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook), paragraph 7-3(C)

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Eustis Mortgage to

- 2A. Implement a quality control plan that complies with HUD requirements outlined in HUD's Handbook 4060.1, REV-2, to include ensuring that the plan is adequate to correct deficiencies identified in this report.
- 2B. Provide training to ensure that its quality control staff and contractors are aware of HUD's quality control program requirements.
- 2C. Update its contract with its quality control contractors to ensure that the contracts contain all HUD requirements, including follow-up, management review, HUD notification requirements, and lender contract monitoring.

SCOPE AND METHODOLOGY

We conducted the audit at Eustis Mortgage's headquarters office in New Orleans, LA, and the HUD Office of Inspector General's (OIG) field offices in New Orleans and Baton Rouge, LA. We performed our audit between August 2012 and January 2013.

To accomplish our objective, we

- Reviewed applicable HUD-FHA regulations, requirements, and mortgagee letters;
- Reviewed reports and information on HUD's Neighborhood Watch system;
- Reviewed Eustis Mortgage's policies and procedures, quality control plan, contracts, reports, and independent audit reports;
- Reviewed a 100 percent sample of 18 defaulted loans with original mortgage amounts totaling more than \$2.5 million;
- Reviewed a nonstatistical sample of 9 property appraisals associated with 8²⁵ of the defaulted loans;
- Conducted onsite visits to the properties of the 17 defaulted loans²⁶ and interviewed 6 borrowers; and
- Conducted interviews with applicable HUD and Eustis Mortgage staff.

During the audit period, Eustis Mortgage originated 762 loans totaling more than \$116 million. For the 18 defaulted loans, we reviewed the loan files to determine whether the loan originations and underwriting procedures were performed in accordance with HUD laws and regulations.²⁷ For our appraisal review, a HUD OIG appraiser performed a desk review of a nonstatistical sample of nine appraisals associated with eight of the defaulted loans to determine whether the appraisals complied with HUD requirements.²⁸ We selected the appraisals based on visual observations of the properties; and data mining which identified one appraiser that prepared appraisals associated with at least 5 of the 18 defaulted loans. Through reviews of the file data, we determined that the data were generally reliable. The HUD OIG appraiser questioned all nine of the appraisals; however, due to the subjectivity involved in the appraisal process, we did not report the potential deficiencies.

For our quality control program review, we assessed Eustis Mortgage's quality control plan and 23 quality control reports issued within our audit scope to determine whether these complied with HUD's requirements.²⁹

Our audit scope generally covered July 1, 2010, through June 30, 2012. We expanded the scope as needed to accomplish our audit objectives. We conducted the audit in accordance with

²⁵ One loan had two appraisals because the property was sold 94 days before the new loan's sales contract.

²⁶ We did not observe the property of one loan due to its travel distance.

²⁷ HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance-on One to Four Unit Mortgage Loans, effective May 2009, updated March 24, 2011

²⁸ HUD Handbook 4150.2, CHG-01, Valuation Analysis of Single Family One to Four Unit Dwellings

²⁹ HUD Handbook 4060.1, REV-2 (FHA Title II Mortgagee Approval Handbook)

generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Controls intended to ensure that FHA-insured single-family loans were originated and underwritten in compliance with HUD requirements.
- Controls intended to ensure that the quality control program complied with HUD requirements and was effective in reducing underwriting errors and noncompliance.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

Based on our review, we believe that the following items are significant deficiencies:

- Eustis Mortgage did not have adequate controls to ensure that its FHA-insured loans were originated and underwritten in accordance with HUD requirements (finding 1).
- Eustis Mortgage did not have adequate controls to ensure that its quality control program was implemented in accordance with HUD requirements and was effective in reducing underwriting errors (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	\$279,456
TOTAL	<u>\$279,456</u>

- 1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, implementation of recommendation 1A will reduce FHA's risk of loss to the insurance fund for the four loans by \$279,456 based on FHA's first quarter 2013 fiscal year-to-date loss severity rate of 57 percent, supported by the Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2012.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

EUSTIS MORTGAGE

March 1, 2013

US Department of HUD
ATTN: Mr. Gerald Kirkland
819 Taylor Street, Suite 13A09
Fort Worth, TX 76102

RE: Draft Audit Report dated 02-15-13 for Eustis Mortgage Corporation

Dear Mr. Kirkland,

Enclosed please find our response to your letter of February 15, 2013 (attached) regarding the audit findings for Eustis Mortgage Corporation. We appreciate the opportunity to respond to the draft and trust that you will incorporate our response into the final audit report.

Eustis Mortgage appreciates and concurs with the high priority that you place on Quality Control, Early Payment Default review, and overall compliance with all HUD requirements. We intend to use the results of this report to improve upon our performance in all facets of our operation, and have in fact already put into place certain procedures that will help in that effort. We will continue to make the changes necessary to comply on all fronts.

If there is further information needed prior to submission of the final report, please feel free to contact me.

Sincerely,



Tom Trahan
Compliance Director
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Comment 1

Comments 3,
4, 5, and 6

Comment 2

Comment 2

Comment 2

Eustis Mortgage did not follow HUD-FHA Underwriting Requirements

Each case narrative cited is addressed separately (see attachment 1).

Eustis Mortgage did not have documentation supporting that it performed site visits

Although Eustis Mortgage home office employees did regularly make visits to each of our branch offices, the finding that we had no documentation to evidence these visits is accurate. In response we have created a log on a shared directory in the home office where any staff member can log that they made a visit to a branch office. Our compliance director manages that folder and regularly makes entries in the log on behalf of others (see attachment 2).

Since beginning with Eustis Mortgage on 11-01-12, our compliance director has also made a site visit to each Eustis Mortgage Branch (exception is Denham Springs, should make visit in early March 2013) and confirmed that all EMC branch locations comply with HUD Handbook 4060.1, REV-2, paragraph 7-3(G) (see attachment 3).

HUD was not notified of serious findings

As noted in your report, Eustis Mortgage did not always report serious findings to HUD. When a serious finding is identified by our QC contractor, EMC always addresses the issue. In most instances, the serious finding is for:

- Something that was missing from the file sent to the QC contractor that EMC actually had in its possession.
- Something that was misinterpreted by the QC auditor and was satisfied with further explanation and or documentation.
- An oversight by an EMC staff member

In order to present a clearer picture of the quality of our loan production, EMC has recently begun responding directly to Adfitech on all QC findings. For instance, when Adfitech finds a serious error for some missing documentation, our old methodology would be to insure that we had the documentation. Now we respond to Adfitech with the the documentation to address the finding. The end result should be a significant reduction in serious findings.

Also, we will begin reporting to HUD any serious findings that are identified by Adfitech along with any supporting documentation that may be submitted back to Adfitech in responses.

Eustis Mortgage did not follow Quality Control Requirements

- Beginning November 1, 2012, Eustis Mortgage no longer makes the selection of which loans get picked for Quality Control review. Eustis sends an excel file to Adfitech including all loans closed in a given month. Adfitech then makes a selection of 10% of each loan type (Conventional, FHA, VA, Rural Development) with a minimum of at least one loan per type per reporting period (assuming that there was at least one loan of each type). Adfitech is instructed to always "round" in favor of more QC (i.e. if there are 11 FHA loans closed during a given period, they are to select a minimum of 2 FHA loans for QC).
- Once the Third Party contractor reviews the QC findings she makes a written report to EMC. In the past, that was the end of the QC process. We are now in the process of setting up procedures whereby our Compliance Director will report to Senior Management for each reporting period recapping the QC findings as well as the responses gathered by the Third Party contractor. The goal is to transform the loan level review data into useful, meaningful information that measures the quality of our originations. Evaluating our performance against industry standard requirements and goals and understanding the effectiveness of processes and controls in our system. Identifying and reporting actionable areas of concern to Senior Management and tracking the effectiveness of the actions taken to improve those areas.
- EMC is now taking a much more pro-active role in assessing the QC findings and addressing the shortfalls. Findings of a serious nature are addressed directly by the manager of the department responsible for the finding. Requiring not only a response from the manager, but requiring the manager to address the issue with their staff and schedule companywide training on the issue where warranted. Also making sure that Senior Management is informed on all actions taken.

Comment 2

Eustis Mortgage did not perform required reviews of some defaulted loans

The new compliance director of EMC on a monthly basis accesses the Neighborhood Watch section of the FHA Connection and pulls a report indicating which loans are considered seriously delinquent (90 days or greater) within the first 6 scheduled payments. Any loan found to be in this category is referred directly to the Branch Manager as well as our Head Underwriter for their review. Said review is to determine if there is anything in our original processing/underwriting/closing of the loan that was overlooked and may have contributed to the early default.

A sample of a recent transaction that fell into this category is attached (see attachment 4).

Comment 2

Eustis Mortgage's Quality Control program was not adequate

Eustis Mortgage Corporation is committed to the process of Quality Control and to improving upon our performance in managing the QC plan and implementing the various aspects of the plan. While a plan has always been in place, the follow through on the details of the plan have not been as thorough as they should have been. Our new Compliance Director has been charged with making sure that we not only have a plan, but further that it is implemented as written and complies with the QC requirements mandated by HUD and other agencies.

Attachment 1

Loan Number 221-4549952
[REDACTED]

Underwriting Deficiencies:

- Credit report contained disputed items

Credit Report – As originally stated we did not understand the requirement if the credit report reflected disputed accounts it required a manual downgrade and review of a DE Underwriter. Due to this, the loan closed as Accept Risk Grade with Accept documentation.

While HUD allows for a lender's representative to sign the Direct Endorsement approval, (HUD-92900A) certifying to the integrity of the data, it is a company policy all FHA loans are reviewed and underwritten by a DE Underwriter. DE Underwriter [REDACTED] reviewed this loan and would have approved it as a Refer with ratios of 31.94%/36.40% and 70% LTV.

Once HUD issued definitive guidance we addressed this internally and issued the attached Production Memo to the entire staff.

Let me assure you this was not done intentionally and was approved and closed in good faith as an Accept loan.

Comment 3

Attachment 1

Loan Number 221-4642722
[REDACTED]

Underwriting Deficiencies:

- Credit Report contained disputed items
- Income was miscalculated

Comment 4

Credit Report – As originally stated we did not understand the requirement if the credit report reflected disputed accounts it required a manual downgrade and review of a DE Underwriter. Due to this the loan closed as Accept Risk Grade with Accept documentation.

While HUD allows for a lender's representative to sign the Direct Endorsement approval, (HUD-92900A) certifying to the integrity of the data, it is a company policy all FHA loans are reviewed and underwritten by a DE Underwriter. DE Underwriter [REDACTED] reviewed this loan. Due to the fact the loan was rated as "accept" with high ratios no further action on her part were taken.

Once HUD issued definitive guidance we addressed this internally and issued the attached Production Memo to the entire staff.

Let me assure you this was not done intentionally and was approved and closed in good faith as an Accept loan.

Miscalculated Income - Borrower's income was calculated on 2010 W2 \$24,488.22 or \$2,010.20 per month. We used the conservative approach as verification of employment and paycheck stubs indicate her rate of pay at \$25,508 annually or \$2,125.66 month. Your figure of \$2,041 per month is not an issue and ratios would have decreased slightly.

Attachment 1

Case Number 221-4608968
[REDACTED]

Underwriting Deficiencies:

- Credit Report contained disputed items
- Payment due during the month of this refinance transaction closing was not paid

Credit Report – As originally stated we did not understand the requirement if the credit report reflected disputed accounts it required a manual downgrade and review of a DE Underwriter. Due to this, the loan closed as Accept Risk Grade with Accept documentation.

While HUD allows for a lender's representative to sign the Direct Endorsement approval, (HUD-92900A) certifying to the integrity of the date, it is a company policy all FHA loans are reviewed and underwritten by a DE Underwriter. DE Underwriter [REDACTED] reviewed this loan and would have approved it as a cash out refinance with ratios of 37.66%/37.66% and 75% LTV. Compensating factors to offset the mortgage payment factor of 37.66% are: Borrower is in law enforcement and on the job over 20 years; Borrower not obtaining maximum LTV; Borrower is debt free and borrower has over \$15,000 in cash reserves.

Payment due during month of refinance was not paid - Attached please find copy of Summary Information from Provident Funding reflecting the November payment. Also noted is date and time this statement was sent to us 11/4/10 11:51 AM.

Comment 5

Attachment 1

Case Number 221-4528193

Underwriting Deficiencies:

- Credit Report contained disputed items
- Automated underwriting system report before closing was not provided
- Gift letter did not include all required elements

Credit Report – As originally stated we did not understand the requirement if the credit report reflected disputed accounts it required a manual downgrade and review of a DE Underwriter. Due to this the loan closed as Accept Risk Grade with Accept documentation.

While HUD allows for a lender's representative to sign the Direct Endorsement approval, (HUD-92900A) certifying to the integrity of the data, it is a company policy all FHA loans are reviewed and underwritten by a DE Underwriter. DE Underwriter [REDACTED] reviewed this loan and would have approved as a Refer with ratios of 20.57%/37.48%.

Once HUD issued definitive guidance we addressed this internally and issued the attached Production Memo to the entire staff.

Let me assure you this was not done intentionally and was approved and closed in good faith as an Accept loan.

Automated underwriting system report before closing was not provided - The AUS report attached showing August 4, 2010 is the only report in our LOS system due to the length of time that has elapsed. The loan closed on July 30, 2010 however there are times when our Investor requires the AUS findings to match the Uniform Residential Loan Application (1003) before they purchase the loan. This is the case.

Please also note when the loan is underwritten exact figures for reserves and/or escrows are not available. According to TOTAL Mortgage Scorecard User Guide FHA recognizes minor differences may occur and therefore resubmission through TOTAL is not required if cash reserves are 10% or less and escrows not more than 2%. Neither of the two apply on this loan.

Gift letter did not include all required elements – Attached is copy of gift letter in the amount of \$2,000 along with copy of URLA 1003 reflecting the donor's name and address. Also included is the wire transfer from donor's bank to borrower's bank. In addition is copy of borrower's history inquiry with Omni Bank to evidence deposit in her account. The fact the dollar amount does not match is a result of our LOS system. When borrower's funds include the gift we must only show \$1.00 as the gift otherwise the gift money will be counted twice and give a false finding with an additional \$2,000 in reserves.

Comment 6

OIG Evaluation of Auditee Comments

- Comment 1** Eustis Mortgage generally agreed with the findings and explained that it intended to use the results of the report to improve performance in operations and that it has already put procedures in place to help in that effort. We appreciate Eustis Mortgage's proactive approach in improving its operational performance based on the findings identified in this report.
- Comment 2** Eustis Mortgage agreed and has taken initiative to address the deficiencies identified in finding 2 regarding its quality control program. We appreciate Eustis Mortgage's efforts in correcting these deficiencies. Eustis Mortgage provided additional documentation to support its corrective actions; however, due to its size we did not include this documentation in the final report. Eustis Mortgage should provide the final supporting documentation to HUD's staff, which will assist Eustis Mortgage with resolving the recommendations.
- Comment 3** Eustis Mortgage stated that it did not understand the requirement that if the credit report reflected a disputed account that it required a manual downgrade review by a direct endorsement underwriter. It also stated that it is company policy that all FHA loans be reviewed by a direct endorsement underwriter and this loan would have been approved as a refer, with front and back ratios of 31.94 and 36.40 percent, respectively; and loan to value of 70 percent. However, there was no documentation in the file supporting the underwriter's analysis or determination that the underwriter would have approved this loan with the listed ratios, one of which exceeded the FHA limits by 0.94 percent.³⁰ The file documentation showed that, based on the disputed accounts, the loan should have been manually underwritten and because it was not, the file did not contain supporting documentation that was required for a manual review to support a loan approval. Thus, we stand by our original conclusion.
- Comment 4** Eustis Mortgage stated that it did not understand the requirement that if the credit report reflected a disputed account that it required a manual downgrade review by a direct endorsement underwriter. It also stated that it is company policy that all FHA loans are reviewed by a direct endorsement underwriter and this loan was reviewed by the underwriter but since the loan was rated an "accept" with high ratios, no further action was taken. We disagree as the file being rated as an "accept" was irrelevant since the loan required a manual downgrade based on the disputed accounts on the borrower's credit report. In addition, the front and back ratios exceeded the FHA qualifying ratios by more than 8 and 12 percentage points, respectively. Further, this borrower defaulted after the first monthly payment and is in foreclosure stage. Because the loan was not manually downgraded, the file did not contain supporting documentation that was required

³⁰ FHA's Mortgage Payment to Income (Front End Ratio) is not to exceed 31 percent and the Total Fixed Payment to Income (Back End Ratio) is not to exceed was 43 percent - HUD Handbook 4155.1, paragraph 4.F.2.b-c.

for a manual review to support a loan approval. Thus, we stand by our original conclusion.

Regarding the miscalculated income, we reviewed Eustis Mortgage's response and agree with the explanation. Thus, we removed the verbiage from the report.

Comment 5 Eustis Mortgage stated that it did not understand the requirement that if the credit report reflected a disputed account that it required a manual downgrade review by a direct endorsement underwriter. It further stated that it is company policy that all FHA loans are reviewed by a direct endorsement underwriter and this loan was reviewed by the underwriter and would have been approved with front and back end ratios of 37.66 and 37.66 percent, respectively; and loan to value of 75 percent. We disagree as there was no documentation in the file supporting the underwriter's analysis or determination that the underwriter would have approved this loan with the listed ratios', as the front ratio exceeded the FHA limits by 7.66 percentage points. Eustis Mortgage further stated compensating factors that would offset the mortgage payment factor of 37.66 percent were, the borrower (1) was in law enforcement and on the job for 20 years; (2) did not obtain maximum loan to value, and (3) was debt free with \$15,000 in cash reserves. However, there was no documentation in the file listing these compensating factors or any analysis of these factors prior to loan approval.

In addition, due to the disputed accounts in the borrower's credit report, the loan review required a manual downgrade. Because the loan was not manually downgraded, the file did not contain supporting documentation that was required for a manual review to support a loan approval, including the compensating factors that the lender now lists in response to this report. Finally, this loan is currently in default and commencing to foreclosure. Thus, we stand by our original conclusion.

Regarding the payment during the month of refinance, we reviewed Eustis Mortgage's response and additional documentation. We agree with the explanation and therefore removed the verbiage from the report.

Comment 6 Eustis Mortgage stated that it did not understand the requirement that if the credit report reflected a disputed account that it required a manual downgrade review by a direct endorsement underwriter. It further stated that it is company policy that all FHA loans be reviewed by a direct endorsement underwriter and this loan would have been approved as a refer with front and back end ratios of 20.57 and 37.48 percent, respectively. There was no documentation in the file supporting the underwriter's analysis or determination that the underwriter would have approved this loan with the listed ratios. The file documentation showed that, based on the disputed accounts, the loan should have been manually underwritten and because it was not, the file did not contain supporting documentation that was required for a manual review to support a loan approval.

Regarding the automated underwriting system report before closing not being in the file, HUD regulations require that the loan package contain all documentation that supports Eustis Mortgage's decision to approve the mortgage loan.³¹ As stated above, the loan should have been manually underwritten. However, when relying on the automated underwriting system for the underwriting of a loan, Eustis Mortgage should have an automated underwriting system report that shows approval before the loan closing, not after, to comply with HUD requirements.

As related to the required elements missing from the gift letter, this loan file included two forms of a gift letter, one in a standardized gift letter form and the other in the loan application. Eustis Mortgage's additional documentation and explanation did not address the deficiency that the standardized gift letter form was missing the donor's address and telephone number, and the gift letter in the loan application was also missing the telephone number, all required elements that should have been included. Thus, we stand by our original conclusions.

³¹ HUD Handbook 4155.1, paragraph 1.B.1.g

Appendix C

SUMMARY DATA FOR QUESTIONED LOANS

Loan Number	Mortgage Amount	Unpaid principal balance as of December 31, 2012	Computed benefit of indemnification³²
221-4549952	\$ 99,300	\$ 95,630	\$ 54,509
221-4642722	131,577	127,933	72,922
221-4603968	181,800	175,538	100,057
221-4528193	94,724	91,173	51,968
Totals	\$507,401	\$490,274	\$279,456

³² Based on FHA's first quarter 2013 fiscal year-to-date loss severity rate of 57 percent, supported by the Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2012

Appendix D

CASE NARRATIVES

Case Narrative – Loan Number 221-4549952

Mortgage amount: \$99,300

Date of loan closing: September 1, 2010

Status as of December 31, 2012: Reinstated after loss mitigation intervention

Payments before first default: 12

Total claim paid: Loss mitigation partial claim totaling \$7,181

HUD loss: N/A

Underwriting Deficiencies:

- Credit report contained disputed items.

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower had a collection account that was in dispute. According to the Total Scorecard Userguide that was in effect at the time of the origination and underwriting, "If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a direct endorsement underwriter for review."³³ Therefore, the file should have been manually underwritten. We performed additional analysis to determine whether this loan met manual underwriting requirements. Since the loan was not manually underwritten, Eustis Mortgage did not meet the following requirements, resulting in material deficiencies:

Eustis Mortgage did not

- Obtain a written explanation from the borrower for major indications of derogatory credit (collections) within the past 2 years. The loan file did not contain documentation showing Eustis Mortgage's analysis of the basis for the derogatory debt (collections that were in dispute).
- Obtain a written explanation regarding inquiries shown on the credit report in the last 90 days.
- Document compensating factors in the file justifying the excessive front-end qualifying ratio of 31.94 percent, which exceeded the FHA limit of 31 percent.
- Obtain the 12-month rental or mortgage payment history.

³³ TOTAL Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

Case Narrative – Loan Number 221-4642722

Mortgage amount: \$131,577

Date of loan closing: March 2, 2011

Status as of December 31., 2012: Foreclosure deed recorded

Payments before first default: One

Total claim paid: \$0

HUD loss: N/A

Underwriting Deficiencies:

- Credit report contained disputed items.

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower had a collection account that was in dispute. According to the Total Scorecard Userguide that was in effect at the time of the origination and underwriting, "If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a direct endorsement underwriter for review."³⁴ Therefore, the file should have been manually underwritten. We performed additional analysis to determine whether this loan met manual underwriting requirements. Since the loan was not manually underwritten Eustis Mortgage did not meet the following requirements, resulting in material deficiencies:

Eustis Mortgage did not

- Meet the traditional or alternative asset documentation requirements because there was no verification of deposit located in the file for both the borrower and coborrower. There were also no bank statements covering 3 consecutive months.
- Obtain a written explanation from the borrower for major indications of derogatory credit (collections) within the past 2 years. The loan file did not contain documentation showing Eustis Mortgage's analysis of the basis for the derogatory debt (collections that were in dispute).
- Document compensating factors justifying the excessive front- and back-end qualifying ratios, which were 39.21 and 55.51 percent, respectively. These percentages exceeded the FHA front- and back-end limits of 31 and 43 percent, respectively.
- Obtain the 12-month rental or mortgage payment history.

³⁴ TOTAL Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

Case Narrative – Loan Number 221-4608968

Mortgage amount: \$181,800

Date of loan closing: November 30, 2010

Status as of December 31, 2012: First legal action to commence foreclosure

Payments before first default: 14

Total claim paid: \$0

HUD loss: N/A

Underwriting Deficiencies:

- Credit report contained disputed items.

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower had a collection account that was in dispute. According to the Total Scorecard Userguide that was in effect at the time of the origination and underwriting, "If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a direct endorsement underwriter for review."³⁵ Therefore, the file should have been manually underwritten. We performed additional analysis to determine whether this loan met manual underwriting requirements. Since the loan was not manually underwritten, Eustis Mortgage did not meet the following requirements, resulting in material deficiencies:

Eustis Mortgage did not

- Obtain a written explanation from the borrower for inquiries shown on the credit report in the last 90 days.
- Obtain a written explanation from the borrower for major indications of derogatory credit (collections) within the past 2 years. The loan file did not contain documentation showing Eustis Mortgage's analysis of the basis for the derogatory debt (collections that were in dispute).
- Document compensating factors in the file justifying the excessive front-end qualifying ratio, which was 38.7 percent. This percentage exceeded the FHA limit of 31 percent.

³⁵ TOTAL Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

Case Narrative – Loan Number 221-4528193

Mortgage amount: \$94,724

Date of loan closing: July 30, 2010

Status as of December 31, 2012: Type II special forbearance-trial payment plan

Payments before first default: 13

Total claim paid: \$0

HUD loss: N/A

Underwriting Deficiencies:

- Credit report contained disputed items.
- Automated underwriting system report before closing was not provided.
- Gift letter did not include all required elements.

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower had a collection account that was in dispute. According to the Total Scorecard Userguide that was in effect at the time of the origination and underwriting, "If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a direct endorsement underwriter for review."³⁶ Therefore, the file should have been manually underwritten. We performed additional analysis to determine whether this loan met manual underwriting requirements. Since the loan was not manually underwritten, Eustis Mortgage did not meet the following requirements, resulting in material deficiencies:

Eustis Mortgage did not

- Meet the traditional or alternative asset documentation requirement because there was no verification of deposit and the loan file contained a bank statement covering only 1 month, instead of the required 3 months.³⁷
- Obtain a written explanation from the borrower for inquiries shown on the credit report in the last 90 days.
- Obtain a written explanation from the borrower for major indications of derogatory credit (collections) within the past 2 years. The loan file did not contain documentation showing Eustis Mortgage's analysis of the basis for the derogatory debt (collections that were in dispute).
- Obtain a 12-month rental or mortgage payment history.

³⁶ TOTAL Mortgage Scorecard User Guide, effective December 2004, Chapter 2, System Overrides and Manual Downgrades, Credit Issues, Disputed Accounts

³⁷ HUD Handbook 4155.1, paragraph 1.B.2.c

Automated Underwriting System Report Before Closing Was Not Provided

Eustis Mortgage was unable to provide the automated underwriting system findings that qualified the borrower at closing. Specifically, the automated underwriting system was run August 4, 2010, but the closing date was July 30, 2010.

Gift Letter Did Not Include All Required Elements

The gift letter in the file and identified on the final uniform residential loan application did not include the donor's address and telephone number as required.