OFFICE OF AUDIT
REGION 4
ATLANTA, GA

Peoples Home Equity, Inc.
Brentwood, TN

Single-Family Housing Mortgage Insurance Program

2014-AT-1013

SEPTEMBER 30, 2014

Issue Date: September 30, 2014

Audit Report Number: 2014-AT-1013

TO: Kathleen Zadareky, Deputy Assistant Secretary for Single Family Housing, HU

//signed//
FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Peoples Home Equity, Inc., Brentwood, TN, Did Not Follow HUD Requirements in Approving FHA Loans and Implementing Its Quality Control Program

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Peoples Home Equity's loan origination, underwriting, and quality control.

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 8M, 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 404-331-3369.

September 30, 2014

People Home Equity Did Not Always Follow HUD Requirements in Approving FHA Loans and Implementing Its Quality Control Program

Highlights

Audit Report 2014-AT-1013

What We Audited and Why

We audited Peoples Home Equity, Inc.(Peoples), a Federal Housing Administration (FHA) approved nonsupervised direct endorsement lender located in Brentwood, TN. We selected Peoples based on its high default rates. The audit was part of our annual audit plan to review single family programs and lenders. Our audit objectives were to determine whether Peoples complied with HUD requirements when it originated and underwrote FHA loans, and implemented its quality control program.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Peoples to (1) idemnify six loans with unpaid balances of $965,262, thereby putting an estimated $521,242 to better use; (2) reimburse HUD for four claims totaling $971,959; (3) continue training staff; (4) enforce written controls; and (5) implement and enforce a quality control plan.

What We Found

Peoples did not always originate and underwrite FHA insured loans in accordance with HUD requirements. Specifically, 10 of 20 loans reviewed contained underwriting deficiencies. This occurred because Peoples' underwriters lacked knowledge, skills, and understanding of how to properly underwrite loans. As a result, Peoples exposed HUD to unnecessary insurance risk of more than $521,000 for six loans and caused HUD to pay more than $971,000 in claims for four loans.

Further, Peoples did not follow HUD's requirements when implementing its quality control program. Peoples' quality control reviews were not conducted in compliance with requirements and the quality control plan did not have the required provisions. This occurred because Peoples did not ensure that its quality control contractor followed HUD's requirements. Because of Peoples' noncompliance with HUD's requirements and lack of due diligence, Peoples placed the FHA insurance fund at risk. As a result, the effectiveness of Peoples' quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

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BACKGROUND AND OBJECTIVES

Peoples Home Equity, Inc. (Peoples), is a Federal Housing Administration (FHA) approved nonsupervised direct endorsement lender located in Brentwood, TN. Nonsupervised lenders can submit applications for mortgage insurance and can originate, sell, purchase, hold, and service FHA-insured mortgages. Under the direct endorsement program, the U.S. Department of Housing and Urban Development (HUD) authorizes approved lenders to underwrite FHA loans without HUD's prior review and approval. Peoples was approved by HUD as an unconditional direct endorsement lender on April 4, 2007.

All FHA approved lenders must follow applicable Federal statues and HUD regulations, handbooks, and mortgagee letters. 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[1] between January 1, 2009, to December 31, 2013, Peoples had underwritten 7,915 loans, of which 186 loans, totaling over $26 million, were seriously delinquent.

Our audit objectives were to determine whether Peoples complied with HUD requirements when it originated and underwrote FHA loans, and implemented its quality control program.

[1] 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: Peoples Did Not Always Originate and Underwrite Loans in Accordance With HUD Requirements

Peoples did not always originate and underwrite FHA insured loans in accordance with HUD requirements. Specifically, of 20 loans reviewed, 10 contained underwriting deficiencies. This occurred because Peoples' underwriters lacked knowledge, skills, and understanding of how to properly underwrite loans. As a result, Peoples exposed HUD to unnecessary insurance risk of more than $521,000 for six loans, and caused HUD to pay more than $971,000 in claims for four loans.

10 Loans With Originating and Underwriting Deficiencies

Our review of 20 FHA insured loans identified 10 loans with originating and underwriting deficiencies (see Appendix D for loan summaries). Specifically, Peoples did not:

- Verify and properly document the borrowers' income and employment**.**
- Obtain documents to support asset accounts.
- Verify and properly document the borrowers' liabilities and credit.
- Resolve conflicting information between the automated underwriting system and the data included in the loan file.

HUD Handbook 4155.1and HUD Handbook 4155.1, REV-5 state the requirements for underwriting FHA-insured loans, including the evaluation of the borrower's capacity to repay the loan, assets available to close the loan, and credit history. Also, the lenders decision to approve the loan must be documented, supported, and verifiable.

The table below summarizes the loan deficiencies that we identified for the 10 loans.

FHA number	Income and employment not documented or verified	Assets not properly documented	Liabilities and credit not documented or verified	Conflicting information not resolved
137-6482287	X			
481-2885825	X			
481-2907257	X	X		
481-3003492	X			
481-3167885				X
483-4104587		X		
483-4119683			X	
483-4573143			X	
483-4640327	X			
483-4774309	X			
Totals	**6**	**2**	**2**	**1**

Peoples approved mortgage loans for FHA insurance that did not meet HUD requirements and represented high risks of default and foreclosure. Peoples' loan underwriting deficiencies for the 10 loans placed the FHA insurance at risks by more than $521,000 for six loans. The FHA insurance fund also paid more than $971,000 for four improper loan claims (see Appendix C).

Income and Employment Were Not Properly Documented and Verified

Six of the 10 loans with underwriting deficiencies included Peoples' improperly documenting and verifying the income and employment, such as (1) not documenting the tax returns to support commission and self-employment income, (2) not verifying employment for two full years, (3) not documenting pay stubs, and (4) not documenting overtime income.

For one loan, the Director of Mortgage Compliance stated that a junior underwriter reviewed the file to determine whether the loan file contained all of the required documentation. He stated that, based on their policy, a junior underwriter should not have reviewed the file. Peoples' President stated the junior underwriter overstepped her authority and was terminated in 2009. Peoples did not provide the policy.

For two loans, the Director of Mortgage Compliance stated that both loans were from 2009 and since that time, Peoples have put various controls, processes and procedures in place to minimize errors. He stated that an accurate income calculation and the use of an income calculation worksheet have become requirements for documenting income. The

Director also stated that Peoples has enacted a second level review of all income. He stated situations such as these have been used as training opportunities.

For two other loans, Peoples did not provide adequate documentation to support the loans. In the first case, Peoples did not provide the missing individual and business tax returns to support the borrower's self-employment income. For the second case, Peoples did not document the 2 year history of dividend and interest income. Peoples stated that they believed the documentation of the dividend/interest income for a 13 month period was sufficient.

For another loan that closed in 2011, the underwriters were advised to make sure that income is from pay stubs independent of verification of employment forms and that all income must be validated using pay stubs and or tax returns.

Assets Were Not Properly Documented

Two of the 10 loans with underwriting deficiencies included Peoples improperly documenting assets. The retirement asset documentation was missing from one loan and information on the percentage of vested funds that can be withdrawn and the terms and conditions for the withdrawals, was missing for both loans. Peoples' staff was unable to locate the missing retirement asset documentation.

Liabilities and Credit Not Properly Documented and Verified

Two of the 10 loans with underwriting deficiencies included Peoples improperly documenting and verifying a collection account that was in dispute and the monthly payment amount for a revolving account that had a balance, but without a monthly payment amount shown on the credit report. In both instances, Peoples' staff misinterpreted FHA guidelines on supporting and verifying disputed collection and revolving accounts.

Conflicting Information Was Not Resolved

One of the 10 loans with underwriting deficiencies involved Peoples not resolving inconsistencies between the automated underwriting system and data in the loan file. The loan involved inconsistencies with the borrower's assets and income amounts. Peoples' staff could not explain the reason for the conflicting information.

Peoples Staff Lacked Skills, Knowledge, and Understanding of HUD Requirements

Peoples' staff did not have adequate skills, knowledge, and understanding in originating and underwriting HUD loans. The President and Director of Mortgage Compliance stated that they had experienced performance issues with their underwriters. The performance issues involved the underwriters using inaccurate and unsupported information and documentation in reviewing and approving loans. There were 3 underwriters associated with the 10 deficient loans. The underwriter that approved 8 of the 10 loans is still employed with Peoples. Peoples attributed her performance issues to her lack of underwriting knowledge. In August 2009, Peoples warned the employee regarding her performance and she was provided online and classroom training courses related to mortgage underwriting during various times from 2010 through 2014.

The other two loans were underwritten by two different underwriters that were cited for having loan underwriting deficiencies. Peoples provided training to the underwriters that included online courses, webinars, and HUD seminars related to mortgage underwriting. However, one underwriter received a verbal warning in May 2009 and was terminated in June 2009. No corrective action was taken against the second underwriter who was terminated in January 2013.

The Director of Mortgage Compliance stated that controls, processes, and procedures were put into place in 2009 to minimize loan errors. However, we determined that Peoples' quality control program was not effective in detecting underwriting deficiencies (see Finding 2).

Conclusion

Since Peoples did not comply with HUD requirements, it originated 10 loans with underwriting deficiencies. As a result, Peoples increased the risk to the FHA insurance fund by more than $521,000 for 6 loans and incurred losses of more than $971,000 for 4 claims paid.

Recommendations

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

1A. Indemnify HUD $521,242 in estimated losses for six loans. The estimated loss is based on the loss severity rate of 54 percent of the total unpaid principal balance of $965,262 as of June 30, 2014.

1B. Reimburse HUD $971,959 for four claims paid.

1C. Continue to provide training to its underwriters to ensure that they follow HUD's requirements for obtaining and verifying information used to qualify borrowers for FHA insurance.

1D. Enforce written controls to ensure that loans comply with HUD's requirements and that underwriting decisions are properly documented and supported.

Finding *2*: Peoples Did Not Follow HUD's Requirements When Implementing Its Quality Control Program

Peoples did not follow HUD's requirements when implementing its quality control program. Peoples' quality control reviews were not conducted in compliance with requirements and the quality control plan did not have the required provisions. This occurred because Peoples did not ensure that its quality control contractor followed HUD's requirements. Because of Peoples' noncompliance with HUD's requirements and lack of due diligence, Peoples placed the FHA insurance fund at risk. As a result, the effectiveness of Peoples' quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

Quality Control Program Did Not Comply with HUD Requirements

Peoples' quality control reviews were not conducted in compliance with HUD's requirements and the quality control plan did not contain the required provisions. Peoples' quality control review contractor performed quality control reviews for the 10 deficient loans and identified issues with all of them. However, the quality control review results for 6 of the 10 deficient loans did not include the issues that we identified. For the remaining four deficient loans, Peoples' quality control contractor's review included the issues that we identified, but Peoples did not document corrective actions taken and did not follow up to ensure that the issues were resolved.

In addition, the contractor's quality control plan did not contain HUD's required provisions. Specifically, its plan lacked five elements required by HUD (see Appendix E). Also, Peoples quality control review contractor did not retain the quality control plans for the 2 year period required by HUD Handbook 4060.1, REV. 2.[2]. The quality control contractor provided only the quality control plan for April 15, 2013. The contractor stated that he was not aware that he was required to retain copies of prior quality control plans for 2 years. Therefore, Peoples quality control plan used in 2012 was not available.

Peoples Did Not Ensure That Its Quality Control Reviews Were in Compliance

Peoples did not ensure that its quality control contractor conducted the quality control reviews in compliance with HUD's requirements. The quality control contractor was not aware of the 2 year file retention requirements regarding the quality control plan or the HUD required provisions that should be included in the plan.

[2] HUD Handbook 4060.1, REV. 2, paragraph 7-3K

Peoples' assessment of the quality control contractor's performance was lacking. The Director of Mortgage Compliance stated he assessed the quality control contractor's performance only for the loan files that the contractor reviewed. Peoples did not review the loan file to assess whether the contractor followed HUD requirements. Peoples' President stated that he relied on the quality control vendor to perform the quality control reviews in accordance with HUD requirements. Regardless of whether the quality control reviews are performed by Peoples or its contractor, Peoples is responsible for ensuring that the reviews comply with HUD Handbook 4060.1, REV.2.[3]

Conclusion

Because of Peoples' noncompliance with HUD's requirements and lack of due diligence, the mortgagee placed the FHA insurance fund at risk. In addition, the effectiveness of Peoples' quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

Recommendation

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

2A. Implement and enforce a quality control program that complies with HUD's requirements. Specifically, Peoples needs to ensure that quality control plans and quality control reviews meet HUD's requirements.

[3] HUD Handbook 4060.1, REV.2, paragraph 7-3(B)(2)

SCOPE AND METHODOLOGY

We conducted the audit between February and August 2014 at the Peoples' home office in Brentwood, TN and the HUD Office of Inspector General's (OIG) Atlanta Regional office. Our audit period covered loans with beginning amortization dates from January 1, 2009 to December 31, 2013, and was adjusted as necessary.

We used HUD's Neighborhood Watch system to identify FHA-insured loans that were originated and underwritten by Peoples. During the audit period, Peoples originated and underwrote 7,915 loans, of which 186 were in serious default. For the 186 loans in serious default, we did a risk ranking analysis giving consideration to include the following factors:

- Loans that were seriously delinquent[4];
- Loans originated at branch offices with high default rates;
- Loans with high front ratios[5];
- Loans with high back ratios[6]; and
- Loans that went into early payment defaults[7].

Our risk analysis yielded a total of 53 loans. We selected a nonstatistical sample of 20 of the 53 FHA insured loans for review. The mortgages for the 20 loans totaled more than $3.4 million. The results of this audit apply only to the items reviewed and cannot be projected to the universe of loans originated or underwritten by Peoples.

To accomplish the audit objectives, we

- Reviewed applicable HUD handbooks and mortgagee letters;
- Reviewed reports and information on HUD's Neighborhood Watch system;
- Reviewed Peoples' organization chart, , quality control plan, contracts, quality control review reports, and independent audit reports;
- Reviewed Peoples' written policies and procedures for originating and underwriting loans;
- Reviewed Peoples' FHA-insured loan files; and
- Interviewed Peoples' management, staff, and external quality control contractor.

We used the source documents in the loan files to review the assets, income, liabilities, and credit of the borrowers. We used the data maintained by HUD's Single Family Insurance

[4] Seriously delinquent loans are loans that are 90 days or more delinquent.
[5] Front Ratio is 35 percent or more. The front ratio is the borrower's total monthly mortgage payment divided by the borrower's gross monthly income.
[6] Back ratio is 46 percent or more. The back ratio or debt to income ratio is the borrower's total monthly debts (i.e., total monthly mortgage payments and other recurring debts) divided by the borrower's gross monthly income.
[7] Early payment default loans are loans that go into default within 0-6 payments

System[8] and Neighborhood Watch to obtain the unpaid mortgage balances and claims paid for each loan as of June 30, 2014.

Peoples hired a quality control contractor to perform its post-closing quality control reviews. For our quality control program review, we assessed Peoples quality control plan and the quality control reviews. The 20 loans in our sample were part of the quality control reviews.

We relied on data maintained in HUD's Neighborhood Watch and Single Family Data Warehouse[9] systems for informational and sampling purposes only. We also relied on data maintained by Peoples' system, such as electronic loan files. Although we did not perform detailed assessments of the reliability of the data, we performed minimal levels of testing and found the data to be adequately reliable for our purposes. Testing for reliability included the comparison of computer-processed data to loan files and other supporting documentation.

We conducted the audit in accordance with 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.

[8] Single Family Insurance System provides information on the loans to include the claims amounts.
[9] Single Family Data Warehouse facilitates report processing and decision making by allowing the user to run queries and reports on the loans.

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 objectives:

- Effectiveness and efficiency of operations – Policies and procedures that the management has implemented to reasonably ensure that a program meets its objectives.

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

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:

- Peoples did not always properly originate and underwrite loans in accordance with HUD regulations (finding 1).

- Peoples did not follow HUD regulations when implementing its quality control program (finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		$521,242
1B	$971,959	

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations. The amount shown represents claims paid by HUD's insurance fund.

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (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 to indemnify loans not approved in accordance with HUD's requirements will reduce FHA's risk of loss to the insurance fund. The amount noted reflects HUD's calculation that FHA loses an average of 54 percent of the unpaid principal balance when it sells a foreclosed-upon property (see the estimated loss to HUD in Appendix C). The 54 percent loss rate is based on HUD Single Family Acquired Asset Management System's computation for the third quarter of fiscal year 2014 based on actual sales.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

9/18/2014

U.S. Department of Housing and Urban Development
Office of Inspector General
75 Spring Street SW., Room 330
Atlanta, GA 30303
Attention: Nikita N. Irons, Regional Inspector General for Audit

Re: Peoples Home Equity, Inc.
Response to September 11, 2014 Report

Dear Ms. Irons,

Peoples Home Equity, Inc. has reviewed the Draft Audit Report dated September 11, 2014. Below you will find the responses to each of the findings listed within the report. We appreciate the time and attention taken by your office during this review and the amount of time provided to PHE to discuss the report and documentation.

Finding 1:

137-6482887 [redacted]:

Comment 1

We agree with the findings that the income for the co-borrower did not support $925.00; however, in review of the income for the borrower, we verified the income used was understated as the borrower is paid in 24 pay periods, which equates to $5,000 per month. The income that was used by the underwriter was $4,656.09. In addition, the 2106 expenses annualized, calculated at $407.00. The total income that is fully supported by the documentation provided is $5,232.00, which would decrease the amount of the back end debt to income ratio. PHE has determined that the findings from the OIG did not increase the risk level of the loan based on the information above and the supporting documentation.

Comment 2

PHE has implemented a policy that requires an income calculation worksheet completed by the Underwriter and uploaded to the loan file for record retention.

481-2885825 [redacted]

Comment 3

PHE agrees with the finding as it pertains to verifying the overtime by providing a two year history. During our review, it was determined that removing the calculation of the overtime would increase the debt to income ratio to 35.9%. The AUS remaining an approved/eligible is highly probable with the increase of the debt to income ratio.

Comment 4

The discrepancy between the annual earnings of $32,869 and the December pay stubs year to date earnings of $32,568 was discussed with [redacted] with the OIG on 9/17/2014. The paystub that shows the lower YTD is due to the paystub being through 12/15 and not 12/31 and the last paystub for 1/9, which was for the pay period ending 12/31 is showing that they only included the YTD for the amount of the beginning of the year and not the end of the year.

Comment 2

PHE has implemented a policy that requires an income calculation worksheet completed by the Underwriter and uploaded to the loan file for record retention.

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Comment 5

481-2907257 [redacted]:

We agree with the findings after reviewing HUD Handbook 4155.1, Rev-5 2-7H that terms of redemption are required. Due to the HUD Handbook 4155.1 changing in 2009, this requirement is no longer required unless the Underwriter is utilizing more than 60% of the retirement funds.

481-3003492 [redacted]:

Comment 2

We agree with the findings. PHE has implemented a policy that requires an income calculation worksheet completed by the Underwriter and uploaded to the loan file for record retention.

481-3167885 [redacted]:

Comment 6

PHE agrees with the findings.

PHE has implemented a process in our Closing Department that regardless if the Investor purchasing the loan requests for PHE to rerun the Total Scorecard, the loan cannot be reran through Total Scorecard once the loan has been closed and disbursed as the information in the Total Scorecard must match the information provided to HUD through the insuring process.

483-4104587 [redacted]:

PHE agrees with the findings.

483-4119683 [redacted]:

Comment 7

PHE does not agree with the findings from OIG. The collection account from Direct TV in 2002 was considered a minor derogatory account, and the fact that the credit bureau denotes the borrower's dispute also adds to arriving at the conclusion that this is minor. As it has been outlined previously, the borrower's credit displayed 48 accounts, of which two were show as derogatory, the one collection mentioned above and 45 files, which includes mortgage, installment, revolving, and student loans that display zero days delinquent. Additionally the borrower's FICO score was 717. PHE has confirmed that per the 4155.1 Rev 5 Section 1: Credit History 2-3, HUD states that a minor derogatory information occurring two or more years in the past does not require explanation. The collection account was over 6 years old from the date the loan was closed.

483-4573143 [redacted]:

Comment 8

PHE agrees with the findings.

PHE has implemented a policy that revolving accounts that do not display a payment, or where a statement is not provided, must be calculated at 5% of the outstanding balance to meet HUD requirements.

483-4640327 [redacted]:

PHE agrees with the findings.

Comment 2

PHE has implemented a policy that requires an income calculation worksheet completed by the Underwriter and uploaded to the loan file for record retention.

483-4774309 [redacted]:

Comment 9

PHE agrees with the findings; the underwriter did not use the business income of $41,823 from the S-Corporation. The income from the borrower's personal return did include a loss which was deducted from the borrower's income. We understand that due to the loan being a cash out refinance, it is required to have two years of business returns according to the AUS and HUD requirements. With that said, PHE has determined that the findings from the OIG did not increase the risk level of the loan based on the information above and the supporting documentation.

Comment 2

PHE has implemented a policy that requires an income calculation worksheet completed by the Underwriter and uploaded to the loan file for record retention.

Finding 1C:

Comment 10

PHE requires training to be provided through various means. We have a yearly meeting to review past performance and current policy and procedures to verify that PHE has controls in place to mitigate risk and to confirm that our policy and procedures are meeting the requirements for the GSE's. Trainings in the form of granting access to HUD, VA, and investor webinars are made available to the underwriting staff. All employees must successfully pass yearly testing on compliance, anti money laundering, suspicious activity and identify theft, Social media guidelines, code of business conduct, compliance and ethics, third party vendor code of conduct and, CFPB final rules compliance. Additionally, PHE maintains a subscription with AllRegs, which has numerous courses available.

Findings 2:

Comment 11

Peoples Home Equity, Inc. (PHE) has utilized an outside vendor, QMS, to perform the post-closing quality control review on 10% of all closed loan files each month additionally all files that placed in Early Payment Default according to the Neighborhood Watch report. PHE does not view QMS as a "mortgagee". According to the 4060.1 Rev. 2, the Mortgagee (PHE) is responsible for ensuring that the outside source (QMS) is meeting HUD's requirements and any agreement (contract) with the outside source must be in writing, stating the roles and responsibilities for each party to meet the HUD requirement. We have confirmed and ensured that the third party vendor follows all HUD requirements, including the five elements listed in Appendix B. The contract signed in 2008 between PHE and QMS specifically states the roles and responsibilities of each party. The Management Team at PHE completes a review of each final monthly report provided by QMS to confirm that PHE has proper procedures and controls in place to ensure the loans comply with the GSE requirements. The Quality Control reports provided by QMS between 2008 and the present confirm that a quality control review was completed on FHA loan files on a monthly basis to ensure that the loans met FHA HUD guidelines. PHE has added that 10% of all files reviewed by the QC vendor are reviewed by PHE internal staff to ensure the QMS is completing the full review required by HUD. In the first quarter of the year PHE completed a Vendor Management review of our third party company, QMS, which included reviewing the updated written policy and procedures for post-closing quality control to verify it meets all GSE requirements. Additionally PHE confirms each month that QMS has completed the due diligence on a percentage of the FHA loans by accessing QMS's secure website to review the thorough Post Closing Audit checklist

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and findings. The Post Closing Audit checklist utilized by QMS during 2008, and the contract in force at the time have been sent previously.

2A:

Comment 12

The revised Quality Control Plan which has been submitted for your review encompasses the requirements of HUD. The reviews are being completed on a timely basis, which includes a pre-funding review of 10% of new files, a post closing review of 10% of closed loan files, and early payment defaults. Staff is notified of the loans reviewed that were originated by their branch. When a loan displays deficiencies, the Branch Manager and Originator become involved in obtaining additional documentation to cure the deficiency. PHE is implementing a new corrective action plan similar to the Fannie Mae and Freddie Mac Action Plan within the next 120 calendar days.

PHE has provided the Quality Control Plan, HUD Handbook Chapter 7 of the 4060.1, the QMS contract in force in 2008, and the audit checklist in force at the time the loan files were reviewed by the third party vendor, QMS.

If you have any questions or concerns, feel free to contact me directly at 615-872-0220 ext. 803 or mferreira@peopleshomeequity.com.

Sincerely,

Peoples Home Equity, Inc.

Mia Ferreira

Mia Ferreira
Director of Compliance

OIG Evaluation of Auditee Comments

Comment 1 For loan number 137-6482887, Peoples agrees that the income for the co-borrower did not support $925. We agree the borrower's income based on the pay stubs was $5,000 per month and not $4,656 used by the underwriter. Peoples stated that the total income that was fully supported by documentation was $5,232, which would decrease the amount of the back end debt to income ratio and would not increase the loan risk level. However, Peoples did not provide documentation to support the negative $407 for employee business expenses and $639 in income for the co-borrower. Without the supporting documentation, we cannot determine the borrowers' debt to income ratio. As a result, the total income claimed by the underwriter in the AUS could not be verified.

Comment 2 Peoples stated it has implemented a policy that requires an income calculation worksheet completed by the underwriter and uploaded it to the loan file for record retention. Since it did not complete the policies before the end of our site visit, HUD will be responsible for reviewing the policy.

Comment 3 For loan number 481-2885825, Peoples commented that it agreed with the finding as it relates to verifying the borrower's overtime using a two year history. However, Peoples stated that removing the overtime would increase the debt to income ratio to 35.9 percent and that the loan would highly probably remain as approved and eligible with the increase of the debt to income ratio. Because Peoples did not properly document the borrower's income in the automated underwriting system we do not know if the loan would have been approved and eligible with the increased debt to income ratio. The underwriter showed the borrower had a total income of $2,739 but this amount included overtime income of $650 which should have been listed separately. As a result, Peoples had income information that was inaccurate and was not properly verified and documented.

Comment 4 Based on additional documentation provided by Peoples regarding the discrepancy between the 2008 annual earnings and the December paystub has been resolved. We deleted the statement from the finding.

Comment 5 Peoples agreed with the finding cited for loan number 481-2907257. Peoples cited HUD Handbook 4155.1, Rev-5, 2-7H for retirement accounts; however, HUD Handbook 4155.1, Rev-5, 2-10K relates to retirement assets. HUD Handbook 4155.1 had been updated when the loan was underwritten on February 27, 2009; therefore, HUD Handbook 4155.1, Rev-5 was applicable.

Comment 6 Peoples stated that it is in agreement with the finding cited for loan number 481-3167885. Peoples stated it has implemented a process that it will not rerun the loan in the automated underwriting system once the loan has been closed. Peoples also stated the information in the automated underwriting system must match information provided to HUD through the insuring process. We also found inconsistencies between the automated underwriting system data and the data in the loan file. Peoples need to ensure that the loan information is correct prior to closing the loan.

Comment 7 Peoples does not agree with our finding on loan number 483-4119683. HUD Handbook 4155.1, Rev-5 paragraph 2-3, states that while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit-including judgments, collections, any other recent credit problems-require sufficient written explanation from the borrower. The HUD regulation considers a collection account as major derogatory credit that must be analyzed and documented. The credit report shows the collection account as in dispute and that it had not been resolved. The credit report did not show the balance due on the account. The disputed collection account may not be included in the borrower's FICO score. The underwriter should have analyzed and documented its review of the disputed collection account to include obtaining an explanation for the disputed collection account and the amount in dispute. The disputed account could have resulted in a downgrade to manually underwrite the loan.

Comment 8 Peoples comment states that it is in agreement with the finding cited for loan number 483-4573143. Peoples stated it has implemented a policy that revolving accounts that do not display a payment must be calculated at 5 percent of the outstanding balance. Since it did not complete the policies before the end of our site visit, HUD will be responsible for reviewing the policy.

Comment 9 Peoples stated that it agreed with the finding cited for loan number 483-4774309 and the underwriter did not obtain the required two years of business tax returns. However, Peoples stated it determined that the findings did not increase the risk level of the loan based on the information and supporting documentation. We disagree, the missing tax information could have increased the risk level of the loan due to borrower having business debts that were not analyzed by the underwriter. The borrower's loan was in default due to curtailment of the borrower's income

Comment 10 We acknowledge that Peoples provided training during the audit since performance issues were identified with the underwriters associated with the deficient loans. Peoples used training as a means to improve loan underwriting. We did not review the adequacy of the training provided and cannot attest to its effectiveness, but acknowledge this is a positive step to improve underwriting performance. Since Peoples did not complete the policies before the end of our site visit, HUD will be responsible for reviewing the policy.

Comment 11 We agree that Peoples is responsible for ensuring that its quality control contractor meets HUD requirements. We also agree that quality control reviews were performed, however, Peoples did not provide documentation to support that it had confirmed and ensured the quality control contractor followed HUD requirements. People stated it completed a vendor management review of its quality control contractor during the first quarter of this year, but did not provide documentation of the review. Peoples also did not document that it had performed an adequate review of the contractor's performance.

Comment 12 We agree that Peoples conducted quality control reviews. However, improvements are needed regarding Peoples' quality control program. The quality control contractor's plan was missing five elements and the quality control contractor did not always include the issues we identified. In addition, Peoples staff did not always document corrective actions taken or follow up to resolve issues with the loans. Peoples stated that it plans to implement a new correct action plan in the next 120 calendar days. The plan will be reviewed by HUD.

Appendix C

SCHEDULE OF INDEMNIFICATION AND CLAIMS REPAYMENT AMOUNTS

FHA loan number	Original mortgage amount	Unpaid principal balance	Loss to HUD[10]	HUD paid claim	Loan status as of June 30, 2014
137-6482287	$ 228,285	$220,947	$119,311	$ 0.00	Reinstated
481-2885825	$ 103,098	$98,425	$ 53,150	$ 0.00	First legal action
481-2907257	$ 123,717	$122,050	$ 65,907	$ 0.00	First legal action
481-3003492	$ 137,362	$134,190	$ 72,463	$ 0.00	Reinstated
481-3167885	$ 218,556	$ 0.00	$ 0.00	$ 70,648	Preforeclosure sale
483-4104587	$ 166,920	$ 0.00	$ 0.00	$ 177,669	Assignment
483-4119683	$ 365,180	$ 0.00	$ 0.00	$ 378,469	Conveyance
483-4573143	$ 208,590	$196,004	$105,842	$ 0.00	First legal action
483-4640327	$ 203,701	$193,646	$104,569	$ 0.00	Delinquent
483-4774309	$ 326,230	$ 0.00	$ 0.00	$ 345,173	Assignment
Total	**$2,081,639**	**$965,262**	**$521,242**	**$ 971,959**	

[10] We classified $521,242 as funds to be put to better use (see Appendix A). This is 54 percent of the $965,262 in unpaid principal balances for the six loans as of June 30, 2014. The 54 percent is the estimated percentage of loss HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management for the third quarter of fiscal year 2014 based on actual sales.

Appendix D

LOAN SUMMARIES

FHA case number: 137-6482287
Mortgage amount: $228,285
Date of loan closing: January 25, 2012
Payments before first default: 4
Unpaid principal balance: $220,947
Status as of June 30, 2014: Reinstated after loss mitigation intervention
Total claim paid: $0

Underwriting Deficiency:

- Borrower's income was not properly supported.

Peoples did not properly document the borrowers' income as required by HUD Handbook 4155.1.[11] There was no documentation in the loan file to support the total monthly income of $5,098 for the borrower and base income of $925 for the co-borrower as shown in the automated underwriting system and on the loan application. Peoples did not include documentation in the loan file to support how the qualifying income was determined.
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[11] HUD Handbook 4155.1 4.D.1.a

FHA case number: 481-2885825
Mortgage amount: $103,098
Date of loan closing: February 4, 2009
Payments before first default: 10
Unpaid principal balance: $98,425
Status as of June 30, 2014: First legal action to commence foreclosure
Total claim paid: $0

Underwriting Deficiencies:

- Borrower's income was not properly supported and verified.

Peoples did not properly document and verify the borrower's income. The automated underwriting system showed that the borrower had a total monthly base employment income of $2,739. However, this amount included overtime income of $650. Peoples included overtime income in the base employment amount when it should have been listed on the automated underwriting system as a separate amount. Peoples had only 1 year of overtime documented in the loan file. Peoples did not follow HUD Handbook 4155.1, REV-5 [12] guidelines and develop a 2 year average and earnings trend for the overtime income. Although the FHA guidelines may accept periods of less than 2 years, Peoples did not justify or document in writing the reason for using the overtime income for qualifying purposes as required.

[12] HUD Handbook 4155.1, REV-5, paragraph 2-7 A

FHA case number: 481-2907257
Mortgage amount: $123,717
Date of loan closing: February 27, 2009
Payments before first default: 12
Unpaid principal balance: $122,050
Status as of June 30, 2014: First legal action to commence foreclosure
Total claim paid: $0
HUD loss: N/A

Underwriting Deficiencies:

- Borrower's assets were not properly supported.
- Borrower's income was not properly verified.

Peoples did not properly document the borrower's retirement assets of $8,987 that was used as assets counted towards available funds. Specifically, Peoples did not document the percentage of vested funds that can be withdrawn and the terms and conditions for the withdrawals as required by HUD Handbook 4155.1 REV-5.[13] Peoples also could not support that the borrower had reserves after closing. Peoples automated underwriting system report showed $13,637 in funds available, which included $4,650 in checking and $8,987 in retirement funds. The report also showed the funds required to close as $4,357 and the reserve amount as $9,280. The borrower's funds totaling $4,650 were supported and verifiable. However, the portion of the assets not used to close the loan but supported that the borrower had reserves ($8,987) was not properly documented.

Peoples also did not properly verify the borrower's dividend and interest income. The borrower's dividend and interest income should have been excluded because it did not meet HUD Handbook 4155.1, REV-5 [14] guidelines that a 2 year history of receipt is required. Peoples could document only the receipt of dividend/interest income for a 13 month period.

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[13] HUD Handbook 4155.1, REV-5, paragraph 2-10 K
[14] HUD Handbook 4155.1, REV-5, paragraph 2-7H

FHA case number: 481-3003492
Mortgage amount: $137,362
Date of loan closing: July 15, 2009
Payments before first default: 5
Unpaid principal balance: $134,190
Status as of June 30, 2014: Reinstated by mortgagor without loss mitigation claim
Total claim paid: $0

Underwriting Deficiencies:

- Borrower's income and employment were not properly supported and verified.

Peoples did not properly support and verify the borrower's income and employment. The automated underwriting system showed that the borrower had a base employment monthly income of $2,743. However, the pay stubs in the loan file showed that the borrower had received commission income and tips in 2009 and not a salary. Peoples also did not document and verify whether the borrower had received salary or commission income in 2007 and 2008. There were no pay stubs, W-2s, or tax returns in the loan file for income received in 2007 and 2008. Peoples did not analyze the borrower's average commission income over the previous 2 years using tax returns and the most recent pay stub as stipulated in HUD Handbook 4155.1 [15]. Peoples also did not analyze commission income to determine whether it had decreased from one year to the next and whether it had been received for more than one year as required. In addition, Peoples did not properly document and verify the borrower's employment history for the most recent2 full years as stipulated in HUD Handbook 4155.1.[16] The loan file did not contain the required employment history documentation for 1 of the 2 years. The loan file contained a statement from the borrower that her former employer was no longer in business. However, there was no W-2 or income verification from the IRS in the loan file to confirm the borrower's previous employment.

[15] HUD Handbook 4155.1, paragraph 4.D.2.g
[16] HUD Handbook 4155.1, paragraph 4.D.1.b

FHA case number: 481-3167885
Mortgage amount: $218,556
Date of loan closing: May 17, 2010
Payments before first default: 7
Unpaid principal balance: N/A
Status as of June 30, 2014: Preforeclosure sale completed
Total claim paid: $70,648

Underwriting Deficiencies:

- Borrower's assets and income included inconsistencies between the automated underwriting system and data in the loan file.

Peoples did not resolve conflicting information in the loan file regarding the borrower's assets and income. Peoples did not ensure that the mortgage loan application package contained all documentation that supports the lender's decision to approve the mortgage loan as required by HUD Handbook 4155.1.[17] The borrower closed on May 17, 2010, but there were two automated underwriting system reports for the borrower. The first one was completed on April 19, 2010, prior to the loan closing, and the other one was completed on May 25, 2010, after the loan closed. There was no other automated underwriting system report before the borrower's closing and the loan was not manually underwritten. The asset and income information for the automated underwriting system, dated April 19, 2010, which was the one closest to the borrower's closing date of May 17, 2010, was inconsistent with the data included in the loan file.

The automated underwriting system, dated April 19, 2010, showed that the total assets of $12,374 were counted towards available funds. However, the bank statements in the loan file did not support the checking or savings balances of $1,174 and $3,700, respectively. Further, the gift funds of $7,500 were not documented in the loan file.

The automated underwriting system also listed the total income as $3,680. However, the documentation in the loan file did not support the social security/disability or base employment income of $777 and $2,903, respectively. The loan file documentation supports the social security/disability income as $1,174. Further, the borrowers' base income was documented in the loan file as $2,864, not $2,903. The loan defaulted due to curtailment of borrower's income.

[17] HUD Handbook 4155.1, paragraph 1.B.1.g

FHA case number: 483-4104587
Mortgage amount: $166,920
Date of loan closing: June 3, 2009
Payments before first default: 2
Unpaid principal balance: N/A
Status as of June 30, 2014: Assignment
Total claim paid: $177,669

Underwriting Deficiency:

- Borrower's assets were not properly documented.

Peoples did not have documentation to support the retirement assets of $6,824 that were used as assets counted towards available funds. The retirement asset documentation was not in the loan file. Peoples was required to verify and document the most recent depository or brokerage statement to show the percentage of vested funds that can be withdrawn and the terms and conditions for the withdrawals as stated in HUD Handbook 4155.1.[18] Peoples also could not support that the borrower had reserves after closing. Peoples' automated underwriting system report showed the total funds available as $13,195, consisting of $771 in checking, $5,600 in gift funds, and $6,824 in retirement funds. The report showed funds required to close as $6,316 and $6,879 in reserves. The borrower had enough funds to close and they were verifiable. However, the portion of the assets not used to close the loan, can be counted as reserves as long as it can be supported and verified. Therefore, $6,824 of the $6,879 reserve amount should have been supported. The loan defaulted due to curtailment of the borrower's income.

[18]HUD Handbook 4155.1, paragraph 5.B.3.a

FHA case number: 483-4119683
Mortgage amount: $365,180
Date of loan closing: March 2, 2009
Payments before first default: 2
Unpaid principal balance: N/A
Status as of June 30, 2014: Property Conveyed to HUD
Total claim paid: $378,469

Underwriting Deficiencies:

- Borrower's credit and liabilities were not properly supported and verified.

Peoples did not properly document and verify a collection account that was in dispute based on the borrower's credit report. There was no documentation in the loan file explaining the disputed collection account and the amount in dispute. The missing documentation is needed to determine whether the loan should have been downgraded to manually underwrite the loan. There was no documentation in the loan file to support that Peoples required the borrower to explain the collection, as required by HUD Handbook 4155.1, REV-5.[19] Peoples also did not document its reasons for approving a mortgage when the borrower had a disputed collection account. Peoples did not determine the actual amount of the collection. The loan defaulted due to curtailment of borrower's income.

[19] HUD Handbook 4155.1, REV-5, paragraph 2-3

FHA case number: 483-4573143
Mortgage amount: $208,590
Date of loan closing: November 15, 2010
Payments before first default: 9
Unpaid principal balance: $196,004
Status as of June 30, 2014: First Legal Action to Commence Foreclosure
Total claim paid: $0

Underwriting Deficiency:

- Borrower's liabilities were not properly supported and verified.

Peoples did not properly document and verify the borrower's liabilities. Peoples did not include documentation in the loan file to support how the borrower's monthly payment of $496 for a revolving account was determined. The automated underwriting system showed that the borrower had a monthly liability of $496 for a $24,387 credit card balance. The credit report showed that the account was a revolving account with no monthly amount shown. Based on Handbook 4155.1,[20] the monthly amount should have been $1,219 or 5 percent of the $24,387 credit card balance, instead of the $496 shown on the automated underwriting system. The loan file did not contain a letter from the creditor or a current statement from the creditor documenting the monthly balance, as required by HUD Handbook 4155.1.

Based on the loan data, Peoples understated the borrower's monthly liabilities by $723. The automated underwriting system showed the borrower's front ratio was 37.61 percent and back ratio was 50.60 percent. However, if the correct calculations were done, the borrower's front and back ratios would be 37.61 and 69.61 percent.

[20] HUD Handbook 4155.1, paragraph 4.C.4.c

FHA case number: 483-4640327
Mortgage amount: $203,701
Date of loan closing: February 25, 2011
Payments before first default: 10
Unpaid principal balance: $193,646
Status as of June 30, 2014: Delinquent
Total claim paid: $0

Underwriting Deficiency:

- Borrower's income was not properly supported and verified.

Peoples did not properly support and verify the borrower's income that was used as the source of income for the loan. There was no documentation in the loan file to support how the borrower's monthly income was determined. The loan file did not contain pay stubs to support the borrower's monthly income of $1,453, as required by HUD Handbook 4155.1.[21]

[21] HUD Handbook 4155.1 paragraph 4.D.2.a

FHA case number: 483-4774309
Mortgage amount: $326,230
Date of loan closing: November 29, 2011
Payments before first default: 3
Unpaid principal balance: N/A
Status as of June 30, 2014: Assignment
Total claim paid: $345,173

Underwriting Deficiency:

- Borrower's income was not properly documented and verified.

Peoples did not properly document and verify the borrower's income. Peoples did not have documentation in the loan file to support how the borrower's other income was determined. There was no supporting documentation for the negative amount of $1,569 in other type of income used in the underwriter's self-employed income analysis. The loan file did not contain the individual and self-employment income documentation for the borrower, as required by HUD Handbook 4155.1.[22] For tax years 2009 and 2010, there were no individual tax returns, including all of the supporting schedules, in the loan file. Also, the Federal business tax return and schedules for tax year 2009 were not in the loan file. In addition, the loan file did not contain a verification of the existence of the borrower's business. The reason for the loan default was curtailment of the borrower's income.

[22] HUD Handbook 4155.1, paragraph 1.B.2.g and HUD Handbook 4155.1, paragraph 4.D.4.d

Appendix E

MISSING QUALITY CONTROL PLAN ELEMENTS

Peoples' contractor's quality control plan did not contain the following five required elements according to HUD Handbook 4060.1, REV-2:

- Findings of fraud or other serious violations must be immediately referred, in writing, to the Director of Quality Assurance Division in the HUD Homeownership Center having jurisdiction   In lieu of submitting a paper report, mortgagees must use the Lender Reporting feature in the Neighborhood Watch Early Warning System. If HUD staff is suspected of involvement, refer to the Office of Inspector General at 451 7th Street SW, Room 8256, Washington, DC 20410. A mortgagee's quality control program must ensure that findings discovered by employees during the normal course of business and by quality control staff during reviews and audits of FHA loans are reported to HUD within 60 days of the initial discovery.

- The quality control review report and follow-up, including review findings and actions taken, plus procedural information, such as the percentage of loans reviewed, basis for selecting loans, and who performed the review, must be ***retained*** by the mortgagee for a period of 2 years. These records must be made available to HUD upon request.

- Mortgagees closing more than 15 loans monthly must conduct quality reviews at least monthly and must address 1 month's activity. Mortgagees closing 15 or fewer loans monthly may perform quality control reviews on a quarterly basis.

- Determine that no employee involved in HUD's origination, processing, underwriting or servicing that has been debarred, suspended, subject to a Limited Denial of Participation or otherwise restricted from participation in HUD or FHA programs. Mortgagees must periodically check employee lists at least semi-annually.

- Mortgagees must review all loans that go into default within the first six payments.