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TO: Phillip Murray, Deputy Assistant Secretary for Housing, HU

Joan S. Hobbs

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

SUBJECT: DHI Mortgage Company, LTD's Scottsdale and Tucson, Arizona, Branches Did Not Always Follow FHA-Insured Loan Underwriting and Quality Control Requirements

HIGHLIGHTS

What We Audited and Why

We audited Federal Housing Administration (FHA)-insured loan processes at two DHI Mortgage Company, LTD (DHI Mortgage) branches in Tucson and Scottsdale, Arizona, to determine whether DHI Mortgage originated, approved, and closed FHA-insured single-family loans in accordance with U.S. Department of Housing and Urban Development (HUD) requirements. We chose DHI Mortgage because the Scottsdale, Arizona, branch had a default rate that was double the default rate for FHA-insured loans for the state of Arizona. After our audit survey, we expanded our review to include the Tucson, Arizona, branch because some loans had both branch numbers on the documentation.

What We Found

DHI Mortgage did not follow HUD requirements for originating, approving, or closing FHA-insured loans. Our review identified the following deficiencies: 205 loans with prohibited restrictive addendums to the purchase contracts and 24 loans with significant underwriting deficiencies. In addition, we noted that DHI Mortgage's quality control processes had weaknesses, including failure to determine that 19 loans were not eligible for FHA insurance because the loan officer had been debarred from participation in FHA-insured loan transactions.

What We Recommend

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require DHI Mortgage to (1) indemnify HUD for more than \$38 million for loans that did not meet FHA insurance requirements, (2) refund or buy down FHA-insured loans for over-insurance totaling \$15,749, and (3) fully implement a quality control plan in compliance with FHA requirements.

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

Auditee's Response

We provided our discussion draft to DHI Mortgage on July 31, 2009, and held an exit conference on August 7, 2009. DHI Mortgage generally disagreed with the audit findings but acknowledged that the audit report uncovered some weaknesses in DHI Mortgage's operations.

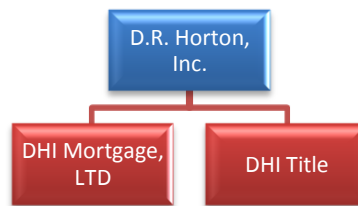
The auditee's response, along with our evaluation of that response, can be found in appendix B of this report. The auditee's response included an Addendum 1 that responded to Finding 2's specific underwriting deficiencies detailed in Appendix D of the audit report. We agreed with some of the items in this addendum and made changes to our report as appropriate. Exhibits A through F of the response were excluded from the report because it was replete with personal identifying information that would cause us to redact most of this response. The complete auditee's response is available upon request, as appropriate, under the Freedom of Information Act.

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BACKGROUND AND OBJECTIVE

DHI Mortgage Company, LTD (DHI Mortgage) is a non-supervised lender¹ approved June 8, 1981, to originate Federal Housing Administration (FHA) loans. DHI Mortgage currently originates loans under the lender insurance program.² The company is a wholly owned subsidiary of D.R. Horton, Inc., a national residential home builder, and an affiliate of DHI Title Company (DHI Title), another wholly owned subsidiary of D.R. Horton, Inc. DHI Mortgage headquarters is at 12357 Riata Trace Parkway, Suite C-150, Austin, Texas, and the company has branches in 20 states. DHI Mortgage provides mortgage financing services principally to purchasers of D.R. Horton, Inc. homes.



DHI Mortgage's Scottsdale, Arizona, branch (FHA number 0542400332, now closed) was selected for review because it had a two-year default rate of 7.22 percent—double the Arizona default rate of 3.48 percent for the same period.³ We expanded our review to include FHA loans from DHI Mortgage's Tucson, Arizona, branch (FHA number 0542400180) because we observed this branch number on some loan applications that had closed under the Scottsdale branch. These two DHI Mortgage branches originated 481 FHA-insured loans⁴ totaling more than \$84 million during our audit period.⁵

FHA, created by Congress in 1934, is the largest mortgage insurer in the world. The cost of FHA mortgage insurance is paid by the homeowners, and the mortgage insurance fund is used to operate the program. The mortgage insurance fund pays claims to lenders in the event of a homeowner default. Between October 1, 2008, and February 28, 2009, FHA insured almost 669,000 single-family mortgages totaling more than \$119 billion, or 69 percent of the single family insured mortgage market.⁶

Our objective was to determine whether DHI Mortgage FHA branch numbers 0542400180 and 0542400332 originated, approved, and closed FHA-insured loans in accordance with U.S. Department of Housing and Urban Development (HUD)-FHA regulations and requirements.

¹ A non-supervised lender is a HUD/FHA approved lending institution that has as its principal activity the lending or investment of funds in real estate mortgages and is not a supervised mortgagee, a loan correspondent, a governmental institution, a government sponsored enterprise or a public or state housing agency, and has not applied for approval for the limited purpose of being an investing mortgagee.

² The U.S. Department of Housing and Urban Development's (HUD) lender insurance program allows lenders to self-insure FHA loans and submit only those case binders (paper or electronic) requested for review by HUD. HUD requests approximately 6 percent of insured loans for review.

³ This information was obtained from the Neighborhood Watch system, which is HUD's Web-based software that displays loan performance data using FHA-insured single-family loan information.

⁴ The 481 FHA-insured loans included 479 forward (purchase) mortgages and two refinanced loans.

⁵ The audit period included FHA-insured loans with beginning amortization dates between October 1, 2006, and September 30, 2008.

⁶ HUD monthly report to the FHA Commissioner: FHA Portfolio Analysis Data as of February 28, 2009.

RESULTS OF AUDIT

Finding 1: DHI Mortgage Did Not Prevent Restrictive Covenants That Violated HUD-FHA Requirements

DHI Mortgage did not ensure that unallowable restrictive covenants were not filed against FHA-insured properties. The restrictive covenants precluded the borrowers from rental or resale of their property for one year and provided for the seller to recoup \$40,000 in liquidated damages if the borrower violated the restrictive covenants. DHI Mortgage allowed the restrictive covenants, generally referred to as a schedule A to purchase contract, because officials believed it would discourage investors from purchasing their affiliate's (the seller's) properties. Because the FHA insurance program requires free assumability with no restrictions, the FHA insurance portfolio had secured more than \$36 million in unpaid mortgage balances for these 205 loans that did not meet this FHA insurance requirement.

Restrictive Covenants Were Applied to Almost Half of the Loans

A review of the title files and the applicable county recorder's records revealed liens on 205 FHA-insured properties of the 481 FHA-insured loans in our audit period.⁷ These liens, called schedule A to purchase contracts, restricted the new owner(s) from resale or rental of the property during the first year of ownership. The execution of these contracts with the purchase agreements violated the regulations governing HUD's FHA-insured mortgage program, which prohibited restrictive covenants and second liens. As illustrated in the excerpt below, the contracts stated that the "Owner hereby grants to Seller a lien against the Property (the 'Lien') to secure Owner's obligations hereunder. Seller may promptly initiate proceedings to foreclose the Lien if Owner defaults in its obligation to pay Seller liquidated damages in the amount of \$40,000 on the date that Owner or any of its successors or assigns conveys during the Restricted Period any rights, title, or interest in the Property without Seller's written consent."

Schedule A to purchase contract corresponding to FHA loan number 022-1894370

ARTICLE I DECLARATION

1.1 **Restriction on Resale or Rental of Property.** Owner, for itself, its successors, and its assigns, hereby declares and agrees that it shall not sell, convey, lease, rent or otherwise transfer its rights, title, or interest in the Property during the period beginning as of even date herewith and expiring one (1) year from close of escrow (the "Restriction Period"), without the prior written consent of Seller, which consent may be withheld in Seller's sole discretion.

1.2 **Liquidated Damages.** Owner acknowledges and agrees that if Owner breaches its obligation under Section 1.1 above, the damages sustained by Seller shall be difficult to calculate with any precision. Accordingly, if Owner or any of its successors or assigns sells, conveys, leases, rents or otherwise transfers during the Restriction Period any rights, title, or interest in the Property without Seller's written consent, Owner shall pay to Seller as liquidated damages the sum of \$40,000.00.

⁷ Our audit period was between October 1, 2006, and September 30, 2008.

**ARTICLE I
LIEN AND SUBORDINATION TO LENDER**

2.1 **Grant of Lien to Seller.** Owner hereby grants to Seller a lien against the Property (the "Lien") to secure Owner's obligations hereunder. Seller may promptly initiate proceedings to foreclose the Lien if Owner defaults in its obligation to pay Seller liquidated damages in the amount of \$40,000.00 on the date that Owner or any of its successors or assigns conveys during the Restriction Period any rights, title, or interest in the Property without Seller's written consent. Owner agrees that all of Seller's reasonable costs and expenses of foreclosure, including reasonable attorney's fees and interest at the rate of 15% per annum from the date of said default, shall become additional indebtedness owed by Owner to Seller that is secured by this Lien. Owner hereby waives any homestead exemption or other exemption now or hereafter existing or enacted under either Arizona or federal law. No transfer of any rights, title or interest in the Property shall relieve Owner from the personal obligation to pay liquidated damages, together with interest, costs, and reasonable attorneys' fees, pursuant to this Covenant; provided, however, that Owner's obligations under this Covenant shall not extend to any breach of this Covenant by Owner's successor(s) in title.

DHI Mortgage was apparently aware that this practice was not allowed for FHA-insured mortgages because there were instances in which the occupancy/investment disclosure addendum to the purchase contract contained the following exclusion from the restrictive covenant when the buyer purchased the property using FHA.

Addendum to purchase contract corresponding to FHA loan number 023-2388693

7. COVENANT RESTRICTING RESALE OR RENTAL OF PROPERTY. The following covenant shall apply to any Buyer other than a Buyer that purchases the Property using FHA or VA financing:

However, despite the exclusion clause number 7, to the schedule A to purchase, the contract was executed and recorded in 205 instances.

Appendix A-1 contains the FHA loan numbers for which we found a schedule A to purchase contract. The schedule A to purchase contracts made the loans ineligible for FHA insurance because the contract addenda included prohibited liens against the FHA-insured property as well as restrictive covenants that prevented the borrower from rental or resale of the FHA-insured property which violated 24 CFR (*Code of Federal Regulations*) 203.32 and 203.41 respectively. The regulations under 24 CFR 203.32 state that after the mortgage offered for insurance has been recorded, the mortgaged property will be free and clear of all liens other than such mortgage. The regulations under 24 CFR 203.41(b) state that an FHA-insured "mortgage shall not be eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance" (see the criteria appendix C).⁸

During an interview, one of the FHA loan borrowers, whose loan contained underwriting deficiencies discussed under finding 2, informed us that although her financial situation changed shortly after purchasing the property, the restrictive covenant with the lien deterred her from trying to rent or sell the property within the first year after purchase to avoid further financial difficulty. However, after the one-year restriction period expired, the borrower decided that the housing market decline had depressed prices to the point that made it unlikely she could sell or rent the home for an amount that would cover the mortgage. As a result, the home went into foreclosure.

⁸ The exception to free assumability is under 24 CFR 203.41(c) "Exception for eligible governmental or nonprofit programs."

DHI Mortgage Officials Used the Covenants to Discourage Investment Purchasers

DHI Mortgage officials stated that the schedule A to purchase contracts was a common practice designed to address a significant problem experienced by D.R. Horton, Inc. – Dietz-Crane (D.R. Horton) and other home builders when home prices were rapidly escalating. In many cases, a buyer who claimed to be purchasing a home for his or her residence was actually an investor seeking to purchase and then quickly sell the home at a profit. D.R. Horton did not consider this flipping practice to be consistent with the goal of building sustainable communities at a reasonable price. Officials stated that the “Schedule A was not designed to prohibit or provide for liquid damages in connection with the bona fide purchase and resale of a home by the owner-occupant. Schedule A simply provides that a home may not be resold within one year of the purchase from D.R. Horton without D.R. Horton’s consent.”

Conclusion

The schedule A to purchase contract put additional unnecessary risk on the FHA-insured loans by restricting the borrower’s ability to rent or sell a property during the first year of the loan and by giving sole discretion to the former seller to grant a waiver of the restrictions. Therefore, the 205 loans with a total unpaid mortgage balance of more than \$36 million did not meet the requirements for FHA insurance. The projected loss to HUD associated with these loans was more than \$15 million⁹ (see appendix A-1).

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require DHI Mortgage to

- 1A. Indemnify HUD against losses for the 205 FHA-insured loans with unallowable covenants and prohibited liens in the amount of \$ 36,157,343. The projected loss to HUD is \$15,256,783 (see appendix A-1).

⁹ This amount was calculated based on 42 percent of the unpaid mortgage balances or the actual loss to HUD when known (as of June 17, 2009). The 42 percent indemnification rate was the average loss on FHA-insured foreclosed properties based on an independent actuarial analysis of the economic net worth and soundness of FHA’s Mutual Mortgage Insurance Fund. This actuarial report presents the findings with respect to the required analysis for fiscal year 2008 using data as of March 31, 2008. The fiscal year 2008 report was issued by Integrated Financial Engineering, Inc., of Rockville, Maryland.

- 1B. Discontinue the use of unallowable covenants and prohibited liens with FHA-insured loans and refrain from executing these documents or filing them with the county recorder's office.
- 1C. Develop and implement verification procedures to ensure that the unallowable restrictive covenant and the prohibited liens are not executed and/or filed with the county recorder's office for FHA-insured loans.

Finding 2: DHI Mortgage Failed to Underwrite FHA-Insured Loans in Accordance with HUD-FHA Requirements

DHI Mortgage did not underwrite 24 FHA-insured loans in accordance with HUD-FHA requirements. This condition occurred because the lender failed to exercise due diligence in underwriting these loans in areas such as income verification, credit evaluation, asset verification, and contract reviews. As a result, the FHA insurance portfolio was at increased risk of loss on more than \$4.1 million in unpaid mortgage balances for loans that did not meet FHA insurance requirements.

Twenty-four Loan Files Contained Significant Underwriting Deficiencies

The loan file reviews of 34 FHA-insured loans identified 24 that had significant underwriting deficiencies regarding the evaluation of income, credit, assets, contract, and other issues. DHI Mortgage did not underwrite the 24 loans as required by HUD Handbook 4155.1, chapter 3 which states that “[t]he lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and [documented]. The lender must also verify and document the identity of the loan applicant(s).” The 24 loans were approved based on many factors that included the reported monthly income, debt obligations, or assets. However, DHI Mortgage closed many of the loans without obtaining the required documentation to support the amounts it used to approve the borrower. For example, the underwriter approved FHA-insured loan 022-1890152 based, in part, on the borrower’s reported monthly overtime income of \$1,084. However, the file documentation did not support the use of this amount for overtime earnings because, among other things, it failed to show a two-year trend for the overtime as required by HUD Handbook 4155.1, paragraph 2-7A (see criteria in appendix C). The types of deficiencies we identified for each approval factor are presented below.

- Income - Deficiencies included improperly calculated income (unqualified income or unsubstantiated income¹⁰) or lack of support to validate income contrary to HUD Handbook 4155.1, paragraph 2-7 and Mortgagee Letter 2004-47. Additionally, this category included the failure to verify that employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2, as well as HUD Handbook 4155.1, paragraph 2-7 and Mortgagee Letter 2004-47.

¹⁰ Unqualified income is income that did not meet HUD guidelines for use in the borrower’s ratios whereas unsubstantiated income is income that was not supported or verified.

- Credit - Deficiencies for debts and liabilities included the failure to provide proof of satisfied judgments before closing as required by HUD Handbook 4155.1, paragraph 2-3C; exclusion of debts from the qualifying ratios without explanation as required by HUD Handbook 4155.1, paragraph 2-11; and failure to properly support and calculate net rental income/loss as required by HUD Handbook 4155.1, paragraph 2-7M2.
- Assets - Deficiencies included missing bank statements contrary to HUD Handbook 4155.1, paragraph 3-1F; failure to verify or substantiate that earnest money was paid by the borrower as required by HUD Handbook 4155.1, paragraph 2-10A; and lack of proof that retirement assets were liquid when used as available funds for qualifying purposes as required by Mortgage Letter 2004-47.
- Contract - Deficiencies included improper restrictive covenants discussed under finding 1, which violated 24 CFR 203.41 and missing addendums to the sales contract contrary to HUD Handbook 4155.1, paragraph 3-1H.
- Other - This category includes items found in the loan file reviews that were not in any of the above categories. For example, we identified loan files that lacked evidence that the realtor had been checked against the lists for limited denial of participation or federal excluded parties and contained loans that were originated by an employee on the federal excluded parties list contrary to HUD Handbook 4155.1, paragraph 2-5. Additionally, we identified instances where the lender financed loan discounts into the mortgage contrary to HUD Handbook 4000.2, paragraph 5-2P (see criteria in appendix C).

The table below lists the 34 FHA loan numbers reviewed and the deficient areas associated with each loan. The table also identifies the 24 loans for which we concluded the underwriting was significantly deficient and therefore warrant indemnification. Appendix D provides underwriting details for each FHA loan number presented in the table below.

FHA loan number	Case file review revealed underwriting deficiency for					Significant underwriting deficiencies
	Income	Credit	Assets	Contract	Other	
022-1864520	X	X	X	X		X
022-1874931	X	X		X		X
022-1883463 ¹¹				X	X	
022-1883781 ¹¹				X	X	
022-1890152	X	X		X		X
022-1892652	X				X	X
023-2356343	X			X	X	X
023-2375190	X		X			X
023-2375473	X	X		X		X
023-2383860 ¹¹	X			X		
023-2384380	X	X		X		X
023-2388693 ¹¹				X		
023-2389873	X	X				X
023-2391447	X	X				X
023-2409090 ¹¹				X		
023-2412241 ¹¹		X		X		
023-2414288	X	X				X
023-2425869	X	X		X		X
023-2426099	X	X		X		X
023-2427150	X	X	X			X
023-2435939	X			X		X
023-2438080 ¹¹		X		X		
023-2438810		X	X	X		X
023-2442707	X					X
023-2447263 ¹¹	X				X	
023-2452473	X					X
023-2453167	X					X
023-2458663	X	X		X		X
023-2468047 ¹¹				X	X	
023-2482980	X	X	X	X	X	X
023-2487907	X					X
023-2529391	X					X
023-2640107 ¹¹	X					
023-2674566	X				X	X
Totals	26	16	5	20	8	<u>24</u>

¹¹ These loans were not counted as having significant underwriting deficiencies because the loan files either had (1) only minor deficiencies and were not considered for indemnification and/or (2) the deficiencies were addressed under findings 1 and/or 3. Specifically, we did not seek indemnification for loans with minor income or credit deficiencies and we did not seek indemnification on loans that financed discount points into the loan amount (instead we are requesting an appropriate reduction of the loan balances).

Lack of Due Diligence Increased Risk of Loss to the FHA Insurance Fund

The foreword in HUD Handbook 4155.1 states, “This [underwriting] decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation.” Because DHI Mortgage did not follow HUD-FHA requirements when underwriting it inappropriately approved the 24 loans. The lender did not exercise both sound judgment and due diligence when it submitted these loans for FHA insurance. Further, DHI Mortgage did not identify the deficiencies in its loan origination process because its quality control reviews of FHA-insured loans were not performed in accordance with HUD requirements (see finding 3). As a result, the FHA insurance fund was at increased risk for losses on the 24 loans with significant underwriting deficiencies.

Conclusion

DHI Mortgage’s failure to follow HUD-FHA regulations and requirements placed the FHA insurance fund at additional risk for losses. The 24 loans that did not meet the requirements for FHA insurance have a total unpaid mortgage balance of more than \$4.1 million, a projected loss to HUD of \$942,818,¹² and overinsurance totaling \$15,749 (see appendix A-2).

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require DHI Mortgage to

- 2A. Indemnify HUD against losses for the 24 FHA-insured loans with significant underwriting deficiencies in the amount of \$4,114,822. The projected loss to HUD is \$942,818.
- 2B. Refund the \$15,749 in overinsurance generated from financing the loan discount into the FHA-insured loan by (1) reimbursing HUD in the amount of the loan discount for any claim paid on the loan; (2) paying down any amount of arrears, penalties, or fees owed on the loan due to delinquency; and then, if applicable, (3) applying the remaining amount of the loan discount against the principal amount owed on the FHA-insured loan.

¹² This amount was calculated based on 42 percent of the unpaid mortgage balances or the actual loss to HUD when known, excluding loans requested for indemnification under finding 1.

Finding 3: Quality Control Was Inadequate

DHI Mortgage did not adequately perform quality control reviews of FHA-insured loans and branch offices we reviewed in accordance with HUD requirements and DHI Mortgage's own quality control plan. Specifically, on-site quality control reviews at the branches did not cover all of the required items, and quality control reviews of loan files we examined did not conform to standards. Also, DHI Mortgage did not fully comply with quality control standards pertaining to conflicts of interest. This condition occurred because DHI Mortgage disregarded HUD's quality control requirements. As a result of the inadequate quality control, a debarred individual was allowed to participate in loan originations, which disqualified 19 FHA-insured loans valued more than \$3.4 million. Also, quality control file reviews were not completed in a timely manner, and company officers had authority in both the lending and title functions. These and other lapses in quality control contributed to increased risk to the FHA insurance fund.

On-Site Quality Control Branch Reviews Were Inadequate

Our evaluation of DHI Mortgage's on-site quality control branch reviews that occurred from October 1, 2006, to September 30, 2008, revealed that they were not performed in accordance with HUD Handbook 4060.1, paragraph 7-3G (see criteria in appendix C), or DHI Mortgage's own quality control plan. Although DHI Mortgage performed on-site branch reviews, certain required items were not covered. The reviews did not effectively establish that offices did not employ or have a contract with individuals who were under debarment, suspension, or a limited denial of participation. Under HUD Handbook 4155.1, paragraph 2-5 these individuals are not eligible to participate in FHA-insured mortgage transactions. Reviewers also did not ensure that HUD was notified of a change of branch address.

These branch review deficiencies unnecessarily increased the risk to the FHA insurance fund. We found 19 FHA-insured loans that DHI originated using an individual who had been debarred¹³ at the time of the loan originations. Therefore, the 19 loans with a total unpaid balance of more than \$3.4 million did not meet requirements for FHA insurance. In addition, DHI Mortgage officials did not always notify HUD of branch changes in a timely manner. HUD relies on compiling and gathering accurate lender data from its on-line information system to monitor individuals and entities involved in FHA-insured loans.¹⁴

¹³ The loan officer worked for DHI Mortgage's FHA branch number 0542400180. The employee originated the 23 FHA-insured loans while on the General Service Administration's Excluded Parties List System; however, four of the loans have been paid in full.

¹⁴ Neighborhood Watch aids HUD/FHA staff in monitoring lenders and HUD programs, and assists lenders and the public in facilitating self-policing of the industry. The system is designed to highlight exceptions, so that potential problems are readily identifiable.

FHA-Insured Quality Control Reviews Were Inadequate

We reviewed 10 quality control review files that corresponded to our underwriting reviews and determined that all 10 did not meet the requirements of HUD Handbook 4060.1, paragraph 7-6, and DHI Mortgage's own quality control plan. Deficiencies included failure to: complete the quality control reviews in a timely manner, obtain an appropriate credit report, reverify the earnest money deposit or gift funds, conduct a desk or field appraisal, review and document the underwriting decision, and review and document the conditional clearance and closing items. The deficient quality control loan reviews may have prevented DHI Mortgage from correcting systemic deficiencies that could reduce unnecessary future risk to HUD. Appendix E provides the FHA loan numbers and the deficiencies we noted in each quality control review.

DHI Allowed Conflicts of Interest

Both the president and vice president of compliance for DHI Mortgage also worked in official capacities for DHI Title. However, there was no evidence that DHI Mortgage reviewed or otherwise provided assurance that a clear and effective separation of the two entities existed and that the borrowers knew at all times exactly with which entity they were doing business—as required by HUD Handbook 4060.1, paragraph 2-9C. Such dual authority raised questions regarding the independence of the lending and closing functions.

Underwriters' compensation agreements at DHI Mortgage included compensation based on the number of loan decisions made. This is a form of commission contrary to HUD Handbook 4060.1, paragraph 2-9A (see criteria in appendix C). Commissions provide an incentive for underwriters to focus on quick underwriting decisions rather than compliance with FHA insurance requirements.

FHA Quality Control Requirements Were Disregarded

The lapses in quality control occurred because DHI Mortgage disregarded HUD's quality control review requirements and its own quality control plan. DHI Mortgage officials informed us that they thought the quality control on-site branch review requirements had been met because the required items were reviewed at the corporate level. However, the corporate reviews did not meet HUD requirements and proved ineffective in some cases, as evidenced by DHI Mortgage's failure to identify a debarred employee and update branch information to HUD. DHI officials also stated that the vice president of compliance at DHI Mortgage filled two roles because his previous position at DHI Title had not been filled. DHI Mortgage's response to the audit report proposed improvements to address the quality control deficiencies we cited. (See appendix B.)

Conclusion

DHI Mortgage's quality control failures allowed endorsements on 19 loans with a total unpaid mortgage balance of more than \$3.4 million that did not meet the requirements for FHA insurance. The projected loss to HUD associated with these loans is \$168,773 (see appendix A-3).¹⁵ DHI's disregard of HUD's requirements to check its employees against federal lists of ineligible individuals, as well as other quality control deficiencies, increased the likelihood of noncompliance and resulted in increased risk to FHA's insurance fund.

Recommendations

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner require DHI Mortgage to

- 3A. Indemnify HUD against losses for the 19 FHA-insured loans originated by a debarred employee in the amount of \$3,477,875. The projected loss to HUD is \$168,773.
- 3B. Revise and implement policies and procedures to reflect HUD requirements for updating FHA branch office changes and to ensure that offices do not employ or have a contract with individuals who are under debarment, suspension, or a limited denial of participation.
- 3C. Fully implement its quality control plan related to FHA-insured loan reviews and FHA branch office reviews.
- 3D. Discontinue or develop and implement procedures regarding officials working for DHI Mortgage and DHI Title to ensure that a clear and effective separation exists between the two entities and that borrowers know at all times exactly with which entity they are doing business.
- 3E. Discontinue the compensation to underwriters in the form of commissions, in appearance and in fact.

¹⁵ This amount was based on 42 percent of the unpaid mortgage balances and the actual loss to HUD if known, excluding loans requested for indemnification under findings 1 and 2.

SCOPE AND METHODOLOGY

We selected DHI Mortgage because of a default rate¹⁶ that was double the Arizona state average. Our audit period covered loans with beginning amortization dates from October 1, 2006, to September 30, 2008. During this period DHI Mortgage FHA branch numbers 0542400180 and 0542400332 originated 481 FHA-insured mortgages, with a total unpaid mortgage balance over \$84 million.

Our review included title files corresponding to 468 of the 481¹⁷ FHA-insured loans. The total unpaid mortgage balance for these loans was over \$80 million. The title file reviews were primarily used to determine if a schedule A to purchase contract was associated with the FHA-insured property.

We also reviewed underwriting documentation in the lender/FHA loan files for 34 FHA-insured loans selected nonstatistically based on the existence of loan defaults and claims. Initially, we used HUD's online information system for FHA loans to obtain a sample that included all FHA loans from DHI Mortgage's branch number 0542400332 with beginning amortization dates between October 1, 2006, and September 30, 2008, and then selected cases that defaulted (or went into claims) within the first two years. This methodology resulted in a sample of 20 FHA loans. During file reviews we noted that some loan records had the DHI Mortgage branch number 0542400180, and so we expanded our underwriting loan reviews to include FHA loans under the 0542400180 branch using the same selection methodology. We then obtained the most up-to-date information, as of January 8, 2009, for our two-year audit period by directly querying HUD's Single Family Data Warehouse.¹⁸ This query identified an additional 14 loans that were in default (90 days or more delinquent) for a total sample of 34 loans.

To perform our quality control file reviews, we selected all early payment default loans and all other quality control reviews from the lender's quality control log that pertained to our underwriting review sample. As a result, we reviewed 10 of the quality control reports that DHI Mortgage performed on the 34 loans in our underwriting review. We also reviewed DHI Mortgage's on-site branch office quality control reviews covering our audit period.

We conducted our fieldwork at DHI Mortgage's Tucson and Scottsdale, Arizona, branch offices between December 2008 and March 2009.

¹⁶ Percentage of loan originations which had first defaults (i.e. became 90 days delinquent) reported by the servicing lender during the first two years of origination.

¹⁷ Although we attempted to review all 481 loans originated during our audit period, we did not receive 13 title files and, therefore, did not conduct a review of those loans. This limitation did not affect the results of our audit, because we did not project our review of the files to the entire population. Instead, we only counted deficiencies associated with the specific FHA loan numbers listed for each finding(s) as a whole; rather, we identified items by the specific FHA loan number associated with the finding(s).

¹⁸ The Single Family Housing Enterprise Data Warehouse (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 housing data. The warehouse consists of data marts developed to support specific business units/communities within the HUD family. Each data mart comprises one or more database tables structured to provide HUD users easy and efficient access to single family housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics. The data is sourced from HUD systems, and contains more detailed information than the Neighborhood Watch system.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials related to single-family requirements;
- Reviewed DHI Mortgage's processing, underwriting, and closing policies and procedures;
- Reviewed DHI Mortgage's loan files;
- Reviewed 468 title files corresponding to the 481 loans originated in our audit period. These were generally limited to the (1) settlement statement (Form HUD-1); (2) file balance sheet; and (3) schedule A to purchase contract, declaration of covenant restricting rental or resale of property, or equivalent;
- Reviewed DHI Mortgage's quality control plan and quality control review reports;
- Interviewed appropriate DHI Mortgage staff;
- Interviewed the branch manager of DHI Title in Scottsdale, Arizona; and
- Interviewed borrowers, when available, associated with the 34 FHA loans in our underwriting review.

We used the source documents in the loan case file to determine borrower income, employment history, and debt. For the loans underwritten by an automated underwriting system, we reviewed the FHA loan file to determine whether it contained the documentation required to support the integrity and accuracy of the data used by the automated underwriting system to recommend approval of the loan. For the manually underwritten loans, we reviewed the loan documents to determine whether they supported the underwriting decision and complied with HUD Handbook 4155.1, Mortgage Credit Analysis.¹⁹

We used data maintained by HUD in its information systems for FHA loans to obtain background information and to select our sample of loans for testing. We did not rely on the data to reach our conclusions; therefore, we did not assess the reliability of the data.

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.

¹⁹ A manually underwritten loan must comply with HUD Handbook 4155.1. HUD's Mortgagee Letter 2004-47 explains that mortgage loans scored as accepted or approved through FHA's TOTAL Mortgage Scorecard are granted a number of credit policy revisions and documentation relief from the instructions in Handbook HUD 4155.1. However, the lenders must still comply with outstanding eligibility requirements and ensure the integrity and accuracy of the data used to render a decision.

INTERNAL CONTROLS

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

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

Relevant Internal Controls

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

- Policies and procedures intended to ensure that FHA-insured loans are properly originated, underwritten (approved), and closed.
- Policies and procedures intended to ensure that the quality control program is an effective tool for reducing underwriting errors.
- Policies and procedures intended to ensure that the quality control program is an effective tool for reducing the lender's branch office noncompliance.

We assessed the relevant controls identified above.

A significant weakness exists if internal controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

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

- DHI Mortgage did not have effective controls in place to ensure that FHA-insured loans were underwritten in accordance with HUD requirements, exposing the FHA insurance fund to unnecessary risk (see findings 1 and 2).
- DHI Mortgage did not have effective controls in place to ensure that FHA-insured loans closed in accordance with HUD requirements, exposing the FHA insurance fund to unnecessary risk (see finding 1).
- DHI Mortgage did not ensure that its plan for quality control loan reviews was fully implemented and that the reviews were conducted in a timely manner (see finding 3).
- DHI Mortgage did not fully implement its quality control plan for on-site branch office reviews to ensure that each branch complied with eligibility and conflict-of-interest requirements for its employees (see finding 3).

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use <u>1/</u>
1A	\$15,256,783
2A	942,818
2B	15,749
3A	168,773
Totals	\$16,384,123

1/ 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.

See the appendixes in this section for further explanation of costs.

Appendix A-1: Loan Details for Schedule A to Purchase Contracts

The table below contains the actual, if known, and projected losses to HUD corresponding to the loans recommended for indemnification under finding 1 resulting from FHA-insured loans with schedule A to the purchase contracts.

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
022-1858519	\$ 148,315		\$ 62,292
022-1858889	180,288		75,721
022-1861293	173,033		72,674
022-1864520	225,103		94,543
022-1865027	156,664		65,799
022-1867629	182,726		76,745
022-1868098	183,874		77,227
022-1869977	156,459		65,713
022-1873959	215,573		90,541
022-1874931	159,147		66,842
022-1876036	178,104		74,804
022-1876348	216,503		90,931
022-1879656	224,602		94,333
022-1882077	209,753		88,096
022-1882083	206,710		86,818
022-1882314	156,588		65,767
022-1882626	213,034		89,474
022-1882973	188,988		79,375
022-1883174	177,122		74,391
022-1883378	146,337		61,462
022-1883428	210,202		88,285
022-1883463	223,321		93,795
022-1883781	195,392		82,065
022-1884236	153,653		64,534
022-1884321	170,898		71,777
022-1884475	153,495		64,468
022-1885674	154,663		64,958
022-1886056	153,587		64,506
022-1886062	149,510		62,794
022-1886374	154,787		65,010
022-1886476	172,354		72,389

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
022-1886555	153,978		64,671
022-1886578	204,206		85,767
022-1887101	144,200		60,564
022-1887328	188,977		79,370
022-1887538	203,103		85,303
022-1887646	174,418		73,256
022-1888188	174,277		73,196
022-1888743	184,363		77,433
022-1888874	157,541		66,167
022-1889291	168,363		70,712
022-1890152	219,081		92,014
022-1890348	158,256		66,468
022-1890589	184,345		77,425
022-1890826	183,574		77,101
022-1893107	159,150		66,843
022-1894370	144,342		60,624
022-1894522	169,015		70,986
022-1894545	147,959		62,143
022-1894618	149,699		62,874
022-1894703	144,672		60,762
022-1895166	158,675		66,644
022-1895898	179,079		75,213
022-1896024	227,919		95,726
022-1896053	186,481		78,322
022-1896103	164,141		68,939
022-1896228	198,764		83,481
022-1900289	167,463		70,335
022-1900555	143,985		60,474
022-1901617	177,357		74,490
022-1902924	192,565		80,877
022-1904035	174,363		73,233
022-1905118	168,860		70,921
022-1907740	182,083		76,475
022-1910307	149,568		62,818
022-1910575	156,298		65,645
022-1912950	177,996		74,758

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
022-1914090	154,912		65,063
022-1914808	165,214		69,390
022-1914939	213,251		89,565
022-1915718	203,335		85,401
022-1915973	183,960		77,263
022-1916975	199,370		83,735
022-1917051	187,794		78,873
022-1918398	207,841		87,293
022-1922051	178,684		75,047
022-1922847	203,087		85,296
022-1924102	174,040		73,097
022-1924437	205,529		86,322
022-1927042	149,806		62,919
022-1928950	131,541		55,247
022-1929405	139,208		58,467
022-1929457	207,936		87,333
022-1929860	204,970		86,087
022-1930041	158,522		66,579
022-1930058	143,547		60,290
022-1930574	150,570		63,239
022-1930881	141,896		59,596
022-1930919	185,656		77,976
022-1931030	184,370		77,436
022-1932444	150,248		63,104
022-1932689	169,848		71,336
022-1932695	196,940		82,715
022-1932830	208,721		87,663
022-1932882	150,803		63,337
022-1933439	193,418		81,236
022-1938623	184,458		77,472
022-1939498	171,567		72,058
022-1942208	188,971		79,368
022-1944868	238,969		100,367
022-1945647	136,631		57,385
022-1949095	169,161		71,048
022-1950364	189,700		79,674

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
022-1951268	189,629		79,644
022-1951414	173,904		73,040
022-1951852	290,505		122,012
022-1952972	172,061		72,266
022-1953689	278,540		116,987
022-1954308	140,875		59,168
022-1954314	168,235		70,659
022-1954451	160,600		67,452
022-1954501	141,341		59,363
022-1955723	168,333		70,700
022-1956895	247,904		104,120
022-1958850	209,989		88,195
022-1961446	166,560		69,955
022-1962277	219,036		91,995
022-1962514	285,068		119,729
022-1962884	187,539		78,766
022-1964719	147,468		61,937
022-1965346	218,331		91,699
022-1966017	190,743		80,112
022-1966703	223,843		94,014
022-1967324	135,395		56,866
022-1967505	151,041		63,437
022-1968053	139,424		58,558
022-1968388	138,213		58,049
022-1968421	248,174		104,233
022-1968438	170,538		71,626
022-1968444	182,274		76,555
022-1968500	243,500		102,270
022-1971233	156,844		65,875
022-1971370	189,186		79,458
022-1971472	213,542		89,688
022-1971618	169,525		71,201
022-1971755	135,410		56,872
022-1972158	175,538		73,726
022-1972216	184,052		77,302
022-1972280	188,037		78,976

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
022-1973473	185,964		78,105
022-1975416	162,399		68,208
022-1975422	224,563		94,317
022-1975576	161,928		68,010
022-1975865	181,417		76,195
022-1975973	224,327		94,217
022-1976463	165,103		69,343
022-1976492	167,627		70,404
022-1977049	159,953		67,180
022-1977055	181,353		76,168
022-1978362	201,876		84,788
023-2320644	169,128		71,034
023-2340287	136,585		57,366
023-2356343	192,796		80,974
023-2375388	248,968		104,567
023-2375473	161,815		67,962
023-2383860	145,298		61,025
023-2383895	161,103		67,663
023-2383979	199,019		83,588
023-2384380	192,236		80,739
023-2387278	190,701		80,094
023-2388425	133,663		56,138
023-2388693	162,073		68,071
023-2389790	164,684		69,167
023-2390356	147,826		62,087
023-2392731	158,364		66,513
023-2400628	249,580		104,824
023-2404478	158,152		66,424
023-2405211	154,805		65,018
023-2406144	138,617		58,219
023-2406167	234,825		98,627
023-2411433	166,259		69,829
023-2412241	193,271		81,174
023-2419965	200,046		84,019
023-2424227	138,773		58,285
023-2425869	139,647		58,652

FHA loans with schedule A to purchase contract			
FHA loan number	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)
023-2426099	209,080	\$120,843	0
023-2435820	223,908		94,042
023-2435939	144,544	98,380	0
023-2436464	131,045		55,039
023-2438080	132,333		55,580
023-2438810	129,867		54,544
023-2438885	149,765		62,901
023-2439585	163,521		68,679
023-2444743	115,815		48,642
023-2448485	124,296		52,204
023-2450676	143,320		60,194
023-2452908	158,159		66,427
023-2454894	250,784		105,329
023-2455303	220,548		92,630
023-2457044	141,541		59,447
023-2458663	137,292		57,663
023-2468047	225,817		94,843
023-2474700	142,334		59,780
023-2478730	140,110		58,846
023-2482980	138,860		58,321
023-2487653	156,690		65,810
023-2492828	127,724		53,644
023-2497053	144,444		60,666
023-2503336	128,574		54,001
023-2504768	147,062		61,766
023-2508248	138,698		58,253
023-2515521	172,782		72,568
023-2523166	124,333		52,220
023-2528475	192,266		80,752
023-2529520	211,510		88,834
Total	\$36,157,343	\$219,223	\$15,037,560

Appendix A-2: Loan Details for Underwriting Deficiencies

The table below contains the actual, if known, and projected losses to HUD corresponding to the loans recommended for indemnification under finding 2, excluding any loans recommended for indemnification under finding 1.

FHA loan number	Significant underwriting deficiencies	Unpaid mortgage balance	Actual loss to HUD	Indemnification amount (42%)	Overinsurance from loan discount
022-1864520 ²⁰	X	\$ 225,103		0	
022-1874931 ²⁰	X	159,147		0	
022-1883463 ²¹				0	\$ 3,397
022-1883781 ²¹				0	
022-1890152 ²⁰	X	219,081		0	
022-1892652	X	141,144		\$ 59,280	
023-2356343 ²⁰	X	192,796		0	
023-2375190	X	232,530		97,663	
023-2375473 ²⁰	X	161,815		0	
023-2383860 ²⁰				0	
023-2384380 ²⁰	X	192,236		0	
023-2388693 ²⁰				0	
023-2389873	X	177,952		74,740	
023-2391447	X	191,099		80,262	
023-2409090 ²²				0	
023-2412241 ²⁰				0	
023-2414288	X	119,929		50,370	
023-2425869 ²⁰	X	139,647		0	
023-2426099 ²⁰	X	209,080		0	
023-2427150	X	143,326		60,197	
023-2435939 ²⁰	X	144,544		0	
023-2438080 ²⁰				0	
023-2438810 ²⁰	X	129,867		0	
023-2442707	X	192,391	\$ 126,218	0	
023-2447263 ²²				0	8,298
023-2452473	X	202,755		85,157	
023-2453167	X	148,277	92,232	0	
023-2458663 ²⁰	X	137,292		0	
023-2468047 ²⁰				0	4,054
023-2482980 ²⁰	X	138,860		0	
023-2487907	X	151,879		63,789	
023-2529391	X	162,278		68,157	
023-2640107 ²²				0	
023-2674566	X	201,794		84,753	
Totals	24	\$4,114,822	\$218,450	\$724,368	\$15,749

²⁰ FHA loans recommended for indemnification under finding 1; therefore, the indemnification amount was excluded from this schedule to prevent overlap.

²¹ FHA loans recommended for indemnification under finding 1 and finding 3; therefore, the indemnification amount was excluded from this schedule to prevent overlap.

²² Although the loan had underwriting deficiencies, they were not significant enough to seek indemnification.

Appendix A-3: Loan Details for Loans Involving Debarred Employee

The table below contains the projected losses to HUD corresponding to the loans recommended for indemnification under finding 3 because these FHA-insured loans were originated by a debarred loan officer.

FHA loan number	Unpaid mortgage balance	Indemnification amount (42%)
022-1876348 ²³	\$ 216,503	
022-1882077 ²³	209,753	
022-1882314 ²³	156,588	
022-1882973 ²³	188,988	
022-1883174 ²³	177,122	
022-1883428 ²³	210,202	
022-1883463 ²⁴	223,321	
022-1883781 ²⁴	195,392	
022-1886056 ²³	153,587	
022-1886374 ²³	154,787	
022-1890348 ²³	158,256	
022-1890826 ²³	183,574	
022-1894618 ²³	149,699	
022-1895324	198,515	\$ 83,376
022-1895898 ²³	179,079	
022-1900289 ²³	167,463	
022-1901617 ²³	177,357	
022-1904035 ²³	174,363	
023-2618882	203,326	85,397
Total	\$3,477,875	\$168,773

²³ FHA loan recommended for indemnification under finding 1; therefore, the indemnification amount was excluded from this schedule to prevent overlap.

²⁴ FHA loan recommended for indemnification under finding 1 and reported under finding 2; therefore, the indemnification amount was excluded from this schedule to prevent overlap.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



VIA E-MAIL AND FEDERAL EXPRESS

August 24, 2009

U.S. Department of Housing and Urban Development
Office of Inspector General – Region IX
Attn: Ms. Joan S. Hobbs
611 West Sixth Street, Suite 1160
Los Angeles, California 90017

Re: DHI Mortgage Branch 0542400332
DHI Mortgage Branch 0542400180
Audit Period: October 1, 2006 – September 30, 2008

Dear Ms. Hobbs:

This letter serves as the response of DHI Mortgage Company, LTD's ("DHIM" or "Company") to your letter dated July 31, 2009, and the Draft Report containing the findings of the completed audit of the DHIM branch offices referenced above that was conducted by the Office of Inspector General ("OIG").

We want to reiterate at the outset that DHIM is committed to adherence to all state and federal laws, and with all HUD established guidelines, as well as maintaining a high standard of best practices, internal policies and procedures. DHIM and its affiliates are also committed to developing strong sustainable communities and to providing lending opportunities that support the American dream of homeownership now and for years to come. As you know from the Draft Report, these two commitments can, in some instances, lead to a conflict, as was the case with respect to the restrictive covenant that serves as the basis for the most substantial finding in the Draft Report. As discussed more fully below, that covenant -- which was prepared by the builder/seller and designed to prevent property flipping -- was not valid or enforceable by the builder in connection with an FHA insured loan. However, in spite of its invalidity, the covenant was inadvertently recorded in a number of instances without the knowledge of DHIM. While DHIM concedes that the recording of the restrictive covenant violated FHA regulations, as explained below, the purpose of the covenant (to protect homeowners from the devastating

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effects of property flipping by investors), the unenforceability of the covenant, the lack of knowledge by DHIM, and the lack of any injury to HUD, are all factors that warrant a remedy other than the indemnification demanded in the Draft Report. With respect to all of the findings of the Draft Report, DHIM responds as follows:

EXAMINATION FINDINGS

Finding #1: DHI Mortgage Allowed Restrictive Covenants That Violated HUD-FHA Requirements.

Comment 1

DHIM acknowledges that, without its knowledge, a covenant which purports to restrict the resale or rental of property (hereinafter "Schedule A") was recorded in connection with 205 FHA insured properties. DHIM vehemently disagrees with the implication that it had knowledge of the actual recording of Schedule A in connection with any FHA insured properties. Additionally, we note the contractual agreement from which Schedule A originated clearly and expressly contains language excluding its use in connection with FHA and VA financing.

Comment 2

The first sentence of the OIG's finding states that "DHI Mortgage approved 205 FHA-insured loans with unallowable restrictive covenants...." The finding further provides that: "DHI Mortgage allowed the restrictive covenants ... because officials believed it would discourage investors from purchasing their affiliate's (the seller's) properties." We respectfully disagree with these statements as they are inaccurate and unsupported by the evidence. Specifically, DHIM approved the loans based on FHA accepted underwriting guidelines and without consideration of any such restrictive covenant. Indeed, during an extensive loan file review, reference to the covenant lien was discovered in only two (2) of the 205 loan files. Based on our review of the loan files, it appears that the builder regularly had the document executed prior to having knowledge of the type of financing the borrower would select. It is also significant that at the time of the origination of these particular loans, DHIM's origination activity was primarily conventional financing, with its FHA activity averaging approximately 10% of its total volume. In addition, none of DHIM's Lenders Instructions to the settlement agent included reference to the recording of Schedule A. Further, as previously noted, the exclusionary language in the Occupancy/Investment Disclosure, which was provided to all of the borrowers, renders the Schedule A irrelevant and unenforceable in connection with FHA transactions.

While the finding implies that DHIM had knowledge of the use of the restrictive covenant for FHA/VA loans, in fact, the evidence indicates the contrary; that is, DHIM did not find this an acceptable practice for FHA/VA loans. The OIG Draft Report reinforces this fact when indicating in the finding that "DHI Mortgage was apparently aware that this practice was not allowed for FHA-insured mortgages because there were instances in which the addendum (occupancy/investment disclosure) to the purchase contract contained an exclusion from the restrictive covenant when the buyer purchased the property using FHA." Draft Report at 6.

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Comment 3

DHIM also takes issue with the OIG's implication that there was harm to any homebuyers as a result of the use of the restrictive covenant. The covenant was used during a time of unprecedented growth in the homebuilding industry. During that period, it was discovered that real estate investors were falsely representing themselves as owner-occupant homebuyers, only to close on the purchase of the property and then quickly flip the property thereafter to a new buyer or rent it out as an investment property. As the OIG is well aware, the practice of property flipping and speculation was a leading contributing factor to the sudden artificial inflation and subsequent severe deterioration of property values which ultimately led to the housing bubble and economic conditions of today throughout our nation. Borrowers representing themselves as owner-occupants with the secretive and subversive intention of renting or flipping the property were perpetrating mortgage fraud. This, in conjunction with the detrimental long term effects on the newly developing community, is what obviously motivated the builder/seller to seek solutions that were specifically designed to put a stop to this practice.

Comment 4

DHIM also notes that borrowers who obtained financing through a conventional loan where the Schedule A was permissible and, indeed, appropriate for the reasons discussed above, still retained the opportunity to sell the subject property as long as the sale was pursuant to a number of any normally occurring life events. The following excerpt from the Schedule A demonstrates this fact:

- a. A transfer resulting from the death of Owner.
- b. A transfer by Owner where the spouse of Owner becomes the only co-owner with Owner of the Property;
- c. A transfer by Owner into a revocable inter vivos trust in which Owner is a beneficiary;
- d. A transfer resulting from the decree of dissolution of marriage or legal separation or from a property settlement agreement incident to such decree;
- e. The transfer, conveyance, pledge, assignment, or other hypothecation of the Property to secure the performance of an obligation, which transfer, conveyance, pledge, assignment or hypothecation will be released or reconveyed upon the completion of such performance; and
- f. The transfer by Owner where (1) at the time of transfer Owner is occupying the Property as Owner's place of residence and (2) the transfer is necessary to facilitate Owner's relocation of his place of residence in order to accommodate a job transfer required by Owner's employer or to accommodate a change in employment location greater than twenty-five miles.

Comment 5

With the clear understanding that the Schedule A did not apply to FHA loans, DHIM proceeded to transact business accordingly. The recording of the Schedule A in connection with FHA insured properties appears to have occurred through miscommunications between the Settlement Agent and the builder/seller. The intention of the Schedule A, being rooted in the deterrence of investors from perpetrating mortgage fraud and unrelated to restricting *bona fide* homeowners in

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Comment 5

any capacity, specifically FHA insured homeowners, is further evidenced by the fact that the Schedule A has never been enforced against any FHA insured borrower.

Comment 6

The Draft Report provides information about an interview with one borrower who claims the covenant resulted in the foreclosure of her property. While any foreclosure is unfortunate, no evidence has been provided showing that the borrower ever attempted to contact the builder to discuss the covenant or to arrange to have the covenant released. If a phone call had been made, the fact that the Schedule A was not even applicable, as clearly shown in the document, would have been brought to the borrower's attention, and an immediate release would have been recorded. It is unclear why the borrower chose not to contact the builder. The deteriorating resale market was obviously the primary cause of this borrower's challenge. Had the borrower contacted the builder, it certainly would have alleviated any concern that he or she might have had regarding the ability to sell her property.

Comment 7

The Draft Report suggests that DHIM should indemnify HUD against losses for the 205 FHA-insured loans with the Schedule A as they "...put additional unnecessary risk on the FHA-insured loans...." As the Schedule A was not applicable to these transactions, it was unenforceable as a matter of law, and was done without the knowledge or approval of DHIM, indemnification is neither appropriate nor warranted. Regarding any alleged additional "risk" to the insurance fund, of the 205 loans, only three (3) reached a pre-foreclosure status during the first 12 months when the Schedule A, albeit recorded in error, could potentially be deemed to be effective.

Comment 8

Accordingly, in response to the Draft Report findings, DHIM proposes the following corrective action measures:

DHIM will research the 205 loans cited in the Draft Report in order to identify any open Schedule A liens that may have been recorded by the settlement agent and that have not yet expired. Upon the discovery of any such liens, DHIM will coordinate the immediate release of all such liens.

DHIM will also conduct training with both the Builder and Title affiliates with respect to the restrictions on the use of unallowable covenants and prohibited liens in connection with FHA loans. In addition, DHIM will enhance its standard closing instructions. Currently, the wording on the instructions to the settlement agent read: "No second lien shall be placed on the property without prior approval." While the Company believes that this instruction should have alerted the settlement agents to contact DHIM prior to the recording of any restrictive covenants, DHIM will change the instructions to the settlement agent to read: "No second liens, or restrictive covenants, are to be placed on the property without prior approval by DHIM." This will be in capitalized and bold text.

The Draft Report requests that DHIM "[d]evelop and implement verification procedures to ensure that the unallowable restrictive covenant and the prohibited liens are not executed and/or

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Comment 9
Comment 10

filed with the county recorder's office for FHA-insured loans." We believe that the training and changes to the instructions to the settlement agents described above are appropriate measures for a lender to take in regards to post-closing initiatives. Lenders have an obligation to follow all regulations, laws and prudent lending practices in order to support borrowers, investors and insurers. Post closing searches of public records to search for unauthorized recorded liens as recommended in the Draft Report would not be feasible for any entity in the mortgage lending industry. Such a practice would increase the cost of lending to homebuyers, while adding little to no benefit or value. It remains DHIM's position that the recording of the Schedule A -- while unintentional and inappropriate -- did not incur any increased liability or cause any losses to any borrowers or to HUD.

Finding #2: DHI Mortgage Failed to Underwrite FHA-Insured Loans in Accordance with HUD-FHA Requirements.

Comment 11

In March 2008, HUD conducted a routine exam of DHIM's offices where it identified certain underwriting deficiencies. Please note that many of the deficiencies that are cited in the OIG Draft Report pre-dated the corrective actions that DHIM took in response to the March 2008 HUD audit; therefore, the issues in the Draft Report have already been addressed. Specifically, DHIM conducted additional reviews of the underwriting quality and provided specialized and detailed training and counseling on the issues identified in the HUD audit. DHIM also made several staffing changes in the Southwest Underwriting Center when it became evident that there were concerns of not meeting DHIM's standard of quality after DHIM provided the extensive training and counseling.

Comment 12

While we feel confident that the Company has provided thorough training with the underwriters on any issues cited after the date these loans were underwritten, DHIM will be preparing and conducting additional training with its underwriting department to review the findings of the report and HUD's guidelines surrounding the items noted during the audit. In addition to the training that was provided in 2008, DHIM discovered through its QC audits that the finding regarding material inquires was not being addressed. This issue was addressed and corrected with the underwriting department in January of 2009. Our managers are diligent with providing on-going training with our underwriting team and will continue to do so in areas where opportunities for improvement present themselves.

Comment 13

In further response to Finding #2, Addendum 1 hereto contains DHIM's loan-by-loan response to each of the alleged underwriting deficiencies set forth in the Draft Report.

Finding #3: Quality Control Was Inadequate.

Comment 14

DHIM is strongly committed to strict compliance with federal, state, and agency regulations and to providing high quality loans to its borrowers as evidenced by its retention of extremely knowledgeable and ample quality control staff. We provide the following explanations in connection with Finding #3:

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On-Site Quality Control Branch Reviews Were Inadequate.**Comment 15**

For a brief period, DHIM employed [REDACTED] as a loan officer. During the course of this audit, DHIM learned that [REDACTED] had been debarred from participation in the FHA program. Accordingly, DHIM immediately reviewed and identified the weakness in its verification process for identifying debarred individuals that caused the error and it has corrected its practice to ensure that it does not occur in the future. Following is an explanation of what occurred in connection with [REDACTED] and DHIM's procedure that was used in processing [REDACTED] eligibility. Attached for review as Exhibit A are multiple examples of the LDP / GSA searches performed on [REDACTED]. In each of the examples provided, with the exception of one GSA search, no matches were found. However, in one example, the search indicated that additional research should have been conducted on [REDACTED] which, unfortunately, was missed by the loan processor and the underwriter. The GSA/EPLS search engine allows for both an exact and partial name search. DHIM had used the "exact" name for all but the one search for [REDACTED] all yielding no results. When DHIM learned of the error, it completed a "partial" name search which provided notice of [REDACTED] debarment.

Comment 16

Accordingly, DHIM has adjusted its policy to include the use of the "partial name search" in order to capture accurate data, followed by the exact name search as a means to distinctly confirm an individual is debarred once identified through the partial search. As part of the hiring process, DHIM completes the searches prior to employment within its corporate Human Resources Department and then semi-annually by the Quality Control Department. In addition, the loan processor conducts a LDP / GSA search for all applicable parties to the transaction as required by HUD (buyer(s), seller, loan officer, listing and selling agents, listing and selling agents agency and any non-profit gift contributor) on each loan file to ensure that each party is clear and that the documentation is included within each loan file. Copies of our policies: QC. 009 HUD-FHA Denial of Participation (LDP/GSA), QC 009.01 HUD-FHA Denial of Participation (LDP/GSA), and Training Bulletin 090806-GSA Search, which was provided to the field outlining this practice, are attached as Exhibit B, hereto.

Comment 17

In conducting additional research regarding [REDACTED], on August 12, 2009, DHIM interviewed the Regional Operations Manager for the DHIM Southwest Region, the former Branch Manager for the Tucson Branch (who is now the Assistant Branch Manager in another location), a former Tucson Loan Officer that is still with the company and a former Tucson Loan Officer that is no longer employed by DHIM. None of the employees indicated that they were aware of [REDACTED] debarment at the time he worked for DHIM. In addition, they indicated that they found his debarment quite puzzling considering that [REDACTED] had worked for [REDACTED] immediately prior to joining DHIM. Prior to entering the mortgage industry, [REDACTED] was employed in the medical profession in the Dominican Republic. While none of these individuals remain in contact with [REDACTED], they believe that he has returned to the Dominican Republic to continue to pursue his medical career.

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Names were redacted on this page for privacy reasons.

Comment 18

The Draft Report further indicates that “DHI Mortgage officials did not always notify HUD of branch changes in a timely manner.” Due to the business model in the Arizona Market, DHIM had four (4) distinct mortgage branch operations, each with the ability to offer FHA-insured loans. With the impending recession and slowing of the Arizona market, DHIM, like many other lenders in the industry, consolidated and resized its operations in accordance to market demand.

Comment 19

It has been DHIM’s practice to terminate the FHA ID for a mortgage branch once the loan pipeline has been closed out and insured. As support for this practice, attached as Exhibit C, is an e-mail exchange between DHIM and a HUD employee of the FHA Lender Approval Branch in Washington, DC. In that communication, the HUD employee states that DHIM “should wait until the Branch’s pipeline has emptied before you terminate it to reduce the risk of problems getting its originations insured.” Additionally, in the e-mail exchange, DHIM asks for further guidance regarding how it should notify HUD of the branch change for the interim period between its closing of the pipeline and notification of the branch change within the FHA Connection system. The HUD employee provided mailing instructions and stated that “We don’t see the need for the letter....”

Comment 20

Further, the timeline of the branch consolidation is also relevant:

1/20/08 - The DHIM Dietz Crane branch closed, and the FHA branch ID number was retained while the FHA pipeline closed and through with government insuring.

3/01/08 - Two (2) new loan officers were hired to originate loans for the Dietz Crane builder division out of the Urban Living Branch. The loan officers were not notified to utilize the Urban Living FHA ID number and, with the Dietz Crane number not being terminated due to pending loan in its pipeline, the branch ID number was inadvertently used by the loan processors in ordering new FHA case numbers.

8/04/08 - The Urban Living branch was closed and merged with the Phoenix Continental Homes, Inc. (“CHI”) branch (0542400095). The address change was not made immediately within the FHA Connection as the FHA Connection does not allow for duplicate physical address locations.

8/05/08 – DHIM’s Licensing department sent a notification to the managers in the Southwest Region and the Phoenix CHI branch confirming the merge of the Urban Living branch and that the FHA ID number of 0542400095 should be utilized going forward for all FHA loans.

9/17/08 - A reminder was sent to the Phoenix CHI branch management to ensure that the correct FHA ID number of 054200095 is being utilized when ordering new case numbers.

Based on this timeline outlined, and the instruction provided directly by HUD, DHIM respectfully disagrees with the OIG’s finding that DHIM failed to notify HUD of branch changes

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Comment 21

in a timely manner. If there is a consistent and more accurate timeframe for notification contrary to what DHIM had verified with HUD, we respectfully request written instruction outlining the correct process and will readily adjust our procedures in accordance with the revised guidance.

Additionally, we have attached as Exhibit D, copies of the following policies: LC.005 FHA BRANCH ID: TERMINATION, QC.001 FHA Branch ID Termination/Merge, and LC.04 FHA Branch ID: Merge. These policies are used to monitor pipelines through government insuring for branches that merge with another branch or that are closed or "decommissioned," to ensure that HUD is notified of such changes in a timely manner.

Comment 22

FHA-Insured Quality Control Reviews Were Inadequate. Appendix E: Quality Control Review Deficiencies Noted by FHA Loan Number.

In response to the loans reviewed as shown in Appendix E, DHIM has enhanced its Quality Control Plan to include the following policies: RES.006 Early Payment Default Audits, Early Payment Default Checklist, RES.004 Origination Risk Committee, and QC.0XX Re-Verifications. Copies of these policies are attached as Exhibit E, hereto.

DHI Allowed Conflicts of Interest.

Comment 23

The Draft Report identifies two specific findings which the OIG alleges constitute conflicts of interest. The first finding is as follows:

Both the president and vice president of compliance for DHI Mortgage also worked in official capacities for DHI Title. Additionally, there was no evidence that DHI Mortgage reviewed or otherwise provided assurance that a clear and effective separation of the two entities existed and that the borrowers knew at all times exactly with which entity they were doing business – as required by HUD Handbook 4060.1, paragraph 2-9-C. Such dual authority raised questions regarding the independence of the lending and closing functions.

DHIM respectfully disagrees with this finding as it is neither supported by DHIM's practice nor evidenced by the letter provided by the OIG as the basis of its concern. At all times, the responsibilities of the two DHIM and DHI Title ("DHIT") officers were conducted with a clear and effective separation, and, at no time were any of its borrower's unclear as to which entity they were conducting business with.

As stated in HUD Handbook 4060.1 REV2, paragraph 2-9C:

Companies with Joint Officers. If a mortgagee has any of the same officers, stockholders, partners, or members as another entity, the officers may represent more than one entity if:

1. There is a clear and effective separation of the two entities, and mortgagors know at all

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- times exactly with which entity they are doing business.
2. There is a duly appointed or elected senior officer, with the required minimum three years of acceptable experience, designated to conduct exclusively the affairs of the mortgagee during normal business hours.

Comment 24

During the audit, the OIG provided the letter which was the basis on which the OIG raised its concern regarding the purported lack of clear and effective separation of the officers' duties. In the letter, which was dated April 7, 2009, ██████████ President of DHIM and DHIT, was providing comments to HUD in connection with a rulemaking proceeding involving HUD's proposed rule on "required use." See HUD Docket No. FR 5180-F-05, RIN 2502-A161. Given ██████████ experience with both entities, he was well-suited to provide comments on behalf of the two entities. The letter, however, does not support the Draft Report's conclusion that ██████████ violated the guideline cited above.

Comment 25

Following the audit, we provided an explanation of the circumstances in which one of its officers, ██████████ served in a dual capacity role for DHIM and DHIT for a brief period of time. Specifically, ██████████ served as the National Operations Manager of DHIT for approximately eight years. At the end of 2008, ██████████ was offered a position with DHIM as the Compliance Manager. ██████████ accepted the position and transferred to DHIM. Due to the decrease in business in the financial services industry, his former position with DHIT was eliminated and his duties disseminated among existing personnel.

In order to allow for a smooth transition for both companies, and based on his extensive history with DHIT, an agreement was reached between DHIT and DHIM to allow ██████████ to be available to answer questions from time to time during the transition period. During this time period ██████████ involvement with DHIT was extremely limited and provided for no conflict of interest between DHIT and DHIM. As all of his DHIT duties have been fully assumed, the agreement between the entities has since been terminated. At no time during the transition period was any mortgagee confused as to the entity with which they were doing business.

Comment 26

DHIM has implemented a policy regarding officials serving DHIM and DHIT to ensure that a clearly defined separation exists between the two entities and that at all times a borrower knows exactly with which entity they are doing business. A copy of the policy is attached as Exhibit F, hereto.

Comment 27

The second finding in the Draft Report under the heading of conflict of interest was as follows:

Underwriters' compensation agreements at DHI Mortgage included compensation based on the number of loan decisions made. This is a form of commission contrary to HUD Handbook 4060.1, paragraph 2-9A (see criteria in appendix). Commissions provide an incentive for underwriters to focus on quick underwriting decisions rather than compliance with FHA insurance requirements.

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DHIM's compensation agreements relating to its underwriters is also cited in support of the finding that "FHA Quality Control Requirements Were Disregarded", in Finding #3 of the Draft Report. DHIM respectfully disagrees with this finding, as its bonus plan in connection with underwriting staff is in compliance with the HUD guidelines and does not create a conflict of interest.

As stated in HUD Handbook 4060.1 REV2, paragraph 2-9A:

Compensation of employees may be on a salary, salary plus commission, or commission only basis and includes bonuses. All compensation must be reported on Form W-2. Employees who perform underwriting and loan servicing activities may not receive commissions.

DHIM underwriters are paid a salary and are eligible for a bonus. The bonus plan requires the underwriter to meet two thresholds -- one tied to the quality of the loans underwritten, and a second tied to the total number of decisions made during the specified period regardless of whether the decision resulted in a loan approval or denial. DHIM's current underwriter bonus plan is in no way a "form of commissions, in appearance and in fact" as cited by the OIG. The lack of ties to an approval driven decision, or the funding of a loan, demonstrates that the underwriter is not in any way enticed to improperly decision a loan. The Quality Control reviews of the underwriting department further manage the decisions made by the underwriters to insure that, regardless of volume, the quality of the underwriting, as well as the overall loan transaction, remains paramount.

Comment 28

In spite of its disagreement with the finding in the Draft Report, effective September 1, 2009, DHIM will revise its bonus compensation structure for its underwriters as follows: In addition to their salary, all underwriters will be paid a set monthly bonus as determined by: 1) the underwriter's level of experience; and 2) the underwriter's satisfactory performance in accordance with the established quality control thresholds each month.

Comment 29

Finally, as part of its corrective actions in response to Finding #3, DHIM has adopted the following policies:

Exhibit B:

- HUD- FHA Denial of Participation (LDP/GSA): Policy No.: QC.009
- HUD- FHA Denial of Participation (LDP/GSA): Policy No.: QC.009.01
- Training Bulletin 090806 – GSA Search

Exhibit D:

- FHA Branch ID Termination/Merge: Policy No. QC.001
- FHA Branch ID Merge: Policy No. LC.004

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August 24, 2009

- FHA Branch ID: Termination: Policy No. LC.005

Exhibit E:

- Early Payment Default Audits: Policy No. RES.006
- Re-Verification Procedure: Policy No. QC.OXX

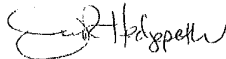
Exhibit F:

- Joint Officers: Policy No. HR.007

Copies of these policies are attached hereto as Exhibits B, D, E, and F.

In conclusion, DHIM appreciates the opportunity to submit this Response to the Draft Report and it hopes that the OIG will modify its Draft Report accordingly. We believe that there is no question but that it was, and remains, the intent of DHIM to comply fully and completely with all standards set forth by HUD and all applicable state and federal laws. While the Draft Report did uncover some weaknesses in DHIM's operations, we believe that the corrective actions identified herein have remedied the issues raised by the OIG. We will be happy to provide you with additional information, or to discuss the information in this Response, at your convenience.

Sincerely,



Jennifer Hedgepeth
Vice President/National Operations Manager
DHI Mortgage Company, LTD

Enclosures

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Comment 30

ADDENDUM 1 TO DHIM'S RESPONSE
DHIM'S RESPONSE TO AUDIT FINDING #2

022-1864520

We are seeking indemnification of this loan based on the lender's failure to properly determine the borrower's capacity to repay the mortgage debt and based on the executed schedule A to purchase contract.

OIG Finding

Income

Although the lender obtained a verification of employment, the lender failed to obtain the most recent pay stub or any other current paystub for the borrower that reflected at least one month of year-to-date earnings as required by Mortgagee Letter 2004-47 to verify current employment. Thus, the lender should have obtained an additional pay stub for the borrower before closing. Since the lender could not verify the borrower's wages properly, the income may not be used in calculating the borrower's income ratios, as stated in HUD Handbook 4155.1, chapter 2, section 2. Accordingly, because the lender could not verify the borrower's qualifying wages, it failed to properly determine the borrower's capacity to repay the debt.

DHIM Response

Income

Agree. A 30 day paystub should have been obtained along with the written Verification of Employment to verify income.

OIG Finding

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof that the account should not have been included. Thus, the additional monthly liability of \$1,247 per month must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

The loan file did not contain an explanation for the three credit report inquiries on the borrower's credit report and the five significant credit report inquiries on the nonpurchasing spouse's credit report that were within 90 days of the credit report date as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

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Comment 31

DHIM Response

Credit

Disagree. The Countrywide Home Loans account was excluded because the property was sold on 10/31/06. There is a HUD-1 in the file to evidence the sale of the home along with payoff of the Countrywide Home Loans account.

Credit

Agree. An inquiry letter should have been obtained to explain material inquiries on both the Borrower's and Coborrower's credit reports.

OIG Finding

Assets

The \$11,000 in net equity assets used to qualify the borrower was not verified and documented as required by HUD Handbook 4155.1, paragraph 2-10G, and the Fannie Mae Underwriting Findings.

Comment 32

DHIM Response

Assets

Disagree. The net equity used to qualify the borrower is evidenced by the HUD-1 from the sale of their current home which shows \$11,863.41 net proceeds to the borrower.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Comment 33

DHIM Response

Contract

Disagree – See DHIM's Response to Audit Finding #1

022-1874931

We are seeking indemnification of this loan because a Chapter 7 bankruptcy rendered it ineligible at the time of closing and based on the executed schedule A to purchase contract.

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Comment 34

OIG Finding

Credit

The borrower had a Chapter 7 bankruptcy discharged on July 28, 2005, and the loan closed on April 6, 2007; therefore, two years did not elapse between the bankruptcy and the loan closing as required by HUD Handbook 4155.1, paragraph 2-3E. Additionally, the borrower's ability to responsibly manage his or her financial affairs was not documented in the loan file.

DHIM Response

Credit

Disagree. Borrower had extenuating circumstances due to medical problems that led to a loss of employment and wages and subsequently caused the Chapter 7 bankruptcy. Per FHA guidelines, an elapsed timeframe of less than 2 years from a Chapter 7 bankruptcy is acceptable if the borrower can show that the bankruptcy was caused by extenuating circumstances in addition to documenting that the situation that led to the bankruptcy is not likely to recur. DHIM obtained a letter from the borrowers regarding the circumstances that led to the bankruptcy but could not obtain more documentation without creating a HIPPA violation.

The borrowers had re-established credit since the previous bankruptcy and had obtained stable employment. The medical condition had been corrected and the borrowers appeared stable at the time of loan approval.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM's Response to Audit Finding #1

022-1883463

We are seeking indemnification of this loan based on the debarred loan originator and the executed schedule A to purchase contract. The FHA-insured loan had an additional minor underwriting deficiency that did not affect the overall insurability of the loan.

Comment 35

Comment 36

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

OIG Finding

Other

The lender included a loan discount fee of \$3,396.54 in the loan amount financed contrary to HUD Handbook 4000.2, paragraph 5-2P, which states that “[d]iscount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount.” Additionally, the loan discount fee was not included in the good faith estimate that was prepared four days before settlement.

DHIM Response

Comment 37

Other

Disagree. The Loan Discount Fee of \$3,396.54 was not financed into the mortgage amount as evidenced by the final Mortgage Credit Analysis Worksheet. Borrower’s closings costs of \$1,951.35 were financed per the final MCAW. The minimum required investment for a sales price of \$229,990.00 is \$6,899.70 (3%), with a base loan amount of \$223,090.00 for an LTV of 97% also as reflected on the final MCAW. The HUD-1 reflects that Nehemiah provided down payment assistance in the amount of \$13,799.40 which covers the borrower’s minimum investment plus additional closing costs. As the OIG also noted, this alleged underwriting deficiency did not affect the overall insurability of the loan.

OIG Finding

Other

The loan was originated by a loan officer employed by DHI Mortgage who was listed on the General Services Administration Excluded Parties List System7 contrary to HUD Handbook 4000.2, paragraph 1-6A, which requires a mandatory rejection if any party to the transaction appears on this list.

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Comment 38

DHIM Response

Other

Disagree. Loan Officer [REDACTED] was checked through the LDP and GSA lists as required by FHA and no evidence was found that he was on either list at the time of loan approval. *See also* DHIM's Response to Audit Finding #3.

022-1883781

We are seeking indemnification of this loan based on the debarred loan originator and the executed schedule A to purchase contract. We did not identify other significant underwriting deficiencies.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – *See* DHIM's Response to Audit Finding #1

OIG Finding

Other

The loan was originated by a loan officer employed by DHI Mortgage who was listed on the General Services Administration Excluded Parties List System, contrary to HUD Handbook 4000.2, paragraph 1-6A, which requires a mandatory rejection if any party to the transaction appears on this list

Comment 40

Other

Disagree. Loan Officer [REDACTED] was checked through the LDP and GSA lists as required by FHA and no evidence was found that he was on either list at the time of loan approval. *See also* DHIM's Response to Audit Finding #3.

022-1890152

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 38.52 and 58.95 percent respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in

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Names were redacted on this page for privacy reasons.

Comment 41

Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's overtime income was inappropriately included, resulting in an overstatement of the monthly income by \$1,084.29.

DHIM Response

Income

Disagree. The borrower had been on his job for 3 years at the time of approval, had earned overtime every year and the employer stated overtime was likely to continue. The amount of overtime had increased from \$7,445 in 2005 to \$13,183 in 2006. Through July 7, 2007 the overtime earned was \$6,776 which makes it on a similar pace as 2006. The underwriter used a year-to-date average of 2007 overtime ($\$6,776 / 6.25 \text{ months} = \$1,084 \text{ per month}$). A 30.25 month average of the overtime would have resulted in \$906 per month which would not be a material difference and would not have changed the underwriting decision.

OIG Finding

Credit

The loan file did not contain an explanation for the 11 credit report inquiries that were within 90 days of the completed credit report, as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

DHIM Response

Credit

Agree. An inquiry letter should have been obtained to determine whether the material inquiries resulted in new debts.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also

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Comment 42

prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

022-1892652

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 41.54 and 51.40 percent, respectively, which far exceeded HUD’s mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower’s overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower’s overtime income was inappropriately included in the borrower’s monthly income, resulting in overstating the monthly income by \$557.12. Additionally, the lender did not establish that the borrower’s overall employment would likely continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower’s capacity to repay mortgage debt.

The borrower, at the time of loan approval, was employed by DHI Mortgage and was laid off shortly after the loan was approved. Therefore, the lender should have known the employment would not have lasted for at least the first three years of the loan, which is required to be established by HUD Handbook 4155.1, chapter 2, section 2, to determine a borrower’s capacity to repay mortgage debt.

DHIM Response

Income

Disagree. The Borrower had been employed by DHI Mortgage for over 2 years, had received overtime and bonus income throughout that time and the overtime and bonus income was marked likely to continue on the Verification of Employment. The overtime and bonus income was averaged over 26 months which is an appropriate timeframe.

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In addition, the date of final loan approval was 9/17/07 and the loan closed 9/26/07. The Borrower's date of employment termination was 10/3/07 which was after final approval and loan funding. The Underwriter would have no prior knowledge of pending company personnel changes and therefore could not have foreseen any reason that this Borrower's income would not be reasonable to continue.

023-2356343

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratio was 83.78 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratio.

OIG Finding

Income

The loan was qualified, in part, on the borrower's base employment income. However, the borrower received Internal Revenue Service Form 1099-MISC, showing nonemployee compensation from the company listed as his current employer, which indicated that he was a contractor rather than an employee. Therefore, the income he received should have been treated as self-employed income rather than employment income. Coborrower A's income also appeared to be nonemployee compensation because no taxes were withheld from the weekly checks and no pay stubs were provided. Therefore, the income coborrower A received should also have been treated as self-employment income.

Neither the borrower's income nor coborrower A's income met the two-year minimum length of self-employment criteria to be included in qualifying income as required by HUD Handbook 4155.1, paragraph 2-9A. This condition resulted in the overstatement of the borrower's monthly income by \$2,080 and coborrower A's monthly income by \$400. Additionally, the lender failed to provide any of the required documents for self-employed income contrary to HUD Handbook 4155.1, paragraph 2-9B.

Bonus income from coborrower B was used in the qualifying income. However, the file did not contain evidence of bonus income for coborrower B as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the bonus income was inappropriately included, and coborrower B's monthly income was overstated by \$300.

DHIM Response

Income

Agree. The Borrower was paid using IRS Form 1099 which indicates self employment and this income would not have been sufficient without a two year history.

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Agree. Coborrower A's income also appears to be from contract work or self employment since no taxes are taken out as indicated on her pay stubs. However, the employer did provide a letter stating she was part of the paid staff which could have been misleading when trying to determine her employment status.

Agree. Coborrower B's bonus income was not documented and should not have been used.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM's Response to Audit Finding #1

OIG Finding

Other

The mortgage credit analysis worksheet provided in the file with the examiner's approval contained different figures than those used for approval in the Automatic Underwriting System. Further, the automated underwriting approval included an additional \$803 per month liability that was not listed in the credit and liabilities section of the Fannie Mae Underwriting Findings. The lender did not explain the additional \$803 debt.

DHIM Response

Other

Disagree. The \$803 debt was the rental obligation for the Non Occupying Coborrower which is required to be counted in the qualifying ratios. This amount should have been on the Mortgage Credit Analysis Worksheet but it was properly reflected in the AUS findings.

023-2375190

We are seeking indemnification of this loan based on the revised total fixed payments-to income ratio, which reflects the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 51.44 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratio.

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OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender failed to (1) support that the coborrower had received such income for the past two years and that it was likely to continue, (2) develop an average of overtime income for the past two years, and (3) establish and document an earnings trend for the coborrower's overtime income. Thus, the lender inappropriately included the coborrower's overtime pay in the ratios, overstating the qualifying total monthly income by \$1,562.87.

DHIM Response

Income

Agree. Overtime, commission and bonus income is not supported in loan file.

OIG Finding

Assets

The lender used a retirement account balance of \$10,443 to assist in qualifying the borrower for the loan. However, the account statement listed only \$8,702.57 in funds available to borrow against the account. Additionally, the lender did not provide evidence that the retirement account allowed for withdrawals for conditions other than in connection with the borrower's employment termination, retirement, or death as required by Mortgagee Letter 2004-47. Therefore, the retirement account funds of \$10,443 used to assist in qualifying the borrower should not have been used as a borrower asset.

DHIM Response

Assets

Agree. The documentation in the file did not support the amount of assets used to qualify the borrower.

023-2375473

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 45.38 and 72.59 percent respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

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OIG Finding

Income

The coborrower's pay stub indicated a set amount of \$1,000 per month outside of commission income. The coborrower had been working for the employer for less than two years, and the lender did not include "a sound rationalization for acceptance" or document the likelihood that the commission income would continue as required by HUD Handbook 4155.1, paragraph 2-7D. Therefore, the lender included \$1,519.32 per month in unallowable income to assist the borrower in qualifying for the loan.

DHIM Response

Income

Disagree. The borrower's pay stub shows a salary of \$1,981.18 paid semi-monthly. In addition, there is a \$500 per month auto allowance which was not used for qualifying. In order to be conservative, the Underwriter took a YTD average of the "salary" listed on the 6/3/06 paystub which resulted a YTD income average of \$2,519.32 per month. There is no indication on the paystub of any "commission" income for the co-borrower.

OIG Finding

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the additional monthly liability of \$10 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

DHIM Response

Credit

Disagree. A credit supplement in the file showed the \$10 monthly debt had been paid in full prior to closing.

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OIG Finding

Credit

The loan file did not contain an explanation for the 14 credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

DHIM Response

Credit

Agree. A letter should have been obtained to determine whether material inquiries resulted in new debts.

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OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

023-2383860

We are seeking indemnification based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

OIG Finding

Income

The lender failed to obtain the most recent pay stub for the borrower that reflected at least one month of year-to-date earnings as required by Mortgagee Letter 2004-47. Thus, the lender should have obtained an additional pay stub for the borrower before closing to properly document the borrower’s income.

DHIM Response

Income

Agree. The borrower started their job on 11/6 and the pay stub was dated 12/8. However, the pay period ended 12/2 so the pay stub did not reflect a full 30 days of YTD earnings. However, as the OIG also noted, this alleged underwriting deficiency did not affect the overall insurability of the loan.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

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DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

023-2384380

We are seeking indemnification of this loan based on the revised mortgage payment-to income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 46.05 and 49.80 percent, respectively, which far exceeded HUD’s mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgage Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document a two year overtime trend analysis as required by HUD Handbook 4155.1, paragraph 2-7 A. The lender also used a thirty two month average for qualifying rather than a twenty four month average as required by HUD Handbook 4155.1, paragraph 2-7 A. The twenty four month average resulted in a declining overtime average which requires additional documentation. However, the lender did not provide a sound rationalization in writing for including the declining overtime income as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower’s overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$319.21.

DHIM Response

Income

Disagree. The borrower had been on the job for 3.5 years and had a history of receiving overtime. The VOE shows overtime as “likely to continue”. DHIM used a 32 month average of overtime income which resulted in overtime of \$319.21 per month. If we had used a 24 month average of 2004 and 2005 the overtime would have been \$355 per month. The YTD overtime income was declining slightly and averaged out to \$210 per month. The most conservative approach would have been to use the YTD average of \$210 per month which would have resulted in a ratio increase from 42.1/ 45.6% to 43.4/46.9%. This would not have changed the underwriting decision on a 702 credit score.

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OIG Finding

Credit

The loan file did not contain an explanation for the seven credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

DHIM Response

Credit

Agree. A letter should have been obtained to determine whether material inquiries resulted in new debts.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – *See* DHIM’s Response to Audit Finding #1.

023-2388693

We are seeking indemnification based on the executed schedule A to purchase contract.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – *See* DHIM’s Response to Audit Finding #1

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023-2389873

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 42.29 and 60.49 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime, commission, and bonus income used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A, when the borrower was with the employer for less than two years. Thus, the borrower's overtime, commission, and bonus income was inappropriately included in the borrower's monthly income, resulting in an overstatement of the borrower's monthly income by \$1,057.30.

DHIM Response

Income

Agree. The income calculation used to qualify the borrower was inappropriately included since the borrower had been with the employer less than 2 years.

OIG Finding

Credit

The lender excluded two of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$115.70 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

DHIM Response

Credit

Agree. Two debts were excluded from the qualifying ratios however one of the debts was clearly a duplicate of another debt that had already been counted. That leaves only one debt that was actually excluded with a \$58 monthly payment.

023-2391447

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the qualifying liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 47.96, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that

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could have justified the excessive ratio. Additionally, we were unable to calculate the true total fixed payments-to-income ratio as the details provided in the loan file did not contain the information needed to accurately calculate the borrower's net rental income or loss.

OIG Finding

Income

The overtime income used to qualify the borrower was not based on a 24-month average of overtime earnings as required by HUD Handbook 4155.1, paragraph 2-7A.

DHIM Response

Income

Disagree. The borrower had a documented trend of receiving overtime income on his current job for over 2 years and the employer had stated that the overtime was likely to continue on the written Verification of Employment dated 9/26/06. The overtime income was averaged over a 20.5 month period for a total of \$899.75 per month. Had the income been averaged over a 32.5 month period of time, the result would have been \$727.85 per month. The difference is nominal and would have only increased the debt-to-income ratio from 45.90% to 47.58% which would not have affected the loan decision; especially since the overtime was trending upward in the most recent 2 years.

OIG Finding

Credit

The credit report contained a civil judgment with a handwritten statement which stated that it would be paid at closing. However, the lender did not provide support that the civil judgment was satisfied before closing as required by HUD Handbook 4155.1, paragraph 2-3C. The HUD-1 settlement statement listed the judgment to be paid at closing, but the title file showed that the check to pay off the judgment was voided.

The loan file contained nothing to support that the borrower received permission from the court to enter into the mortgage transaction as required by HUD Handbook 4155.1, paragraph 2-3E, after the borrower filed for Chapter 13 bankruptcy.

We were unable to determine the actual net loss on the borrower's rental property, as the loan file did not contain enough information to determine the additional expenses associated with the rental property. The lender did not determine the amount for the fee listed as "TRASH" payable by the owner on the lease agreement. Additionally, the lender did not obtain information as to whether the rental property had corresponding monthly mortgage insurance premiums or homeowners' association dues. Therefore, the lender did not properly calculate the net rental profit or loss in accordance with HUD Handbook 4155.1, paragraph 2-7M2, which requires that, after the gross rental amount is reduced for vacancies and maintenance, then the principal and interest, homeowners' association dues, etc., are to be subtracted to determine the net profit or loss on the rental property.

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The lender excluded the borrower's Chevron account listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$10 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

DHIM Response

Credit

Agree. Sufficient evidence that the judgment was paid at closing was not obtained.

Agree. The file does not contain evidence that the borrower received permission from the court to enter into a mortgage transaction.

Agree. The loan file did not contain evidence of the cost of "Trash" which was to be paid for by the Borrower in association with the lease agreement on the rental property.

Agree. The Chevron debt was excluded from the qualifying ratios. However, this debt was only \$10 per month and would have been unlikely to change the loan decision.

023-2409090

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan.

OIG Finding

Contract

The lender did not provide the addendum to the purchase contract for occupancy/investment disclosure in the FHA loan file as required by HUD Handbook 4155.1, paragraph 3-1H, and the Fannie Mae Underwriter Findings.

DHIM Response

Based on this one finding, a response is not required. . As the OIG noted, this alleged underwriting deficiency did not affect the overall insurability of the loan.

023-2412241

We are seeking indemnification of this loan based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

OIG Finding

Credit

The lender excluded the coborrower's auto lease listed on her pay stub without providing an explanation or proof of the reason for the exclusion. Thus, the additional monthly

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liability of \$356.38 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings. As the OIG also noted, this alleged underwriting deficiency did not affect the overall insurability of the loan.

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DHIM Response

Credit

Disagree. The debt for the coborrower's lease in the amount of \$356.38 would have increased the debt-to-income ratio from 33% to 40% which would still have been within HUD guidelines and would not have changed the loan decision.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

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Contract

Disagree – See DHIM's Response to Audit Finding #1

023-2414288

We are seeking indemnification of this loan based on the inability to determine the borrower's liabilities.

OIG Finding

Income

The borrower's income was not verified through a completed verification of employment as required by the Fannie Mae Underwriting Findings. The verification of employment did not contain earnings details, and the probability of continued employment was marked "n/a," indicating non-applicable.

DHIM Response

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Income

Disagree. DHIM met the AUS findings which required a year-to-date pay stub and a verbal verification of employment. The employer would not complete the verbal verification of employment over the phone so we verified the information in writing. Most employers will not comment on probability of continued employment and will frequently mark "n/a" as a response to this question.

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OIG Finding

Credit

The lender did not obtain a credit history for the borrower's nonpurchasing spouse as required by HUD Handbook 4155.1, paragraph 2-2D, which requires a credit report for a nonpurchasing spouse in a community property state such as Arizona. Although the nonpurchasing spouse provided a letter stating that she did not have a Social Security number, it remains the lender's responsibility to exhaust all possible means to resolve the issue. Without obtaining the nonpurchasing spouse's credit report or establishing alternative credit, the lender was unable to determine the coborrower's liabilities.

DHIM Response

Credit

Disagree. The non purchasing spouse provided a letter stating she did not have a Social Security number and therefore DHIM was unable to pull a credit report through the credit bureaus.

023-2425869

We are seeking indemnification of this loan based on the revised mortgage payment-to income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 53.89 and 84.26 percent, respectively, which far exceeded HUD's mortgage payment-to income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The borrower's income used to qualify was based, in part, on Social Security disability income; however, the lender did not obtain supporting documents to show that this income was likely to continue for at least the first three years of the mortgage as required by HUD Handbook 4155.1, paragraph 2-7E. Therefore, the income did not meet the requirements for use in qualifying the borrower. This condition resulted in an overstatement of the borrower's income by \$1,886.63.

DHIM Response

Income

Disagree. The Social Security Administration will not provide any information regarding disability income and/or its likelihood to continue. The borrower had received the income for six years and there was documentation in the file that the borrower's pension income was a lifetime benefit due to disability so it was reasonable to conclude that the Social Security income would also continue for the next three years.

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OIG Finding

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$103 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

DHIM Response

Credit

Agree. The debt for \$103 should have been included in the qualifying ratios. However, it is unlikely to have changed the underwriting decision. The debt-to-income ratio would have increased from 42% to 45% on a 680 credit score.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM's Response to Audit Finding #1

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023-2426099

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 37.35 and 71.32 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including

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the borrower's overtime pay and (2) an overtime trend over a two-year period. Although the lender documented on the verification of employment that the overtime income was likely to continue and that it was based on a 24-month average, the most recent pay stub provided for the new year did not support the continuance of the overtime income. Thus, the borrower's overtime income was inappropriately included in the borrower's monthly income, resulting in an overstatement of the borrower's monthly income by \$3,323.93.

DHIM Response

Income

Agree. The income average approved by the Underwriter was not supported by the most recent year-to-date pay stub.

OIG Finding

Debt

The lender did not include a new debt, a timeshare that resulted from a material inquiry, "Merchants Credit Info," listed on the borrower's credit report as required by HUD Handbook 4155.1, paragraph 2-3B, and the Fannie Mae Underwriting Findings. The inclusion of this debt would have further increased the total fixed payments-to-income ratio.

DHIM Response

Debt

Agree. DHIM did not obtain an explanation for material inquiries and, therefore, did not discover the new debt acquired by the Borrower prior to closing.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM's Response to Audit Finding #1

023-2427150

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After

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revision, the ratios were 46.67 and 73.99 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the inclusion of bonus earnings in the qualifying ratios as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's bonus pay, (2) a bonus trend over a two-year period, (3) that the amount of monthly bonus income used was based on a 24-month average, and (4) the likelihood that the bonus income would continue. Thus, the borrower's bonus income was inappropriately included and resulted in an overstatement of the monthly income by \$1,198.68. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower's capacity to repay mortgage debt.

DHIM Response

Income

Agree. Bonus income was not averaged over a 24 month period and, therefore, could not be determined as likely to continue.

OIG Finding

Credit

The lender did not provide supporting documentation of the deposit amount and the source of funds the borrower used to pay the \$1,000 earnest money deposit as required by HUD Handbook 4155.1, paragraph 2-10A, when the borrower's documented savings does not support the ability to pay such deposit. During an interview with the borrower, we were informed that the \$1,000 earnest money deposit was borrowed from family. However, we did not include this information in the revision of the borrower's ratios, although doing so would have further increased the borrower's total fixed payments-to-income ratio.

DHIM Response

Credit

Disagree. The loan file contained a cancelled check from the borrower for the \$1000 earnest money so there was no reason to believe that the deposit was not paid from the borrower's own funds. The borrower's net payroll checks were over \$900 every two weeks plus bonuses of approximately \$1000 per month so this size earnest money check

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would not be considered an unusual amount for the borrower to pay from his own earnings and savings.

OIG Finding

Assets

The \$1,380 in retirement assets listed to qualify the borrower was not verified and documented as required by HUD Handbook 4155.1, paragraph 2-10, and the Fannie Mae Underwriting Findings.

DHIM Response

Assets

Agree. No documentation was in the file to document the retirement assets used.

023-2435939

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 59.44 and 103.94 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The borrower's income used to qualify was based on Social Security disability income; however, the lender did not obtain supporting documents to show that this income was likely to continue for at least the first three years of the mortgage as required by HUD Handbook 4155.1, paragraph 2-7E. Therefore, the income did not meet the requirements for use to qualify the borrower. This condition resulted in an overstatement of the borrower's monthly income by \$2,013.75.

The coborrower's employment was not verified as likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower's capacity to repay mortgage debt.

DHIM Response

Income

Agree. DHIM did not document the likelihood of the Social Security disability income to continue. However, the borrower was of retirement age and had been receiving the income for the three prior years. Any additional documentation directly related to the disability of the borrower would have violated HIPPA.

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Disagree. The coborrower had been employed for 3.5 years and we had no reason to question the continuance of the coborrower's employment.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Comment 66

Contract

Disagree – See DHIM's Response to Audit Finding #1

023-2438080

We are seeking indemnification of this loan based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

OIG Finding

Credit

The lender excluded four of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

DHIM Response

Comment 67

Credit

Disagree. The four accounts were collection accounts. The loan was an Approve/Eligible loan through AUS. Therefore it was the Underwriter's discretion whether to require payment in full. As the OIG also noted, this alleged underwriting deficiency did not affect the overall insurability of the loan.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

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DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

023-2438810

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the qualifying liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratio was 78.57 percent, which far exceeded HUD’s total fixed payments to income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document an allowable compensating factor that could have justified the excessive ratio.

Credit

The documentation in the loan file did not support that the six student loans were deferred or otherwise should have been excluded from the borrower’s total fixed payments-to-income ratio. The student loan repayments, according to the borrower’s credit report, were set to begin September 13, 2007. Since the repayment of the loans was to begin within five months of closing, the student loans were required to be included as a monthly liability as stated in HUD Handbook 4155.1, paragraph 2-11C. Additionally, debts without a monthly repayment term specified on the credit report are to be calculated at 5 percent of the balance or \$10 per month, whichever is greater. Thus, the balance of the student loan accounts of \$32,365 multiplied by 5 percent equates to an additional monthly debt of \$1,618.25, which was not included by the lender in the total fixed payments-to-income ratio.

In addition to the excluded liabilities discussed above, the borrowers informed us that they borrowed about \$3,600 before closing with repayment terms of at least \$150 per month. This would have increased the ratios further; however, we did not include this monthly obligation in our revision of the ratios because we did not have the exact amount of the debt or the repayment terms.

DHIM Response

Credit

Disagree. The file did not contain evidence that the six student loans were deferred for more than 12 months from closing which would have justified their exclusion. However, the file did contain evidence that the borrower had further enrolled in college classes starting June 2007 and going through August 2008 which would have led to further deferment of the borrower’s student loans for as long as borrower was in school.

Disagree. There was no way for DHIM to have known that the borrower had taken out a new debt prior to closing. There was a letter in the file from the borrower explaining all inquiries on the credit report and this letter did not indicate the borrower had opened any new debts prior to closing.

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OIG Finding

Assets

A recent bank statement accompanying the verification of deposit—needed to support the borrower’s assets—was not provided as required by HUD Handbook 4155.1, paragraph 3-1F. Additionally, the lender failed to obtain documentation of the source of funds used for the earnest money deposit when the verification of deposit did not support the borrower’s ability to fund the earnest money deposit as required by HUD Handbook 4155.1, paragraph 2-10A.

DHIM Response

Assets

Agree. There was no evidence in the file that the borrower had sufficient assets to pay for the earnest money deposit.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

023-2442707

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 32.28 and 48.40 percent, respectively, which exceeded HUD’s mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. Although the lender documented that the borrower had received

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overtime income in the past, the lender failed to support that the overtime income was likely to continue. Further, the most current pay stub used to support the borrower's income provided a gross pay amount for the current year that did not support the continuance of the overtime pay. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of monthly income by \$544.08. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

DHIM Response

Income

Disagree. The borrower worked for the US Postal Service since December 2001. The income was averaged as a whole (base + overtime) over a 24 month period. Borrower has a history of increased earnings and taking this type of average would be acceptable and likely to continue considering length of employment and profession. If only base pay had been used, the debt-to-income ratio would have increased to 48%, and it is reasonable to believe file would still have been approved.

023-2447263

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan

OIG Finding

Income

The loan file did not support that the bonus income used to assist in qualifying the borrower was likely to continue as required by HUD Handbook 4155.1, paragraph 2-7A. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

DHIM Response

Income

Disagree. The employer sent its own version of a written Verification of Employment and its form does not include likelihood of continued employment. It is not uncommon for employers not to answer this question and there was no reason for DHIM to believe the income would not continue as the employee had been with the same employer for eight years and a two year average of income was used.

OIG Finding

Other

The lender included a loan discount fee of \$8,298.39 in the loan amount financed, contrary to HUD Handbook 4000.2, paragraph 5-2P, which states that "[d]iscount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount." Additionally, the loan file demonstrated that the

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borrower paid the closing funds for the loan discount of \$8,298.39 in the form of a cashier's check. Thus, the borrower paid twice for the loan discount.

DHIM Response

Other

Disagree. The loan discount fee of \$8,298.39 was not financed into the mortgage amount as evidenced by the final Mortgage Credit Analysis Worksheet. The borrower's closing costs of \$1,000.00 were financed per the final MCAW. The minimum required investment for a sales price of \$259,343.00 is \$7,780.29 (3%), with a base loan amount of \$251,262.00 for an LTV of 97% also reflected on the final MCAW. The HUD-1 reflects that Neighborhood Gold provided down payment assistance in the amount of \$7,780.00 and the borrower's credit in the amount of \$1,000.00 for earnest money, which covers the borrower's minimum investment. The borrower did not pay twice for the loan discount fee. The discount fee was charged to the borrower at closing in the amount of \$8,298.39. The amount of funds required at closing, less seller paid closing costs (consisting of down payment, all other borrower paid closing costs, etc.) would have come to \$17,078.39. When the credits were deducted (Neighborhood Gold \$7,780.00, earnest money deposit of \$1,000.00) this leaves an amount due from the borrower at closing of \$8,298.39. This is the amount of the cashier's check that the borrower brought to closing (date of the cashier's check, DHI Title receipt of cashier's check and the HUD-1 are all March 30, 2007). Essentially the borrower brought his/her own funds to closing to pay for the amount of the discount points, further evidencing that the discount points were not financed into the loan amount, however paid for by the borrower's own funds that were verified within the loan file. As the OIG also noted, the alleged underwriting deficiencies did not affect the overall insurability of the loan.

023-2452473

We are seeking indemnification of this loan because the lender failed to support the use of the borrower's commission income, which was the sole income used to qualify the borrower.

OIG Finding

Income

The borrower had been with the current employer for seven months at the time of the income verification. The employer remarks stated, "commission paid by flag hour or per job," and listed the borrower's year-to-date earnings under commissions as the sole income used to qualify the borrower. The borrower's previous employer listed income as base pay and not as commission income. Therefore, the lender failed to support the use of the borrower's commission income as required by HUD Handbook 4155.1, paragraph 2-7D, which requires at least one year of earned commissions with a sound rationalization for acceptance documented by the lender.

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DHIM Response

Income

Agree. The commission income was not supported per FHA guidelines

023-2453167

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 40.18 and 63.28 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, (3) that the amount of monthly overtime income used was based on a 24-month average, and (4) the likelihood that the overtime income would continue. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$789.80. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

DHIM Response

Income

Agree. The overtime income was not properly documented as the pay stub reflects all income under base pay. Overtime income should have been based on a 24 month average. We disagree that likelihood of continued employment was in question as borrower had been employed with same company since March 2005.

OIG Finding

Other

The lender's verification of the coborrower's identity resulted in another name being associated with the coborrower's Social Security number provided. However, the lender did not document the resolution of this discrepancy as required by HUD Handbook 4155.1, paragraph 3-1C.

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DHIM Response

Other

Disagree. DHIM obtained a Rapid Reporting Direct Check to verify that the Social Security number matched the borrower.

023-2458663

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 37.04 and 59.84 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime, bonus, and stipend pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime, bonus, and stipend pay; (2) an overtime, bonus, and stipend trend over a two-year period; (3) that the amount of monthly overtime, bonus, and stipend was based on 24-month average earnings; and (4) the likelihood that the overtime, bonus, and stipend income would continue. Thus, the borrower's overtime, bonus, and stipend income was inappropriately included and resulted in an overstatement of the monthly income by \$3,247.01.

DHIM Response

Income

Agree. The borrower's overtime was not documented over a 24 month period and thus, should not have been used in qualifying.

OIG Finding

Credit

The loan file did not contain an explanation for the 12 credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

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DHIM Response

Credit

Agree. DHIM did not obtain a letter to address material inquiries and determine if any new debts had been opened as a result.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

023-2468047

We are seeking indemnification based on the executed schedule A to purchase contract. The FHA-insured loan had an additional minor underwriting deficiency that did not affect the overall insurability of the loan.

OIG Finding

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

DHIM Response

Contract

Disagree – See DHIM’s Response to Audit Finding #1

OIG Finding

Other

The lender included a loan discount fee of \$4054.45 in the loan amount financed, contrary to HUD Handbook 4000.2, paragraph 5-2P, which states, “[d]iscount points

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charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount.”

DHIM Response

Other

Disagree. The loan discount fee of \$4,054.45 was not financed into the mortgage amount as evidenced by the final Mortgage Credit Analysis Worksheet. The borrower’s closing costs of \$1,158.00 were financed per the final MCAW. The minimum required investment for a sales price of \$235,320.00 is \$7,059.60 (3%), with a base loan amount of \$228,260.00 for an LTV of 97% also reflected on the final MCAW. The HUD-1 reflects Gift Funds (Neighborhood Gold down payment assistance) in the amount of \$7,060.00 which covers the borrower’s minimum investment. In addition to seller paid closing costs (which the HUD-1 evidences that the borrower paid \$3,723.56 of the discount points and that the borrower paid \$330.89), the borrower also brought funds to closing in the amount of \$3,000.00 to cover additional closing costs, which were verified in the loan file.

023-2482980

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio and the executed schedule A to purchase contract. The total fixed payments-to-income ratio was 53.76 percent which reflects allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. The total fixed payments-to-income ratio far exceeded HUD’s total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the monthly base pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower’s monthly income was overstated; however, the difference was not material.

DHIM Response

Income

The difference in income calculation is nominal as noted by OIG Finding.

OIG Finding

Credit

The borrower’s credit report showed a late mortgage payment that would require an explanatory statement according to HUD Handbook 4155.1, paragraph 2-3, which states that major indications of derogatory credit require written sufficient explanation from the

borrower. Further, according to HUD Handbook 4155.1, paragraph 2-3A, the payment history of the borrower's housing obligations holds significant importance in evaluating credit. However, no such information was provided.

The borrower had an inquiry on the credit report that was not explained as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, three months before settlement the borrower opened a new credit card that had a balance owed of \$1,339. The lender did not determine the purpose of the debt as required by HUD Handbook 4155.1, paragraph 2-3B.

The lender stated on the mortgage credit analysis worksheet that "[t]he borrower is leasing her existing [mortgaged property], however she qualified with the full mortgage payment."

The fixed payment-to-income ratio (53.76 percent) exceeded HUD's allowable limit of 43 percent without appropriate compensating factors as required by HUD Handbook 4155.1, paragraph 2-13.

DHIM Response

Credit

Agree. DHIM should have addressed the late mortgage payment.

Agree. DHIM did not obtain a letter from the borrower addressing material inquiries that may have resulted in new debts.

Disagree. The comment on the Mortgage Credit Analysis Worksheet cited by the OIG did not correspond to the manner in which the file was approved. The loan was an Approve/Eligible through TOTAL with a 36.37% debt-to-income ratio, which included the lease income and negative net rental income of \$94.75 per month.

OIG Finding

Assets

A recent bank statement accompanying the verification of deposit—necessary to support the borrower's assets—was not provided as required by HUD Handbook 4155.1, paragraph 3-1F.

DHIM Response

Assets

Disagree. The AUS findings state that "one" of the following may be used to verify assets. A) VOD; B) most recent bank statement showing previous months balance; or C) most recent two months bank statements. The VOD was sufficient to satisfy the AUS finding.

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OIG Finding

Other

The lender did not examine HUDs limited denial of participation list or the General Services Administration's Excluded Parties List System for possible inclusion of the borrower's real estate agent as required by HUD Handbook 4000.2, paragraph 1-6A.

DHIM Response

Other

Agree. DHIM did not include the borrower's real estate agent in its search of HUD's limited denial of participation list or the General Services Administration's Excluded Parties Listed System for possible inclusion.

023-2487907

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 50.01 and 63.38 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings, and (4) the likelihood that the overtime income would continue. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$1,070.35. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

DHIM Response

Income

Agree. DHIM noted that the overtime income was not justified since the borrower had only been on the job for one year, thus, a history of previous overtime income was not documented.

023-2529391

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 62.30 and 64.84 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document an allowable compensating factor that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$435.

The borrower's pay stubs did not support 40 hours per week of wages that were used to qualify. The borrower's year-to-date earnings supported a monthly income of \$2,167.35, and this reduced the borrower's qualifying base monthly income by another \$640.65.

DHIM Response

Income

Agree. The overtime income was not verified by the borrower's current employer as likely to continue. The previous written Verification of Employment does not verify overtime earnings. Thus, justification for using overtime income was not sufficiently supported. The borrower's pay stubs do reflect a 40 hour work week. However, year-to-date earnings do not support 40 hours and therefore, the income should have been recalculated using a year-to-date average.

OIG Finding

Other

The lender's verification of the borrower's identity resulted in another name being associated with the borrower's Social Security number; however, the lender did not document the resolution of this discrepancy as required by HUD Handbook 4155.1, paragraph 3-1C.

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DHIM Response

Other

Disagree. DHIM obtained a Rapid Reporting Direct Check to verify the borrower's Social Security number.

023-2640107

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime and bonus pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime and bonus pay, (2) an overtime and bonus trend over a two-year period, and (3) that the amount of monthly overtime and bonus income used was based on a 24-month average of overtime and bonus earnings. Additionally, the lender did not provide a sound rationalization in writing for including the declining bonus and overtime income in qualifying income as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$380.24. The resulting ratio(s) met HUD's threshold(s) after the correct income was applied.

DHIM Response

Income

The income calculation discrepancy was noted as nominal by the OIG and did not affect the overall insurability of the loan.

023-2674566

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 56.36 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

OIG Finding

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower and coborrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's and coborrower's overtime pay, (2) an overtime trend over a

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two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's and coborrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$457. On the mortgage credit analysis worksheet, although the underwriter's approval was present, the remarks section indicated that overtime income was not used to qualify the borrowers. Additionally, the lender did not establish that the borrower's and coborrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2. Further, the most recent two years of employment for the coborrower were not verified as required by HUD Handbook 4155.1, paragraph 2-6, and Mortgagee Letter 2004-47.

DHIM Response

Income

Disagree. The borrower had been on the job for eight years and received overtime for at least the past two years. The underwriter should have used a 25.5 month average of overtime which would have resulted in overtime income of \$112.24 per month instead of the \$151 per month that was used. The difference was nominal and would not have affected the approval decision. The employment verification was done by The Work Number and that entity does not comment on the likelihood of continuance of overtime income or employment.

The coborrower had received overtime for 13 months. If averaged over 16.75 months, the result would have been \$405.44 per month instead of the \$457 that was used. The difference is nominal and would not have affected the approval decision.

The coborrowers income verification noted "n/a" under probability of continued employment. This is not uncommon and many employers refuse to answer this question.

DHIM did show a two year history of employment for the coborrower on the application. Their present employer was Arizona Federal Credit Union from 9/11/06 to present (2/20/08) and the previous employer was Texans Credit Union from 8/2/04 to 9/15/06. We obtained the 2005 W-2 but failed to obtain the 2006 W-2 to verify this employment.

OIG Finding

Other

The loan officer noted that at one time, this FHA loan was rated by the automated underwriting system as refer/eligible; however, the loan was ultimately approved/eligible through the automated underwriting system. This is contrary to the Fannie Mae Underwriting Findings and Mortgagee Letter 2004-47, which indicate that a registered direct endorsement underwriter must fully underwrite those applications in which the automated underwriting system refers the loan application to an underwriter for review and comply with the underwriting requirements described in HUD Handbook 4155.1 and applicable mortgagee letters.

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DHIM Response

Other

Disagree. The loan was an Approve/Eligible at the time of final loan approval and therefore, the underwriter approved the file according to the AUS Findings.

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OIG Evaluation of Auditee Comments

Comment 1 We disagree with DHI Mortgage's assertion that it lacked knowledge that the restrictive covenants were recorded and therefore had no responsibility to ensure its FHA-insured loans were (1) freely assumable as required under 24 CFR (*Code of Federal Regulations*) 203.41, and (2) free and clear of all other liens as required under 24 CFR 203.32(a). The regulations under 24 CFR 203.32(a) state "a mortgagor must establish that, after the mortgage offered for insurance has been recorded, the mortgaged property will be free and clear of all liens other than such mortgage, and that there will not be outstanding any other unpaid obligations contracted in connection with the mortgage transaction or the purchase of the mortgaged property, except obligations that are secured by property or collateral owned by the mortgagor independently of the mortgaged property." Thus, it was DHI Mortgage's responsibility to ensure that the liens, which were included in the restrictive covenant, were not placed against the FHA-insured property. If DHI Mortgage had ensured its FHA loans were free of the improper liens, then it would have been aware that the related properties also had restrictive covenants that violated FHA's free assumability rule.

We agree that the contractual agreement from which the schedule A to purchase contract originated provided exclusionary language for FHA and VA financed loans. Additionally, 24 CFR 203.41(b) explicitly states, "[a] mortgage shall not be eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance." Because the 205 loans discussed under finding 1 of the report were subject to legal restrictions on conveyance, these loans were clearly ineligible for FHA insurance.

Comment 2 We acknowledge the auditee's point that the first statement of finding 1 was imprecise. The original statement under finding 1 "DHI Mortgage approved 205 FHA-insured loans with unallowable restrictive covenants" was intended to address the overall responsibilities of the FHA-approved lender, and not the specific underwriting function. To improve the statement's accuracy we changed the report wording to state DHI Mortgage did not ensure that unallowable restrictive covenants were not filed against FHA-insured properties. We did not change the statement "officials believed it would discourage investors from purchasing their affiliate's (the seller's) properties," because this was based upon the following excerpt from a letter dated June 5, 2009 provided to the OIG by DHI Mortgage's attorney:

Schedule A to the purchase contract was designed to address a significant problem experienced by D.R. Horton, Inc. ~ Dietz-Crane (D.R. Horton) and other home builders when home prices were escalating at a rapid rate. In many cases a buyer claiming to be purchasing a home for his or her residence actually was an investor seeking to purchase and then quickly sell the home at a profit. D.R. Horton did not consider the flipping practice to be consistent with the goal of building sustainable communities at reasonable prices. FHA even recognized the various

We acknowledge that DHI Mortgage used the Schedule A to Purchase Contract with the conventional market in mind. However, 24 CFR (*Code of Federal Regulations*) 203.41 was clear that such a restriction on the resale of a property made the mortgage ineligible for FHA insurance.

24 CFR 203.41 Free Assumability

(a)(3) Legal restrictions on conveyance means any provision in any legal instrument, law or regulation applicable to the mortgagor or the mortgaged property, including but not limited to a lease, deed, sales contract, declaration of covenants, declaration of condominium, option, right of first refusal, will, or trust agreement, that attempts to cause a conveyance (including a lease) made by the mortgagor to:... (ii) Be the basis of contractual liability of the mortgagor for breach of an agreement not to convey, including rights of first refusal, pre-emptive rights or options related to mortgagor efforts to convey; (iii) Terminate or subject to termination all or a part of the interest held by the mortgagor in the mortgaged property if a conveyance is attempted; (iv) Be subject to the consent of a third party;....

(b) Policy of free assumability with no restrictions. A mortgage shall not be eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance, except as permitted by this part.

The auditee's response notes that, for the audit time period, DHI's loan origination activity was primarily conventional financing, with its FHA activity averaging approximately 10 percent of its total volume. It is OIG's opinion that, because DHI officials were aware that the use of the Schedule A was a common practice, they should have taken extra steps to ensure that the covenant was removed once it was determined that a specific loan would be FHA-insured. Moreover, because the unallowed covenant was found on 205 FHA-insured loans, DHI Mortgage's failure to follow FHA's rule was systematic in this case, and not an isolated technical violation.

Comment 3 We disagree with DHI Mortgage’s implied response that use of the restrictive covenant could not have harmed the homebuyers because it was used at a time of unprecedented growth in the homebuilding industry. The schedule A to purchase contract, as discussed under finding 1, states the “[s]eller may promptly initiate proceedings to foreclose the Lien if Owner defaults in its obligation to pay Seller liquidated damages in the amount of \$40,000 on the date that Owner or any of its successors or assigns conveys during the Restricted Period any rights, title, or interest in the Property without Seller’s written consent.” The prospect of the \$40,000 liability could readily deter a borrower from renting or selling their property if the need arose. The notion expressed in the auditee’s response that it is obvious that the FHA-exclusionary language in the original sales contract would likely take precedence over the recorded lien assumes the homebuyer has sophisticated legal knowledge. Finding 1 discussed the instance where a borrower informed us that, although she experienced financial difficulties after the first four month’s mortgage payments, she believed that she could not attempt to find a renter for the property because of the restrictive covenant. However, after the one-year restriction period expired, the borrower decided that the housing market decline had depressed prices to a point that made it unlikely she could sell or rent the home for an amount that would cover the mortgage. As a result, the home went into foreclosure. The auditee’s response asserts that it was the purchaser’s responsibility to seek release from the lien and implies that the borrower must have been an investor. In OIG’s opinion, there is no basis for either of these assertions. The “life events” presented in the auditee response as reasons the lien would be released do not include financial difficulties alone.

Comment 4 This portion of the auditee’s response pertains to conventional loans and therefore is not relevant to the finding regarding FHA-insured loans

Comment 5 See OIG responses to comments 1 and 2.

Comment 6 See OIG responses to comment 3.

Comment 7 See OIG responses to comments 1, 2, and 3.

Comment 8 This portion of the auditee’s response pertains to the lender's proposed corrective actions for deficiencies reported under finding 1. HUD will review adequacy and implementation of these proposed actions during the audit resolution process.

Comment 9 The report does not recommend any specific procedures that DHI Mortgage should adopt to ensure that improper covenants and/or liens are not placed on FHA-insured properties.

Comment 10 The OIG would like to reiterate that any FHA-insured loans with an executed schedule A to purchase contract, which contains the restrictive covenants and the lien against the FHA-insured property, violate 24 CFR 203.41(b) and 203.32(a) respectively and are therefore not FHA insurable.

- Comment 11** OIG acknowledges that DHI Mortgage made changes as a result of HUD's March 2008 exam of DHI Mortgage's offices.
- Comment 12** This portion of the auditee's response pertains to the lender's proposed corrective actions for deficiencies reported under finding 2. HUD will review adequacy and implementation of these proposed actions during the audit resolution process.
- Comment 13** We excluded the auditee's Addendum 1 which responded to the specific underwriting deficiencies detailed in Appendix D of our report, as well as the OIG comments, due to the volume of the material. We disagreed with some of the items in the Addendum 1, but did make changes to our report for other items, as appropriate. The auditee's response to the underwriting narratives in Appendix D and our comments are available on request.
- Comment 14** This discussion addresses DHI Mortgage's commitment to compliance and does not impact the findings of the audit report.
- Comment 15** We agree that the auditee's use of the exact name search feature for screening contributed to weaknesses in its verification process to identify debarred individuals. DHI Mortgage's exhibit A was excluded from the auditee response section of our audit report but is available upon request.
- Comment 16** This portion of the auditee's response pertains to the lender's proposed corrective actions for deficiencies reported under finding 3. HUD will review adequacy and implementation of these proposed actions during the audit resolution process. DHI Mortgage's exhibit B was excluded from the auditee response section of our audit report but is available upon request.
- Comment 17** This portion of the auditee's response relates information it gathered regarding the debarred loan officer after the OIG informed DHI Mortgage of the violation. This information does not impact the report's finding.
- Comment 18** This portion of the auditee's response provides background information, but does not relate to the report's finding.
- Comment 19** We acknowledge that HUD provided DHI Mortgage guidance to wait until the FHA branch's loan pipeline had cleared before terminating the FHA branch identification with HUD. However, the auditee's response acknowledges it did not notify HUD of the address change for the Urban Living Branch – see comment 20. We modified the report language to state “Reviewers also did not ensure that HUD was notified of a change of branch address.” DHI Mortgage's exhibit C was excluded from the auditee response section of our audit report but is available upon request.

- Comment 20** We disagree with DHI Mortgage's position that it did not fail to notify HUD of branch changes in a timely manner because the response acknowledges that it did not update the address for the Urban Living FHA ID immediately after the branch was closed and merged.
- Comment 21** This portion of the auditee's response refers to DHI Mortgage's policies for branch office terminations and merges. The documents provided did not provide any new information that would impact the audit report finding 3. DHI Mortgage's exhibit D was excluded from the auditee response section of our audit report but will be made available upon request.
- Comment 22** This portion of the auditee's response pertains to the lender's proposed corrective actions for the deficiencies reported under finding 3. HUD will review the adequacy and implementation of these proposed actions during the audit resolution process. DHI Mortgage's exhibit E was excluded from the auditee response section of our audit report but will be made available upon request.
- Comment 23** We disagree with the auditee's response that the officials working in the capacity of both DHI Mortgage and DHI Title did not constitute a conflict of interest. During our review we found that the individuals worked in official capacity for both companies and that DHI Mortgage's written policies did not provide practices for keeping the official duties separate.
- Comment 24** The letter referred to in the auditee's response was not part of the audit report. We disagree with the auditee's response that the letter was the basis on which OIG raised its concern regarding the purported lack of clear and effective separation of the officer's duties. The letter was provided to DHI Mortgage officials to demonstrate OIG's documentation that the president of DHI Mortgage had worked in an official capacity for both DHI Mortgage and DHI Title. OIG's concern was based on the auditee's lack of written policies regarding keeping the official duties separate for each company, because we had identified two individuals with dual official functions. See OIG's response to comment 23.
- Comment 25** This portion of the auditee's response relates the corrective action taken to address an issue raised under finding 3. HUD will review the adequacy and implementation of the proposed corrective action during the audit resolution process.
- Comment 26** This portion of the auditee's response pertains to the lender's changed policies related to the audit report finding 3. HUD will review the adequacy and implementation of the proposed corrective action during the audit resolution process. DHI Mortgage's exhibit F was excluded from the auditee response section of our audit report to reduce the volume of the report.

- Comment 27** We disagree with the auditee’s response that the bonus compensation for underwriters did not violate HUD Handbook 4060.1, paragraph 2-9A. We acknowledge the bonus was tied to the total number of decisions made regardless of the approval outcome. However, by rewarding the quantity of underwriting actions, the bonus structure provided an incentive for quick decisions rather than compliance with FHA insurance requirements. The result was that the bonuses functioned as commissions.
- Comment 28** This portion of the auditee’s response pertains to the lender's proposed corrective actions for a deficiency cited under finding 3. HUD will review the adequacy and implementation of the proposed corrective action during the audit resolution process.
- Comment 29** This portion of the auditee’s response is a list of the exhibits provided as part of proposed corrective actions in response to finding 3. HUD will review the adequacy and implementation of the proposed corrective actions during the audit resolution process.
- Comment 30** We acknowledge the auditee’s expressed intent to comply fully and completely with all standards set forth by HUD. We also acknowledge that DHI Mortgage has proposed corrective actions for certain deficiencies cited in the audit report. HUD will review the adequacy and implementation of the proposed corrective actions during the audit resolution process.
- Comment 31** We disagree with the auditee’s response. The HUD-1 contained in the loan documents was an “Estimated Statement”, not a final HUD-1. Additionally, the credit report dated September 5, 2006 showed the monthly liability. Since, the monthly debt was not properly documented as paid in full prior to closing the monthly liability was to be used in the qualifying ratios as required by HUD Handbook 4155.1, paragraph 2-11 and the Fannie Mae Underwriting Findings.
- Comment 32** We disagree with the auditee’s response. The HUD-1 contained in the loan documents was an “Estimated Statement”, not a final HUD-1. DHI Mortgage should have provided the final HUD-1 and/or a copy of the funds received. A more appropriate handbook citation would have been HUD Handbook 4155.1, paragraph 2-10E. This has been changed in the report.
- Comment 33** See OIG responses to comments 1 through 3.
- Comment 34** We disagree with the auditee’s response. The lender did not comply with the requirements under HUD Handbook 4155.1, paragraph 2-3E, which specifically states the “borrower also must have demonstrated a documented ability to responsibly manage his or her financial affairs.” Furthermore, the 10 percent down on the home loan and the cash reserves discussed on the mortgage credit analysis worksheet in the remarks section were loan funds that came from the borrower’s 401(k). The language in the audit report was revised for clarification.

Comment 35 See OIG responses to comments 1 through 3.

Comment 36 See OIG responses to comments 1 through 3.

Comment 37 We disagree with the auditee's response. Regardless of what the Mortgage Credit Analysis Worksheet says, the Amount Financed Itemization clearly indicates the discount fee was financed into the FHA-insured loan. The Amount Financed Itemization, dated June 14, 2007, one day prior to closing, totals to \$226,436.00. This is the same amount of the new loan balance on the HUD-1. Therefore, the loan includes the amounts listed on the Amount Financed Itemization, which includes the discount fee of \$3,396.54, contrary to HUD Handbook 4000.2, paragraph 5-2P.

Comment 38 We disagree with the auditee's response. We acknowledge that the lender ran the loan officer's first and last names through the General Service Administration Excluded Parties List System (Excluded Parties List), with a negative result. However, the Excluded Parties List did contain the loan officer's name with the middle initial, but did not return the match because the lender used the exact match function. The fact remains that the loan officer was on the Excluded Parties List and HUD Handbook 4000.2, paragraph 1-6A and HUD Handbook 4155.1, paragraph 2-5, states "If the name of any party to the transaction appears on either list, the application is not eligible for mortgage insurance." The report language in the corresponding narrative was changed to clarify that the loan was not eligible for FHA mortgage insurance because a party to the transaction appeared on a debarment list. See OIG response to comment 15.

Comment 39 See OIG responses to comments 1 through 3.

Comment 40 See OIG responses to comment 35.

Comment 41 We disagree with the auditee's response because the income analysis provided was not in the lender's documentation at the time of the loan's approval. The lender must document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings prior to the loan approval.

Comment 42 See OIG responses to comments 1 through 3.

Comment 43 We disagree with the auditee that the overtime was appropriate. The analysis and explanation for the use of the overtime was not performed at the time of the loan approval. For additional clarification on the deficiencies of the loan approval we have added an "Other" section in appendix D of the report for loan number 022-1892652. In this section we demonstrate the lender's failure to follow proper protocol for processing an employee loan.

Comment 44 See OIG responses to comments 1 through 3.

Comment 45 We disagree with the auditee's response. The response explained that the \$803 discrepancy between the debt on the Mortgage Credit Analysis Worksheet and the debt listed on the automated underwriting system approval was the non occupying coborrower's rental obligation. However, this discrepancy was not explained in the loan documents prior to loan closing. As a result, the underwriting deficiency will remain in the audit report.

Comment 46 We disagree with auditee's response. The lender documented two paystubs that had inconsistent pay amounts and pay periods. At a minimum, the lender should have inquired about the current pay discrepancy and pay period length discrepancy. Based on the loan documentation it appeared that some portion of the coborrower's income was either commission or a bonus. In either instance, additional analysis and documentation was required to conform to HUD Handbook 4155.1, paragraph 2-7D. We have updated the loan detail in appendix D to say that the qualified income contribution from the coborrower was unknown as was its impact on the qualifying ratios.

Comment 47 We agree with the auditee's response that a supplement in the file showed the \$10 monthly debt had been paid in full prior to closing. This item was removed from the loan details in appendix D for loan number 023-2375473.

Comment 48 See OIG responses to comments 1 through 3.

Comment 49 See OIG responses to comments 1 through 3.

Comment 50 We disagree with the auditee's response because the overtime analysis provided was not in the lender's documentation at the time the borrower was qualified. Therefore, the full amount of overtime was excluded in the OIG recalculation of the ratios. Because the overtime income was in apparent decline, further justification to support its use is required by HUD Handbook 4155.1, paragraph 2-7A.

Comment 51 See OIG responses to comments 1 through 3.

Comment 52 See OIG responses to comments 1 through 3.

Comment 53 We partially agree with the auditee's response. We accepted that one of the two debts excluded from the qualifying ratios appeared to be a duplicate. The audit report has been updated to reflect only one account was excluded; however, the ratios remained the same because the OIG's revised ratios had only included the amount for one of the excluded accounts.

Comment 54 We disagree with the auditee's response. As stated in the response, the overtime income was averaged over a 20.5-month period instead of a 24-month average as

required by HUD Handbook 4155.1, paragraph 2-7A. Further, the auditee's response below under "Credit" agreed with OIG that the loan file contained other deficiencies related to additional borrower credit items that would have impacted the loan decision.

Comment 55 We agree with the auditee's response that the excluded debt would not have changed the loan decision. We did not change the audit report which already stated "The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan."

Comment 56 See OIG responses to comments 1 through 3.

Comment 57 We partially disagree with the auditee's response because HUD Handbook 4155.1, chapter 2 section 2, states the likelihood of its (the employment's) continuance must be established to determine a borrower's capacity to repay mortgage debt. We acknowledge that the earnings information was provided through a pay stub and the audit report has been updated.

Comment 58 We disagree with the auditee's response. Although the nonpurchasing spouse provided a letter stating she did not have a Social Security number, credit history must still be provided in the loan file as required by HUD Handbook 4155.1, paragraph 2-2D.

Comment 59 We disagree with the auditee's response because the lender did not obtain or otherwise document the likelihood of the continuance of the borrower's Social Security disability income as required by HUD Handbook 4155.1, paragraph 2-7E. Further, the auditee's response stated that "it was reasonable to conclude that the Social Security income would continue for the next three years." However, this was an opinion not documented in the loan file as part of the underwriter's decision and was formed by officials in response to the report.

Comment 60 We disagree with the auditee's response because there were additional items that would have impacted the loan decision pertaining to the borrower's income and contract. See response to comments 59 and 61 pertaining to these other deficiencies.

Comment 61 See OIG responses to comments 1 through 3.

Comment 62 See OIG responses to comments 1 through 3.

Comment 63 We disagree with the auditee's response because the borrower's documented funds were limited to a downpayment assistance gift and retirement account funds, which did not support the ability to pay such an earnest money deposit. In such a case, HUD Handbook 4155.1, paragraph 2-10A requires the lender to document the deposit and the source of funds used to pay the deposit.

Comment 64 The auditee's response agreed with OIG's conclusion regarding the need to document the likelihood of the Social Security disability income to continue. See OIG response to comment 59.

Comment 65 We disagree with the auditee's response and maintain that the loan documents did not support the likelihood of the coborrower's continued employment. The auditee's response to the audit report stated the "coborrower had been employed for 3.5 years and we had no reason to question the continuance of the coborrower's employment." However, this statement does not establish that the coborrower's employment was likely to continue; it simply relates the borrower's employment history with the company. Further, this opinion was formed in response to the audit report and was not documented by the underwriter at the time of loan approval.

Comment 66 See OIG responses to comments 1 through 3.

Comment 67 We partially disagree with the auditee's response. The underwriter was required to provide an explanation or proof of the reason for excluding the credit accounts listed on the automated approval as required by HUD Handbook 4155.1, paragraph 2-11 and the Fannie Mae Underwriting Findings. We did not change the report which already stated that this was a minor underwriting deficiency and did not affect the overall insurability of the loan.

Comment 68 See OIG responses to comments 1 through 3.

Comment 69 We disagree with the auditee's response that a demonstration of enrollment in additional classes was sufficient to show the borrower's student loans were deferred. The credit report listed the student loans payments to begin five months after loan closing and there was no letter in the loan file stating the loans would be deferred. Therefore, in accordance with HUD Handbook 4155.1, paragraph 2-11C the monthly liability was to be included in the borrower's qualifying ratios.

We disagree that the lender had no way of knowing that the borrower had taken out new debt prior to closing. It is the lender's responsibility to ascertain the source of funds for an earnest money deposit when the borrower does not demonstrate the ability to pay the deposit. See the discussion of assets in appendix D loan under number 023-2438810.

Comment 70 See OIG responses to comments 1 through 3.

Comment 71 We disagree with the auditee's response. The response explained how the borrower's income was calculated, but the loan file did not provide support to justify the use of the borrower's overtime pay in the income ratios as required by HUD Handbook 4155.1, paragraph 2-7A. In addition, the response states the borrower's length of employment and profession support the use of the average of the base plus overtime income. However, this opinion was formed in response to

the audit report and was not established and documented by the underwriter at the time of loan approval.

Comment 72 We disagree with the auditee's response that there was no reason to believe the income would not continue as the employee had been with the same employer for eight years. This opinion was formed in response to the audit report and was not documented by the underwriter at the time of loan approval.

Comment 73 We disagree with the auditee's response. Regardless of what the Mortgage Credit Analysis Worksheet says, the Amount Financed Itemization clearly indicates the discount fee was financed into the FHA-insured loan. The Amount Financed Itemization, dated March 30, 2007, the same day as closing, totals to \$255,335.00. This is the same amount of the new loan balance on the HUD-1. Therefore, the loan includes the amounts listed on the Amount Financed Itemization, which includes the discount fee of \$8,298.39, contrary to HUD Handbook 4000.2, paragraph 5-2P. If the discount fee was financed into the loan and the borrower paid for the discount in the form of a cashier's check, then the borrower paid for the fee twice.

Comment 74 We disagree with the auditee's response and maintain that the loan documents did not support the likelihood of the borrower's continued employment. The response to the audit report stated the "borrower had been employed with [the] same company since March 2005." However, this statement does not establish that the borrower's employment was likely to continue; it simply relates the borrower's employment history with the company. Further, this opinion was formed in response to the audit report and was not documented by the underwriter at the time of loan approval.

Comment 75 We agree with the auditee's response regarding the Rapid Reporting Direct Check and have removed this deficiency from the report.

Comment 76 See OIG responses to comments 1 through 3.

Comment 77 See OIG responses to comments 1 through 3.

Comment 78 We disagree with the auditee's response. Regardless of what the Mortgage Credit Analysis Worksheet says, the Amount Financed Itemization clearly indicates the discount fee was financed into the FHA-insured loan. The Amount Financed Itemization, dated May 15, 2007, four days prior to closing, totals to \$231,683.00. This is the same amount of the new loan balance on the HUD-1. Therefore, the loan includes the amounts listed on the Amount Financed Itemization, which includes the discount fee of \$4,054.45, contrary to HUD Handbook 4000.2, paragraph 5-2P.

Comment 79 We disagree with the auditee's response. In this instance, the loan was not approved through the automated underwriting system. There was an approval from the automated underwriting system on June 13, 2007 at 12:47 p.m. However, there was an automated underwriting refer on June 13, 2007 at 1:15 p.m. Upon review of the Mortgage Credit Analysis Worksheet, dated June 17, 2007, the June 13, 2007 automated underwriting refer is more closely related based on the ratios contained in the documents. However, neither automated underwriting printout matches the Mortgage Credit Analysis Worksheet. Based on the automated underwriting this loan should have been referred for manual underwriting. Therefore, the credit deficiencies cited in the audit report were not changed.

Comment 80 We disagree with the auditee's response because this should have been a manually underwritten loan, see response to comment 79. Therefore, the loan must contain the documentation requirements set forth in HUD Handbook 4155.1, which includes a bank statement accompanying the verification of deposit to support the borrower's assets under paragraph 3-1F of the handbook.

Comment 81 We agree with the auditee's response regarding the Rapid Reporting Direct Check and have removed this deficiency from the report.

Comment 82 We disagree with the auditee's response and maintain that the lender failed to document the following: (1) the reason for including the borrower's and co-borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings prior to the loan approval.

The auditee's response stated the "borrower had been on the job for eight years and received overtime for at least the past two years." However, this statement does not establish that the borrower's employment was likely to continue; it simply relates the borrower's employment history with the company. Further, this opinion was formed in response to the audit report and was not documented by the underwriter at the time of loan approval. Additionally, as the lender stated the overtime income was averaged over 25.5-month period, thus overtime income was not based on a 24-month average as required by HUD Handbook 4155.1, paragraph 2-7A.

The auditee's response stated the coborrower income verification noted "n/a" under probability of continued employment and added "This is not uncommon and many employers refuse to answer this question." However, HUD Handbook 4155.1, chapter 2 section 2, states the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt.

Although the auditee's response cited a two year history of employment on the coborrower's application, the loan file did not include supporting documentation

required under HUD Handbook 4155.1, paragraph 2-6 and Mortgagee Letter 2004-47.

Comment 83 We disagree with auditee's response because the loan should have been manually underwritten when the automated underwriting system previously returned the loans as refer/eligible.

Appendix C

CRITERIA

This criteria appendix includes the referenced CFR, HUD Handbook, and Mortgagee Letter requirements discussed in the body of the report and in the underwriting narratives under appendix D.

Code of Federal Regulations (CFR)

24 CFR 202.5(f) Business changes states:

The lender or mortgagee shall provide prompt notification to the Secretary of all changes in its legal structure, including, but not limited to, mergers, terminations, name, location, control of ownership, and character of business.

24 CFR 203.32 Mortgage lien states:

(a) ...a mortgagor must establish that, after the mortgage offered for insurance has been recorded, the mortgaged property will be free and clear of all liens other than such mortgage, and that there will not be outstanding any other unpaid obligations contracted in connection with the mortgage transaction or the purchase of the mortgaged property, except obligations that are secured by property or collateral owned by the mortgagor independently of the mortgaged property.

24 CFR 203.41 free assumability; exceptions states:

(a)(3) Legal restrictions on conveyance means any provision in any legal instrument, law or regulation applicable to the mortgagor or the mortgaged property, including but not limited to a lease, deed, sales contract, declaration of covenants, declaration of condominium, option, right of first refusal, will, or trust agreement, that attempts to cause a conveyance (including a lease) made by the mortgagor to:... (ii) Be the basis of contractual liability of the mortgagor for breach of an agreement not to convey, including rights of first refusal, pre-emptive rights or options related to mortgagor efforts to convey; (iii) Terminate or subject to termination all or a part of the interest held by the mortgagor in the mortgaged property if a conveyance is attempted; (iv) Be subject to the consent of a third party;....

(b) Policy of free assumability with no restrictions. A mortgage shall not be eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance, except as permitted by this part.

(c) Exception for eligible governmental or nonprofit programs.

HUD Handbook 4000.2, Revision 3

Paragraph 1-6

HUD Limited Denial of Participation (LDP) and Federal Lists. A borrower suspended, debarred, or otherwise excluded from participation in the Department's programs is not eligible for a FHA-insured mortgage. The lender must examine HUD's LDP list and the government-wide General Services Administration's (GSA's) "List of Parties Excluded from Federal Procurement or Nonprocurement Programs" and document this review on the HUD-92900-WS/92900-PUR. If the name of any party to the transaction appears on either list, the application is not eligible for mortgage insurance.

Paragraph 5-2P

Discount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount.

HUD Handbook 4000.4, Revision 1, Change 1

Paragraph 1-14

If possible, the application should be processed by a different branch or the mortgagee's main office. Although the draft report did not previously address this, the case must be clearly identified in the remarks section of the Mortgage Credit Worksheet and beneath Box F, "Employment," on the front of the case binder.

HUD Handbook 4060.1, Revision 2

Paragraph 2-9A

Employees are those individuals who are under the direct supervision and control of an FHA approved mortgagee and where the individuals are exclusively employed by the FHA approved mortgagee in the mortgage lending and real estate fields. The mortgagee must demonstrate the essential characteristics of the employer-employee relationship upon inquiry by the Department. [See also paragraphs 2-9(D) and 2-9(G)]

Compensation of employees may be on a salary, salary plus commission, or commission only basis and includes bonuses. All compensation must be reported on Form W-2. Employees who perform underwriting and loan servicing activities may not receive commissions.

Paragraph 2-9C

If a mortgagee has any of the same officers, stockholders, partners, or members as another entity, the officers may represent more than one entity if:

1. There is a clear and effective separation of the two entities, and mortgagors know at all times exactly with which entity they are doing business.

Paragraph 7-3G

A mortgagee's offices, including traditional, nontraditional branch and direct lending offices engaged in origination or servicing of FHA-insured loans, must be reviewed to determine that they are in compliance with the Department's requirements.

1. The review must include, but not necessarily be limited to, confirmation of the following items:

- * The office is properly registered with FHA and the address is current;
- * Operations are conducted in a professional, business-like environment;...
- * The office is sufficiently staffed with trained personnel;
- * Office personnel have access to relevant statutes, regulations, HUD issuances and Handbooks, either in hard copy or electronically;
- * Procedures are revised to reflect changes in HUD requirements and personnel are informed of the changes;
- * Personnel at the office are all employees of the mortgagee or contract employees performing functions that FHA allows to be outsourced; and
- * The office does not employ or have a contract with anyone currently under debarment or suspension, or a Limited Denial of Participation....

3. When it is not feasible for Quality Control staff to visit each branch, qualified personnel from another office of the mortgagee, not involved in the day-to-day processes they are reviewing, or an outside firm may perform the review.

Paragraph 7-6

In order for a Quality Control Program to be useful and acceptable to FHA, there are several requirements that must be met. Mortgagees must adhere to each of the requirements below when conducting reviews.

A. **Timeliness.** Loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected prior to closing are identified as early after closing as possible.

B. **Frequency.** For mortgagees closing more than 15 loans monthly, quality control reviews must be conducted at least monthly and must address one month's activity.

Mortgagees closing 15 or fewer loans monthly may perform quality control reviews on a quarterly basis....

D. **Early Payment Defaults.** In addition to the loans selected for routine quality control reviews, mortgagees must review all loans going into default within the first six payments. As defined here, early payment defaults are loans that become 60 days past due.

E. **Documentation Review and Verification.** The Quality Control Program must provide for the review and confirmation of information on all loans selected for review.

1. **Credit Report.** A new credit report must be obtained for each borrower whose loan is included in a Quality Control Review, unless the loan was a streamline refinance or was processed using a FHA approved automated underwriting system exempted from this requirement.... A full Residential Mortgage Credit Report must be obtained from a different credit source on cases in which the in-file report reveals discrepancies with the original credit report.

2. Credit Document Reverification. Documents contained in the loan file should be checked for sufficiency and subjected to written reverification. Examples of items that must be reverified include, but are not limited to, the mortgagors' employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds. Sources of funds must be acceptable as well as verified. Other items that may be reverified include mortgage or rent payments. If the written reverification is not returned to the mortgagee, a documented attempt must be made to conduct a telephone reverification. If the original information was obtained electronically or involved alternative documents, a written reverification must still be attempted. Any discrepancies must be explored to ensure that the original documents (except blanket verification releases) were completed before being signed, were as represented, were not handled by interested third parties and that all corrections were proper and initialed. All conflicting information in the original documentation should have been resolved before the complete file was submitted to the underwriter.

3. Appraisals. A desk review of the property appraisal must be performed on all loans chosen for a Quality Control review... The desk review must include a review of the appraisal data, the validity of the comparables, the value conclusion (as repaired to meet safety and soundness requirements in HUD Handbook 4905.1 (as revised)), any changes made by the underwriter and the overall quality of the appraisal. Mortgagees are expected to perform field reviews on 10 % of the loans selected during the sampling process outlined previously in paragraph 7-6 C and D. Field reviews must be performed by licensed appraisers listed on FHAs Roster of Appraisers. Mortgagees should select loans for field reviews based on factors such as those listed previously in paragraph 7 6(C)(2) and the following:

- * Property complaints received from mortgagors;
- * Discrepancies found during desk reviews;
- * Large adjustments to value;
- * Comparable sales more than six months old;
- * Excessive distances from comparables to the subject property;
- * Repetitive sales activity for the subject property;
- * Investor-sold properties;
- * Identity of interest between buyer and seller;
- * Seller identity differs from owner of record; and
- * Vacant properties.

In addition, a field review should be completed on loans selected in accordance with paragraphs 7-6(C) and (D) where the desk review revealed significant problems/deficiencies with the appraisal report. If serious deficiencies or patterns are uncovered, mortgagees must report these items, in writing, to the Quality Assurance Division in the HUD Homeownership Center having jurisdiction.

4. Occupancy Reverification. In cases where the occupancy of the subject property is suspect, mortgagees must attempt to determine whether the mortgagor is occupying the property.... If it is found that the mortgagor is not occupying a property mortgaged as owner-occupied, mortgagees must report this, in writing, to the Quality Assurance Division in the HUD Homeownership Center having jurisdiction....

F. Underwriting Decisions. Each Direct Endorsement loan selected for a quality control review must be reviewed for compliance with HUD underwriting requirements, sufficiency of documentation and the soundness of underwriting judgements.

G. Condition Clearance and Closing. Each loan selected for a quality control review must be reviewed to determine whether:

- * Conditions which were required to be satisfied prior to closing were in fact met prior to closing...
- * The loan was closed and funds disbursed in accordance with the mortgagees underwriting and subsequent closing instructions; and
- * The closing and legal documents are accurate and complete.

HUD Handbook 4155.1, Revision 5

Foreword

This Handbook describes the basic mortgage credit underwriting requirements for single family (one to four units) mortgage loans insured under the National Housing Act. For each loan FHA insures, the lender must establish that the borrower has the ability and willingness to repay the mortgage debt. This decision must be predicated on sound underwriting principles consistent with the guidelines, rules, and regulations described throughout this Handbook and must be supported by sufficient documentation....

While it is not FHA's intent to insure mortgages that are likely to result in default, regardless of the borrower's equity, lenders may exercise some discretion in the underwriting of home mortgages where the borrower's financial and other circumstances are not specifically addressed by this Handbook. However, lenders are expected to exercise both sound judgment and due diligence in the underwriting of loans to be insured by FHA.

Chapter 2, section 2

The anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue. This section describes acceptable types of income, procedures for calculating effective income, and requirements for establishing income stability.

Paragraph 2-2

Except for the obligations specifically excluded by state law, the debts of the non-purchasing spouse must be included in the borrower's qualifying ratios if the borrower resides in a community property state or the property to be insured is located in a community property state. Although the nonpurchasing spouse's credit history is not to

be considered a reason for credit denial, a credit report that complies with the requirements of paragraph 2-4 must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio.

Paragraph 2-3

... While minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit—including judgments, collections, and any other recent credit problems—require sufficient written explanation from the borrower....

When reviewing the borrower's credit and credit report, the lender must pay particular attention to the following:

A. **Previous Rental or Mortgage Payment History.** The payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity-of-interest with the borrower) or verification of mortgage directly from the mortgage servicer, or through canceled checks covering the most recent 12-month period.

B. **Recent and/or Undisclosed Debts.** The lender must ascertain the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment on the property being purchased. Similarly, the borrower must provide a satisfactory explanation for any significant debt that is shown on the credit report but not listed on the loan application. The borrower must explain in writing all inquiries shown on the credit report in the last 90 days.

C. **Collections and Judgments.** Court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement.... FHA does not require that collection accounts be paid off as a condition of mortgage approval. Collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness with the lender documenting its reasons for approving a mortgage where the borrower has collection accounts or judgments. The borrower must explain in writing all collections and judgments....

E. **Bankruptcy.** A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the discharge of the bankruptcy. Additionally, the borrower must have re-established good credit or chosen not to incur new credit obligations. The borrower also must have demonstrated a documented ability to responsibly manage his or her financial affairs....

A Chapter 13 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage provided the lender documents that one year of the payout period under the bankruptcy has elapsed and the borrower's payment performance has been satisfactory (i.e., all required payments made on time). In addition, the borrower must receive permission from the court to enter into the mortgage transaction.

Paragraph 2-5

A borrower must be rejected if any of the following conditions apply:

A. HUD Limited Denial of Participation (LDP) and the U.S. General Services Administration's "List of Parties Excluded from Federal Procurement and Non-Procurement Programs" (GSA List) A person suspended, debarred, or otherwise excluded from participation in the Department's programs is not eligible to participate in FHA-insured mortgage transactions. The lender must examine HUD's LDP list and the government-wide General Services Administration's (GSA) "List of Parties Excluded from Federal Procurement or Nonprocurement Programs" and document this review on the HUD 92900-WS/92900-PUR. If the name of the borrower, seller, listing or selling real estate agents, or loan officer appears on either list, the application is not eligible for mortgage insurance....

Paragraph 2-6

We do not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent two full years.... The borrower also must explain any gaps in employment spanning one month or more. Allowances for seasonal employment, such as is typical in the building trades, etc., may be made if documented by the lender.

Paragraph 2-7

The income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan. If the borrower intends to retire during this period, the effective income must be the amount of documented retirement benefits, social security payments, or other payments expected to be received in retirement....

In most cases, the borrower's income will be limited to salaries or wages. Income from other sources can be included as effective income with proper verification by the lender. Procedures for analyzing other acceptable income sources besides salaries and wages are described below:

A. Overtime and Bonus Income. Both overtime and bonus income may be used to qualify if the borrower has received such income for the past two years and it is likely to continue. The lender must develop an average of bonus or overtime income for the past two years, and the employment verification must not state that such income is unlikely to continue.

Periods of less than two years may be acceptable provided the lender justifies and documents in writing the reason for using the income for qualifying purposes.

An earnings trend also must be established and documented for overtime and bonus income. If either type shows a continual decline, the lender must provide a sound rationalization in writing for including the income for borrower qualifying. If bonus

income varies significantly from year to year, a period of more than two years must be used in calculating the average income....

D. Commission Income. Commission income must be averaged over the previous two years. The borrower must provide copies of signed tax returns for the last two years, along with the most recent pay stub. (Unreimbursed business expenses must be subtracted from gross income.) Individuals whose commission income shows a decrease from one year to the next require significant compensating factors to allow for loan approval. Borrowers with commission income received for more than one but less than two years may be considered favorably provided the underwriter is able to make a sound rationalization for acceptance and can document the likelihood of continuance. Commissions earned for less than one year are not considered effective income. Exceptions may be made for situations in which the borrower's compensation was changed from a salary to commission within a similar position with the same employer. A borrower also may qualify when the portion of earnings not attributed to commissions would be sufficient to qualify the borrower for the mortgage.

E. Retirement and Social Security Income. Retirement and social security income require verification from the source (former employer, Social Security Administration) or federal tax returns. If any benefits expire within the first full three years, the income source may be considered only as a compensating factor....

M... 2. Current Leases. If a property was acquired since the last income tax filing and is not shown on Schedule E, a current signed lease or other rental agreement must be provided. The gross rental amount must be reduced for vacancies and maintenance by 25 percent (or the percentage developed by the jurisdictional HOC [homeownership center]), before subtracting PITI and any homeowners' association dues, etc., and applying the remainder to income (or recurring debts, if negative)....

Paragraph 2-9

The following conditions apply to underwriting self-employed borrowers:

A. Minimum Length of Self Employment. Income from self-employment is considered stable and effective if the borrower has been self-employed for two or more years. The high probability of failure during the first few years of a business makes the following requirements necessary for individuals who have been self-employed less than two years:

1. Between One and Two Years. An individual self-employed between one and two years must have at least two years of documented previous successful employment (or a combination of one year of employment and formal education or training) in the line of work in which the borrower is self-employed or in a related occupation to be eligible...

B. Documentation Requirements. The following documents are required from self-employed borrowers:

1. Signed and dated individual tax returns, plus all applicable schedules, for the most recent two years.

2. Signed copies of federal business income tax returns for the last two years, with all applicable schedules, if the business is a corporation, an "S" corporation, or a partnership.

3. A year-to-date profit and loss (P&L) statement and balance sheet...

Paragraph 2-10

The cash investment in the property must equal the difference between the amount of the insured mortgage, excluding any upfront MIP [mortgage insurance premium], and the total cost to acquire the property including prepaid expenses and closing costs as described in paragraph 1-9. All funds for the borrower's investment in the property must be verified and documented. Acceptable sources of these funds include the following:

A. **Earnest Money Deposit.** If the amount of the earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Satisfactory documentation includes a copy of the borrower's cancelled check. A certification from the deposit-holder acknowledging receipt of funds and separate evidence of the source of funds is also acceptable. Evidence of source of funds includes a verification of deposit or bank statement showing that at the time the deposit was made the average balance was sufficient to cover the amount of the earnest money deposit....

E. **Sales Proceeds.** The net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. A fully executed HUD-1 Settlement Statement must be provided as satisfactory evidence of the cash sales proceeds accruing to the borrower. If the property has not sold by the time of underwriting, loan approval must be conditioned upon verifying the actual proceeds received by the borrower. The lender must document both the actual sale and the sufficiency of the net proceeds required for settlement....

G. **Sale of Personal Property.** If the borrower intends to sell personal property items (cars, recreational vehicles, stamps, coins, baseball card collections, etc.) to obtain funds required for closing, the borrower must provide a satisfactory estimate of their worth, in addition to conclusive evidence the items have been sold. The estimated worth of the items being sold may be in the form of published value estimates, such as those issued by automobile dealers, philatelic or numismatic associations, or a separate written appraisal by a qualified appraiser with no financial interest in the loan transaction. Only the lesser of this estimate of value or the actual sales price is considered as assets to close.

Paragraph 2-11

The following are types of liabilities that must be considered in qualifying borrowers:

A. **Recurring Obligations.** The borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other additional recurring charges extending ten months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc. Debts lasting less than ten months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing; this is especially true if the borrower will have limited or no cash assets after loan closing.

The following additional information deals with revolving accounts and alimony payments:

1. Revolving Accounts. If the account shown on the credit report has an outstanding balance, monthly payments for qualifying purposes must be calculated at the greater of 5 percent of the balance or \$10 (unless the account shows a specific minimum monthly payment)....

C. Projected Obligations. If a debt payment, such as a student loan, is scheduled to begin within twelve months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis, unless the borrower provides written evidence that the debt will be deferred to a period outside this timeframe.

Similarly, balloon notes

that come due within one year of loan closing must be considered in the underwriting analysis.

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

Paragraph 2-13

Compensating factors that may be used to justify approval of mortgage loans with ratios exceeding our benchmark guidelines are those listed below. Underwriters must record on the "remarks" section of the HUD 92900-WS/HUD 92900-PUR the compensating factor(s) used to support loan approval. Any compensating factor used to justify mortgage approval must be supported by documentation.

A. The borrower has successfully demonstrated the ability to pay housing expenses equal to or greater than the proposed monthly housing expense for the new mortgage over the past 12-24 months.

B. The borrower makes a large downpayment (ten percent or more) toward the purchase of the property.

C. The borrower has demonstrated an ability to accumulate savings and a conservative attitude toward the use of credit.

D. Previous credit history shows that the borrower has the ability to devote a greater portion of income to housing expenses.

E. The borrower receives documented compensation or income not reflected in effective income, but directly affecting the ability to pay the mortgage, including food stamps and similar public benefits.

F. There is only a minimal increase in the borrower's housing expense.

G. The borrower has substantial documented cash reserves (at least three months' worth) after closing. In determining if an asset can be included as cash reserves or cash to close, the lender must judge whether or not the asset is liquid or readily convertible to cash and can be done so absent retirement or job termination. Also see paragraph 2-10K. Funds borrowed against these accounts may be used for loan closing, but are not to be considered as cash reserves. "Assets" such as equity in other properties and the proceeds

from a cash-out refinance are not to be considered as cash reserves. Similarly, funds from gifts from any source are not to be included as cash reserves.

H. The borrower has substantial non-taxable income (if no adjustment was made previously in the ratio computations).

I. The borrower has a potential for increased earnings, as indicated by job training or education in the borrower's profession.

J. The home is being purchased as a result of relocation of the primary wage earner, and the secondary wage-earner has an established history of employment, is expected to return to work, and reasonable prospects exist for securing employment in a similar occupation in the new area. The underwriter must document the availability of such possible employment.

Chapter 3

The lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and [documented]. The lender must also verify and document the identity of the loan applicant(s).

Paragraph 3-1

... The following documents are generally required for mortgage credit analysis in all transactions except for certain streamline refinances...

C. Social Security Number [SSN] Evidence. For all borrowers, including US citizens, the lender is required to document a valid SSN for each borrower, co-borrower, and co-signer on the mortgage.... Each borrower must provide the lender with evidence of his or her own valid SSN as issued by the Social Security Administration (SSA).... While the actual social security card is not required, the lender is required to validate the SSN. Lenders may use various means for validating the SSN including examining the borrower's pay stubs, passport, valid tax returns, and may use service providers including those with direct access to the SSA. The lender is also required to resolve any inconsistencies or multiple SSNs for individual borrowers that are revealed during loan processing and underwriting. (Also see paragraph 2-2 B)....

F. VOD. VOD and most recent bank statements are to be provided. "Most recent" means at the time the initial loan application is made. Provided the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be updated. Alternative Documentation. As an alternative to obtaining a VOD, the lender may obtain from the borrower original bank statement(s) covering the most recent three-month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent, consecutive statements....

H. Sales Contract. The sales contract and any amendments or other agreements and certifications are to be included in the case binder. Either an original or a certified true copy of the sales contract received by the lender is required.

Mortgagee Letter 2004-47

The lender using the TOTAL Mortgage Scorecard must conduct a manual underwriting review according to FHA requirements for all loan applications that generate a “refer” rating. The DE underwriter must determine if the borrower is creditworthy in accordance with FHA standard credit policies and requirements. It is FHA policy that no borrower will be denied a FHA insured mortgage loan solely on the basis of a risk assessment generated by the TOTAL Mortgage Scorecard....

Current Employment---The lender must obtain the single most recent pay stub (showing year-to-date earnings of at least one month) **and** any one of the following to verify current employment:

- Written Verification of Employment (VOE)
- Verbal verification of employment (Lender or service provider must document individual verifying the employment.)
- Electronic verification acceptable to FHA....

Employment History---The lender is required to verify the applicant’s employment history for the previous two years. However, direct verification is *not* required if *all* of the following conditions are met:

- The current employer confirms a two-year employment history (this may include a paystub indicating a hiring date)
- Only base pay is used to qualify (no overtime or bonuses)
- The borrower signs form IRS 4506 or 8821 for the previous two tax years.

If the applicant has not been employed with the same employer for the previous two years and/or all conditions immediately above cannot be met, then the lender must obtain one of the following for the most recent two years to verify the applicant’s employment history:

- W-2(s)
- VOE(s)
- Electronic verification acceptable to FHA....

Cash reserves may include certain retirement accounts. To account for withdrawal penalties and taxes, only 60% of the vested amount of the account may be used. The lender must document the existence of the account with the most recent depository or brokerage account statement. In addition, evidence must be provided that the retirement account allows for withdrawals for conditions other than in connection with the borrower's employment termination, retirement, or death. If withdrawals can only be made under these circumstances, the retirement account may not be included as cash reserves. If any of these funds are also to be used for loan settlement, that amount must be subtracted from the amount included as cash reserves.

Mortgagee Letter 2005-16

[F]or manually underwritten mortgages where the Direct Endorsement (DE) underwriter must make the credit decision, the qualifying ratios are raised to 31% and 43%.... As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

Appendix D

NARRATIVE LOAN SUMMARIES FOR UNDERWRITING DEFICIENCIES

The following narratives provide the details for the deficiencies noted in the table contained in finding 2.

FHA loan number: 022-1864520
Requesting indemnification: Yes

Loan status: Claim²⁵
Default status: Preforeclosure sale completed²⁶

We are seeking indemnification of this loan based on the lender's failure to properly determine the borrower's capacity to repay the mortgage debt and based on the executed schedule A to purchase contract.

Income

Although the lender obtained a verification of employment, the lender failed to obtain the most recent pay stub or any other current paystub for the borrower that reflected at least one month of year-to-date earnings as required by Mortgagee Letter 2004-47 to verify current employment. Thus, the lender should have obtained an additional pay stub for the borrower before closing. Since the lender could not verify the borrower's wages properly, the income may not be used in calculating the borrower's income ratios,²⁷ as stated in HUD Handbook 4155.1, chapter 2, section 2. Accordingly, because the lender could not verify the borrower's qualifying wages, it failed to properly determine the borrower's capacity to repay the debt.

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof that the account should not have been included. Thus, the additional monthly liability of \$1,247 per month must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

The loan file did not contain an explanation for the three significant credit report inquiries on the borrower's credit report and the five significant credit report inquiries on the nonpurchasing spouse's credit report that were within 90 days of the credit report date as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

²⁵ A loan status of claim means the loan was conveyance claim terminated. A claim is the amount of the insurance benefit prescribed by HUD related to the default.

²⁶ A default status of preforeclosure sale completed means that a borrower in default sold their home and used the sale proceeds to satisfy the mortgage debt even if the proceeds were less than the amount owed. The lender can then file a claim for certain insurance benefits.

²⁷ The mortgage payment expense-to-effective income (mortgage payment-to-income) ratio is the total mortgage payment (which includes the principal and interest, escrow deposits for real estate taxes, hazard insurance, the mortgage insurance premium, homeowners' association dues, ground rent, special assessments, and payments for any acceptable secondary financing) divided by the gross effective monthly income. The total fixed payment-to-effective income (total fixed payments-to-income) ratio is the total of the mortgage payment and all recurring charges (including installment debts, revolving accounts, and child support) divided by the gross effective income.

Assets

The \$11,000 in net equity assets used to qualify the borrower was not verified and documented as required by HUD Handbook 4155.1, paragraph 2-10E, and the Fannie Mae Underwriting Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 022-1874931

Loan status: Active²⁸

Requesting indemnification: Yes

Default status: Special forbearance²⁹

We are seeking indemnification of this loan because a Chapter 7 bankruptcy rendered it ineligible at the time of closing and based on the executed schedule A to purchase contract.

Income

The borrower's monthly income used in the qualifying ratios was based on the annual salary. However, the borrower's current pay stub showed year-to-date earnings that did not reflect the entire salary. The impact on the ratios was not material.

Credit

The borrower had a Chapter 7 bankruptcy discharged on July 28, 2005, and the loan closed on April 6, 2007; therefore, two years did not elapse between the bankruptcy and the loan closing. The lender failed to document the borrower's ability to responsibly manage his or her financial affairs as required by HUD Handbook 4155.1, paragraph 2-3E.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

²⁸ A loan status of active means that the loan is currently insured by the Federal Housing Administration (FHA) and is not conveyance claim terminated or terminated with no claim.

²⁹ A default status of special forbearance means that the borrower has a written repayment agreement.

FHA loan number: 022-1883463
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer³⁰

We are seeking indemnification of this loan based on the debarred loan officer and the executed schedule A to purchase contract. The FHA-insured loan had an additional minor underwriting deficiency that did not affect the overall insurability of the loan.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Other

The lender included a loan discount fee of \$3,396.54 in the loan amount financed contrary to HUD Handbook 4000.2, paragraph 5-2P, which states that “[d]iscount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount.” Additionally, the loan discount fee was not included in the good faith estimate that was prepared four days before settlement.

The loan was originated by a loan officer employed by DHI Mortgage who was listed on the General Services Administration Excluded Parties List System³¹ contrary to HUD Handbook 4000.2, paragraph 1-6A, which states “[i]f the name of any party to the transaction appears on either list, the application is not eligible for mortgage insurance.”

FHA loan number: 022-1883781
Requesting indemnification: Yes

Loan status: Active
Default status: Special forbearance

We are seeking indemnification of this loan based on the debarred loan officer and the executed schedule A to purchase contract. We did not identify other underwriting deficiencies for this loan.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Other

The loan was originated by a loan officer employed by DHI Mortgage who was listed on the General Services Administration Excluded Parties List System, contrary to HUD Handbook

³⁰ This means that the property was conveyed to HUD (the insurer).

³¹ List of parties excluded from federal procurement or nonprocurement programs.

4000.2, paragraph 1-6A, which states "[i]f the name of any party to the transaction appears on either list, the application is not eligible for mortgage insurance."

FHA loan number: 022-1890152
Requesting indemnification: Yes

Loan status: Active
Default status: Special forbearance

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 38.52 and 58.95 percent respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's overtime income was inappropriately included, resulting in an overstatement of the monthly income by \$1,084.29.

Credit

The loan file did not contain an explanation for the 11 credit report inquiries that were within 90 days of the completed credit report, as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

Contract

A schedule A to purchase contract was executed and which contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 022-1892652
Requesting indemnification: Yes

Loan status: Claim
Default status: Foreclosure sale held³²

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 41.54 and 51.40 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31

³² A default status of foreclosure sale held means that the foreclosure sale was held.

and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's overtime income was inappropriately included in the borrower's monthly income, resulting in overstating the monthly income by \$557.12. Additionally, the lender did not establish that the borrower's overall employment would likely continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower's capacity to repay mortgage debt.

The borrower, at the time of loan approval, was employed by DHI Mortgage and was laid off shortly after the loan was approved. Therefore, the lender should have known the employment would not have lasted for at least the first three years of the loan, which is required to be established by HUD Handbook 4155.1, chapter 2, section 2, to determine a borrower's capacity to repay mortgage debt.

Other

A different branch or the main office should have processed the application because it was an employee loan. HUD Handbook 4000.4, paragraph 1-14, "If possible, the application should be processed by a different branch or the mortgagee's main office. Although the draft report did not previously address this, the case must be clearly identified in the remarks section of the Mortgage Credit Worksheet and beneath Box F, "Employment," on the front of the case binder." The processor, originator and interviewer were all from the local Tucson office. Additionally, the MCAW did not identify the loan as an employee loan. Although the underwriter may not have known about the impending borrower layoff, if the Mortgage Credit Analysis Worksheet had been properly identified, then individuals who processed the loan may have been able to halt the loan or inform the underwriter.

FHA loan number: 023-2356343

Loan status: Active

Requesting indemnification: Yes

Default status: Special forbearance

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratio was 83.78 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratio.

Income

The loan was qualified, in part, on the borrower's base employment income. However, the borrower received Internal Revenue Service Form 1099-MISC, showing nonemployee compensation from the company listed as his current employer, which indicated that he was a contractor rather than an employee. Therefore, the income he received should have been treated as self-employed income rather than employment income. Coborrower A's income also appeared to be nonemployee compensation because no taxes were withheld from the weekly checks and no pay stubs were provided. Therefore, the income coborrower A received should also have been treated as self-employment income.

Neither the borrower's income nor coborrower A's income met the two-year minimum length of self-employment criteria to be included in qualifying income as required by HUD Handbook 4155.1, paragraph 2-9A. This condition resulted in the overstatement of the borrower's monthly income by \$2,080 and coborrower A's monthly income by \$400. Additionally, the lender failed to provide any of the required documents for self-employed income contrary to HUD Handbook 4155.1, paragraph 2-9B.

Bonus income from coborrower B was used in the qualifying income. However, the file did not contain evidence of bonus income for coborrower B as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the bonus income was inappropriately included, and coborrower B's monthly income was overstated by \$300.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Other

The mortgage credit analysis worksheet provided in the file with the examiner's approval contained different figures than those used for approval in the Automatic Underwriting System. Further, the automated underwriting approval included an additional \$803 per month liability that was not listed in the credit and liabilities section of the Fannie Mae Underwriting Findings. The lender did not explain the additional \$803 debt.

FHA loan number: 023-2375190
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 51.44 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratio.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender failed to (1) support that the coborrower had received such income for the past two years and that it was likely to continue, (2) develop an average of overtime income for the past two years, and (3) establish and document an earnings trend for the coborrower's overtime income. Thus, the lender inappropriately included the coborrower's overtime pay in the ratios, overstating the qualifying total monthly income by \$1,562.87.

Assets

The lender used a retirement account balance of \$10,443 to assist in qualifying the borrower for the loan. However, the account statement listed only \$8,702.57 in funds available to borrow against the account. Additionally, the lender did not provide evidence that the retirement account allowed for withdrawals for conditions other than in connection with the borrower's employment termination, retirement, or death as required by Mortgagee Letter 2004-47. Therefore, the retirement account funds of \$10,443 used to assist in qualifying the borrower should not have been used as a borrower asset.

FHA loan number: 023-2375473
Requesting indemnification: Yes

Loan status: Active
Default status: Delinquent³³

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios and based on the executed schedule A to purchase contract. The qualified income contribution from the coborrower was unknown as was its impact on the qualifying ratios. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The lender documented two paystubs that had inconsistent pay amounts and pay periods. At a minimum, the lender should have inquired about the current pay discrepancy and pay period length discrepancy. Based on the loan documentation it appeared that some portion of the coborrower's income was either commission or a bonus. In either instance, additional analysis and documentation was required to conform to HUD Handbook 4155.1, paragraph 2-7D. We were unable to determine the coborrower's qualified income contribution, or the impact on the qualifying ratios.

Credit

The loan file did not contain an explanation for the 14 credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

³³ A default status of delinquent means that the account has a payment due and is unpaid, and there is no other action reportable. This code must be reported as the initial delinquency code.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2383860
Requesting indemnification: Yes

Loan status: Active
Default status: Repayment³⁴

We are seeking indemnification based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

Income

The lender failed to obtain the most recent pay stub for the borrower that reflected at least one month of year-to-date earnings as required by Mortgagee Letter 2004-47. Thus, the lender should have obtained an additional pay stub for the borrower before closing to properly document the borrower's income.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2384380
Requesting indemnification: Yes

Loan status: Active
Default status: Special forbearance

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 46.05 and 49.80 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document a two year overtime trend analysis as required by HUD Handbook 4155.1, paragraph 2-7 A. The lender also used a thirty two month average for qualifying rather than a twenty four month average as required by HUD Handbook 4155.1, paragraph 2-

³⁴ A default status of repayment means that a repayment plan has been entered into (any repayment plan that is not a special forbearance).

7 A. The twenty four month average resulted in a declining overtime average which requires additional documentation. However, the lender did not provide a sound rationalization in writing for including the declining overtime income as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$319.21.

Credit

The loan file did not contain an explanation for the seven credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2388693

Loan status: Claim

Requesting indemnification: No

Default status: Property conveyed to insurer

We are seeking indemnification based on the executed schedule A to purchase contract.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2389873

Loan status: Active

Requesting indemnification: Yes

Default status: Special forbearance

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 42.29 and 60.49 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime, commission, and bonus income used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A, when the borrower was with the employer for less than two years. Thus, the borrower's overtime, commission, and bonus income was

inappropriately included in the borrower's monthly income, resulting in an overstatement of the borrower's monthly income by \$1,057.30.

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$57.85 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

FHA loan number: 023-2391447

Loan status: Claim

Requesting indemnification: Yes

Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the qualifying liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 47.96, which exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratio. Additionally, we were unable to calculate the true total fixed payments-to-income ratio as the details provided in the loan file did not contain the information needed to accurately calculate the borrower's net rental income or loss.

Income

The overtime income used to qualify the borrower was not based on a 24-month average of overtime earnings as required by HUD Handbook 4155.1, paragraph 2-7A.

Credit

The credit report contained a civil judgment with a handwritten statement which stated that it would be paid at closing. However, the lender did not provide support that the civil judgment was satisfied before closing as required by HUD Handbook 4155.1, paragraph 2-3C. The HUD-1 settlement statement listed the judgment to be paid at closing, but the title file showed that the check to pay off the judgment was voided.

The loan file contained nothing to support that the borrower received permission from the court to enter into the mortgage transaction as required by HUD Handbook 4155.1, paragraph 2-3E, after the borrower filed for Chapter 13 bankruptcy.

We were unable to determine the actual net loss on the borrower's rental property, as the loan file did not contain enough information to determine the additional expenses associated with the rental property. The lender did not determine the amount for the fee listed as "TRASH" payable by the owner on the lease agreement. Additionally, the lender did not obtain information as to whether the rental property had corresponding monthly mortgage insurance premiums or homeowners' association dues. Therefore, the lender did not properly calculate the net rental profit or loss in accordance with HUD Handbook 4155.1, paragraph 2-7M2, which requires that, after the gross rental amount is reduced for vacancies and maintenance, then the principal and interest, homeowners' association dues, etc., are to be subtracted to determine the net profit or loss on the rental property.

The lender excluded the borrower's Chevron account listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$10 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

FHA loan number: 023-2409090
Requesting indemnification: No

Loan status: Active
Default status: Special forbearance

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan.

Contract

The lender did not provide the addendum to the purchase contract for occupancy/investment disclosure in the FHA loan file as required by HUD Handbook 4155.1, paragraph 3-1H, and the Fannie Mae Underwriter Findings.

FHA loan number: 023-2412241
Requesting indemnification: Yes

Loan status: Active
Default status: Special forbearance

We are seeking indemnification of this loan based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

Credit

The lender excluded the coborrower's auto lease listed on her pay stub without providing an explanation or proof of the reason for the exclusion. Thus, the additional monthly liability of \$356.38 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2414288
Requesting indemnification: Yes

Loan status: Claim
Default status: Foreclosure sale held

We are seeking indemnification of this loan based on the inability to determine the borrower's liabilities.

Income

The borrower's income was not verified through a completed verification of employment as required by the Fannie Mae Underwriting Findings. The verification of employment did not contain the probability of continued employment and was marked "n/a," indicating nonapplicable.

Credit

The lender did not obtain a credit history for the borrower's nonpurchasing spouse as required by HUD Handbook 4155.1, paragraph 2-2D, which requires a credit report for a nonpurchasing spouse in a community property state such as Arizona. Although the nonpurchasing spouse provided a letter stating that she did not have a Social Security number, it remains the lender's responsibility to exhaust all possible means to resolve the issue. Without obtaining the nonpurchasing spouse's credit report or establishing alternative credit, the lender was unable to determine the coborrower's liabilities.

FHA loan number: 023-2425869
Requesting indemnification: Yes

Loan status: Active
Default status: First legal action to commence foreclosure³⁵

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 53.89 and 84.26 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The borrower's income used to qualify was based, in part, on Social Security disability income; however, the lender did not obtain supporting documents to show that this income was likely to continue for at least the first three years of the mortgage as required by HUD Handbook 4155.1, paragraph 2-7E. Therefore, the income did not meet the requirements for use in qualifying the borrower. This condition resulted in an overstatement of the borrower's income by \$1,886.63.

Credit

The lender excluded one of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion. Thus, the total monthly liability of \$103 must be used in qualifying the borrower as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

³⁵ This default status means that the first public legal action required to initiate foreclosure was completed.

FHA loan number: 023-2426099
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 37.35 and 71.32 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay and (2) an overtime trend over a two-year period. Although the lender documented on the verification of employment that the overtime income was likely to continue and that it was based on a 24-month average, the most recent pay stub provided for the new year did not support the continuance of the overtime income. Thus, the borrower's overtime income was inappropriately included in the borrower's monthly income, resulting in an overstatement of the borrower's monthly income by \$3,323.93.

Debt

The lender did not include a new debt, a timeshare that resulted from a material inquiry, "Merchants Credit Info," listed on the borrower's credit report as required by HUD Handbook 4155.1, paragraph 2-3B, and the Fannie Mae Underwriting Findings. The inclusion of this debt would have further increased the total fixed payments-to-income ratio.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2427150
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 46.67 and 73.99 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the inclusion of bonus earnings in the qualifying ratios as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's bonus pay, (2) a bonus trend over a two-year period, (3) that the amount of monthly bonus income used was based on a 24-month average, and (4) the likelihood that the bonus income would continue. Thus, the borrower's bonus income was inappropriately included and resulted in an overstatement of the monthly income by \$1,198.68. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower's capacity to repay mortgage debt.

Credit

The lender did not provide supporting documentation of the deposit amount and the source of funds the borrower used to pay the \$1,000 earnest money deposit as required by HUD Handbook 4155.1, paragraph 2-10A, when the borrower's documented savings does not support the ability to pay such deposit. During an interview with the borrower, we were informed that the \$1,000 earnest money deposit was borrowed from family. However, we did not include this information in the revision of the borrower's ratios, although doing so would have further increased the borrower's total fixed payments-to-income ratio.

Assets

The \$1,380 in retirement assets listed to qualify the borrower was not verified and documented as required by HUD Handbook 4155.1, paragraph 2-10, and the Fannie Mae Underwriting Findings.

FHA loan number: 023-2435939
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 59.44 and 103.94 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The borrower's income used to qualify was based on Social Security disability income; however, the lender did not obtain supporting documents to show that this income was likely to continue for at least the first three years of the mortgage as required by HUD Handbook 4155.1, paragraph 2-7E. Therefore, the income did not meet the requirements for use to qualify the borrower. This condition resulted in an overstatement of the borrower's monthly income by \$2,013.75.

The coborrower's employment was not verified as likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2, which requires the likelihood of its continuance be established to determine a borrower's capacity to repay mortgage debt.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2438080
Requesting indemnification: Yes

Loan status: Active
Default status: Servicing transferred or sold to another lender³⁶

We are seeking indemnification of this loan based on the executed schedule A to purchase contract. The FHA-insured loan had additional minor underwriting deficiencies that did not affect the overall insurability of the loan.

Credit

The lender excluded four of the borrower's accounts listed on the credit report without providing an explanation or proof of the reason for the exclusion as required by HUD Handbook 4155.1, paragraph 2-11, and the Fannie Mae Underwriter Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2438810
Requesting indemnification: Yes

Loan status: Claim
Default status: Servicing transferred or sold to another lender

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio, which reflects the qualifying liabilities as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratio was 78.57 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgage Letter 2005-16. The lender did not document an allowable compensating factor that could have justified the excessive ratio.

³⁶ This is used to advise that the servicing was transferred to new mortgage servicer - both the losing and gaining mortgages servicers must report.

Credit

The documentation in the loan file did not support that the six student loans were deferred or otherwise should have been excluded from the borrower's total fixed payments-to-income ratio. The student loan repayments, according to the borrower's credit report, were set to begin September 13, 2007. Since the repayment of the loans was to begin within six months of closing, the student loans were required to be included as a monthly liability as stated in HUD Handbook 4155.1, paragraph 2-11C. Additionally, debts without a monthly repayment term specified on the credit report are to be calculated at 5 percent of the balance or \$10 per month, whichever is greater. Thus, the balance of the student loan accounts of \$32,365 multiplied by 5 percent equates to an additional monthly debt of \$1,618.25, which was not included by the lender in the total fixed payments-to-income ratio.

In addition to the excluded liabilities discussed above, the borrowers informed us that they borrowed about \$3,600 before closing with repayment terms of at least \$150 per month. This would have increased the ratios further; however, we did not include this monthly obligation in our revision of the ratios because we did not have the exact amount of the debt or the repayment terms.

Assets

A recent bank statement accompanying the verification of deposit—needed to support the borrower's assets—was not provided as required by HUD Handbook 4155.1, paragraph 3-1F. Additionally, the lender failed to obtain documentation of the source of funds used for the earnest money deposit when the verification of deposit did not support the borrower's ability to fund the earnest money deposit as required by HUD Handbook 4155.1, paragraph 2-10A.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2442707
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income and liabilities as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 32.28 and 48.40 percent, respectively, which exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-

7A. Although the lender documented that the borrower had received overtime income in the past, the lender failed to support that the overtime income was likely to continue. Further, the most current pay stub used to support the borrower's income provided a gross pay amount for the current year that did not support the continuance of the overtime pay. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of monthly income by \$544.08. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

FHA loan number: 023-2447263
Requesting indemnification: No

Loan status: Active
Default status: Servicing transferred or sold to another lender

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan.

Income

The loan file did not support that the bonus income used to assist in qualifying the borrower was likely to continue as required by HUD Handbook 4155.1, paragraph 2-7A. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

Other

The lender included a loan discount fee of \$8,298.39 in the loan amount financed, contrary to HUD Handbook 4000.2, paragraph 5-2P, which states that "[d]iscount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount." Additionally, the loan file demonstrated that the borrower paid the closing funds for the loan discount of \$8,298.39 in the form of a cashier's check. Thus, the borrower paid twice for the loan discount.

FHA loan number: 023-2452473
Requesting indemnification: Yes

Loan status: Active
Default status: Servicing transferred or sold to another lender

We are seeking indemnification of this loan because the lender failed to support the use of the borrower's commission income, which was the sole income used to qualify the borrower.

Income

The borrower had been with the current employer for seven months at the time of the income verification. The employer remarks stated, "commission paid by flag hour or per job," and listed the borrower's year-to-date earnings under commissions as the sole income used to qualify the borrower. The borrower's previous employer listed income as base pay and not as commission income. Therefore, the lender failed to support the use of the borrower's commission income as required by HUD Handbook 4155.1, paragraph 2-7D, which requires at least one year of earned commissions with a sound rationalization for acceptance documented by the lender.

FHA loan number: 023-2453167
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 40.18 and 63.28 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, (3) that the amount of monthly overtime income used was based on a 24-month average, and (4) the likelihood that the overtime income would continue. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$789.80. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

FHA loan number: 023-2458663
Requesting indemnification: Yes

Loan status: Active
Default status: First legal action to commence foreclosure

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements, and based on the executed schedule A to purchase contract. After revision, the ratios were 37.04 and 59.84 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime, bonus, and stipend pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime, bonus, and stipend pay; (2) an overtime, bonus, and stipend trend over a two-year period; (3) that the amount of monthly overtime, bonus, and stipend was based on 24-month average earnings; and (4) the likelihood that the overtime, bonus, and stipend income would continue. Thus, the borrower's overtime, bonus, and stipend income was inappropriately included and resulted in an overstatement of the monthly income by \$3,247.01.

Credit

The loan file did not contain an explanation for the 12 credit report inquiries that were within 90 days of the completed credit report as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, the lender did not determine whether the material inquiries resulted in new debts as required by the Fannie Mae Underwriting Findings.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

FHA loan number: 023-2468047
Requesting indemnification: Yes

Loan status: Active
Default status: Servicing transferred or sold to another lender

We are seeking indemnification based on the executed schedule A to purchase contract. The FHA-insured loan had an additional minor underwriting deficiency that did not affect the overall insurability of the loan.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Other

The lender included a loan discount fee of \$4054.45 in the loan amount financed, contrary to HUD Handbook 4000.2, paragraph 5-2P, which states, “[d]iscount points charged by the lender on a purchase transaction may be charged to the buyer but may not be financed into the mortgage amount.”

FHA loan number: 023-2482980
Requesting indemnification: Yes

Loan status: Active
Default status: Delinquent

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratio and the executed schedule A to purchase contract. The total fixed payments-to-income ratio was 53.76 percent which reflects allowable qualifying-income as calculated by the OIG in accordance with HUD/FHA requirements. The total fixed payments-to-income ratio far exceeded HUD’s total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the monthly base pay used in the income ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower's monthly income was overstated; however, the difference was not material.

Credit

The borrower's credit report showed a late mortgage payment that would require an explanatory statement according to HUD Handbook 4155.1, paragraph 2-3, which states that major indications of derogatory credit require written sufficient explanation from the borrower. Further, according to HUD Handbook 4155.1, paragraph 2-3A, the payment history of the borrower's housing obligations holds significant importance in evaluating credit. However, no such information was provided.

The borrower had an inquiry on the credit report that was not explained as required by HUD Handbook 4155.1, paragraph 2-3B. Additionally, three months before settlement the borrower opened a new credit card that had a balance owed of \$1,339. The lender did not determine the purpose of the debt as required by HUD Handbook 4155.1, paragraph 2-3B.

The lender stated on the mortgage credit analysis worksheet that "[t]he borrower is leasing her existing [mortgaged property], however she qualified with the full mortgage payment." The fixed payment-to-income ratio (53.76 percent) exceeded HUD's allowable limit of 43 percent without appropriate compensating factors as required by HUD Handbook 4155.1, paragraph 2-13.

Assets

A recent bank statement accompanying the verification of deposit—necessary to support the borrower's assets—was not provided as required by HUD Handbook 4155.1, paragraph 3-1F.

Contract

A schedule A to purchase contract was executed and contained a covenant restricting resale or rental of the property for one year, which is prohibited by 24 CFR 203.41. The schedule A included a grant of lien to the seller in the amount of \$40,000, which is also prohibited by 24 CFR part 203.32(a). Therefore, the schedule A to purchase contract rendered the property ineligible for FHA insurance.

Other

The lender did not determine whether the real estate agent was on HUD's limited denial of participation list or the General Services Administration's Excluded Parties List System as required by HUD Handbook 4000.2, paragraph 1-6A.

FHA loan number: 023-2487907³⁷
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 50.01 and 63.38 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings, and (4) the likelihood that the overtime income would continue. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$1,070.35. Additionally, the lender did not establish that the borrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2.

FHA loan number: 023-2529391
Requesting indemnification: Yes

Loan status: Active
Default status: Delinquent

We are seeking indemnification of this loan based on the revised mortgage payment-to-income and total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratios were 62.30 and 64.84 percent, respectively, which far exceeded HUD's mortgage payment-to-income and total fixed payments-to-income benchmark ratios of 31 and 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document an allowable compensating factor that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$435. Additionally, the borrower's pay stubs did not support 40 hours per week of wages that were used to qualify. The borrower's year-to-date earnings supported a monthly income of \$2,167.35, and this reduced the borrower's qualifying base monthly income by another \$640.65.

³⁷ DHI Mortgage had FHA loan number 023-2487907 recorded as 023-248667-0.

FHA loan number: 023-2640107
Requesting indemnification: No

Loan status: Active
Default status: Special forbearance

The FHA-insured loan had minor underwriting deficiencies that did not affect the overall insurability of the loan.

Income

The loan file did not contain the appropriate support to justify the overtime and bonus pay used in the ratios to qualify the borrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's overtime and bonus pay, (2) an overtime and bonus trend over a two-year period, and (3) that the amount of monthly overtime and bonus income used was based on a 24-month average of overtime and bonus earnings. Additionally, the lender did not provide a sound rationalization in writing for including the declining bonus and overtime income in qualifying income as required by HUD Handbook 4155.1, paragraph 2-7A. Thus, the borrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$380.24. The resulting ratio(s) met HUD's threshold(s) after the correct income was applied.

FHA loan number: 023-2674566
Requesting indemnification: Yes

Loan status: Claim
Default status: Property conveyed to insurer

We are seeking indemnification of this loan based on the revised total fixed payments-to-income ratios, which reflect the allowable qualifying income as calculated by the OIG in accordance with HUD/FHA requirements. After revision, the ratio was 56.36 percent, which far exceeded HUD's total fixed payments-to-income benchmark ratio of 43 percent as stated in Mortgagee Letter 2005-16. The lender did not document any compensating factors that could have justified the excessive ratios.

Income

The loan file did not contain the appropriate support to justify the overtime pay used in the income ratios to qualify the borrower and coborrower as required by HUD Handbook 4155.1, paragraph 2-7A. The lender did not document the following: (1) the reason for including the borrower's and coborrower's overtime pay, (2) an overtime trend over a two-year period, and (3) that the amount of monthly overtime income used was based on a 24-month average of overtime earnings. Thus, the borrower's and coborrower's overtime income was inappropriately included and resulted in an overstatement of the monthly income by \$457. On the mortgage credit analysis worksheet, although the underwriter's approval was present, the remarks section indicated that overtime income was not used to qualify the borrowers. Additionally, the lender did not establish that the borrower's and coborrower's overall employment was likely to continue as required by HUD Handbook 4155.1, chapter 2, section 2. Further, the most recent two years of employment for the coborrower were not verified as required by HUD Handbook 4155.1, paragraph 2-6, and Mortgagee Letter 2004-47.

Other

The loan officer noted that at one time, this FHA loan was rated by the automated underwriting system as refer/eligible; however, the loan was ultimately approved/eligible through the automated underwriting system. This is contrary to the Fannie Mae Underwriting Findings and Mortgagee Letter 2004-47, which indicate that a registered direct endorsement underwriter must fully underwrite those applications in which the automated underwriting system refers the loan application to an underwriter for review and comply with the underwriting requirements described in HUD Handbook 4155.1 and applicable mortgagee letters.

Appendix E

QUALITY CONTROL REVIEW DEFICIENCIES NOTED BY FHA LOAN NUMBER

The table below contains the quality control review deficiencies noted for the 10 FHA loans reviewed, as discussed in finding 3.

FHA loan number	Type of quality control review	Was the review completed in a timely manner?	Was a new credit report pulled and compared with the original?	Were all required reverifications completed?	Was a desk or field appraisal review conducted?	Was the underwriting decision reviewed and documented?	Were the condition clearance and closing items reviewed and documented?
022-1883463	Early payment default	No, 5 months.	Yes	No, lacking reverification of deposit and gift.	No	No	No
022-1892652 ³⁸	Regular review	No	No	No	No	No	No
023-2414288	Regular review	Yes	No, missing nonpurchasing spouse's credit report.	No, lacking reverification of deposit and gift.	No	No, the reviewer stated "QC [quality control reviewer] found significant errors, but agrees with the loan decision." No explanation provided for contradictory decision.	No
023-2426099	Early payment default	No, 11 months.	Yes	No, lacking reverification of deposit and gift.	No	No	No
023-2442707	Early payment default	No, 12 months.	Yes	No, lacking reverification of deposit and gift.	No	No	No
023-2447263	Regular review	Yes	No, credit report was not compared.	No, lacking reverification of deposit and gift.	No	No	No

³⁸ DHI Mortgage did not provide any quality control review documents for this FHA loan.

FHA loan number	Type of quality control review	Was the review completed in a timely manner?	Was a new credit report pulled and compared with the original?	Were all required reverifications completed?	Was a desk or field appraisal review conducted?	Was the underwriting decision reviewed and documented?	Were the condition clearance and closing items reviewed and documented?
023-2453167	Early payment default	No, 7 months.	Yes	No, lacking reverification of deposit and gift.	No	No	No
023-2458663	Early payment default	No, 13 months.	Yes	No, lacking reverification of deposit and gift. Verification of employment hire date differed two years from that in loan file - no discussion or resolution.	No	No	No
023-2640107	Early payment default	Yes, 3 months.	No. Discrepancy with original versus quality control credit report. Failed to pull a credit report from a different company.	No, lacking reverification of deposit and gift.	No	No	No
023-2674566	Early payment default	No, 8 months.	No. Discrepancy with original versus new credit report. Failed to pull a credit report from a different company.	No, lacking reverification of deposit and gift.	No	No	No