



Issue Date February 28, 2012

Audit Report Number 2012-FW-1004

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

//signed//

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

SUBJECT: PrimeLending Mortgage, LLP, Plano, TX, Did Not Always Follow HUD-FHA
Underwriting Requirements for 12 of 20 Loans Reviewed

HIGHLIGHTS

What We Audited and Why

We performed an audit of PrimeLending, A PlainsCapital Company, located in Dallas, TX, a Federal Housing Administration (FHA) direct endorsement lender. We selected PrimeLending for audit because of its high default rate in the Houston, Dallas, and Fort Worth, TX, offices as compared to the average default rate for all FHA loans in those areas. Our objective was to determine whether PrimeLending complied with U. S. Department of Housing and Urban Development (HUD) and FHA loan origination requirements for loans endorsed between April 1, 2009, and May 31, 2011.

What We Found

PrimeLending did not always follow HUD-FHA underwriting requirements for 12 of 20 loans reviewed. This noncompliance occurred because PrimeLending misunderstood FHA guidance, it failed to exercise due diligence in underwriting the loans, and its internal control system did not detect or prevent the origination of those loans. As a result, PrimeLending improperly originated 2 loans that resulted in losses to FHA's Mutual Mortgage Insurance Fund of \$103,013 and 10 loans that increased the risk to the insurance fund by more than \$845,000.

Further, Prime Lending caused HUD-FHA to pay \$110,343 in claims on eight ineligible loans.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require PrimeLending to (1) reimburse the FHA insurance fund \$103,013 in actual losses on 2 loans; (2) indemnify 10 loans that placed the FHA insurance fund at unnecessary risk with unpaid balances of more than \$1.6 million, thereby putting an estimated \$845,763¹ in funds put to better use; (3) repay \$110,343 in claims paid on 8 loans; and (4) ensure that it accurately enters information into HUD's Neighborhood Watch system and correct the data errors cited in this report.

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

Auditee's Response

We provided our discussion draft to PrimeLending on January 24, 2012, and held the exit conference on January 31, 2012. PrimeLending provided its response on February 9, 2012. PrimeLending generally disagreed with the findings.

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

¹ According to the Single Family Acquired Asset Management System's case management profit and loss by acquisition as of September 2010, FHA's average loan loss experience is about 59 percent of the unpaid principal balance upon sale of a mortgaged property.

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BACKGROUND AND OBJECTIVE

PrimeLending, a PlainsCapital Company, is a residential mortgage originator licensed to originate and close loans in 50 States and the District of Columbia. As of December 31, 2010, it operated from 205 locations in 33 States. PrimeLending was approved by the U. S. Department of Housing and Urban Development (HUD) to originate Federal Housing Administration (FHA)-approved mortgage loans on February 13, 1990. It primarily originates single-family residential loans to customers in its 205 offices. After originating loans, PrimeLending sells the loans on the secondary market; thus, it 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 the mortgage loan without prior HUD review or approval. PrimeLending was responsible for complying with all applicable HUD-FHA regulations and was required to evaluate the borrower's ability and willingness to repay the mortgage debt. It was protected against loss from default by FHA's Mutual Mortgage Insurance Fund, which is funded by borrowers' premiums. FHA's mortgage insurance programs help low- and moderate-income families become homeowners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers who might not be able to meet conventional underwriting requirements by protecting the lender against loss from default.

According to HUD's Neighborhood Watch system,² from May 1, 2009, to April 20, 2011, PrimeLending originated a total of 8,559 FHA loans in the Houston, Dallas, and Fort Worth areas. During the same period, 134 of the loans with a total origination value of more than \$15 million defaulted within the first year.³

Our objective was to determine whether PrimeLending followed HUD-FHA loan origination requirements for loans endorsed between April 1, 2009, and May 31, 2011.

² Neighborhood Watch refers to a Web-based software application that displays loan performance data for lenders and appraisers using FHA insured single family loan information. The system is designed to highlight exceptions so that potential problems are readily identifiable.

³ HUD defines a default as the inability to make timely monthly 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.

RESULTS OF AUDIT

Finding: PrimeLending Did Not Always Follow HUD-FHA Underwriting Requirements for 12 of 20 Loans Reviewed

PrimeLending did not always follow HUD-FHA requirements for 12 of 20 loans reviewed. Some of the loans contained multiple underwriting deficiencies. This noncompliance occurred because PrimeLending misunderstood FHA guidance, it failed to exercise due diligence in underwriting the loans, and its internal control system did not detect or prevent the origination of those loans. As a result, PrimeLending improperly originated 2 loans that resulted in losses to FHA's insurance fund of \$103,013 and 10 loans that increased the risk to the insurance fund by more than \$845,000. Further, it caused HUD-FHA to pay \$110,343 in claims on eight ineligible loans.

PrimeLending Did Not Follow HUD-FHA Requirements

PrimeLending did not follow HUD-FHA requirements for 12 of 20 loans reviewed. Some loans contained multiple deficiencies. Specifically, PrimeLending did not

- Manually underwrite, as required, seven loans when borrowers' credit reports contained disputed items;
- Properly review four appraisals;
- Address asset or debt deficiencies for four loans;
- Complete one loan application correctly; and
- Obtain required payroll documentation for one loan.

Further, PrimeLending did not obtain a credit report, as required by its quality control plan, for a loan that defaulted within six payments. Lastly, PrimeLending incorrectly entered loan data for 16 of 86 (21 percent) loans into HUD's Neighborhood Watch system.

The following table shows a summary of the loan deficiencies. Appendix D contains case narratives describing the underwriting deficiencies for the 12 loans.

Underwriting deficiencies by loan

Case number	Disputed accounts	Appraisal not reviewed	Debt & asset deficiencies	Other deficiencies
511-0153486		X		
492-8717246		X		
493-9082225	X			
492-8705878	X			
491-9600782	X	X	X	
493-9572318			X	
492-8492165			X	X
511-0178080	X			
492-8634079	X			
511-0074780	X	X		
493-9219962	X			
493-9075326			X	
Totals	7	4	4	1

PrimeLending Did Not Manually Underwrite Loans When Credit Reports Contained Disputed Items

For 7 of the 20 loans reviewed (35 percent), PrimeLending did not manually underwrite loans when the borrower’s credit report contained disputed items. FHA requirements state that any credit report containing disputed items must be manually underwritten.⁴ HUD-FHA reaffirmed to PrimeLending in a letter, dated June 10, 2010,⁵ that credit reports containing disputed items required manual underwriting instead of automated underwriting. Prior to the letter dated June 10, 2010, PrimeLending did not require loans with disputed items to be manually underwritten, only that the loans be reviewed by an underwriter before closing. Two loans in our review contained disputed items after HUD-FHA notified PrimeLending. These loans closed from 8 to 9 days after PrimeLending received the HUD-FHA notification. Because manual underwriting guidelines are generally more stringent than automated underwriting, it was unknown whether the loans would have qualified for FHA insurance as PrimeLending did not manually underwrite the loans.

⁴ FHA’s Technology Open To Approved Lenders (TOTAL) Mortgage Scorecard User Guide, page 21
⁵ PrimeLending received the letter on June 21, 2010.

PrimeLending Did Not Properly Review Appraisals

PrimeLending did not properly review four appraisals.⁶ Specifically, it did not review the appropriateness of the appraisers' deductions for the difference in the number of rooms, site size, or condition of properties for three loans; did not question appraised values for other loans.

For three loans, the appraiser did not make deductions for the difference in the number of rooms or for the site size and did not consistently deduct for the average condition of the sales property and the comparable properties.

For one loan, the appraiser valued the subject property at \$76 per square foot. The appraiser valued the comparables at \$57, \$66, and \$60, respectively (see pictures 1 through 4). If PrimeLending had reviewed the appraisal, it might have questioned the valuation per square foot of the properties based upon the pictures. The appraisal explained some of the \$26,598 increase in price from the property's previous sale of \$35,162 in March 2007 as a kitchen upgrade, new heating and air conditioning, windows, siding, doors, and insulation. According to the January 2010 appraisal, the value of the property in picture 1 increased 76 percent from March 2007 to January 2010. PrimeLending originated the loan with FHA insurance for \$61,760 in January 2010. After foreclosure, this property sold for \$42,943 in April 2011, with a loss to HUD of \$33,686.



Picture 1: Subject property valued at \$76 per square foot

Picture 2: Comparable 1 valued at \$57 per square foot

⁶ HUD Handbook 4155.2, chapter 4-1, paragraph (e)



Picture 3: Comparable 2 valued at \$66 per square foot



Picture 4: Comparable 3 valued at \$60 per square foot

Four Loans Had Debt and Asset Deficiencies

PrimeLending Did Not Include Credit Card Debt in Debt-to-Income Ratios

PrimeLending did not include some credit card debt for two loans. It was responsible for including and reviewing all debt.⁷ For one loan, PrimeLending did not include \$1,292 in credit card debt. The borrower's debt-to-income ratio totaled 56 percent without the credit card debt and 58 percent including the credit card debt. The desktop underwriting findings report noted the omission and required PrimeLending to support excluding the debt. The file contained no such documentation.

For another loan, the borrower's credit report contained credit card debt of \$2,039. The desktop underwriting findings report required PrimeLending to support the payoff of the debt. The file did not contain payoff evidence before closing. PrimeLending should not have closed this loan without the payoff evidence.

PrimeLending Showed a Secondary Lien as a Gift

PrimeLending showed a secondary lien from the Texas Department of Housing and Community Affairs as a gift and in the reserves on the desktop underwriter report. This report overstated the assets of the borrower. HUD-FHA regulations prohibit the inclusion of secondary financing as a gift.⁸ Without the inclusion of the secondary lien, the borrower maintained only \$840 in reserves.⁹ The borrower's debt-to-income ratio including the house payment was at 48 percent without the secondary lien. Although, FHA does not require a reserve amount for

⁷ FHA's TOTAL Mortgage Scorecard User Guide, page 9

⁸ TOTAL Mortgage Scorecard User Guide, page 18

⁹ This amount includes what the borrower maintained in her checking and savings accounts after reducing the accounts by the amount of funds needed to close.

single family loans, the TOTAL Mortgage Scorecard¹⁰ manual stated that it used the borrower's reserves as an element for evaluating the borrower. PrimeLending used inaccurate information in obtaining TOTAL Mortgage Scorecard approval.

A Coborrower Showed the Purchased Property as an Asset on the Application

The coborrowers' assets on the loan application included the property purchased. By including the purchased asset, the coborrowers' asset-to-liability amounts increased. PrimeLending stated that it was a data entry error. With the inclusion of the purchased property in the total assets, the coborrowers' net assets totaled \$141,985, and without the inclusion of the purchased property in the net worth, the coborrowers' net worth totaled \$2,985. Since TOTAL Mortgage Scorecard uses a combination of items to underwrite loans, this inaccurate information invalidated the approval.

Other Loan Deficiencies Noted

For loan number 492-8492165, PrimeLending marked both the initial and final loan applications incorrectly. The loan applications showed that the coborrowers would be owner occupants, but they never intended to reside at the property as it was purchased for the mother of a coborrower. The coborrowers had already received an FHA loan on the property they occupied. PrimeLending stated that it knew about the coborrowers' intent and incorrectly marked the loan applications.

For this same loan, FHA's loan file contained only one 2-week payroll documentation, a duplicate of that 2-week payroll documentation, and a verification of current employment. The desktop finding report required documentation of 1 full month's earnings followed by current employment verification. PrimeLending stated that a data entry error caused it to obtain only the 2-week payroll instead of the full month's payroll documentation as required.

Other Quality Control Deficiencies Were Noted

PrimeLending Did Not Obtain a Required Credit Report

For the loans reviewed, PrimeLending did not obtain a required credit report during the early default review for one loan. PrimeLending's January 2010 quality control plan required obtaining a credit report for loans that default within the first 6 months. PrimeLending stated that it obtained a report but did not

¹⁰ FHA's TOTAL Mortgage Scorecard evaluates the overall creditworthiness of the applicants based on a number of credit variables and indicates a recommended level of underwriting and documentation to determine a loan's eligibility for insurance by FHA.

upload the report to the file. Because of the age of the report, the credit reporting company could not recreate it. There was no documentation showing that PrimeLending obtained the credit report as required.

PrimeLending Did Not Ensure the Accuracy of Neighborhood Watch Data

Information in HUD's Neighborhood Watch system showed that the audit sample included some manually underwritten loans. Although HUD's data system showed the loans as manually underwritten, PrimeLending provided documentation showing that 16 of 86 (21 percent) of the manually underwritten loans shown in Neighborhood Watch were originated by TOTAL Mortgage Scorecard. PrimeLending stated that its servicer entered the information incorrectly.

Conclusion

PrimeLending did not follow HUD-FHA requirements for 12 of 20 loans reviewed. Three loans contained multiple underwriting deficiencies. This noncompliance occurred because PrimeLending misunderstood FHA guidance, it failed to exercise due diligence in underwriting the loans, and its internal control system did not detect or prevent the origination of those loans. As a result, PrimeLending improperly originated 2 loans that resulted in losses to FHA's insurance fund of \$103,013 and 10 loans that increased the risk to the insurance fund by more than \$1 million. Further, PrimeLending caused HUD-FHA to pay \$110,343 in claims on eight ineligible loans.

Recommendations

We recommend that the Deputy Assistant Secretary of Single Family Housing require PrimeLending to

- 1A. Reimburse the FHA insurance fund \$103,013 for losses incurred on loan numbers 492-8717246 and 511-0153486.
- 1B. Indemnify HUD for 10 insured loans with unpaid principal balances of \$1,433,497, thereby putting an estimated \$845,763 to better use based on the FHA insurance fund average loss rate of 59 percent of the unpaid principal balances (see appendix C).
- 1C. Repay the FHA insurance fund \$110,343 for claims paid as of November 30, 2011, or the current total amount of claims paid on eight loans (see appendix C).
- 1D. Establish a policy to ensure data is entered accurately and correct the data errors cited in this report.

SCOPE AND METHODOLOGY

We performed our fieldwork between June 28 and November 29, 2011, at PrimeLending's Dallas and Bedford, TX, offices and our offices in Fort Worth and Houston, TX.

To accomplish our objective, we

- Reviewed applicable HUD-FHA regulations, requirements, and mortgagee letters;
- Reviewed reports and information on HUD's Neighborhood Watch and Single Family Data Warehouse systems;¹¹
- Reviewed PrimeLending's files, quality control plans, early default reports, independent audit reports, correspondence with HUD, and a consent order, dated January 11, 2011;
- Conducted interviews with applicable PrimeLending staff; and
- Conducted onsite visits to 20 properties and conducted 10 interviews with borrowers.

Using HUD's Neighborhood Watch system, we determined which FHA lender originated defaulted loans in the Houston, Dallas, and Fort Worth, TX offices. We obtained a download of defaulted loans originated and endorsed by PrimeLending in these offices from May 1, 2009, to April 30, 2011. We determined that PrimeLending originated a total of 8,559 loans in the Houston, Dallas and Fort Worth offices during the audit scope of which 134 defaulted. The original loan value of the 134 defaulted loans totaled \$19,706,488. We selected a random nonstatistical sample of 20 loans that defaulted within the first 6 months, were manually underwritten, a refinance, or HUD maintained a paper copy of the loan file. The original loan values totaled more than \$2.5 million. We reviewed the loan documents for each of the 20 selected loans. We used a nonstatistical random sample because we wanted to determine what types of errors might exist and did not intend to project the test results to the population of the loans. We did not evaluate the reliability of HUD's Neighborhood Watch or Single Family Data Warehouse systems because we use the data for background purposes only.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

¹¹ Single Family Data Warehouse is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of single-family data. It consists of database tables structured to provide HUD user's easy and efficient access to single family housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics.

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:

- Policies and procedures intended to ensure that FHA insured loans are properly originated, underwritten, and closed.
- Safeguarding FHA insured mortgages from high-risk exposure.
- Policies and procedures intended to ensure that the quality control program is an effective tool in reducing underwriting errors and noncompliance.

We assessed the relevant controls identified above.

A deficiency in internal controls 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 Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- PrimeLending did not have effective controls in place to ensure that its underwriters complied with HUD loan origination and underwriting requirements (finding).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A	\$103,013	
1B		<u>\$845,763</u>
1C	<u>110,343</u>	
Totals	<u>\$213,356</u>	<u>\$845,763</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ 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 1B will reduce FHA's risk of loss to the insurance fund for the 10 loans by \$845,763 based on FHA's fiscal year 2010 average loss experience of 59 percent of the unpaid principal balance.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1



February 3, 2012

US Dept of Housing and Urban Development
Office of Inspector General, Region VI
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102

Re: OIG Audit – PrimeLending 7366300002
Audit Report Number 2012-FW-100X

Attn: Gerald R. Kirkland, Regional Inspector General for Audit

PrimeLending, a PlainsCapital Company (PL) is in receipt of your draft Audit Report. The audit period expanded from June 28 to November 29, 2011.

PrimeLending was selected for audit because of its high default rate in the Houston, Dallas, and Fort Worth, Texas offices as compared to the average default rate for all FHA loans in those offices. Loans reviewed were endorsed between April 1, 2009 and May 31, 2011.

PL endeavors to provide dependable and professional service and has repeatedly demonstrated its commitment to borrowers and allegiance to the FHA program. PL would never knowingly violate FHA guidelines or endanger the portion of its business and, as a result, PL has at all times placed a premium on FHA compliance. It has consistently been careful to ensure compliance with insurer, guarantor, and investor requirements and has always taken its Quality Control responsibilities seriously. In addition, PL has been dedicated to customer service. We consistently aimed to make the lending process as simple as possible for borrowers and worked closely with each individual applicant to ensure that he or she received the type of financing that best fit his or her needs.

PL is committed to operating in a safe and sound manner and in compliance with all FHA policies and procedures. We believe in originating high quality FHA mortgages and underwriting them in accordance with all FHA requirements. In this regard, PL takes great pride in the fact that HUD's Neighborhood Watch (NW) system shows that PL's national Compare Ratio is just 93%. As of December 31, 2011, PL's national default/claim rate for all its FHA mortgages is 1.72% compared to FHA's national default/claim rate for all mortgages of 1.85%. In fact, even in Texas, our statewide default/claim rate is 1.28%, while FHA's statewide default/claim rate is 1.36%. Accordingly, while we accept responsibility when we make mistakes, our NW performance demonstrates that nationally and in the state of Texas, PL's default/claim rates are lower than FHA's and that PL is closely adhering to FHA policies and procedures.

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Dallas, TX 75252

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Comment 2

Finding

PrimeLending Did Not
Manually Underwrite Loans
When Credit Reports
Contained Disputed Items

For 8 of the 20 loans reviewed (40 percent), PrimeLending did not manually underwrite loans when the borrower's credit report contained disputed items. FHA requirements state that any credit report containing disputed items must be manually underwritten.² HUD-FHA reaffirmed to PrimeLending in a letter, dated June 10, 2010,³ that credit reports containing disputed items required manual underwriting instead of automated underwriting. Prior to the letter dated June 10, 2010, PrimeLending did not require loans with disputed items to be manually underwritten only that the loans be reviewed by an underwriter before closing. Two loans in our review contained disputed items after HUD-FHA notified PrimeLending. These loans closed from 8 to 9 days after PrimeLending received the HUD-FHA notification. Because manual underwriting guidelines are generally more stringent than automated underwriting, it was unknown whether the loans should have qualified for FHA insurance.

Comment 3

Response to the Finding

493-9219962

Loan approved July 20, 2009
FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were opened between 2004 and 2007 And the disputed student loans were consolidated and current. The file contained a "clear" CAVIRS.

492-8634079

Loan approved December 9, 2009
FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were minor in nature and would not have impacted the Total Scorecard decision.

493-9681464

Loan approved June 25, 2010
FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were minor in nature and reflected a zero balance.

492-8705878

Loan approved January 7, 2010
FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were from 2004 and 2005 and minor in nature.

493-9082225

Loan approved April 21, 2009
FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Comment 2

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were from 2007 with late pays of over 12 months.

511-0178080

Loan approved May 25, 2010

FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed account on this particular loan was from 2007.

511-0074780

Loan approved December 21, 2009

FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were greater than 24 months.

491-9600782

Loan approved July 10, 2009

FHA Mortgagee Letter 2004-47, Total Mortgage Scorecard User Guide Update, Chapter 2, page 20, states:

Disputed Accounts

If the credit report reveals that the borrower is disputing any credit accounts or public records, the mortgage application must be referred to a DE underwriter for review.

The Guide does not state the loan must be downgraded to a manual underwrite. PrimeLending's FHA loans are all underwritten by DE underwriters, therefore PL complied with the requirement.

The disputed accounts on this particular loan were 2003, 2005 & 2007.

Summary

PL respects the importance of analyzing a borrower's credit performance and examining their attitude towards credit obligations. It is PL's policy and practice, with respect to every FHA applicant, to scrutinize the applicant's credit record and reasonably determine the potential borrower's creditworthiness. Given the potential risks not only to the Department, but to PL, of making a poor credit decision, PL's management endeavors to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis. PL's employees take their underwriting responsibilities seriously and understand that they will face severe consequences for unsatisfactory analysis of borrower credit. PL employees never would knowingly jeopardize PL's stability or its relationship with the Department.

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

Comment 4

Finding

PrimeLending Did Not Properly Review Appraisals

PrimeLending did not properly review four appraisals.⁶ Specifically, it did not review the appropriateness of the appraisers' deductions for the difference in the number of rooms, site size, or condition of properties for three loans; did not question appraised values for two loans; did not question when an appraiser exceeded the allowed 25 percent adjustment;⁷ and did not obtain an explanation when an appraiser used comparables that were more than 6 months old.

For two loans, the appraiser did not make deductions for the difference in the number of rooms or for the site size and did not consistently deduct for the average condition of the sales property and the comparable properties.

For one loan, the appraiser valued the subject property at \$76 per square foot. The appraiser valued the comparables at \$57, \$66, and \$60, respectively (see pictures 1 through 4). If PrimeLending had reviewed the appraisal, it might have questioned the valuation per square foot of the properties based upon the pictures. The appraisal explained some of the \$26,598 increase in price from the property's previous sale of \$35,162 in March 2007 as a kitchen upgrade. According to the January 2010 appraisal, the value of the property in picture 1 increased 76 percent from March 2007 to January 2010. PrimeLending originated the loan with FHA insurance for \$61,760 in January 2010. After foreclosure, this property sold for \$42,945 in April 2011, with a loss to HUD of \$33,686.

For another loan, one comparable exceeded the allowed 25 percent adjustment of gross sales price. This problem occurred because the appraiser based a \$6,745 adjustment on seller concessions.⁸ However, the allowed 6 percent sales concessions for that comparable property calculated to \$4,305. Thus, the appraiser's adjustments exceeded the FHA statutory 6 percent allowed sales concession. HUD regulations require a dollar-for-dollar reduction in the sales price for sales concessions in excess of 6 percent.⁹ PrimeLending was responsible for reviewing the appraisals and ensuring that it supported the appraised amounts.

For a final loan, an appraiser included two comparables that were more than 6 months old without explanation. HUD-FHA regulations¹⁰ require an explanation for all sales data in excess of 6 months old. PrimeLending did not obtain an explanation for either comparable.

Response to the Findings

491-9600782

All the comparables contain the same square footage for "site size" which differs from the subject by 412 square foot. There is less than a 1% difference from the comparables, which appears to be negligible and would not affect the value. PL does not understand the reference to the inconsistency for the number of rooms. When

comparing the room count on the drawing to the room count listed on page 2 of the appraisal, they match. Please advise.

511-0074780

PL does not understand the reference to the inconsistency for the number of rooms because when we compared the room count on the drawing to the room count listed on page 2 of the appraisal, they match. Please advise.

Comparable number one did not have a positive adjustment for age of property and size of site. While this is noted as a deficiency, PL does not feel that an adjustment was warranted. If adjusted, it would have made the value even higher. Comparables two and three are exactly the same, while there could have been a negative adjustment for site size, the age of the comps would have washed the negative adjustment out.

The appraiser provided the information regarding the two listings to support the overall market value of the area, which demonstrates the lack of declining values.

PL feels the value was well supported by the information contained in the appraisal.

492-8717246

While the square footage for the comparables contained variations of the price per square foot, it should be noted that all comparables were on the market a relatively long period of time. PL does not normally rely on the photos of the property to determine if the square footage calculation is valid.

In addition to the kitchen upgrades mentioned in the finding, a new HVAC was installed as well as insulated windows, insulation added to the attic, vinyl siding, tile in the bath, upgraded plumbing and electrical, new interior/exterior doors and refinished hardwood floors. These upgrades/additions contributed to the increase in sales price over a period of 36 months.

In regards to the finding concerning the six percent (6%) seller contribution on comparable number three exceeded the maximum seller contribution allowance, it would not impose a dollar for dollar reduction on another lender's transaction. This would only apply to a new transaction completed by PL.

PL does not generally adjust for both square footage and room count, it's usually one or the other. The missed adjustment for condition would have only increased the final value, which would not have caused a negative impact. In addition, the site size adjustment across the board would only have increased the overall value and value was never in question.

Observation: Estimated value of property currently reflects a \$58,500 value, which is much higher than the bid HUD accepted.

511-0153486

The price per square foot of the two unit in the same project differ from \$5 to \$9 per square foot. The \$9.00 per square foot difference is for an inferior unit as addressed in the report, one would pay less for an unit that is inferior to the subject. The unit with the \$7.00 per square foot difference was based on a similar unit, but sold very quickly. One would surmise that the seller was very motivated in this transaction. FHA has always allowed the "100 rule", if the comparables were within 100 square

Comment 5

foot of each other, the difference was negligible, therefore would not require an adjustment.

All comparables support the value as determined by the appraisal and all comparables, with the exception of comparable number three, are like the subject property. The only adjustment for size was the adjustment for one less bedroom.

While FHA discourages the use of an active listing and/or a pending sale, PL feels this information is valuable. Although, it is not used in determining market value, it gives the lender some idea of what is going on in the neighborhood.

492-8492165

The appraiser did address the use of comparables that had sold more than six months earlier on the Supplemental Addendum "Comments on Sales Comparison Approach"

Due to lack of more similar home sales which have occurred within the past 6 months, it may have been necessary to utilize home sales beyond this time frame for comparison. Each of the comparable sales, however, has occurred within the FNMA accepted 12 month time frame.

Finding

Four Loans Had Debt and Asset Deficiencies

PrimeLending Did Not Include Credit Card Debt in Debt-to-Income Ratios

PrimeLending did not include some credit card debt for two loans. It was responsible for including and reviewing all debt.¹¹ For one loan, PrimeLending did not include \$1,292 in credit card debt. The borrower's debt-to-income ratio totaled 56 percent without the credit card debt and 58 percent including the credit card debt. The desktop underwriting findings report noted the omission and required PrimeLending to support excluding the debt. The file contained no such documentation.

For another loan, the borrower's credit report contained credit card debt of \$2,059. The desktop underwriting findings report required PrimeLending to

support the payoff of the debt. The file did not contain payoff evidence before closing. PrimeLending should not have closed this loan without the payoff evidence.

Response to Finding

493-9075326

The \$1,292 AMEX credit card debt was omitted from ratios because the borrower was an "authorized user" only. FHA has never required this to be counted in the calculation of the ratios; therefore, would not have required this to be paid in full because it was not the obligation of the borrower.

Comment 6

493-9572318

The omitted debt was an AMEX monthly account which is required to be paid off monthly with no option of a minimum monthly payment. While PL did not require the evidence the debt was paid in full, the borrower's asset account reflected sufficient funds to pay the debt and the assets were reduced by the balance due. The inclusion of this monthly debt (5% of balance) would not have adversely affected the Total Scorecard recommendation.

491-9600782

FHA allows us to show the down payment assistance as a secondary lien so that the combined loan to value (CLTV) reflects the true loan to value. The amount shown as a "gift" was not credited towards the borrower's minimum investment.

PL inadvertently included the DPA funds in reserves and it is a correct statement that the borrower is not required to hold a reserve account at closing. The inclusion of the DPA funds would not have affected the Total Scorecard recommendation as Total provides favorable results up to 56% with zero reserves.

492-8492165

The co-borrower's final URLA reflected the subject property as an asset and included in their net worth. The omission of this information would not have adversely affected Total Scorecard recommendation.

Finding

Other Loan Deficiencies Noted

For loan number 492-8492165, PrimeLending marked both the initial and final loan applications incorrectly. The loan applications showed that the coborrowers would be owner occupants, but they never intended to reside at the property as it was purchased for the mother of a coborrower. The coborrowers had already received an FHA loan on the property they occupied. PrimeLending stated that it knew about the coborrowers' intent and incorrectly marked the loan applications.

For this same loan, FHA's loan file contained only one 2-week payroll documentation, a duplicate of that 2-week payroll documentation, and a

verification of current employment. The desktop finding report required documentation of 1 full month's earnings followed by current employment verification. PrimeLending stated that a data entry error caused it to obtain only the 2-week payroll instead of the full month's payroll documentation as required.

For another loan, the desktop underwriter findings report listed one loan's property as ineligible. Specifically the findings stated that the loan amount of \$154,900 exceeded the FHA maximum loan calculation of \$149,575 based on the property's appraised value. The loan file contained no documentation showing that PrimeLending considered the desktop underwriter's finding of ineligibility.

Comment 7

Response to Findings

492-8492165

While the initial and final URLA's mistakenly reflected the Non-Occupant Co-Borrower's occupancy as "owner occupied", this information had no bearing on the overall decision of the loan. The calculations were computed via FHA guidelines which requires adding the additional housing expense in the ratios.

Total Scorecard states to obtain the most recent YTD paystub documenting one full month of earnings. The Co-Borrower's paystub provided in the file contained YTD income through May 15th, which more than includes a full month income.

511-0178080

This loan transaction utilized the \$100 down option offered by FHA, thus, would render an "Approve/Ineligible" recommendation by Total Scorecard due to the fact the borrower was not required to make the minimum down payment. This finding is not valid and should be removed from this report.

Finding

Other Quality Control
Deficiencies Were Noted

PrimeLending Did Not Obtain a Required Credit Report

For the loans reviewed, PrimeLending did not obtain a required credit report during the early default review for one loan. PrimeLending's January 2010 quality control plan required obtaining a credit report for loans that default within the first 6 months. PrimeLending stated that it obtained a report but did not upload the report to the file. Because of the age of the report, the credit reporting company could not recreate it. There was no documentation showing that PrimeLending obtained the credit report as required.

PrimeLending Did Not Ensure the Accuracy of Neighborhood Watch Data
Information in HUD's Neighborhood Watch system showed that the audit sample included some manually underwritten loans. Although HUD's data system showed the loans as manually underwritten, PrimeLending provided documentation showing that 16 of 86 (21 percent) of the manually underwritten loans shown in Neighborhood Watch were originated by TOTAL Mortgage Scorecard. PrimeLending stated that its servicer entered the information incorrectly.

Response to the Findings

492-8492165

Quality Assurance's written EPD summary refers to a debt that was to be paid in full, but the QA review credit report reflected the debt as unpaid. Without the review credit report, the auditor could not have made such a statement. QA inadvertently

Comment 8

Comment 9

failed to upload a copy of the QA review credit report and when discovered, could not retrieve a copy due to the length of time since ordering.

PrimeLending Did Not Ensure the Accuracy of Neighborhood Watch Data
 PL realizes the importance of data integrity and we regularly remind our employees of the importance of ensuring the data entered in all systems, especially the FHA Connection is accurate. After a thorough review of the list of loans noted in this exception, there were only seven loans needing correction in FHA Connection.

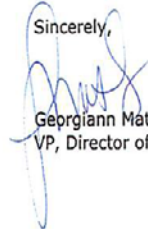
493-9232214	Correct finding--Need to correct NW to reflect ZFHA
492-8643709	Correct finding--Need to correct NW to reflect ZFHA
491-9564271	Correct finding--Need to correct NW to reflect ZFHA
011-6568116	Correct finding--Need to correct NW to reflect ZFHA
264-0190228	Correct finding--Need to correct NW to reflect ZFHA
561-9444765	Correct finding--Need to correct NW to reflect ZFHA
264-0190190	Correct finding--Need to correct NW to reflect ZFHA

PrimeLending is unable to make these corrections due to the fact the loans have been endorsed. We will forward a request to FHA asking that they change the loans to reflect "ZFHA".

During our review, we found that the FHA-LT's were incorrectly check marked as being scored by TOTAL. The FHA-LT's have since been corrected and we will use this as a training tool going forward.

PrimeLending appreciates the opportunity to address your concerns and await for direction on how to proceed. If you have any questions, please feel free to contact me at gmathews@primelending.com or 972-713-3289.

Sincerely,



Georgiann Mathews
VP, Director of Quality Assurance

OIG Evaluation of Auditee Comments

- Comment 1** We appreciate the efforts taken by PrimeLending to comply with FHA requirements.
- Comment 2** We removed one of the loans based upon information provided by PrimeLending making it seven loans or 35 percent of our sample and revised the finding accordingly.
- Comment 3** We disagree with PrimeLending that it complied with the requirement to manually underwrite loans that contained disputed items. PrimeLending contended that HUD only required an underwriter to review a loan that contained disputed items. It further contended that all its loans were reviewed by an underwriter. However, it did not define what exactly the underwriter reviewed or how this differed from manually underwriting the loans. As stated in the finding, HUD affirmed to PrimeLending that loans with disputed items should be manually underwritten. HUD's manual underwriting requirements are more stringent than TOTAL scorecard requirements. For example, PrimeLending would have had to comply with HUD's regulations on compensating factor in manually underwriting these loans. Specifically, in four instances, the borrowers had back end ratios that exceed 43 percent with two exceeding 50 percent. In six of the seven instances, the front end ratio exceeded 31 percent with one exceeding 40 percent. PrimeLending should have obtained additional information before making the decision on whether to approve these loans for FHA insurance. In these seven instances, we are not asserting that PrimeLending as underwriter made a "poor" decision in approving these loans, but rather that PrimeLending did not do what it was required to do before making its decision. Therefore, PrimeLending did not support its underwriting decision.
- Comment 4** We considered PrimeLending's comments and made adjustments to findings and case narratives as appropriate. PrimeLending stated that it does not normally rely on photographs of the property to determine value. However, the photographs in the report visually represent the differences in the subject property and the comparables. With respect to the adjustments for square footage and room count, the appraisals were not consistent and seemed to favor a higher value for the subject property.
- Comment 5** TOTAL scorecard approval on loans did not release PrimeLending from any and all documentation requirements. Contrary to PrimeLending statements, the TOTAL scorecard manual states, "the lender remains accountable for compliance with FHA eligibility requirements as well as for any credit, capacity and documentation requirements." The desktop findings report required that PrimeLending obtain evidence or documentation prior to closing, and PrimeLending did not obtain the evidence or documentation.

Further, TOTAL Mortgage Scorecard User Guide clearly states that no form of secondary financing, with or without payments, is to be shown as a gift. PrimeLending entered the secondary lien as a gift in TOTAL scorecard and included it as an asset of the borrower as shown on the desktop findings report. PrimeLending stated it would not have affected the TOTAL scorecard approval. Because PrimeLending obtained incorrect information, it does not know if the TOTAL scorecard approval would have been affected or not.

- Comment 6** We accept PrimeLending’s statement that it was a mistake. PrimeLending stated that it would not have affected the TOTAL scorecard approval. However, PrimeLending must support its decision to underwrite a loan with FHA insurance. This was one of multiple loan deficiencies with this loan.
- Comment 7** Based on documentation provided by PrimeLending, this loan was removed from the finding.
- Comment 8** It is PrimeLending’s responsibility to ensure that it documents efforts conducted in the review of early defaulted loans.
- Comment 9** We agree with PrimeLending’s actions to resolve this issue.

Appendix C

SUMMARY DATA FOR LOANS REVIEWED¹²

Case number	Mortgage amount	Unpaid principal amount	HUD loss on loan ¹³	Computed benefit of indemnification ¹⁴	Claims paid ¹⁵	Claim type
511-0153486	\$120,280		\$69,327			Conveyance
492-8717246	\$61,760		\$ 33,686			Conveyance
493-9082225	\$233,211	\$224,592		\$132,510	\$ 15,420	Partial
492-8705878	\$123,692	\$120,863		\$ 71,309	\$ 12,036	Partial
491-9600782						Special forbearance
493-9572318	\$158,083	\$154,268		\$ 91,018	\$ 200	Special forbearance
492-8492165	\$136,972	\$134,014		\$ 79,068	\$ 200	Special forbearance
511-0178080	\$163,975	\$159,031		\$ 93,828		
492-8634079	\$158,385	\$155,638		\$ 91,827	\$ 750	Loan modification
511-0074780	\$132,023	\$128,393		\$ 75,752	\$ 750	Loan modification and preforeclosure sale, loss mitigation
493-9219962	\$131,410	\$127,797		\$ 75,400	\$80,987	
493-9075326	\$124,503	\$120,749		\$ 71,242		
	<u>\$111,836</u>	<u>\$108,151</u>		<u>\$ 63,809</u>		
Totals	<u>\$1,656,130</u>	<u>\$1,433,497</u>	<u>\$103,013</u>	<u>\$845,763</u>	<u>\$ 110,343</u>	

¹² Loan information is based on the loan status as of November 30, 2011.

¹³ The HUD loss on loan amount was obtained from HUD's Single Family Acquire Asset Management System. This system tracks properties from acquisition to final sale after foreclosure and maintains all accounting data associated with the loan.

¹⁴ FHA's average loss experience is about 59 percent of the \$1,433,497 in unpaid principal balance for loans that complete the foreclosure process (see footnote 1).

¹⁵ These amounts are ineligible costs that should be repaid to HUD. The loans should not have been approved for FHA insurance and, therefore, were not entitled to claim payments. If HUD took title to or sold the properties rather than seeking repayment of claims paid, the amount to be repaid should be adjusted to the amount of actual loss to FHA.

Appendix D

CASE NARRATIVES

Case Narrative – Loan Number 511-0153486

Mortgage amount: \$120,280

Date of loan closing: April 23, 2010

Status as of November 30, 2011: Conveyed to insurer

Payments before first default: Two

Total claim paid: \$125,035—conveyance

HUD loss: \$69,327

Underwriting deficiencies:

- Appraisal not reviewed properly

Summary:

Appraisal Not Reviewed Properly

PrimeLending did not properly review the appraisal. The appraisal contained inconsistencies for the number of rooms and square footage of the condominium even though two of the comparable properties were the same complex. The price per square foot for similar condominiums in the same complex used as comparables valued the condominiums at \$5 to \$9 per square foot less than the subject property. Further, the adjustment for the difference in square footage appeared to be low considering that all of the properties had sale prices of more than \$100 per square foot. The appraiser did not make an adjustment for another room and 72 square feet of space and only made a \$3,800 adjustment for 191 more square feet (approximately \$20 per square foot) for another comparable.

Also, the comparables included one property that was a pending sale and one that had an active listing sale, which HUD discourages.¹⁶ HUD regulations required PrimeLending to properly review the appraisal.¹⁷

¹⁶ HUD Handbook 4051.2, chapter 4-6, paragraph (A)(4)

¹⁷ HUD Handbook 4155.2, chapter 4-1, paragraph (e)

Case Narrative – Loan Number 492-8717246

Mortgage amount: \$61,760

Date of loan closing: February 17, 2010

Status as of November 30, 2011: Conveyed to insurer

Payments before first default: Zero

Total claim paid: \$67,722—conveyance

HUD loss: \$33,686

Underwriting deficiencies:

- Appraisal not properly reviewed

Summary:

Appraisal Not Properly Reviewed

PrimeLending did not properly review the appraisal. The appraiser did not make deductions for the difference in the number of rooms or for the site size and did not consistently deduct for average condition. In this instance, the appraiser valued the subject property at \$76 per square foot. The appraiser valued the comparables at \$57, \$66 and \$60, respectively. See pictures 1 through 4 in the body of the report. If PrimeLending had properly reviewed the appraisal, it should have questioned the square foot value of the properties based upon the pictures. The sales price of the property increased 76 percent from its previous sale's price of \$35,162 in March 2007. The appraisal stated that some of the \$26,598 price increase was due to a kitchen upgrade. The subject property originated with FHA insurance of \$61,760 in February 2010. After foreclosure, HUD sold the property for \$42,943 in April 2011 for a total loss to the insurance fund of \$33,686.

Case Narrative – Loan Number 493-9082225

Mortgage amount: \$233,211

Date of loan closing: April 30, 2009

Status as of November 30, 2011: Delinquent

Payments before first default: Three

Total claim paid: \$15,420—partial claim

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's credit report, dated April 1, 2009, contained four disputed items. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.¹⁸ For instance, if PrimeLending had manually underwritten this loan, it would have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, the front end ratio totaled 39 percent and the back end ratio totaled 56 percent exceeding HUD's manual underwriting ratio standard of 31 and 43 percent, respectively. PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual.

¹⁸ TOTAL Mortgage Scorecard User Guide, page 21

Case Narrative – Loan Number 492-8705878

Mortgage amount: \$123,692

Date of loan closing: February 3, 2010

Status as of November 30, 2011: Delinquent

Payments before first default: Two

Total claim paid: \$12,036—partial claim

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's revised credit report, dated January 2, 2010, contained two disputed items. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.¹⁹ For instance, if PrimeLending had manually underwritten this loan, it would have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, the front end ratio totaled 36 percent exceeding HUD's manual underwriting ratio standard of 31 percent. PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual.

¹⁹ Ibid

Case Narrative – Loan Number 491-9600782

Mortgage amount: \$158,083

Date of loan closing: August 12, 2009

Status as of November 30, 2011: Chapter 13 bankruptcy

Payments before first default: Three

Total claim paid: \$200—special forbearance

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items
- Appraisal not reviewed properly
- Secondary lien shown as a gift
- Secondary lien shown in borrower's reserves

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's revised credit report, dated July 13, 2009, contained five disputed items. Of the five disputed items, one was a closed credit item, and one was a foreclosure. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.²⁰ For instance, if PrimeLending had manually underwritten this loan, it would have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, the front end ratio totaled 35 percent and the back end ratio income totaled 48 percent exceeding HUD's manual underwriting ratio standard of 31 and 43 percent, respectively. PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual.

Appraisal Not Reviewed Properly

PrimeLending did not properly review the appraisal. The appraisal contained inconsistencies for the number of rooms and did not deduct for differences in the site sizes.

Secondary Lien Shown as a Gift

PrimeLending showed the secondary lien from the Texas Department of Housing and Community Development as a gift on the desktop underwriter report. This lien incorrectly increased the assets of the borrower. FHA regulations prohibit secondary financing from being used as gift funds toward the borrower's minimum required investment.²¹

Secondary Lien Shown in Borrower's Reserve

PrimeLending showed the secondary lien in the reserves of the borrower on the desktop underwriting report. Without the inclusion of the secondary lien, the borrower maintained only

²⁰ Ibid

²¹ TOTAL Mortgage Scorecard User Guide, page 18

\$840 in reserves. Although FHA does not require a reserve amount for single-family loans, this loan was underwritten with TOTAL Mortgage Scorecard, which included reserves as an element in its evaluation. The borrower's debt-to-income ratio including the house payment was 48 percent without the secondary lien's inclusion.

Case Narrative – Loan Number 493-9572318

Mortgage amount: \$136,972

Date of loan closing: April 13, 2010

Status as of November 30, 2011: Special forbearance

Payments before first default: Two

Total claim paid: \$200—special forbearance

HUD loss: N/A

Underwriting deficiencies:

- Credit card debt payoff not in file

Summary:

Credit Card Debt Payoff Not in File

The borrower's credit report, dated March 12, 2010, contained credit card debt of \$2,039 that was not paid off before closing. FHA required PrimeLending to include in total debt all debts listed on credit report.²² Also, the desktop underwriting findings report stated that evidence of the debt payoff must be included in the file. PrimeLending was responsible²³ for obtaining all documentary requirements to originate this loan. The file contained no evidence that the borrower paid off the debt.

²² TOTAL Mortgage Scorecard User Guide, Liabilities, section VI, page 9.

²³ Ibid., page 1

Case Narrative – Loan Number 492-8492165

Mortgage amount: \$163,975

Date of loan closing: July 31, 2009

Status as of November 30, 2011: Legal action to commence foreclosure

Payments before first default: Two

Total claim paid: \$0

HUD loss: N/A

Underwriting deficiencies:

- Loan application was completed incorrectly
- Coborrowers' assets included property purchased
- Coborrowers' payroll was not sufficiently documented
- Appraisal contained two comparables more than 6 months old

Other deficiencies

- PrimeLending did not obtain required credit report during early default review

Summary:

Loan Application Was Completed Incorrectly

PrimeLending marked both the initial and final loan applications incorrectly. The loan applications showed that the coborrowers would be owner occupants, but they never intended to reside at the property as it was purchased for the mother of one of the coborrowers. The coborrowers already had an FHA loan on the property they occupied. PrimeLending stated that it incorrectly marked the loan applications.

Coborrowers' Assets Included Property Purchased

The coborrowers' assets on the loan application included the property purchased. By including the purchased asset, the coborrowers' assets to liability increased. PrimeLending stated that the problem was caused by a data entry error. With the inclusion of the purchased property in the net worth, the coborrowers' net assets totaled \$141,985, and without the inclusion of the property purchased, the net worth was \$2,985.

Coborrowers' Payroll Was Not Sufficiently Documented

FHA's loan file contained only one 2-week payroll record as income documentation, a duplicate of that 2-week payroll documentation, and a verification of current employment. The desktop finding report required 1 full month's earnings and current employment verification. PrimeLending claimed that a data entry error caused it to not obtain the full month's payroll documentation.

PrimeLending Did Not Obtain Required Credit Report during Early Default Review

PrimeLending did not obtain a required credit report during its early default review for this loan. PrimeLending's January 2010 quality control plan required it to obtain a credit report for loans that defaulted within the first six payments. PrimeLending stated that it obtained a credit report but did not upload the report to the loan file. Because of the age of the report, the credit reporting company could not recreate it. There was no documentation showing that PrimeLending obtained the credit report as required.

Case Narrative – Loan Number 511-0178080

Mortgage amount: \$158,385

Date of loan closing: June 29, 2010

Status as of November 30, 2011: Reinstatement after loss mitigation intervention

Payments before first default: Three

Total claim paid: \$750—loan modification

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's revised credit report, dated April 5, 2010, contained a disputed item. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.²⁴ PrimeLending did not manually underwrite this loan.

²⁴ Ibid

Case Narrative – Loan Number 492-8634079

Mortgage amount: \$132,023

Date of loan closing: December 17, 2009

Status as of November 30, 2011: Reinstatement after loss mitigation intervention

Payments before first default: One

Total claim paid: \$750—loan modification

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's revised credit report, dated October 2009, contained three disputed items. The disputed items included a bankruptcy filed in July 2005. The loan file contained an explanation for one disputed item. The borrower stated that the late payments were a result of illness. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.²⁵ For instance, if PrimeLending had manually underwritten this loan, it would have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, the front end ratio totaled 33 percent and the back end ratio income totaled 56 percent exceeding HUD's manual underwriting ratio standard of 31 and 43 percent, respectively. PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual.

²⁵ Ibid

Case Narrative – Loan Number 511-0074780

Mortgage amount: \$131,410

Date of loan closing: December 30, 2009

Status as of November 30, 2011: Preforeclosure sale completed

Payments before first default: Three

Total claim paid: \$750—loan modification; \$80,237—preforeclosure sale, loss mitigation

HUD loss: N/A

Underwriting deficiencies:

- Credit report contained disputed items
- Appraisal was not reviewed properly

Summary:

Borrower's Credit Report Contained Disputed Items

The borrower's credit report, dated December 2010, contained four disputed items. FHA requirements state that any credit report containing disputed items must be manually underwritten.²⁶ PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual. If PrimeLending manually underwrote this loan it would at a minimum have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, both the front end and back end ratios totaled 47 percent exceeding HUD's manual underwriting ratio standard of 31 and 43 percent, respectively.

Appraisal Was Not Reviewed Properly

PrimeLending did not properly review the appraisal. The appraisal contained inconsistencies for the number of rooms and did not make adjustments for the site size and age of property. HUD-FHA requirements state that PrimeLending is responsible for properly reviewing the appraisal.²⁷

²⁶ Ibid

²⁷ HUD Handbook 4155.1, chapter 4-1, paragraph (e)

Case Narrative – Loan Number 493-9219962

Mortgage amount: \$124,503

Date of loan closing: July 24, 2009

Status as of November 30, 2011: Reinstated by borrower without loss mitigation claim

Payments before first default: Three

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's credit report, dated June 15, 2009, contained three disputed items. FHA required PrimeLending to manually underwrite loans when the credit report containing disputed items.²⁸ For instance, if PrimeLending had manually underwritten this loan, it would have had to document and explain compensating factors associated with exceeding HUD's underwriting ratios. For this loan, the front end ratio totaled 33 percent exceeding HUD's manual underwriting ratio standard of 31 percent. PrimeLending did not manually underwrite this loan as required by the TOTAL scorecard manual.

²⁸ Ibid

Case Narrative – Loan Number 493-9075326

Mortgage amount: \$111,836

Date of loan closing: April 29, 2009

Status as of November 30, 2011: Delinquent

Payments before first default: Four

Total claim paid: \$0

HUD loss: N/A

Underwriting deficiencies:

- Loan file lacked documentation supporting debt omission

Summary:

Loan File Lacked Documentation Supporting Debt Omission

The borrower's credit report, dated January 27, 2009, contained a credit card debt of \$1,292. The desktop underwriting findings report acknowledged the omission of the credit card account from the underwriting analysis during liability reconciliation, but it required documentation that supported the omission. PrimeLending's responsibility, according to HUD-FHA regulations,²⁹ required obtaining all documentary requirements to originate this loan. The file contained no supporting documentation to exclude the debt.

²⁹ TOTAL Mortgage Scorecard User Guide, page 1