



Issue Date October 9, 2009

Audit Report Number 2010-NY-1002

TO: Vicki Bott, Deputy Assistant Secretary for Single Family Housing, HU

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, New York/New Jersey,
2AGA

SUBJECT: Jersey Mortgage Company, Cranford, New Jersey, Did Not Always Comply
with HUD/FHA Loan Underwriting Requirements

HIGHLIGHTS

What We Audited and Why

We audited the Jersey Mortgage Company (Jersey Mortgage), a nonsupervised¹ lender located in Cranford, New Jersey. Jersey Mortgage was selected for review because its default rate of 7.40 percent for loans with beginning amortization dates between August 1, 2006, and July 31, 2008, was higher than the state of New Jersey's default rate of 5.35 percent.

The audit objectives were to determine whether Jersey Mortgage (1) approved Federal Housing Administration (FHA)-insured loans in accordance with the requirements of the U.S. Department of Housing and Urban Development (HUD)/FHA, which include adherence to prudent lending practices, and (2) developed and implemented a quality control plan in compliance with HUD/FHA requirements.

What We Found

Jersey Mortgage did not always approve FHA-insured loans in accordance with the requirements of the HUD/FHA. Specifically, Jersey Mortgage approved 13

¹ A non-supervised lender is a FHA approved non-depository financial entity that has as its principal activity the lending or investing of funds in real estate mortgages.

loans in which there were significant underwriting deficiencies such as (1) inadequate verification of borrower's credit, (2) inadequate compensating factors for loans with high debt-to-income ratios, (3) inadequate verification of funds to close loans, and (4) improper verification of employment and income information. As a result, loans were approved for potentially ineligible borrowers, which caused HUD/FHA to incur an unnecessary insurance risk. The remaining two loans contained technical deficiencies. These deficiencies occurred because Jersey Mortgage lacked adequate controls to ensure that loans were processed in accordance with HUD requirements.

Jersey Mortgage failed to ensure that its quality control plan was implemented in accordance with HUD/FHA's requirements. Specifically, (1) quality control reviews were not conducted for the loans that defaulted within the first six payments after closing or for the rejected loans, and (2) management did not provide responses or corrective actions for the deficiencies identified in quality control reviews. Consequently, the effectiveness of its quality control plan, which was designed to ensure accuracy, validity, and completeness in its loan underwriting process, was lessened.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Jersey Mortgage to (1) indemnify HUD against future losses on 12 loans with significant underwriting deficiencies, (2) reimburse HUD for the amount of claims and associated fees paid on one loan with significant underwriting deficiencies, and (3) implement quality control procedures to ensure compliance with the requirements to review early defaults and rejected loans. We also recommend that HUD's Homeownership Center's Quality Assurance Division follow up with Jersey Mortgage within six months to ensure that quality control review procedures were properly implemented.

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 a draft report to Jersey Mortgage officials on July 6, 2009 and requested their response by July 22, 2009. We discussed the results of our review during the audit and at an exit conference held on July 29, 2009. Jersey Mortgage officials provided written comments at the exit conference and generally disagreed with the draft report findings. The complete text of Jersey Mortgage's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Jersey Mortgage Company (Jersey Mortgage) became an approved U.S. Department of Housing and Urban Development (HUD) lender in 1986. The company originates loans, which it then sells to investors and other mortgage bankers.

Jersey Mortgage is a non-supervised lender that has as its principal activity the lending or investing of funds in real estate mortgages. A non-supervised lender may originate, underwrite, purchase, hold, service and sell FHA insured mortgages and submit applications for mortgage insurance. A non-supervised lender may maintain an FHA approved branch office for the origination of FHA insured mortgages, and must maintain a warehouse line of credit or other mortgage funding program that is acceptable to the Department. For continued approval a non-supervised lender must submit to the Department an acceptable audit report within 90 days of the close of its fiscal year.

The main office of Jersey Mortgage is located at 20 Commerce Drive, Suite 340, Cranford, New Jersey, and it has one branch office in Manasquan, New Jersey. Jersey Mortgage has five underwriters and ten loan officers.

Between August 1, 2006, and July 31, 2008, Jersey Mortgage underwrote 649 Federal Housing Administration (FHA)-insured mortgages in New Jersey and experienced a default rate of 7.40 percent, which was significantly higher than the New Jersey state average default rate of 5.35 percent.

The objectives of this audit were to determine whether Jersey Mortgage (1) approved FHA-insured loans in accordance with the requirements of HUD/FHA, which include adherence to prudent lending practices, and (2) developed and implemented a quality control plan in compliance with HUD/FHA requirements.

RESULTS OF AUDIT

Finding 1: Jersey Mortgage Did Not Always Comply with HUD/FHA's Underwriting Requirements

Jersey Mortgage did not always approve FHA-insured loans in accordance with the requirements of HUD/FHA. Specifically, Jersey Mortgage approved 13² loans in which there were significant underwriting deficiencies such as (1) inadequate verification of borrower's credit, (2) inadequate compensating factors for loans with high debt-to-income ratios, (3) inadequate verification of funds to close loans, and (4) improper verification of employment and income information. For one of the 13 loans, HUD paid a claim that resulted in a loss of \$229,427. There were two loans that contained technical violations. As a result, loans were approved for potentially ineligible borrowers, and contributed to HUD/FHA's assuming an unnecessary insurance risk. The deficiencies occurred because Jersey Mortgage did not have adequate controls to ensure that loans were processed in accordance with HUD/FHA requirements.

Significant Underwriting Deficiencies

Our review of 15 loans with amortization dates between August 1, 2006, and July 31, 2008, disclosed significant underwriting deficiencies in 13 loans. The deficiencies occurred because Jersey Mortgage did not follow prudent lending practices and regulations prescribed by HUD in its origination and underwriting of the loans.

HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance," prescribes basic underwriting requirements for FHA-insured single-family mortgage loans. The lender must ensure that the borrower has the ability and willingness to repay the mortgage debt. This assessment must be based on sound underwriting principles in accordance with the guidelines, rules, and regulations described in the handbook and supported by sufficient documentation. In addition, chapter 3-1 of the handbook requires that the application package contain sufficient documentation to support a lender's decision to approve a mortgage. While this decision involves some subjectivity, our examination of 15 loans approved by Jersey Mortgage disclosed significant underwriting deficiencies in the approval of 13 loans. Specifically, Jersey Mortgage did not always (1) adequately verify borrowers' credit, (2) obtain adequate compensating factors for loans with high debt-to-income ratios, (3) verify that there were

² We originally reviewed 21 loans for our audit; however, two of the loans had insurance status terminated and two loans that contained deficiencies were cleared when loans were reviewed on-site. In addition, two loans that contained deficiencies were also cleared when we reviewed documentation provided at the exit conference. As a result, we are reporting on 15 loans.

sufficient cash reserves to close the loans, and (4) properly verify employment and/or income information.

Significant deficiencies are noted in the chart below and in appendix C. The deficiencies noted are not independent of one another, as one loan may have contained more than one deficiency.

Areas of deficiencies	Number of loans
Inadequate credit analysis	3 of 13 loans
Excessive debt-to-income ratios without adequate compensating factors	6 of 13 loans
Inadequate verification of funds to close on HUD-1 settlement statement	9 of 13 loans
Inadequate verification of income and/or employment	7 of 13 loans

Specific examples of these significant underwriting deficiencies follow:

- For FHA case #352-5605932, the lender did not conduct an adequate analysis of the borrower's credit history. The credit report in the file contained two judgments in March 2002 and May 2003. However, the lender did not obtain information on the status of the judgments or an explanation from the borrower as required by HUD Handbook 4155.1, REV-5, section 2-3. In addition, the lender did not adequately verify the source of the donor's gift. The donor of the gift deposited \$9,000 into his own account on July 25, 2007, and then made the gift payment of \$8,000 on July 25, 2007, to the coborrower. The assets available on the mortgage credit analysis worksheet were shown as \$8,010, and the HUD-1 settlement statement indicated that the borrower would have needed \$8,000 to close. If we do not include the gift amount, the borrower would have had \$10 available to close and would not have had sufficient funds to close the loan. Also, the monthly employment income on the mortgage credit analysis worksheet was listed as \$6,515; however our calculation of the monthly employment income based on the paystubs was \$5,958. The employment income was overstated, which resulted in the lender calculating incorrect debt-to-income ratios of 41.24 and 48.44 percent. After adjusting the borrower's income, these ratios would increase to 45.09 and 52.97 percent. The lender also did not list compensating factors. Mortgagee Letter 2005-16 states that the lender must describe the compensating factors used to justify mortgage approval when the borrower's mortgage payment-to-income ratio (front) and the total fixed payment-to-income ratio (back) exceed 31 and 43 percent. In addition, for one of the coborrowers, there were employment gaps for the months of April 2006, August 2006, and September 2006. The lender did not obtain an explanation for the gaps in employment as required by HUD Handbook 4155.1 REV-5, section 2-6.

- For FHA case #352-5601063, the lender did not conduct an adequate analysis of the borrower's credit history. The credit report in the file contained derogatory items, and a judgment was listed for the coborrower. The file contained a letter written by the coborrower; however, it was inadequate because it did not explain the derogatory items and judgments listed on the credit report as required by HUD Handbook 4155.1, REV-5, section 2-3. The lender also did not obtain an explanation for the source of funds in the file per HUD Handbook 4155.1, REV-5, section 2-10C. The HUD-1 settlement statement showed an earnest money deposit of \$10,000. A total of \$9,000 of the \$10,000 earnest money deposit had been transferred from the borrower's checking account as of May 29, 2007. However, on May 29, 2007, an unexplained deposit of \$1,170 was made to the borrower's checking account, resulting in a pretransfer balance of \$9,080. If this deposit had not been made on May 29, 2007, the checking account balance would have been \$7,910. The HUD-1 settlement statement for the FHA loan indicated that the borrowers were required to pay \$5,044 at closing. Due to the unsupported earnest money deposit of \$1,170, the borrowers would have needed \$6,214 at closing. Also, the checking account statement contained two non-payroll deposits during the period July 19 through July 20, 2007, totaling \$2,230. There was no explanation by the borrower for these excessive deposits. Since the funds to close were not verified, the borrowers did not have sufficient funds to close. Further, employment income was overstated, as the lender used monthly income of \$5,388 on the mortgage credit analysis worksheet which resulted in the lender calculating incorrect debt-to-income ratios of 46.29 and 48.53 percent. After adjusting the borrower's income to the documented monthly income of \$5,328, these ratios would have increased to 46.81 and 49.08 percent. Mortgage Letter 2005-16 states that for manually underwritten mortgages in which the direct endorsement underwriter must make the credit decision, the qualifying ratios are raised to 31 percent and 43 percent and if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval. The compensating factors listed on the mortgage credit analysis worksheet that the borrower had an excellent work history and was making the down payment from his own funds were not allowable according to HUD Handbook 4155.1, REV-5, section 2-13.
- For FHA case #352-5545714, the lender did not conduct an adequate analysis of the borrower's credit history. The credit report indicated that several accounts were in collection; however, the lender did not obtain an explanation from the borrower as required by HUD Handbook 4155.1, REV-5, section 2-3. The HUD-1 settlement statement reported an earnest money deposit of \$10,000 that exceeded 2 percent of the sale price; the lender did not obtain supporting documentation for the deposit as required

by HUD Handbook 4155.1, REV-5, section 2-10 A. The HUD-1 settlement statement also indicated that the borrower was required to pay \$12,382 at closing, yet due to the unsupported earnest money deposit of \$10,000, the borrower would have needed \$22,382 to close. Since the funds to close were not all verified, the borrower did not have sufficient funds to close the loan. Also, the mortgage credit analysis worksheet and the loan application listed \$36,011 as assets, which appeared to be the borrower's retirement account of \$34,612 and the checking account balance of \$1,399. The lender obtained a copy of the retirement statement from October 1 through December 31, 2006. However, the lender did not obtain evidence of redemption as required by HUD Handbook 4155.1, REV-5, section 2-10K.

- For FHA case #351-4900883, the lender did not adequately verify employment income when the lender did not obtain the borrower's original pay stubs covering the most recent 30-day period per HUD Handbook 4155.1, REV-5, section 3-1E. The property was later conveyed to the insurer, and HUD paid a claim of \$229,427.

Technical Underwriting Deficiencies

Two of the fifteen cases audited contained technical deficiencies of noncompliance with HUD requirements that were not serious enough to negatively impact approval of the loans. For FHA case #352-5532937, there were missing bank statements in the file. For FHA case #351-4824525, the total fixed payment-to-income ratio was 46 percent, and there were no compensating factors listed on the mortgage credit analysis worksheet

Conclusion

Jersey Mortgage did not always approve FHA-insured loans in accordance with the requirements of HUD/FHA. These deficiencies occurred because Jersey Mortgage did not have adequate procedures and controls to ensure that all HUD underwriting requirements were properly implemented and documented. As a result, it approved 13 loans for which HUD paid a claim on one loan totaling \$229,427 and remains at risk for more than \$3 million in potential claims for the other 12 loans (see appendix C). The final loss that HUD will incur depends upon what HUD realizes when it disposes of the property. HUD's most recent data disclosed that its loss rate is 42 percent. Net sales proceeds after considering carrying and sales expenses may mitigate the amount of the claim paid. Loans for which HUD remains at risk can be mitigated by requesting that the lender indemnify HUD. In this case, the lender reimburses HUD for any insurance claim, taxes, interest, and other expenses connected with the disposition of the property, reduced by any amount recouped by HUD via sale or other disposition.

Appendix C of the report provides a summary of the underwriting deficiencies noted in the 13 cases. Appendix D of this report provides a more detailed description of the deficiencies by case.

Recommendations

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

- 1A. Indemnify HUD against future losses of \$1,281,314³ related to the 12 loans with significant underwriting deficiencies.
- 1B. Reimburse HUD for the \$96,359⁴ in loss funds resulting from the amount of claims and associated fees paid on one loan with significant underwriting deficiencies (case #351-4900883).
- 1C. Establish procedures to ensure that all HUD underwriting requirements are properly implemented and documented.

³ The amount of cost savings or funds to be put to better use on the loans for which indemnification is recommended is estimated at \$1,281,314 (42 percent of the unpaid principal balance of \$3,050,747)

⁴ Based upon HUD's current 42 percent default loss experience, the amount of ineligible costs for one loan for which a claim was paid is estimated at \$96,359 (42 percent of the claim paid of \$229,427)

Finding 2: Jersey Mortgage Had Weaknesses in the Implementation of its Quality Control Plan

Jersey Mortgage had weaknesses in the implementation of its quality control plan. It did not always comply with HUD's and its own quality control requirements to ensure that (1) HUD-insured FHA loans that went into default within the first six months were reviewed, (2) 10 percent of rejected loans were reviewed, and (3) management addressed the material deficiencies in the quality control findings. These noncompliances occurred because Jersey Mortgage did not establish procedures to ensure that its quality control plan was properly implemented. Consequently, the effectiveness of its quality control plan, which was designed to ensure accuracy, validity, and completeness in its loan underwriting process, was lessened.

Loans Defaulting within the First Six Payments Not Reviewed

Loans that defaulted within the first six payments (early payment defaults) were not reviewed as required by HUD regulations and the lender's own quality control plan. HUD Handbook 4060.1, REV-2, section 7-6D, requires that lenders review all loans going into default within the first six payments. Jersey Mortgage's quality control plan, section 3, states that all FHA loans that go into default within the first six months will be reviewed. However, quality control reviews were not conducted for 30 of the 32 early defaulted loans. Further, the two loans reviewed were apparently randomly selected, as opposed to being selected because they defaulted within six months. This condition occurred because Jersey Mortgage did not adequately implement its quality control plan. Quality control reviews of early defaulted loans can provide valuable information about the causes of default that may indicate inadequate underwriting. Jersey Mortgage officials acknowledged this weakness and stated that review of these defaulted loans would be enforced.

Rejected Loans Not Reviewed

HUD Handbook 4060.1, REV-2, section 7-8A, states that of the total loans rejected, a minimum of 10 percent or a statistical random sampling that provides a 95 percent confidence level with 2 percent precision must be reviewed. Our review disclosed that Jersey Mortgage did not follow this requirement. Jersey Mortgage officials acknowledged this weakness and stated that review of rejected loans would be enforced. Jersey Mortgage officials did not maintain records that permitted identification of the FHA rejected loans so it was impossible to determine how many rejected loans should have been reviewed.

Quality Control Review Findings Not Addressed

Management did not provide written responses to the quality control review findings or document what corrective action was taken to address the noted material findings. HUD Handbook 4060.1, REV-2, section 7-3I, requires that management take prompt action to deal appropriately with any material findings. The final report or an addendum must identify actions being taken, the timetable for their completion, and planned follow-up activities. Review of loan files revealed that no management response was provided for the quality control review findings. The quality control liaison stated that management follow-up and corrective action were conducted verbally; however, management officials did not document their actions. Jersey Mortgage officials agreed to implement the required control procedures and stated that written responses to quality control findings would be documented.

Conclusion

Jersey Mortgage had weaknesses in the implementation of its quality control plan because it did not ensure that (1) all HUD-insured FHA loans that went into default within the first six months were reviewed, (2) 10 percent of rejected loans were reviewed, and (3) management provided follow-up for quality control findings. These noncompliances occurred because Jersey Mortgage did not establish procedures to ensure that its quality control plan was properly implemented. Consequently, the effectiveness of its quality control plan, which was designed to ensure accuracy, validity, and completeness in its loan underwriting process, was lessened.

Recommendation

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

- 2A. Jersey Mortgage to implement its quality control procedures, to ensure that (1) all loans that default within the first six payments and 10 percent of rejected loans are properly selected and reviewed, and (2) adequate management follow-up is provided for any material findings resulting from quality control reviews.
- 2B. HUD's Homeownership Center's Quality Assurance Division to follow up with Jersey Mortgage in six months to ensure that the required quality control procedures were implemented.

SCOPE AND METHODOLOGY

To achieve our audit objectives, we reviewed applicable laws, regulations, HUD handbooks, mortgagee letters, and reports from HUD's Quality Assurance Division. We reviewed the independent audit reports issued by Jersey Mortgage's independent auditor and interviewed Jersey Mortgage's quality control officials, originators, and underwriters to obtain an understanding of its internal controls.

We reviewed 17 defaulted loans from HUD's Neighborhood Watch system that were underwritten by Jersey Mortgage with beginning amortization dates between August 1, 2006, and July 31, 2008. Loan selection was based on the following factors: (1) less than six payments were made before the first 90-day default was reported, and (2) the loan was not a streamline refinance.

We performed detailed testing and review of Jersey Mortgage's underwriting procedures and reviewed documentation from both HUD's Homeownership Center endorsement files and loan files provided by Jersey Mortgage officials. Our detail testing and review involved (1) analysis of borrowers' income, assets, and liabilities; (2) review of borrowers' credit history and savings ability; (3) verification of selected data on the underwriting worksheets and settlement statements; and (4) confirmation of employment and gifts. We communicated compliance issues with HUD and Jersey Mortgage officials. The results of our detailed testing only apply to the 17 loans tested and cannot be projected.

We also reviewed Jersey Mortgage's quality control plan, as well as its quality control reports and logs. We tested the sufficiency and timeliness of quality control reviews for closed loans. We selected a sample of nine quality control reports to test the adequacy of quality control review procedures and to determine compliance with HUD requirements.

We performed the audit fieldwork from January through March 2009 at Jersey Mortgage's main office located at 20 Commerce Drive, Suite 340, Cranford, New Jersey. Our audit generally covered the period August 1, 2006, through July 31, 2008, and was expanded as necessary.

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

INTERNAL CONTROLS

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

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objective.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A significant weakness exists if management 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:

- Jersey Mortgage did not ensure that certain loans were processed in accordance with all applicable HUD underwriting requirements (see finding 1).
- Jersey Mortgage did not adequately implement its quality control plan to ensure compliance with HUD's and its own quality control requirements (see finding 2).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A		\$1,281,314
1B	\$96,359	

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

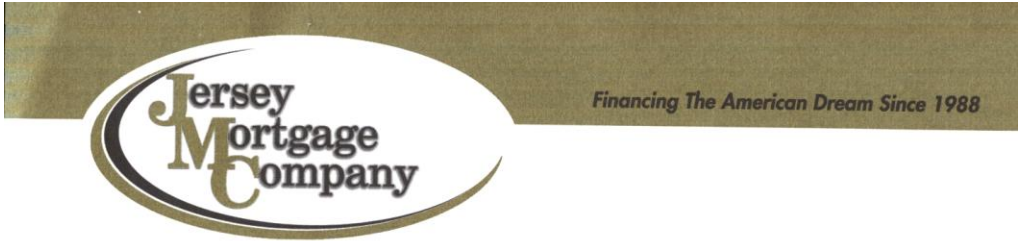
2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, if HUD implements our recommendations to indemnify the loans that were not originated in accordance with HUD/FHA requirements, it will reduce HUD's risk of loss to the insurance fund. The above amount reflects statistics showing that HUD has an average loss experience of 42 percent of the claim amount when it sells a foreclosed property.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

		
July 29, 2009		
<u>VIA FEDERAL EXPRESS</u>		
Mr. Edgar Moore Regional Inspector General for Audit U.S. Department of Housing and Urban Development Office of the Inspector General Region 2AGA 26 Federal Plaza Room 3430 New York, New York 10278-0068		
RE: Jersey Mortgage Company HUD OIG Draft Audit Report		
Dear Mr. Moore:		
Jersey Mortgage Company ("Jersey" or "Company") is in receipt of the Draft Audit Report ("Report"), dated July 6, 2009, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of Inspector General ("OIG"). The Report is based on a review of the Company conducted between January and March 2009. The audit covers 21 loans originated by the Company during the period August 1, 2006 through July 31, 2008.		
The Report states that its objectives were to determine whether Jersey: (1) originated HUD-insured loans in accordance with prudent lending practices and HUD requirements; and (2) developed and implemented a Quality Control Plan in compliance with FHA guidelines. The Report contains two findings, alleging underwriting deficiencies in 15 cases and concerns with the implementation of the Quality Control Plan in connection with certain Quality Control reviews. Based on these findings, the Report recommends that HUD require Jersey to: (1) indemnify, or reimburse losses to, the Department in connection with 15 loans involving underwriting findings; and (2) implement its Quality Control procedures to ensure that all early payment default loans are reviewed and that adequate management follow-up is provided for any material quality control review findings.		
The OIG provided Jersey with an opportunity to submit written comments for inclusion in the final report. This response summarizes Jersey's history and operations,		
20 Commerce Drive - Suite 340 DC:1347448 v1.0304348-00102 Cranford, NJ 07016 800-342-6597	www.jerseymortgage.com	38 Taylor Avenue - Suite A Manasquan, NJ 08736 800-622-4242

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including improvements the Company has made to its Quality Control procedures, and addresses the individual findings in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations. That said, we understand that final audit reports routinely include auditors' comments about the audited lender's written response, but that the company is not provided an opportunity to respond to these additional comments. Often, these comments include substantive allegations or statements that were not a part of the draft audit report provided to the company. To the extent that the OIG makes such additional substantive comments in this instance, we respectfully request an opportunity to respond to these additional statements to ensure that a full picture of the audited issues is presented in the final Report.

I. BACKGROUND

Jersey was incorporated on February 25, 1988. It received approval as a participant in the Department's Federal Housing Administration ("FHA") loan programs in November of 1986. Headquartered in Cranford, New Jersey, the Company operates through two FHA-approved locations and one Direct Lending office in New Jersey and employs approximately sixty individuals. Jersey sells all loans that it originates into the secondary market on a servicing-released basis, and its primary investors include Bank of America, Wells Fargo, and GMAC. The Company enjoys excellent relationships with both consumers and its investors, and Jersey's employees consistently strive to produce high quality loans in compliance with HUD/FHA standards. In addition, the Company works with the New Jersey Mortgage Finance Agency on a regular basis, and has received awards from this entity for its assistance in providing housing opportunities to first-time homebuyers in New Jersey.

FHA lending constitutes approximately 70% of Jersey's business operations. Because FHA lending represents a substantial portion of Jersey's overall production, the Company is committed to its relationship with the Department and takes its responsibilities under the FHA program seriously. We are dedicated to working with HUD to extend credit to qualified FHA borrowers, and we would never knowingly violate FHA requirements nor endanger the reputation of the Company or its employees. In addition, Jersey is dedicated to customer service. We aim to make the lending process as simple as possible for borrowers and work closely with each individual applicant to ensure that he or she receives the type of financing that best fits his or her needs. Throughout our existence, we have endeavored to provide dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA program.

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Comment 1

II. RESPONSE TO THE FINDINGS

The Report contains two findings, including several sub-findings, in which it alleges that Jersey did not originate 15 loans in accordance with HUD requirements or prudent lending practices, and did not implement certain aspects of its Quality Control Plan. Upon receipt of the draft Report, Jersey conducted a thorough review of the findings and loan files, as well as examined applicable HUD/FHA guidelines and internal Company procedures at the time these loans were originated, in an effort to provide pertinent information and documentation with this response. Our review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD's requirements. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate Jersey's general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report, evidence our adherence to FHA requirements in connection with the findings and several cited loans, and set forth our opposition to the manner in which the recommendations are presented in the Report.

A. FINDING 1 – JERSEY COMPLIED WITH HUD'S UNDERWRITING REQUIREMENTS

Finding 1 of the Report asserts in several sub-findings that the Company did not originate 15 of the 17 loans reviewed in compliance with HUD requirements. Specifically, the Report asserts that these loans involved deficiencies in: (1) compensating factors for high qualifying ratios; (2) credit analysis and/or debt verification; (3) source of funds to close; (4) income calculation/documentation; and (5) certain "other" findings.¹ We address each of these individual allegations in turn below.

1. Compensating Factors

In eight loans, the Report asserts that the borrowers exceeded HUD's recommended debt-to-income ratios without documented, valid compensating factors,

¹ We note that the draft Report asserts that two loans contained "technical deficiencies" that were not serious enough to negatively impact loan approval. As Jersey addressed these issues throughout the OIG's review, and the auditors determined that these findings do not warrant further action by HUD, we have not provided individual responses to these two cases herein.

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as such factors were not listed in the "Remarks" section of the Mortgage Credit Analysis Worksheet ("MCAW").

The Department has acknowledged that "[u]nderwriting is more of an art than a science and requires the careful weighing of circumstances that affect the borrower's ability and willingness to make timely mortgage payments." Mortgagee Letter 00-24; see also Mortgagee Letter 95-07. Underwriting requires the subjective evaluation of information based on experience in determining whether a potential borrower is creditworthy. An underwriter must carefully weigh all aspects of an individual's case and, were two underwriters to review the same file, one might approve a loan where the other would deny a loan. Significantly, each underwriter may have made a reasonable and prudent underwriting decision.

Furthermore, the Department expressly permits a mortgagee to approve FHA financing to a borrower with qualifying ratios that exceed the benchmark guidelines of 31% and 43% where significant compensating factors justify loan approval. See, e.g., HUD Handbook 4155.1, REV-5, ¶¶ 2-12, 2-13; Mortgagee Letter 2005-16.² The Department has professed that the "FHA does not set an arbitrary percent by which ratios may be exceeded but rather FHA relies on the underwriter to judge the overall merits of the loan application and to determine what compensating factors apply and the extent to which those factors justify exceeding the ratios." Mortgagee Letter 00-24 (emphasis added). Thus, where a potential borrower's qualifying ratios are high, an underwriter has to consider all relevant circumstances and exercise discretion in deciding whether to approve or reject a loan. This discretion is particularly important when the same loans underwritten manually could be submitted through an automated underwriting system and approved with much higher qualifying ratios. With different standards for varying types of underwriting, the Department must rely on underwriters to adequately analyze a borrower's financial circumstances and take into account all relevant factors, including the range of acceptable levels in qualifying ratios.

It is Jersey's policy to carefully consider each borrower's circumstances and document significant compensating factors in the "Remarks" section of the MCAW in compliance with HUD guidelines. This policy has been in place since the Company's inception, and we regularly remind our employees of the importance of ensuring that debt-to-income ratios in excess of HUD's guidelines are justified by significant compensating factors. Contrary to the allegations in this sub-finding, when

² While the Department has issued a new online version of Mortgage Credit Analysis Handbook, 4155.1, the new Handbook became effective for loans originated on or after May 11, 2009, after the loans cited in the Report were originated and closed. We therefore rely on the prior Handbook, 4155.1 REV-5, and accompanying Mortgagee Letters throughout this response.

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compensating factors or other justifications were required, Jersey obtained the necessary documentation to demonstrate these factors, and either included the documentation in the loan file or noted these factors in the "Remarks" section of the MCAW. We address a representative sample of the cited loans below.

a. – FHA Case No. 352-5516470

In this case, the Report asserts that the file did not document factors to compensate for the borrower's excessive front-end debt-to-income ratio of 41.31%, which exceeded HUD's benchmark guideline.

Comment 2

Contrary to this allegation, Jersey recorded the compensating factors used to justify loan approval on the MCAW, which were supported by loan file documentation (Exhibit A-1). First, as you know, FHA guidelines provide that for borrowers with limited recurring expense, greater latitude is permissible on the borrower's front-end ratio than on the total fixed payment ratio. See HUD Handbook 4155.1, REV-5, ¶ 2-12(A). Thus, as the borrower's back-end ratio of 41.31% was within HUD guidelines, and the borrower maintained only \$48 in monthly recurring obligations (Exhibit A-1), the underwriter was justified in assigning less weight to this figure. Second, the loan file contained documentation demonstrating significant compensating factors in this case. For instance, the borrower's verification of rent ("VOR") in the loan file substantiated the borrower's excellent rental history, which was noted on the MCAW (Exhibit A-1). Importantly, the VOR evidenced that the borrower was currently paying housing expenses on a timely basis, and had done so for nearly a year prior to closing (Exhibit A-2). HUD Handbook 4155.1 REV-5, ¶ 2-13 expressly states that a borrower's "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" is a compensating factor.

In addition, the borrower had been employed in the same line of work for over five years (Exhibit A-3), and the loan was underwritten and approved by the New Jersey Housing & Mortgage Finance Agency with no conditions (Exhibit A-4). Based on these compensating factors, we believe the underwriter more than justified the higher-than-average front-end ratio in this case. See HUD Handbook 4155.1, REV-5, ¶ 2-13. The borrower, therefore, qualified for FHA financing, and indemnification is not warranted. We respectfully request that this finding be removed from the final Report.

b. – FHA Case No. 351-4942197

Comment 3

In the Williams loan, the sub-finding asserts that, although the borrowers' back-end ratio was 47% and thus exceeded HUD's benchmark guideline of 43%, the MCAW did not list any compensating factors to justify loan approval.

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Comment 3

As an initial matter, we note that this loan received an "Approve/Eligible" rating from Fannie Mae's Desktop Underwriter ("DU") automated underwriting system, which calculated the qualifying ratios in this instance (**Exhibit B-1**). HUD guidelines expressly state that lenders must describe compensating factors used to justify mortgage approval if the ratios are exceeded on manually underwritten mortgages, rather than on those cases that receive approval from an automated underwriting system. See Mortgagee Letter 2005-16. Moreover, while not expressly noted on the MCAW, the loan file documented several compensating factors that justified loan approval even with the slightly higher-than-average back-end ratio in this case. Significantly, the loan file contained pay stubs and tax returns documenting that the borrower's non-purchasing spouse, who would reside in the property, earned additional income that was not used for qualifying purposes in this case (**Exhibit B-2**). A note attached to these documents clearly states that the underwriter considered this income as a compensating factor (**Exhibit B-2**). HUD guidelines expressly state that additional income not reflected in effective income compensates against higher debt-to-income ratios. See HUD Handbook 4155.1 REV-5, ¶ 2-13(E). The loan file also indicated that the borrower had saved approximately \$5,000 in a retirement account prior to closing (**Exhibit B-3**), which evidenced her ability to accumulate savings, another express compensating factor noted by the Department. *Id.* ¶ 2-13(C). Finally, the loan file indicates that the borrower had good job stability, as she had been employed with the Trenton Board of Education for almost seven years prior to closing (**Exhibit B-4**). Based on these recognized, significant compensating factors, even with a slightly higher back-end ratio, the borrower in this case qualified for FHA financing. Indemnification, therefore, is not warranted, and this finding should be removed from the final Report.

c. – FHA Case No. 352-5601063

In this case, the Report asserts that the borrowers' qualifying ratios exceeded the HUD's benchmark guidelines; however, the compensating factors listed in the Remarks section of the MCAW, which included the borrower's excellent work history and use of the borrowers' own funds to meet the downpayment, were "unallowable."³

Comment 4

Contrary to this allegation, the loan file documented significant compensating factors, including those listed in the Remarks section and other factors expressly identified by the Department as compensating against higher ratios, that justified

³ We note that the Report asserts that, based on recalculated monthly income of \$5,328 versus the \$5,388 used, the borrowers' ratios would have increased to 46.81%/49.08%. As discussed in detail below, the Company respectfully disagrees with the allegation that income was miscalculated in this case. That said, even if the borrowers' ratios increased as alleged in the Report, the compensating factors evidenced in the file would have justified loan approval in this case.

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approval of these borrowers for FHA financing. For instance, in addition to the co-borrower's income from Dependable Temp, which the underwriter included in the qualifying income, the loan file evidenced that the co-borrower had a second job with Wal-Mart, which she started in March of 2007 (**Exhibit C-1**). The W-2 form from this job indicates that the co-borrower earned additional income from this second job of \$19,166 in 2007 (**Exhibit C-2**), the year the loan closed (**Exhibit C-3**). The underwriter did not include these earnings in the borrowers' qualifying income in this case; however, the loan file and additional documentation clearly document that the co-borrower earned an additional \$1,600 in monthly income. HUD Handbook 4155.1 REV-5, ¶ 2-13 expressly states that such "documented compensation or income not reflected in effective income, but directly affecting the ability to pay the mortgage" is a compensating factor. Moreover, the rental verification in the file demonstrates that the borrowers had made timely rental payments for the past twelve years (**Exhibit C-4**). The same Handbook provision also states that a borrower's "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" is a compensating factor. Here, the borrowers' excellent twelve-year rental history compensated against higher ratios in this case.

In addition to these compensating factors, which are expressly recognized by HUD guidelines, the Remarks section on the MCAW indicated that the borrower had excellent employment history, as evidenced by the verification of employment ("VOE") indicating that he had been in his current position with Track Data Corp. for over eight years (**Exhibit C-5**) and that the borrowers used their own funds, rather than downpayment assistance or gifts from family members, to satisfy closing costs (**Exhibit C-6**). While not listed in HUD guidelines, these facts evidence the borrowers' employment stability and financial commitment to the FHA loan at issue, and the underwriter reasonably concluded that such factors, along with the additional factors evidenced in the loan file, would help to offset the higher-than-average qualifying ratios in this case. We maintain that the Company complied with HUD guidelines in the Gill loan and, as a result, this finding should be removed from the final Report.

d. – FHA Case No. 352-5526607

In the Brunson loan, the Report asserts that, based on recalculated qualifying income of \$5,013, \$66 less than the \$5,079 reflected on the MCAW, the borrowers' ratios were 37.7%/46%; however, the MCAW did not list compensating factors to justify the higher qualifying ratios.

Comment 5

As discussed in Section II.A.4, below, Jersey respectfully disagrees with the Report's allegations regarding the calculation of income in this case. The Company maintains that the MCAW reflected accurate ratios of 37.2%/45.45% based on loan file documentation. Nevertheless, even if the ratios were recalculated using the Report's

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lower qualifying income amount, the borrowers in this case would have qualified for FHA financing. While not expressly noted on the MCAW, the loan file documented several compensating factors that justified loan approval even with the higher-than-average ratios in this case. Importantly, the loan file documented that the borrowers had made timely rental payments for the past three years (Exhibits D-1, D-2). As discussed above, HUD guidelines expressly state that a borrower's "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" is a compensating factor. HUD Handbook 4155.1 REV-5, ¶ 2-13(A). Furthermore, the loan file evidenced that the borrowers had a minimal increase of only \$300 in their housing expenses (Exhibit D-3), another compensating factor expressly recognized by the Department. See HUD Handbook 4155.1 REV-5, ¶ 2-13(A). Finally, the loan file indicates that the borrowers had taken responsibility for their credit obligations and satisfied all outstanding debts prior to closing (Exhibit D-3). These significant factors evidence the borrowers' willingness and ability to timely meet their mortgage obligation and offset the higher qualifying ratios, even with the income recalculation in this instance. For these reasons, indemnification of this loan is unwarranted. Thus, we request that this finding be removed from the final report.

e. – FHA Case No. 352-5564815

In the Doda loan, the Report alleges that the qualifying ratios were 37.73%/44.45%; however, the MCAW did not list compensating factors in the Remarks section.

Comment 6

As discussed above, while the qualifying ratios in this instance slightly exceeded HUD's qualifying ratios of 31%/43%, the Department expressly permits a mortgagee to approve FHA financing to such borrowers based on enumerated compensating factors. See HUD Handbook 4155.1 REV-5, ¶ 2-13. Here, the loan file contained evidence that the co-borrower was earning income that was not used to qualify the borrowers (Exhibit E-1, E-2), which was supported by the borrower's tax returns for 2007 (Exhibit E-3). As you know, HUD guidelines expressly state that documented income not reflected in the qualifying income compensates against higher ratios in FHA-insured transactions. See HUD Handbook 4155.1 REV-5, ¶ 2-13(E). In addition, the borrower had excellent job history, as he had been employed at his current position for over five years prior to closing (Exhibit E-4, E-5). The underwriter evaluated the strong compensating factors in this case and reasonably determined that the borrowers qualified for the FHA loan. Therefore, we request that this finding and any request for indemnification in connection with this issue be removed from the final report.

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f. – FHA Case No. 352-5628101

Finally, in the Cox loan, **this sub-finding** asserts that, based on recalculated qualifying income and debt amounts, the borrowers' ratios exceeded HUD's benchmark guidelines, but the file did not reference compensating factors that would have offset these ratios.

The Company addresses the Report's concerns with the debt and income calculations in Sections II.A.2 and II.A.4 of this response; however, even if the borrowers' ratios were recalculated based on the amounts discussed below, the borrowers would have qualified for FHA financing, based on the significant compensating factors present in this case. Specifically, the loan file documented that the co-borrower earned approximately \$3,500 in monthly income from her position with The New York Christian Times (**Exhibit F-1**), which she had held for over seventeen years (**Exhibit F-2**), that the underwriter did not use to qualify the borrowers for FHA financing (**Exhibit F-3**). The borrower's pay stubs also reflected overtime income (**Exhibit F-4**) that the underwriter did not include in calculating the borrowers' qualifying ratios on the MCAW (**Exhibit F-3**). As discussed above, FHA guidelines expressly state that documented income not reflected in effective earnings compensates against higher qualifying ratios. See HUD Handbook 4155.1 REV-5, ¶ 2-13(E). In addition, the loan file evidenced significant savings on the part of the borrowers (**Exhibit F-5**). HUD guidelines also state that a demonstrated ability to accumulate savings constitutes a compensating factor in evaluating a borrower's ability to qualify for FHA financing. See HUD Handbook 4155.1 REV-5, ¶ 2-13(C). Finally, the borrower had excellent job history, as he had been employed in his current position for over twenty years (**Exhibit F-6**). These substantial compensating factors would have offset the higher-than-average ratios in this case. The borrowers qualified for the FHA-insured loan in this instance and, for these reasons, we maintain that indemnification would be inappropriate. Thus, we request that this allegation be removed from the final report.

2. Credit Analysis

In five loans, the Report takes issue with the Company's evaluation of the borrowers' creditworthiness. Specifically, this sub-finding asserts that the borrowers' credit histories involved collections, judgments, and/or delinquent accounts or asserts that debts were not properly verified.

Jersey respects the importance of analyzing a borrower's credit performance and examining his or her attitude towards credit obligations. It is Jersey's policy and practice, with respect to every FHA applicant, to scrutinize the applicant's credit record and reasonably determine the potential borrower's creditworthiness. Given the potential risks not only to the Department, but to the Company, of making a poor credit decision,

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the Company's management endeavors to monitor underwriting performance and provide ongoing training to employees on the issue of credit analysis.

That being said, we note that HUD delegated to FHA lenders the responsibility for analyzing a borrower's credit and determining an individual's creditworthiness. See HUD Handbook 4155.1 REV-5, ¶ 2-3. While HUD has established specific guidelines, credit analysis remains largely subjective. For example, where derogatory credit items are present, lenders have discretion to consider the borrower's unique circumstances and determine whether financing is appropriate. As discussed above, the Department has recognized that underwriting is more of an art than a science and requires the careful weighing of the circumstances in each individual case. Thus, it is Jersey's policy to carefully scrutinize a borrower's credit history to obtain any documentation or explanation necessary to assess a borrower's credit risk. See Mortgage Letters 00-24 and 95-07; see also HUD Handbook 4155.1 REV-5, ¶ 2-3. While two underwriters may make different decisions about a borrower's credit in the same case, both underwriters may have complied with FHA requirements and made reasonable underwriting decisions. Jersey takes its underwriting responsibility seriously and would never knowingly approve a loan to an unqualified borrower.

In the cases cited in the Report, Jersey complied with FHA guidelines by examining the borrowers' overall pattern of credit behavior and reasonably determining that the borrowers qualified for FHA financing. The Company properly considered each borrower's previous housing obligations, recent and/or undisclosed debts, collections, judgments, and bankruptcies, and Jersey underwriters reasonably determined that past derogatory items did not reflect a current disregard for financial obligations. The loan files contain required documentation and Jersey prudently exercised the discretion granted to it by the FHA. As discussed below, the borrowers in these cases generally were hard-working individuals who took responsibility for their financial obligations. As a result, Jersey adhered to FHA requirements by reasonably determining that the borrowers were creditworthy and qualified for FHA loans. We address a representative sample of the cited loans below.

a. – FHA Case No. 352-5526607

In the Brunson loan, the Report alleges that the loan file did not contain an explanation for two judgments reflected on the borrowers' credit report, and that the amount of child support being paid by the borrower was not verified. Jersey respectfully disagrees with these assertions.

With regard to the judgments, Jersey understands and appreciates that lenders are required to analyze a borrower's past credit record to determine whether past derogatory items resolved from a disregard for, or an inability to manage, financial

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obligations, or to factors beyond the control of the borrower. See HUD Handbook 4155.1 REV-5, ¶ 2-3. As discussed above, it is Jersey's policy to carefully scrutinize a borrower's credit history and to examine the borrower's overall pattern of credit behavior. See id. Contrary to the Report's suggestion, Jersey complied with this requirement in the Brunson loan. In this case, while the borrower's credit report reflected two judgments, the Company obtained an explanation regarding each of these matters. With regard to the Maryland tax lien, the borrower's credit explanation letter indicated that the borrowers had addressed this issue (**Exhibit G-1**) and provided evidence of their satisfaction of this obligation to Jersey prior to closing (**Exhibit G-2**). With regard to the second judgment, the borrowers' explanation letter indicated that this account would be satisfied at closing (**Exhibit G-2**), and the HUD-1 Settlement Statement ("HUD-1") documented this satisfaction (**Exhibit G-3**). Thus, the borrowers addressed the judgments in their letter of explanation and evidenced their commitment to honoring their financial responsibilities by satisfying these accounts prior to or at closing.

Comment 8

With regard to the child support, contrary to the assertion in the Report, the loan file indicated that the borrower was responsible for making an \$89 weekly payment for child support (**Exhibit G-4**). While the annualized monthly amount of this payment would be \$385 ($\$89 \times 52 \text{ weeks} = \$4,628/12 = \$385$), the underwriter conservatively estimated the borrower's monthly obligation to be \$418 on the MCAW (**Exhibit D-3**). This conservative estimate actually increased, rather than decreased, the borrowers' qualifying ratios and thus did not affect the borrowers' ability to qualify for FHA financing.

In summary, Jersey maintains that it complied with HUD guidelines in analyzing the borrowers' credit profile in the Brunson loan and the underwriter reasonably determined that the borrowers had taken responsibility for their obligations and demonstrated an acceptable credit risk. For these reasons, Jersey respectfully requests that the indemnification recommendation in this instance be removed from the final Report.

b. – FHA Case No. 352-5628101

Here, the Report alleges that the total monthly installment debt used to calculate the borrowers ratios should have been \$1,055, rather than \$716.

Comment 7

With regard to the calculation of a borrower's debts, the Company consistently has required its underwriters to examine all of a borrower's outstanding liabilities, such as installment loans, revolving charge accounts, child support and student loans, extending ten months or more from closing when determining whether a particular borrower qualifies for FHA financing. See HUD Handbook 4155.1, REV-5, CHG-1, ¶ 2-

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11(A). To the extent that the underwriter did not consider all of the borrower's current debts in this case, such practice was against Company policy, and Jersey has reminded all of its underwriters of the importance of ensuring that all of a borrower's current debts and payment amounts are considered and used to calculate the qualifying ratios in each FHA loan underwritten by Jersey. We are confident that any issues identified in the Report have been resolved. That said, with regard to the Cox loan, any oversight with regard to analyzing the borrowers' debt resulted in, at worst, harmless error. The Report indicates that including the additional debts would have increased the borrowers' qualifying ratios. As discussed above, however, the loan file demonstrates that significant compensating factors present in this case would have offset the higher-than-average ratios. For instance, the loan file documented that the co-borrower earned approximately \$3,500 in monthly income, and the borrower earned additional overtime income (Exhibit F-4), that the underwriter did not include in calculating the borrowers' qualifying ratios on the MCAW (Exhibit F-3). In addition, the loan file evidenced significant savings on the part of the borrowers (Exhibit F-5), and the borrower had an excellent employment history of over twenty years (Exhibit F-6). These compensating factors more than offset the higher qualifying ratios that would have resulted from inclusion of the additional debt in the borrowers' ratios. For this reason, we request that the recommendation for indemnification in connection with this finding be removed from the final report.

c. – FHA Case No. 352-5545714

In this case, the Report asserts that the credit report indicated several delinquent accounts; however, the loan file did not contain an explanation from the borrower regarding the reasons for these delinquencies.

Comment 9

As discussed above, with regard to analyzing a potential borrower's credit, Jersey understands and appreciates that it must obtain a written explanation from the borrower regarding all delinquent inquiries shown on a credit report obtained prior to closing. See HUD Handbook 4155.1 REV-4, CHG-1, ¶ 2-3(B). It is the Company's policy and procedure to do so, and we have reminded our employees of the importance of this analysis in response to the OIG's audit. While the Company acknowledges that the loan file did not contain an explanation regarding the referenced debts, any oversight in this case constituted, at worst, harmless error. During the course of the OIG's review, Jersey contacted the borrower in this case and obtained a written explanation of the reasons for the past delinquencies (Exhibit H). This explanation evidences that the borrowers' past credit issues resulted from an operation that caused the borrower to miss work for a period of six months (Exhibit H). This explanation evidences that a medical issue, rather than a disregard for credit obligations, caused the

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borrowers' past delinquencies. For this reason, we believe that indemnification is inappropriate and request that this recommendation be removed from the Report.

3. Source of Funds

In this sub-finding, the Report alleges that, in several cases, the loan file did not adequately document the source and/or the adequacy of the funds used for the borrower's downpayment and/or earnest money deposit ("EMD"). Jersey respectfully disagrees with the assertions in many of the cited loans. Our individual responses to a representative sample of these cases follows.

a. – FHA Case No. 352-5516470

In this loan, the Report asserts that the borrower needed \$5,835 to close; however, the loan file documented only \$3,043 in available funds.

As indicated in the Report, in this case, the borrower needed \$5,835 to close the loan on May 14, 2007 (**Exhibit I-1**). As acknowledged in the Report, the borrower's bank account contained evidence of over \$3,043 in savings as of February 23, 2007, a few months prior to closing (**Exhibit I-2**). In examining the loan file in this case, it appears that the underwriter approved the loan file for FHA financing on March 19, 2007 (**Exhibit A-1**). At that time, the funds necessary to close the loan were verified in the file. It appears that, between the date of the underwriter's loan approval and the actual closing date, the borrower required increased funds to close; however, the Company's underwriter was not informed of this fact or given an opportunity to obtain additional asset verification. In response to this case, Jersey has reminded all of its employees and settlement agents of the importance of ensuring that the underwriter verifies all necessary assets prior to closing and we are confident that such circumstances will not recur. Nevertheless, the borrower's VOE (**Exhibit A-3**) and pay stubs (**Exhibit I-3**) demonstrated that she earned \$1,900 on a bi-weekly basis. Based on this information, the borrower would have received several pay checks between the February bank statement and the closing date of May 14, 2007 (**Exhibit I-1**) and could have used a portion of her earnings to satisfy the remaining funds needed to close the loan. Therefore, we believe that further action in this case is not appropriate and this finding should be removed from the final report.

b. – FHA Case No. 351-4842564

In the Batie loan, the Report alleges that the loan file did not verify sufficient funds to close, as the \$4,207 ending balance of the borrower's credit union account reflected two large, unexplained deposits of \$1,600 and \$1,900.

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In this case, the borrowers needed \$6,104 to close the loan on December 28, 2006 (**Exhibit J-1**). As acknowledged in the Report, the co-borrower's savings account reflected verified assets of \$3,432 on December 12, 2006 (**Exhibit J-2**). In addition, the borrower's credit union account reflected \$4,207 in assets as of December 20, 2006 (**Exhibit J-3**), \$3,500 of which was derived from two deposits on December 6, and December 16, 2006. Jersey understands and appreciates that FHA lenders must verify large or excessive increases in account funds used to close the loan. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B). It is the Company's policy and procedure to do so in each FHA loan it originates, and Jersey maintains that it did so in this case. A review of the borrower's credit union account statements from July 2006 through November 2006 evidence that these two deposits were not excessive based on the borrower's past pattern of deposit (**Exhibit J-4**). Specifically, this account statement reflects similar deposits in August and October of 2006 (**Exhibit J-4**). Thus, the underwriter was not required to obtain an explanation for these two deposits pursuant to FHA guidelines. Nevertheless, in preparation of this response, Jersey obtained an explanation from the borrower regarding these deposits (**Exhibit J-5**). In her letter, the borrower stated that the funds for these deposits were a combination of the borrower's payroll checks from her position with the Department of Corrections (**Exhibit J-6**), Social Security income she received for her three children (**Exhibit J-7**), and AFLAC payments she was receiving at the time (**Exhibit J-5**).

The above discussion and attached documentation evidences that the \$4,207 in the borrower's credit union was adequately verified and, at the time of closing, the borrowers had sufficient funds to close this loan. For these reasons, we maintain that indemnification in this case is unwarranted, and request that this finding be removed from the final report.⁴

c. – FHA Case No. 352-5596824

Here, the Report asserts that \$784 of the funds to closed were not verified, as the borrower's credit union account statement referenced a large deposit of \$900; however, the loan file did not include an explanation regarding the source of these funds.

⁴ We note that the Report also takes issue with two deposits of \$980 and \$950, made on September 13, 2006 and October 4, 2006, respectively (**Exhibit J-4**). As discussed above, the borrower received Social Security income for her three children, which amounted to \$950 per month (**Exhibit J-7**). These entries reflect the borrower's deposit of these amounts for the months of September and October 2006. As the loan file evidenced the source of these funds, we request that this allegation be removed from the final report.

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In this case, the borrowers needed \$5,749 to close the loan on June 22, 2007 (**Exhibit K-1**). As acknowledged in the Report, the borrower's credit union account reflected assets of \$5,864 on June 21, 2007 (**Exhibit K-2**), \$900 of which was derived from a deposit on that date. As discussed above, Jersey understands and appreciates that FHA lenders must verify large increases in account funds used to close the loan. See HUD Handbook 4155.1 REV-5, ¶ 2-10(B). It is the Company's policy and procedure to do so in each FHA loan it originates, and Jersey maintains that it did so in this case. A review of the borrower's pay stubs reflects that he deposited \$625 per week into a checking account, in addition to the direct deposits to his credit union savings account (**Exhibit K-3**). The underwriter reasonably determined that the \$900 deposit of funds into the credit union account could have come from the borrower's income that he had deposited into the checking account. Based on this information and the borrower's income of \$8,460 per month (**Exhibit K-4**), the underwriter concluded that \$900 did not constitute a large or excessive deposit in this instance. Thus, the underwriter was not required to obtain an explanation for this deposit pursuant to FHA guidelines. Contrary to the assertion in the Report, the borrower's credit union account reflected verified funds of \$5,865 (**Exhibit K-2**), which was sufficient to cover the \$5,749 in funds necessary to close the loan the next day (**Exhibit K-1**). For these reasons, indemnification is not warranted, and this finding should be removed from the final Report.

d. – FHA Case No. 352-5545714

In the Towers loan, the Report alleges that the loan file did not contain supporting documentation for the deposit of the EMD.

Comment 13

Jersey understands and appreciates that, if the amount of the EMD exceeds two percent of the sales price, the lender must verify the deposit amount and the source of funds. See HUD Handbook 4155.1 REV-5, ¶ 2-10(A). It is the Company's policy and procedure to require evidence of the source and deposit of the EMD in each FHA-insured loan in which it exceeds two percent of the sales price. We acknowledge, however, that the loan file did not contain such documentation in the Towers case, and we have reminded our employees of the importance of retaining such documentation in all cases. Nevertheless, any oversight with regard to the EMD in the Towers loan constituted, at worst, harmless error. In preparation of this response, Jersey obtained documentation from the borrower that he withdrew \$35,000 from his retirement account on January 27, 2007 (**Exhibit L-1**). These funds would have been more than sufficient to cover both the \$10,000 EMD and the funds necessary to close this loan on March 23, 2007 (**Exhibit L-2**). Moreover, the settlement agent included the \$10,000 EMD on the HUD-1, and certified to the accuracy of the information contained in that document (**Exhibit L-2**). For these reasons, we maintain that indemnification in connection with

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the Towers loan would be inappropriate, and request that this finding be removed from the final report.

4. Income Calculation

In six of the loans audited by the OIG, the Report contends that the Company did not properly calculate the borrower's income and/or did not obtain adequate support for the borrower's employment. Jersey respectfully disagrees with the allegations in several of the cases included in this sub-finding, and our individual responses to a representative sample of these cases are set forth below.

a. – FHA Case No. 352-5601063

In the Gill loan, the Report asserts that, although the loan file documented overtime income for the past 30 months, the lender did not verify that such income was likely to continue and, thus, such income should not have been included in the qualifying income, which would have increased the borrowers' qualifying ratios.

Jersey respectfully disagrees with this allegation. HUD guidelines generally permit the use of overtime income to qualify a borrower when these earnings can be documented for the past two years and the income is likely to continue. See HUD Handbook 4155.1 REV-5, ¶ 2-7(A). To do so, "[t]he 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." *Id.* (emphasis added). Jersey strictly adhered to these requirements in the Gill loan. The borrower's VOE, as substantiated by his pay stubs, clearly indicated that the borrower had earned regular overtime income for the past three years (Exhibit C-5). The employer and Jersey used this information to develop average monthly earnings for the borrower as reflected on both the VOE (Exhibit C-5) and the MCAW (Exhibit C-6). Moreover, as required by HUD guidelines to evidence likelihood of continuance, the VOE did not state that the overtime income was unlikely to continue (Exhibit C-5). Contrary to the allegation in the Report, no further verification was necessary. In addition, we note that employers often, as a policy, do not complete the likelihood of continuance section of the VOE. Thus, HUD merely requires that lenders ensure that there is no indication that such income will cease in the immediate future. Here, nothing in the loan file suggested that the borrower would not continue to earn overtime income, and the fact that the borrower had done so for three years indicated that such earnings were likely to continue. In accordance with HUD guidelines, Jersey properly verified the borrower's consistent overtime income and its likelihood of continuance. Indemnification would be unwarranted and, this allegation should therefore be removed from the Report.

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b. – FHA Case No. 352-5526607

In this case, the Report alleges that the loan file did not contain adequate documentation to support the co-borrower's employment with Ali's Brushstroke Painting Company and that the income for this position was overstated by \$66 on the MCAW.

With regard to the co-borrower's employment documentation, Jersey understands and appreciates that HUD's alternative documentation guidelines for employment require FHA lenders to obtain a telephone verification and pay stubs covering "the most recent 30-day period," which is defined to mean the time at which the initial loan application is made, provided the documents are not more than 120 days old as of closing. See HUD Handbook 4155.1 REV-5, ¶ 3-1(F). Jersey maintains that it complied with these requirements in the Brunson loan. As acknowledged in the Report, the loan file contained a telephone verification from the co-borrower's employer (**Exhibit M-1**), as well as four pay stubs covering a 30-day period prior to closing (**Exhibit M-2**). While one of these pay stubs covered a week in December and the remaining pay stubs covered weeks in November, the pay stubs included in the loan file nevertheless covered a 30-day period prior to closing and clearly evidenced that the borrower was employed by Ali's Brushstroke Painting Company and earned \$200 per week (**Exhibits M-1, M-2**). Thus, Jersey maintains that it complied with HUD guidelines in documenting the co-borrower's employment in this case.

In addition, Jersey respectfully disagrees with the assertion regarding calculation of the co-borrower's monthly income from this position. As stated above, the co-borrower's paychecks from this employer evidenced that she earned \$200 in weekly income (**Exhibit M-2**). Based on this documentation, the underwriter properly calculated the co-borrower's monthly income in this case to be \$866 (\$200 per week x 52 weeks = \$10,400/12 months = \$866 per month), which the underwriter used to calculate the borrower's effective income on the MCAW (**Exhibit D-3**).

The above discussion and attached documentation evidences Jersey's compliance with HUD guidelines in documenting the co-borrower's income and calculating her monthly earnings in this case. For these reasons, the request for indemnification in this case is unwarranted and we request that these findings be removed from the final report.

c. – FHA Case No. 352-5628101

In the Cox loan, the Report takes issue with the calculation of the borrower and co-borrower's income. With regard to the borrower, this sub-finding asserts that overtime income was used as qualifying income; however, such earnings were not documented in accordance with HUD guidelines. With regard to the co-borrower, the

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Report asserts that the Social Security income in the loan file was overstated and should have been reflected as \$1,429, rather than \$1,846.

With regard to the overtime income, Jersey respectfully disagrees with the assertion in the Cox loan. While this income may have been entered into the automated underwriting system in this case, overtime income was not used to calculate the borrowers' effective income or qualify the borrowers for FHA financing in this case. The MCAW clearly indicates that the underwriter considered only the borrower's base income of \$3,888 (Exhibit F-3), which was well-documented on the borrower's pay stubs (Exhibit F-4). Moreover, had the underwriter considered overtime income in this case, such income was sufficiently documented in the loan file. HUD guidelines generally permit the use of overtime income to qualify a borrower when these earnings can be documented for the past two years. See HUD Handbook 4155.1 REV-5, ¶ 2-7(A). While the loan file does not document a two-year history of overtime income in this case, the loan file contains evidence of consistent overtime income for the 9.5 months in 2007 (Exhibit F-4) prior to closing (Exhibit N-1). HUD guidelines permit lenders to consider overtime income earned for periods of less than two years, provided that the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes. Id.

In this instance, the loan file contained substantial evidence that the borrower had received regular overtime income in his employment with Media Information Services, and would continue to do so. The verbal VOE contained in the loan file indicated that the borrower had a twenty-year history with the company and his probability of continued employment was "good" (Exhibit F-6). With regard to overtime in this position, the borrower's pay checks indicated that the borrower in fact earned consistent overtime at a rate of \$33.64 per hour throughout 2007 (Exhibit F-4), and his W-2 forms from prior years also indicated overtime earnings (Exhibit N-2). Based on this documentation, the underwriter could have considered the borrower's overtime income in this case. For this reason, and as the underwriter did not consider the borrower's overtime income in calculating the borrower's effective income and qualifying ratios, we request that this allegation be removed from the final report.

With regard to the co-borrower's Social Security income, contrary to the suggestion in the Report, HUD guidelines expressly permit such nontaxable income to be "grossed up" by 25% to account for the continuing tax savings attributable to such income. See HUD Handbook 4155.1 REV-5, ¶ 2-7(Q). In this instance, the loan file documented that the co-borrower received \$1,429 in monthly Social Security income in 2007 (Exhibit N-3). Thus, based on HUD guidelines, Jersey should have considered the "grossed up" amount of \$1,786, rather than the base amount of \$1,429 as suggested in the Report. That said, based on an inadvertent error in calculating the

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2007 increase, the \$1,846 used to qualify the borrowers in this case was slightly overstated. Jersey has reminded its employees of the importance of accurately calculating all borrower earnings used in qualifying income, and we are confident that this issue will not recur. In any event, with regard to the Cox loan, any oversight with regard to the co-borrower's income resulted in, at worst, harmless error. The slightly lower qualifying income would have been offset by the significant compensating factors present in this case. As discussed above, the loan file documented that the co-borrower earned approximately \$3,500 in monthly income, and the borrower earned additional overtime income (Exhibit F-4), that the underwriter did not include in calculating the borrowers' qualifying ratios on the MCAW (Exhibit F-3). In addition, the loan file evidenced significant savings on the part of the borrowers (Exhibit F-5), and the borrower had an excellent employment history of over twenty years (Exhibit F-6). These compensating factors more than offset the higher qualifying ratios that would have resulted from the slight decrease in the co-borrower's effective income. For this reason, we request that the recommendation for indemnification in connection with this finding be removed from the final report.

d. – FHA Case No. 351-4900883

Finally, in the Diaz loan, the Report asserts that the loan file contained four pay stubs with dates ranging from April 13 to May 18, 2007; however, the file did not contain pay stubs covering the "most recent" 30-day period.

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As discussed above, Jersey understands and appreciates that HUD's alternative documentation guidelines for employment require FHA lenders to obtain a telephone verification and pay stubs covering "the most recent 30-day period," which is defined to mean the time at which the initial loan application is made, provided the documents are not more than 120 days old as of closing. See HUD Handbook 4155.1 REV-5, ¶ 3-1(F). Jersey maintains that it complied with these requirements in the Diaz loan. The loan file contained a telephone verification from the borrower's employer (Exhibit O-1), as well as four pay stubs covering a 30-day period prior to closing (Exhibit O-2). While these pay stubs did not cover four consecutive weeks, the pay stubs included in the loan file nevertheless covered a 30-day period prior to closing and clearly evidenced that the borrower was employed by Thurston Transportation and earned \$1,229 per week in this position (Exhibits O-1, O-2). Jersey maintains that it complied with HUD guidelines in documenting the borrower's employment in this case. Therefore, indemnification is unwarranted and this finding should be removed from the final report.

5. "Other" Findings

Finally, in all but one of the loans cited, Appendix C raises concerns with "other" issues based on the OIG's review of the loan files in these cases. These cases include

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allegations regarding, among other things, bank account documentation, verification of assets and rent, and gift fund documentation. We address these issues in a representative sample of cases in turn below.

a. – FHA Case No. 351-4942197

In this loan, Appendices C and D-4 take issue with the borrower's savings account documentation. Specifically, the Report asserts that: (1) the loan file did not contain bank statements for the two most recent, consecutive months; and (2) did not verify the source of a \$4,630 deposit into the savings account on June 29, 2007. Jersey respectfully disagrees with these assertions.

With regard to the bank statements, Jersey understands and appreciates the Department's requirement that a loan file contain a Verification of Deposit ("VOD") and most recent bank statement or, alternatively, the two most recent, consecutive statements, showing the previous month's balance. See HUD Handbook 4155.1 REV-5, ¶ 3-1. In connection with loans originated by automated underwriting systems, however, FHA guidelines state that the lender is accountable for documentation aspects not addressed in the user's guides provided by the automated underwriting system's creator. See Mortgage Letter 99-26. The Williams loan was underwritten using Fannie Mae's DU. The user's guide for DU states that the DU system indicates the asset verifications that are required to complete the individual underwriting file. See Fannie Mae Desktop Underwriter Guide, Ch. 2. Verification messages are provided on the Fannie Mae Underwriting Findings report requiring the specific asset documentation required in each case. Based on these directives, in loans underwritten by DU, Jersey obtained the documentation indicated in the verification messages provided in the Underwriting Findings reports.

The Williams case received an Approve/Eligible recommendation from DU, indicating the loan met both credit risk and eligibility requirements (Exhibit B-1). Jersey complied with the verification messages on the Underwriting Findings report and the loan file contained all the necessary asset documentation for the borrower. Finding 30 of the report required assets for the borrower to be "verified by one of the following: (a) VOD; (b) most recent statement showing the previous month's balance; or (c) most recent two months statements to verify sufficiency of funds required to close (Exhibit B-1) (emphasis added). In compliance with this verification message, the loan file contained a copy of the borrower's checking account statements covering the period from April 20, 2007 through August 16, 2007 (Exhibit P-1), and, with regard to the savings account, the most recent activity statement, which covered the period from July 23, 2007 to August 14, 2007, and showed the previous month's balance (Exhibit P-2). Therefore, the loan file contained all necessary asset documentation in accordance with FHA and DU requirements. While the loan file also contained another activity statement

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for the borrower's savings account covering the period from June 18, 2007 to June 29, 2007, this statement was not required in this case.

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With regard to the June 29, 2007 deposit into the borrower's savings account, Jersey understands and appreciates that an FHA lender must verify all funds used for the borrower's investment in the property. See HUD Handbook 4155.1 REV-5, ¶ 2-10. Where funds in a borrower's savings or checking account are used to cover the borrower's investment, HUD guidelines require that, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. Id. These requirements, however, only apply to those funds that are used by the borrower to meet the borrower's investment in the property. The loan file, however, makes clear that the referenced \$4,630 deposit was not used to close the Williams loan. In this case, the borrowers needed only \$3,856.01 to close the loan on August 31, 2007 (Exhibit P-3). The borrower's checking account indicated that the borrower had \$2,076.57 in verified funds as of August 16, 2007 (Exhibit P-1). Moreover, the borrower's most recent savings account statement indicated an ending balance on August 14, 2007 of \$4,920.67, which was derived from two deposits of \$4,920.57 on August 10, 2007 and \$4,366.09 on July 26, 2007 (Exhibit P-2). The loan file contained documentation to verify that: (1) the August 10, 2007 deposit was derived from the retirement account of the borrower's non-purchasing spouse (Exhibit P-4); and (2) the July 26, 2007 deposit was derived from the borrower's retirement account (Exhibit B-3). As this documentation verified the source of the funds necessary to close this loan, Jersey was not required to obtain verification of the June 29, 2007 deposit into the borrower's savings account. Thus, the Company complied with HUD guidelines in verifying the borrowers' closing funds in this case.

In summary, Jersey complied with HUD guidelines regarding the borrower's asset documentation in this case and properly verified all funds used to close the Williams loan. Therefore, the allegations regarding the borrower's savings account documentation should be removed from the final Report.

b. – FHA Case No. 352-5605932

In this case, the Report alleges that the \$8,000 gift from the borrower's relative that was the source of the funds to close was not adequately documented, as the loan file did not adequately verify the source of funds that the donor used as the gift.

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As you know, with regard to gift funds obtained from a relative, as in this case, HUD guidelines require a lender to obtain the following documents when the gift funds are in the homebuyer's account prior to closing: (1) a gift letter specifying, among other items, the dollar amount given, the donor's name, address, telephone number, and relationship to the borrower, and stating that no repayment is required; (2) a copy of the

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canceled check or other withdrawal document showing the withdrawal from the donor's personal account; and (3) evidence that the funds have been deposited into the borrower's account. See HUD Handbook 4155.1, REV-5, ¶2-10 (C).

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As stated in the Report, the borrower received an \$8,000 gift from a relative. To evidence the gift, Jersey obtained a gift letter in the amount of \$8,000 from the borrower's step-brother (**Exhibit Q-1**). The loan file also contained a copy of the donor's bank statement (**Exhibit Q-2**) and a cashier's check made payable to the borrower (**Exhibit Q-3**), which evidenced the donor's withdrawal of the gift funds. Finally, the loan file contains a copy of the borrower's bank statement, evidencing the deposit of the \$8,000 gift on July 25, 2007 (**Exhibit Q-4**), well before closing on September 5, 2007 (**Exhibit Q-5**). This documentation fully complied with HUD guidelines regarding evidencing the transfer of gift funds from a family member. Contrary to the assertion in the Report, Jersey was not required to verify the source of the funds the donor used to provide this gift. HUD requirements expressly state that "[a]s a rule, we are not concerned with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction. Donors may borrow gift funds from any other acceptable source provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift." HUD Handbook 4155.1 REV-5, ¶ 2-10(C). In this case, the OIG does not allege, and there is no evidence to suggest, that the donor derived the gift funds from an impermissible source. The attached documentation demonstrates that the donor in fact provided the gift used to satisfy the funds needed to close this loan, and the donor expressly indicated on the gift letter that he did not expect repayment of these funds by the borrower (**Exhibit Q-1**). As the enclosed documents satisfy HUD guidelines regarding gift documentation, we maintain that indemnification is unwarranted and this loan should be removed from the final Report.

c. – FHA Case No. 351-4842564

In this loan, the Report alleges that the loan file did not contain adequate documentation for the borrower's credit union account, as the statements reflected gaps in August, October and November of 2006. While acknowledging that the Company provided statements covering July 5 through November 4, 2006, the Report asserts that bank statements from November 5 through November 24, 2006 remain outstanding.

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As discussed above, with regard to bank statements, Jersey understands and appreciates the Department's requirement that a loan file contain a VOD and most recent bank statement or, alternatively, the two most recent, consecutive statements, showing the previous month's balance. See HUD Handbook 4155.1 REV-5, ¶ 3-1. In the Batie loan, while the loan file contained credit union statements reflecting past balances and account activity for July 5 through August 4, 2006, September 5 through

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October 4, 2006, and November 25 through December 20, 2006, we acknowledge that these statements did not cover a two-month consecutive period. We have reminded our employees of the importance of ensuring that, in each FHA-insured loan, the borrower provides either a VOD and bank statement or consecutive bank statements for two months showing the previous month's balance. We are confident that this issue has been resolved. That said, as acknowledged in the Report, in preparation of this response, Jersey obtained from the borrower statements for this account covering the period from July 5 through November 4, 2006 (Exhibit J-4). This statement demonstrates the borrower's account history for a four-month period prior to closing, and satisfies the Department's requirements regarding bank statement documentation. Thus, contrary to the allegation, Jersey was not required to obtain statements for the period covering November 4 through November 24, 2006. For these reasons, we maintain that indemnification would be inappropriate and ask that this finding be removed from the final report.

d. – FHA Case No. 351-4900883

In this loan, the Report asserts that the loan file did not contain evidence of the source of funds for \$3,220 in deposits reflected on the borrower's bank statement.

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As discussed above, Jersey understands and appreciates that an FHA lender must verify all funds used for the borrower's investment in the property. See HUD Handbook 4155.1 REV-5, ¶ 2-10. Where funds in a borrower's savings or checking accounts are used to cover the borrower's investment, HUD guidelines require that, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. *Id.* These requirements, however, only apply to those funds that are used by the borrower to meet the borrower's investment in the property. In the Diaz loan, however, the file clearly indicates that the referenced \$3,220 in deposits were not used to close this loan. As acknowledged in the Report, the borrower's bank statement indicated a balance of \$11,004 as of March 31, 2007 (Exhibit R-1). Thus, even without the \$3,220 in deposits, the borrower had \$7,784 in verified funds, which was more than sufficient to cover the \$5,830 needed to close the loan on May 24, 2007 (Exhibit R-2). As this documentation verified the source of the funds necessary to close this loan, Jersey was not required to obtain verification of the deposits referenced in the Report. The Company complied with HUD guidelines in verifying the borrowers' closing funds in this case and, as a result, indemnification is not warranted. We therefore request that this finding be removed from the final report.

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e. – FHA Case No. 352-5503273

In this case, the Report asserts that the loan file did not contain an explanation regarding the source of funds for \$5,169 in deposits reflected on the borrower's bank statement.

As discussed above, Jersey understands and appreciates that an FHA lender must verify all funds used for the borrower's investment in the property. See HUD Handbook 4155.1 REV-5, ¶ 2-10. Where funds in a borrower's savings or checking accounts are used to cover the borrower's investment, HUD guidelines require that, if there is a large increase in an account, or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. *Id.* These requirements, however, only apply to those funds that are used by the borrower to meet the borrower's investment in the property. In this case, the file clearly indicates that the referenced \$5,169 in deposits were not used to close this loan. The loan file contained documentation of other accounts, including a mutual fund account statement, evidencing that the borrower had at least \$14,375 in verified assets as of March 31, 2006 (Exhibit S-1). Thus, even without the \$5,169 in deposits, the borrower had more than sufficient verified funds to cover the \$10,348 needed to close the loan on August 4, 2006 (Exhibit S-2). As this documentation verified the source of the funds necessary to close this loan, Jersey was not required to obtain verification of the deposits referenced in the Report. The Company complied with HUD guidelines in verifying the borrowers' closing funds in this case and, as a result, indemnification is not warranted. We therefore request that this finding be removed from the final report.

f. – FHA Case No. 352-5596824

In this case, the Report asserts that, although the loan application and MCAW reflect an \$800 monthly rental payment, the borrower indicated that he did not pay rent prior to purchasing the home securing the FHA-insured loan in this case.

With regard to rental verifications, Jersey understands and appreciates that FHA lenders must determine a borrower's payment history of his or her housing obligations prior to obtaining an FHA-insured loan. See HUD Handbook 4155.1 REV-5, ¶ 2-3A. Jersey did so in this case. While certain loan documentation referenced an \$800 rental payment by the borrower, this appears to be a typographical error in this file. The borrower provided a letter to Jersey, dated June 7, 2007, in which he clearly explained that for the past two years he had lived with his parents on a rent-free basis (Exhibit T). Based on this information, the underwriter had no need to obtain rental verification or otherwise analyze the borrower's past payment of housing obligations. That said, Jersey understands and appreciates the importance of ensuring that all loan file documentation is consistent and accurately reflects the borrower's financial situation,

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including past housing obligations. See HUD Handbook 4000.4 REV-1, CHG-2, ¶ 2-4(C)(5); see also HUD Handbook 4155.1 REV-5, ¶ 3-1(L). We have counseled our employees in this regard and are confident that any concerns have been addressed. That said, any oversight in this case was harmless, as the loan file clearly evidences the borrower's housing situation prior to closing (**Exhibit T**). Therefore, we believe that indemnification would be inappropriate and request that this finding be removed from the final report.

g. – FHA Case No. 352-5545714

Finally, in the Towers loan, the Report asserts that the \$36,011 in assets listed on the MCAW were not verified, as the redemption amount was calculated at 70%, rather than 60%, without explanation and the loan file did not contain evidence of redemption of the funds.

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Jersey understands and appreciates that retirement account assets may be included in the underwriting analysis up to only 60 percent of value unless the borrower provides conclusive evidence that a higher percentage may be withdrawn and that evidence of redemption is required. See HUD Handbook 4155.1 REV-5, ¶ 2-10(K). It is Jersey's policy and procedure to limit calculations regarding such accounts to 60% absent such conclusive evidence and obtain documentation of redemption of the funds by the borrower in each FHA loan involving such accounts. Although the loan file contained evidence of the borrower's substantial retirement savings and ability to withdraw these funds (**Exhibit U**), we acknowledge that the loan file did not contain the required evidence in this case. That said, any oversight in this regard constituted harmless error. In preparation of this response, Jersey obtained evidence of the borrower's redemption of \$35,000 in funds from his retirement account (**Exhibit L-1**), prior to closing (**Exhibit L-2**). This documentation provides conclusive evidence of the borrower's ability to redeem 70% of his retirement savings, as well as evidence that he in fact did so in this instance (**Exhibit L-1**). For these reasons, we believe the request for indemnification in this case is not warranted, and request that this sub-finding be removed from the final report.

6. Recommendations

In addition to opposing several of the individual allegations contained in the Report, Jersey disagrees with certain aspects of the recommendations made in connection with the loans referenced in Finding 1. As you know, Finding 1 of the Report recommends, among other things, that the Department require the Company to: (1) indemnify HUD for potential losses of \$1,526,704 in connection with 14 active loans; and (2) reimburse HUD for the actual losses that HUD will ultimately paid on one loan terminated by claim to the Department once the underlying property has been sold,

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which the OIG estimates will be \$96,359. To derive the estimated losses in connection with the 14 active loans and the unfinalized claim, the Report indicates that it included 42% of the unpaid principal balance in these cases. According to Appendix A, this multiplier was selected based on information provided by HUD showing that its losses on sales average 42 percent of the claim paid.

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Jersey would not take issue with the OIG's inclusion of the Department's actual losses in connection with loans for which claims have been made, and acknowledges that using the 42% multiplier represents a fair potential loss in the one loan at issue in which a claim has been made to HUD, but the actual losses are unknown at the time of the Report's issuance. The Company does, however, take strong exception to inclusion of the \$1,526,704 in estimated losses in the 14 remaining loans. First, we note that the \$1,526,704 figure does not represent a payment that the Report recommends Jersey pay to HUD, but rather reflects a mere estimate of the losses the Department could incur if these 14 loans ultimately result in claims to HUD. For this reason, the heading in Appendix C that labels this figure as the "Amount Requested for Indemnification" is inaccurate. The Report merely recommends that HUD request indemnification, but any amounts paid to HUD in connection with any indemnifications will be determined based on the actual losses to HUD upon resolution of the claim made to the Department, rather than the estimates included in this document.

All but one of the 15 of the loans at issue remain active. In most cases, these loans are performing and the borrowers are consistently making payments. Jersey appreciates that these 14 loans may have entered default at some point; however, none of these 14 loans have been foreclosed, terminated, or resulted in insurance claims to the Department. To date, HUD has not incurred any loss in connection with these cases and it is not possible to determine whether the Department will ever incur losses in these cases. Moreover, in the event that HUD does pay a claim in any of these loans, there is no guarantee that the Department will sustain monetary loss, as HUD may be able to recoup the claim amount in the sale of the underlying property.

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Notwithstanding these facts, the Report suggests that the Department will experience losses in the amount of 42% of the unpaid principal balance of each one of these 14 loans, and lists the financial risk to the Department, which it defines as "funds to be put to better use," as \$1,526,704. This calculation assumes that every one of the 14 active loans will go into foreclosure and result in a claim to HUD. Such an assumption would be supportable if 100% of the loans that enter default resulted in claims to HUD; however, that percentage is significantly lower. Thus, there is no reason to believe that any of these loans, let alone all 14 of them, will result in a claim or financial loss to the Department. HUD has collected its insurance premium in each of these cases, which continue to perform as active FHA loans. Based on these facts,

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absent evidence that the 14 loans at issue will result in an actual claim to the Department, the over \$1.5 million potential loss figure is greatly inflated and does not paint an accurate picture of the risks associated with this matter. It appears that inclusion of such an inflammatory figure in the final Report serves only as an attempt to justify the costs of the audit of this Company, rather than portray the precise amount of the potential losses that HUD may incur in connection with these 14 loans.

Moreover, as noted above, this arbitrary monetary figure is included with a mere recommendation to the Department to require the Company to indemnify it in connection with certain loans. Upon receiving the final Report, the Department will have an opportunity to independently review the audit findings and make an independent determination of whether indemnification is warranted in any of these cases. As discussed at length earlier in this response, Jersey disagrees that the vast majority of the findings set forth in the Report warrant indemnification. HUD may also disagree with the Report's assertions and decide not to pursue indemnification in some or all of the 14 cases. Notwithstanding the fact that these findings are preliminary, the OIG's recommendations assume that HUD will accept each allegation and pursue indemnification in each case and goes so far as to label the \$1.5 million as an "Amount Requested for Indemnification."

In addition, while the audit process is still ongoing at the time the OIG issues its "final" report, the Report and the OIG's recommendations are made public on the OIG website. As a result, a lender's investors and peers are able to access the preliminary recommendations of the OIG before a final assessment as to their merit can be made by the Department. These entities often misinterpret the OIG's recommendations to be final actions by the Department, and also frequently misunderstand the potential losses cited to be the actual financial penalties assessed by HUD on the audited FHA lender. Under these circumstances, making these preliminary recommendations public and including an inflammatory potential loss figure that is based on the unsupported assumption that every single loan at issue will result in a claim to HUD will have a material, adverse effect on the business of the audited FHA lender. If the OIG's goal is to present the reader with a full and accurate disclosure of the audit and its implications to the audited lender, the Report should include the following disclosure on the first page in bold, capitalized lettering:

THE REPORT FINDINGS REFLECT THE VIEWS OF THE OFFICE OF INSPECTOR GENERAL AND DO NOT CONSTITUTE A FINAL DETERMINATION OF THE MATTERS RAISED HEREIN BY THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT. THE FINAL DETERMINATION IN THIS MATTER WILL BE MADE BY THE REPORT'S ADDRESSEE, THE HUD ASSISTANT SECRETARY FOR HOUSING – FEDERAL HOUSING COMMISSIONER, WHO WILL ULTIMATELY

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DECIDE WHETHER TO ACCEPT THE REPORT'S RECOMMENDATIONS IN WHOLE OR IN PART OR REJECT THEM.

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The above discussion demonstrates that the over \$1.5 million estimated loss figure is unrepresentative of the Department's actual loss risk in connection with the 14 active loans cited in Finding 1. Inclusion of this overstated figure in the Report unfairly represents the loss exposure to HUD, and ultimately the Company, as a result of this audit. Therefore, Jersey strongly opposes the inclusion of this figure in the final Report and requests that it be removed or amended to portray a more accurate picture of the potential losses in the active FHA loans cited in the Report. As the recommendation regarding these loans is that the Company indemnify HUD, the Report should merely state this recommendation without including estimated losses that are difficult, if not impossible, to predict accurately in these loans. At the very least, if the final Report continues to include the average claim loss paid for these 14 loans as the potential financial risk to HUD and the Company, the Report should also clarify the percentage of defaulted loans that result in a claim to HUD and include the potential losses based on this significantly reduced number of loans. This figure would present readers with a more accurate and fair picture of the financial risks associated with the loans identified in the Report.

B. FINDING 2 – JERSEY'S COMPLIANCE WITH HUD'S QUALITY CONTROL REQUIREMENTS

In Finding 2, the Report alleges that the Company did not implement its Quality Control Plan in certain areas. Specifically, the Report asserts that the Company did not ensure that: (1) all early payment default loans were reviewed; (2) ten percent of rejected FHA loan files were reviewed; and (3) management addressed any material deficiencies identified in Quality Control review findings. As a result, Finding 2 recommends that HUD require Jersey to implement its Quality Control procedures regarding these items and conduct a follow-up review of Jersey's Quality Control procedures to ensure implementation of these items.

Comment 24

Jersey practices strict Quality Control and adheres to a detailed Quality Control Plan. See HUD Handbook 4160.1 REV-1, ¶ 6-1. With regard to the Report's assertions, Jersey understands and appreciates that it is required to review all loans that go into default or are foreclosed upon within six months of closing and include at least 10% of rejected loan applications in its Quality Control review sample. See HUD Handbook 4060.1 REV-2, CHG-1 ¶¶ 7-6(D), 7-8(A)(1). The Company acknowledges that, in the past, its Quality Control policies and procedures did not strictly comply with these requirements. We continuously strive to improve the Company's Quality Control department and have taken significant steps to enhance our Quality Control review procedures to ensure full compliance with HUD guidelines and to allow Jersey's

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Comment 24

management to quickly identify and remedy any issues that may affect loan quality or performance. To the extent that the Company had not fully implemented these improvements prior to this review, Jersey has intensified its efforts to ensure that its Quality Control review procedures fully adhere to HUD guidelines. With regard to Quality Control reviews of early payment default loans, Jersey now reviews the Department's Neighborhood Watch system on a monthly basis to monitor the performance of the Company's loans. When early payment defaults are identified, we submit these cases to our third-party Quality Control review company, TENA, Inc., who reviews these loans, along with a 10% sample of the Company's FHA-insured loans and a 10% sample of rejected loan applications. In addition, we ensure that TENA reports all Quality Control findings, including those involving early payment default and rejected loan files, to Jersey's management, who review the findings and take timely action to ensure that any deficiencies identified in its Quality Control reviews are addressed. We believe that these improvements address the issues identified in the Report and evidence our commitment to continue to improve our Quality Control process and enhance our loan quality and performance.

III. CONCLUSION

Comment 1

Jersey takes the matters raised in the draft Report seriously. Because FHA lending comprises a significant portion of Jersey's overall business operations, the Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, Jersey substantially complied with FHA underwriting requirements and made loans to qualified FHA borrowers. Jersey's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of Jersey, or do not affect the underlying loans' insurability. Jersey at no time misrepresented information it submitted to the Department. Moreover, since the loans cited in the Report were originated, the Company has made several improvements to its Quality Control procedures and has continued to enhance its underwriting practices.

Comment 1

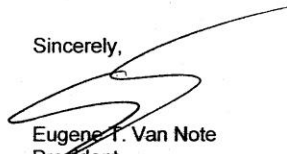
We believe that this response and accompanying exhibits demonstrate that certain of the Report's recommendations in connection with the cited loans are unwarranted. We respectfully request that the OIG revise its recommendations to fit the facts of this case and remove allegations from the Report in those instances in which Jersey has demonstrated its compliance with HUD requirements.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Krista Cooley, at (202) 778-9257.

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Thank you for your kind consideration.

Sincerely,



Eugene T. Van Note
President

cc: Krista Cooley, Esq.

OIG Evaluation of Auditee Comments

- Comment 1** Jersey Mortgage officials indicate that several of the findings in the report are at variance with the facts and do not constitute violations of HUD/FHA requirements or affect the underlying loans insurability. However, based on evaluation of Jersey Mortgage officials' comments and additional documentation provided at the exit conference, we believe the findings in the report are not at variance with the facts and do constitute violations of HUD/FHA requirements. As such, OIG's overall conclusions are provided in the below evaluation of auditee comments and were necessary we have revised the report to reflect the additional information provided.
- Comment 2** Jersey Mortgage officials indicated that borrower's with limited recurring expenses are allowed greater latitude on the front end ratio and that the Verification of Rent (VOR) had demonstrated the borrower's excellent rental payment history. HUD Handbook 4155.1 REV-5, section 2-13 states that any compensating factor used to justify mortgage approval must be supported by documentation. Present housing expenses paid timely is not an allowable compensating factor. Section 2-13 cites allowable compensating factors and indicates that if 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 this would be an acceptable compensating factor. However, the borrower's current housing expense was \$2,000 per month and the proposed housing expenses were \$3,182 per month, which is significantly higher (59% increase) than the current housing expenses. Also, Jersey Mortgage officials indicated the borrower had been employed in the same line of work for over five years and that the loan was underwritten and approved by the New Jersey Housing & Mortgage Finance Agency with no conditions. However, these are not allowable compensating factors per HUD Handbook 4155.1 REV-5, section 2-13. As such; Jersey Mortgage officials did not have adequate documented compensating factors to justify the high debt to income ratio. Therefore this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 3** Jersey Mortgage officials provided documentation to show that the loan had complied with the automated underwriting requirements for Fannie Mae's Desktop Underwriter. As such, we revised the report to eliminate this case from the report.
- Comment 4** Jersey Mortgage officials indicated that the Mortgage Credit Analysis Worksheet (MCAW) and file contained significant compensating factors regarding the high debt to income ratio. The MCAW listed as compensating factors excellent work history and that the down payment came from the borrowers' own funds. However, these are not allowable compensating factors per HUD Handbook 4155.1 REV-5, section 2-13. Since, the borrower did not make a large deposit of ten percent or more, the use of his own funds for the deposit is not an allowable

compensating factor. Jersey Mortgage officials also stated that \$1,600 of monthly income from a job started by the co-borrower in March 2007 was not included in income, therefore this qualified as a compensating factor. We recalculated the co-borrowers \$19,166 paid for ten months as being equal to \$1,916 in additional income a month, which results in recomputed ratios of 34.42 and 36.09 percent (front and back respectively). However, the front ratio is still in excess of the HUD limit of 31 percent thus, the additional income is not an adequate compensating factor, per HUD Handbook 4155.1, REV-5, Sec 2-13; therefore, this case will remain in the report.

Comment 5 Jersey Mortgage officials indicated that the debt to income ratios were accurately computed and that because the borrowers had made timely rental payments over three years, only had a \$300 increase in housing expenses, and had satisfied all outstanding debts before the closing; these were adequate compensating factors. The original debt to income ratios were 37.20 and 45.45 percent and exceeded the HUD limits. The compensating factors cited by Jersey Mortgage officials are not allowable per HUD Handbook 4155.1 REV-5, section 2-13, which requires that any compensating factor used to justify mortgage approval must be supported by documentation. The proposed mortgage payment on the MCAW was \$1,890, which was substantially higher (26% increase) than the \$1,500 current rental payment. Section 2-13 requires documentation that 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, however the file did not contain such documentation. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.

Comment 6 Jersey Mortgage officials stated that the file contained evidence of additional income from the co-borrower, which was not used to qualify the borrowers and was a compensating factor as was the borrower's excellent work history. HUD Handbook 4155.1 REV-5, section 2-13 states that any compensating factor used to justify mortgage approval must be supported by documentation. Excellent work history is not an allowable compensating factor per section 2-13. Jersey Mortgage officials cited additional income from the co-borrower as being a compensating factor, which was supported by the borrowers' tax return for 2007. However, the documentation provided included tax transcripts for 2007 that revealed the co-borrower had earned a total of \$3,599 in 2007 from two new/different employers. Jersey Mortgage officials did not provide adequate documentation to show what the monthly earnings were, when the employments had started, and proof that the co-borrower was still employed at the time of the closing; thus the additional income was not adequately supported. Furthermore, re-computation of the debt to income ratios using an additional \$300 of monthly income resulted in a front end ratio of 36.02 percent, which still exceeded the HUD limit of 31 percent. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.

- Comment 7** Jersey Mortgage officials indicated that the income used in underwriting the loan was not overstated. We evaluated Jersey Mortgage official's response and supporting documentation and conclude that the borrowers' income were not materially overstated; as such, since the ratios were reduced to be within HUD limits we have eliminated this case from the report.
- Comment 8** Jersey Mortgage officials demonstrated that it had complied with HUD guidelines in analyzing the borrower's credit profile and debt for child support; thus they had adequately resolved the cited deficiencies. As such, we have adjusted the report to eliminate the cited credit and debt deficiencies. However, the case is still recommended for indemnification based on the other significant deficiencies that existed.
- Comment 9** Jersey Mortgage officials acknowledged that they did not obtain an explanation regarding the referenced debts and stated that they obtained a written explanation during the course of the audit. HUD Handbook 4155.1 REV-5, section 2-3 states that major indications of derogatory credit including judgments, collections, and any other recent credit problems require sufficient written explanation from the borrower. As such, since this information was not obtained during the underwriting of the loan the case remains in the report, and is still recommended for indemnification.
- Comment 10** Jersey Mortgage officials acknowledged that the borrower needed additional funds to close. They state that the underwriter was not informed of the fact and was not provided the opportunity to obtain additional asset verification, but Jersey Mortgage officials indicated that the additional funds could have been provided from the borrower's \$1,900 biweekly pay. HUD Handbook 4155.1 REV-5, section 2-10 states that all funds for the borrower's investment in the property must be verified and documented. The HUD-1 settlement statement indicates that the borrower needed \$5,835 to close. However, review of the checking account bank statement revealed that the borrower had \$3,043 in available funds. Jersey Mortgage officials did not verify and document all of the sources of the funds to close. As such, at the time of the closing, officials did not document that the borrower had sufficient funds available for closing the loan. Therefore this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 11** Jersey Mortgage officials indicated that it had verified all large or excessive increases in account funds used to close the loan. Jersey Mortgage officials indicated that no written explanation for two deposits totaling \$3,500 made in December was required because similar deposits were made in August and October 2006. HUD Handbook 4155.1 REV-5, section 2-10 states that all funds for the borrower's investment in the property must be verified and documented. Thus, Jersey Mortgage officials did not obtain a credible written explanation for the large deposits before the loan closed. Therefore this deficiency will remain in the report and the case is still recommended for indemnification.

- Comment 12** Jersey Mortgage officials indicated that the borrower had sufficient verified funds to close because the \$900 deposit was not large in relation to the borrower's income and could have come from the borrower's salary. HUD Handbook 4155.1 REV-5, section 2-10 states that all funds for the borrower's investment in the property must be verified and documented at the time of closing. Jersey Mortgage officials did not verify or document the \$900 deposit; therefore the borrower did not have sufficient verified funds to close the loan. This deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 13** Jersey Mortgage officials obtained documentation regarding the withdrawal of \$35,000 from the borrower's retirement account in response to our audit which provided sufficient funds to pay the earnest money deposit and close the loan. HUD Handbook 4155.1 REV-5, section 2-10 states that all funds for the borrower's investment in the property must be verified and documented. When this loan was underwritten the lender did not exercise due diligence to verify and document all funds required to close the loan, as such there was not sufficient verified funds to close the loan. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 14** Jersey Mortgage officials indicated that they verified that the borrower had received overtime income over the last three years and that the verification of employment did not state that the overtime was not likely to continue. HUD Handbook 4155.1 REV-5, section 2-7A states 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. The verification of employment form did not indicate whether overtime was likely to continue and officials did not obtain any other statements from the employer regarding overtime. As such, there was a lack of documented assurance that the overtime was likely to continue. Therefore this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 15** Jersey Mortgage officials indicated that the co-borrowers income was not overstated and that there were four pay stubs covering the 30 day period prior to closing. HUD Handbook 4155.1 REV-5, section 3-1 E provides that as an alternative to obtaining a VOE, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 Forms from the previous two years. However, the lender did not obtain four consecutive pays stubs covering the 30 day period prior to closing. The lender provided copies of checks that were not cashed or processed by the bank, and did not have copies of pay stubs, therefore the co-borrower's monthly income was not adequately supported. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.

- Comment 16** Jersey Mortgage officials stated that it complied with the HUD requirements by obtaining four pay stubs covering a 30 day period prior to closing. HUD Handbook 4155.1 REV-5, section 3-1 E provides that as an alternative to obtaining a VOE, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 Forms from the previous two years. The lender did not obtain four consecutive pays stubs covering the 30 day period prior to closing. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 17** Jersey Mortgage officials stated that the verification of gift funds met all of HUD's requirements. HUD Handbook 4155.1 REV-5, section 2-10C, states that the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds. The donor of the gift deposited \$9,000 into his own account on July 25, 2007, and then made the gift payment of \$8,000 on July 25, 2007, to the co-borrower. The lender did not adequately verify the source of the donor's gift because the documentation on file did not support that the funds were indeed the donor's own funds and not provided from an unacceptable source. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.
- Comment 18** Jersey Mortgage officials acknowledged that the file did not contain bank statements for the most recent two month consecutive period before the closing. In response to our audit Jersey Mortgage officials subsequently obtained the bank statement covering the four month period before the closing. HUD Handbook 4155.1, Rev-5, section 3-1F, provides that if the bank statement shows the previous month's balance, the requirement is met by obtaining the two most recent, consecutive statements. However, the lender did not obtain bank statements for the two most recent consecutive months at the time of the closing. The lender also did not obtain a credible explanation for non-payroll deposits, nor adequately verify the funds to close; as such sufficient verified funds were not available to close the loan. Therefore, this case is still recommended for indemnification.
- Comment 19** Jersey Mortgage officials indicated that the borrower had enough verified funds to close the loan and that the \$3,220 in deposits were not used to close the loan. Upon further review, since the bank statement did show two deposits totaling \$7,300 from a gift and a federal tax refund that had been adequately verified and would have provided adequate funds to close; we eliminated the deficiency regarding an inadequate savings pattern or source of funds, pertaining to this case, from the report.
- Comment 20** Although the lender did not obtain a credible explanation for \$5,169 of non-payroll deposits to the borrower's checking account Jersey Mortgage officials indicated that the borrower had sufficient verified assets to be able to close the loan and that they had complied with the HUD guidelines. Jersey Mortgage officials indicated that the borrower had at least \$14,375 of verified assets that

would have covered the \$10, 348 of funds needed to close the loan. The documentation provided by Jersey Mortgage officials consisted of a quarterly statement for a mutual fund that had a balance of \$14,376. HUD Handbook 4155.1 REV-5, section 2-10L requires the lender to verify that stocks and bonds were redeemed; however this was not done for this case.

Further, Jersey Mortgage officials used FHA Total Mortgage Scorecard to underwrite this loan. The FHA Total Mortgage Scorecard User Guide required the lender to obtain the most recent statements for each account to verify that there were sufficient funds to close and to resubmit the loan when material changes are discovered or otherwise occur during loan processing. Jersey Mortgage officials did not resubmit the loan through the automated underwriting system even though there had been a substantial decrease in the borrower's assets from \$47,219 when underwritten to only \$15,014 on the final loan application which included the balance of the mutual fund that had no evidence of redemption. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.

Comment 21 Jersey Mortgage officials indicated that the \$800 rental payment by the borrower appears to be a typographical error and that the borrower had provided a June 27, 2007, letter which explained that he lived rent free with his parents and therefore no further verification was needed. HUD Handbook 4155.1 REV-5, section 2-3 A requires the lender 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 the mortgage directly from the mortgage servicer, or through canceled checks covering the most recent 12-month period. The borrower signed the initial and final loan applications that both listed a monthly rental payment of \$800 which was used in preparing the mortgage credit analysis worksheet. However, prior to closing the lender failed to obtain a credible explanation for the discrepancy in the rent information provided on loan applications, which had been certified as being true and correct by the borrower. Therefore, this deficiency will remain in the report and the case is still recommended for indemnification.

Comment 22 Jersey Mortgage officials acknowledged that the loan file did not contain the required documentation to justify including more than 60 percent of the value of the retirement account in the underwriting analysis. As such, in response to the audit, Jersey Mortgage officials obtained documentation from the borrower to show that the retirement funds had been redeemed and that the higher percentage of funds in the account was available for the closing. HUD Handbook 4155.1 REV-5, section 2-10 states that all funds for the borrower's investment in the property must be verified and documented. When this loan was underwritten the lender did not verify all the funds required to close the loan; as such, sufficient verified funds were not available at the closing. This deficiency will remain in the report and the case is still recommended for indemnification.

Comment 23 Jersey Mortgage officials disagreed with the amount cited in the report as being the potential loss for the loans with significant underwriting deficiencies. Jersey Mortgage indicated that it is not possible to know the amount of the actual losses and whether there will be any loss on these loans. The amount recommended for indemnification is based on historical experience and represents 42 percent of the unpaid principal balance. The actual loss on individual loans may be higher or lower than the average loss experience. The purpose of indemnification is to protect the government from having to pay claims for loans that were not properly underwritten. The government will not have to absorb the loss for any of the loans recommended for indemnification and if no claim is filed on a loan the lender will not have to make any reimbursement. The recommendations presented in the report are based on an analysis performed by HUD-OIG and does not represent any final decision determined by HUD.

Comment 24 The comments made by Jersey Mortgage officials related to our finding 2 are responsive to the finding.

Appendix C

SUMMARY OF UNDERWRITING DEFICIENCIES

Case number	Unpaid balance amount	Amount requested for indemnification	Excessive debt-to-income ratios without adequate compensating factors	Inadequate credit analysis	Inadequate verification of funds to close on HUD-1 settlement statement	Inadequate support for income calculation	Inadequate support for employment	Other deficiencies <u>1/</u>	Appendix reference
352-5568382	\$324,136	\$136,137			X			X	D-1
352-5531330	\$212,414	\$89,214	X			X		X	D-2
352-5516470	\$340,945	\$143,197	X		X				D-3
352-5601063	\$255,729	\$107,406	X	X	X	X		X	D-4
352-5605932	\$303,594	\$127,509	X	X		X	X	X	D-5
352-5526607	\$217,899	\$91,518	X		X	X	X	X	D-6
352-5564815	\$283,352	\$119,008	X		X			X	D-7
351-4842564	\$212,201	\$89,124			X			X	D-8
351-4902260	\$225,411	\$94,673			X			X	D-9
351-4900883	\$0	\$0 <u>2/</u>					X		D-10
352-5503273	\$229,938	\$96,574						X	D-11
352-5596824	\$177,120	\$74,390			X			X	D-12
352-5545714	\$268,008	\$112,563		X	X			X	D-13
Total	\$3,050,747	1,281,314^{3/}	6	3	9	4	3	11	

Notes:

1/ The other deficiencies include inadequate evaluation of savings pattern, verification of assets in retirement savings account not verified, inadequate bank account documentation, inadequate gift fund transfer, inadequate earnest money deposit documentation, inadequate support for assets, inaccurate debt-to-income ratios, need to resubmit the loan through the automated underwriting system, incomplete MCAW, and inadequate verification of rent payments.

2/ Based on HUD's current 42 percent default loss experience, the amount of ineligible costs for one loan for which a claim was paid is estimated at \$96,359 (42 percent of the claim paid of \$229,427).

3/ The amount of cost savings or funds to be put to better use on the loans for which indemnification is recommended is estimated at \$1,281,314 (42 percent of the unpaid principal balance of \$3,050,747)

Appendix D

CASE SUMMARY NARRATIVES

Appendix D-1
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Case number: 352-5568382
Loan amount: \$324,901
Unpaid balance: \$324,136
Closing date: July 12, 2007
Default status: First legal action to commence foreclosure

Pertinent Details:

A. Inadequate Gift Fund Transfer

In the file, there was a gift letter; however, there was no documentation for the gift fund transfer. The amount of the gift was \$3,220. The donor made the gift with a cashier's check, and the cashier's check was dated July 17, 2007; however, the date of the closing for the loan was July 12, 2007. Thus, the gift was provided after the loan closed. Further, HUD Handbook 4155.1, REV-5, section 2-10C, states that if the donor purchased a cashier's check, money order, official check, or any other type of bank check as a means of transferring the gift funds, the donor must provide a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account. The lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. In the FHA case file, there was no documentation showing that the funds came from the donor's personal account.

B. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The lender did not verify or document that the borrower had adequate funds to close. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement indicated that the borrowers were required to pay \$11,762. If the gift amount of \$3,220 is added back because the lender did not verify and document the source of funds (see in section A), the borrower would have been required to pay \$14,982. According to the mortgage credit analysis worksheet, the borrower only had assets of \$5,765. Thus, the borrower would have been short of funds to close by \$9,217 (\$14,982 – \$5,765) and did not have sufficient funds to close the loan.

Case number: 352-5531330
Loan amount: \$214,150
Unpaid balance: \$212,414
Closing date: November 30, 2006
Default status: Delinquent

Pertinent Details:

A. Inaccurate Debt-to-Income Ratios

B. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The ratios calculated by the lender were incorrect because the borrower's and co-borrower's monthly income was overstated. On the mortgage credit analysis worksheet, the lender listed the mortgage payment-to-income ratio (front) as 39.36 percent and the total fixed payment-to-income ratio (back) as 51.44 percent. Based on the corrected monthly income of \$3,610, we calculated ratios of 50.50 percent and 67.25 percent, respectively. Mortgagee Letter 2005-16 states that the lender must describe the compensating factors used to justify mortgage approval, when the borrower's mortgage payment-to-income ratio (front) and the total fixed payment-to-income ratio (back) exceeds 31 and 43 percent, respectively. However, the mortgage credit analysis worksheet did not list compensating factors. The compensating factors provided later by the lender that there was an 84 percent loan-to-value ratio, the borrower had two months cash reserve, and present housing expenses were paid in a timely manner are not considered to be allowable compensating factors according to HUD Handbook 4155.1, REV-5, section 2-13.

C. Inadequate Support for Income Calculation

The borrowers' monthly income of \$4,720, shown on the mortgage credit analysis worksheet and the loan application, was overstated by \$1,110. The borrower's base pay was listed as \$2,397. The coborrower's base pay was listed as \$1,213. The borrower's other earnings were listed as \$1,110. In the file, there was a checking statement as of October 16, 2006, which showed monthly Social Security direct deposits of \$460 on September 1 and October 3, 2006. It appeared that the lender included the Social Security income. HUD Handbook 4155.1, REV-5, section 2-7E, states that retirement and Social Security income require verification from the source (former employer, Social Security Administration) or federal tax returns. Also, the lender appears to have included income from the borrower's son as her other earnings of \$650 per month. In the file, there were copies of checks from her son's income for September 2, 2006 (\$159); September 9, 2006 (\$173); October 7, 2006 (\$158); October 14, 2006 (\$142); and November 25, 2006 (\$142). However, these checks did not add up and were not verified. Therefore, we calculated the monthly employment income to be \$3,610 (\$2,397 + \$1,213) because the borrower's Social Security income and borrower's son's income had not been properly verified and documented. Therefore, monthly income was overstated by \$1,110.

Case number: 352-5516470
Loan amount: \$345,100
Unpaid balance: \$340,945
Closing date: May 14, 2007
Default status: Reinstated by Mortgagor

Pertinent Details:

A. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The lender calculated the mortgage payment expense-to-income ratio (front) as 41.31 percent, which exceeded HUD's threshold; however, no allowable compensating factors were listed. Mortgagee Letter 2005-16 states that if either or both ratios exceed 31 percent and 43 percent, the lender must describe the compensating factors used to justify the mortgage approval.

B. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The HUD-1 settlement statement indicates that the borrower needed \$5,835 to close. However, review of the checking account bank statement revealed that the borrower had \$3,043 in available funds. It appeared that the borrower did not have sufficient funds to close and was short of funds to close by \$2,792 (\$5,835 - \$3,043).

Case number: 352-5601063
Loan amount: \$256,795
Unpaid balance: \$255,729
Closing date: July 23, 2007
Default status: First legal action to commence foreclosure

Pertinent Details:

A. Inaccurate Debt-to-Income Ratios

B. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The ratios calculated by the lender were incorrect because the borrower's monthly income was overstated. On the mortgage credit analysis worksheet, the lender listed the mortgage payment expense-to-income ratio (front) as 46.29 percent and the total fixed payment-to-income ratio (back) as 48.53 percent using monthly income of \$5,388. Based on the documented monthly income of \$5,328, we calculated ratios of 46.81 percent and 49.08 percent, respectively. Mortgagee Letter 2005-16 states that for manually underwritten mortgages in which the direct endorsement underwriter must make the credit decision, the qualifying ratios are raised to 31 percent and 43 percent and if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval. The compensating factors listed on the mortgage credit analysis worksheet of excellent work history and that the down payment was made with the borrower's own funds were not allowable according to HUD Handbook 4155.1, REV-5, section 2-13.

C. Inadequate Evaluation of Savings Pattern

The checking account statement indicated that the borrower had made two nonpayroll deposits on July 19 and July 20, 2007, totaling \$2,230. The available balance for the checking account statement was \$4,001 as of July 20, 2007. There was no explanation in the file by the borrower for these excessive deposits. HUD Handbook 4155.1, REV-5, section 2-10B, states that if there is a large increase in a bank account, the lender must obtain credible explanation of the source of those funds.

D. Inadequate Verification of Earnest Money Deposit

The HUD-1 settlement statement shows an earnest money deposit of \$10,000. A total of \$9,000 of the \$10,000 earnest money deposit had been transferred from the borrower's checking account as of May 29, 2007. However, on May 29, 2007, a deposit of \$1,170 was made to the borrower's checking account, resulting in a pretransfer balance of \$9,080. If this deposit had not been made on May 29, 2007, the checking account balance would have been \$7,910. There was no explanation in the file for the source of these funds. HUD Handbook 4155.1, REV-5, section 2-10A, states that 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 accumulated savings, the lender must verify with documentation the deposit amount and source of funds.

E. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The lender did not verify or document that the borrower had adequate funds to close. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement for the FHA loan indicated that the borrowers were required to pay \$5,044 at closing. Due to the unsupported earnest money deposit of \$1,170 (explained in section D), the borrowers would have needed \$6,214 at closing. In the checking account statement, the available balance was \$4,001; however, if the unexplained nonpayroll deposit of \$2,230 (see section C) is not included, the borrower would have had \$1,771 (\$4,001 - \$2,230) in available funds in the checking account. The assets in the savings account were verified as \$126, thus total available funds were \$1,898. Therefore, the borrower would have had a deficit of \$4,316 (\$6,214 - \$1,898). Since the funds to close were not verified as explained above, the borrower did not have sufficient funds to close.

F. Inadequate Support for Income Calculation

The file contained documentation of an average monthly overtime income of \$305 for 30 months. However, the lender did not verify that overtime income was likely to continue. HUD Handbook 4155.1, REV-5, section 2-7A, states that 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.

G. Inadequate Credit Analysis

The credit report contained derogatory items, and a judgment was listed for the coborrower. The file contained a letter written by the coborrower; however, it was inadequate because it did not explain the derogatory items and judgment listed on the credit report. HUD Handbook 4155.1, REV-5, section 2-3, states that major indications of derogatory credit including judgments, collections, and any other recent credit problems require sufficient written explanation from the borrower. The lender did not obtain a credible explanation for derogatory credit.

Case number: 352-5605932
Loan amount: \$305,210
Unpaid balance: \$303,594
Closing date: September 5, 2007
Default status: Special forbearance

Pertinent Details:

A. Inaccurate Debt-to-Income Ratios

B. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The lender listed the mortgage payment-to-income ratio (front) as 41.24 percent and the total fixed payment-to-income ratio (back) as 48.44 percent on the mortgage credit analysis worksheet. The ratios calculated by the lender were incorrect because the borrower's monthly income was overstated. Based on a monthly income of \$5,958, we calculated ratios of 45.09 percent and 52.97 percent, respectively. Mortgagee Letter 2005-16 states that the lender must describe the compensating factors used to justify mortgage approval when the borrower's mortgage payment-to-income ratio (front) and the total fixed payment-to-income ratio (back) exceed 31 and 43 percent, respectively. The lender did not list compensating factors.

C. Inadequate Gift Funds Transfer

The donor of the gift deposited \$9,000 into his own account on July 25, 2007, and then made the gift payment of \$8,000 on July 25, 2007, to the coborrower. However, the lender did not adequately verify the source of funds for the gift. The assets available on the mortgage credit analysis worksheet were shown as \$8,010. If the gift amount is not included, the borrower would have had \$10 available to close. The HUD-1 settlement statement indicated that the borrower would have needed \$8,000 to close. HUD Handbook 4155.1, REV-5, section 2-10C, states that the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds. The lender did not adequately verify the source of the donor's gift.

D. Inadequate Support for Income Calculation

The monthly employment income on the mortgage credit analysis worksheet was listed as \$6,515; however, our calculation of the monthly employment income based on the pay stubs was \$5,958. Therefore, monthly income was overstated by \$557.

E. Inadequate Support for Employment

For one of the coborrowers, there were employment gaps for the months of April 2006, August 2006, and September 2006, with no explanations as to the reason for these gaps. HUD Handbook 4155.1, REV-5, section 2-6, states that the borrower also must explain any gaps in

employment spanning one month or more. The lender did not obtain an explanation for the gaps in employment.

F. Inadequate Credit Analysis

The lender did not conduct an adequate analysis of the borrower's credit history. The credit report in the file contained two judgments in March 2002 and May 2003. The lender did not obtain information on the status of the judgments or an explanation from the borrower. HUD Handbook 4155.1, REV-5, section 2-3, states that major indications of derogatory credit including judgments, collections, and any other recent credit problems require sufficient written explanation from the borrower.

Case number: 352-5526607
Loan amount: \$218,900
Unpaid balance: \$217,899
Closing date: January 12, 2007
Default status: Chapter 13 – bankruptcy

Pertinent Details:

A. Inaccurate Debt-to-Income Ratios

B. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The ratios calculated by the lender were incorrect because the borrower's monthly income was overstated. The mortgage credit analysis worksheet listed the mortgage payment expense-to-income ratio (front) as 37.20 percent and the total fixed payment-to-income ratio (back) as 45.45 percent. Based on a monthly income of \$5,013, we calculated ratios of 37.70 percent and 46.05 percent, respectively. Mortgagee Letter 2005-16 states that the lender must describe the compensating factors used to justify the mortgage approval when the borrower's mortgage payment expense-to-income ratio (front) and the total fixed payment-to-income ratio (back) exceeds 31 and 43 percent, respectively. The lender did not list compensating factors.

C. Inadequate Support for Assets

The mortgage credit analysis worksheet listed \$5,807 as assets, which appeared to be a \$5,000 grant, \$800 (cash on hand), and \$7 (credit union account). However, there was no supporting documentation in the file for the \$800 in cash on hand. HUD Handbook 4155.1, REV-5, section 2-10M, provides that borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the home buyer's cash assets for closing, the money must be verified—whether deposited in a financial institution or held by the escrow/title company—and the borrower must provide satisfactory evidence of the ability to accumulate such savings. The asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. The file did not contain such documents.

D. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The lender did not verify or document that the borrower had adequate funds to close. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement for the FHA loan indicated that the borrowers were required to pay \$3,037 in addition to the \$5,000 in funds provided by the grant. In the section of the HUD-1 settlement statement, entitled "Amounts to Be Paid by or on Behalf of Borrower," the \$5,000 (grant) was included. Based on the assets

available of \$807, the \$800 would be excluded because it was not supported (explained in section C). Thus, the borrowers would only have had \$7 according to the verified available assets. Therefore, the borrowers would have had a deficit of \$3,030 (\$3,037 - \$7) at closing. Since the funds to close were not verified as explained above, the borrower did not have sufficient funds to close.

E. Inadequate Support for Employment

The lender did not obtain the co-borrower's original pay stubs covering the most recent 30-day period. In the file, there was documentation indicating a verbal verification of employment and copies of checks dated November 4, 2006, November 14, 2006, November 29, 2006, and December 29, 2006. HUD Handbook 4155.1, REV-5, section 3-1E, requires the lender to obtain a verification of employment and the most recent pay stub showing year-to-date earnings for at least one month; this was not done.

F. Inadequate Support for Income Calculation

The co-borrower's monthly employment income (base pay) on the mortgage credit analysis worksheet was listed as \$866; however, our calculation of the monthly employment income based on pay stubs was \$800. Therefore, income was overstated by \$66.

G. Incomplete Mortgage Credit Analysis Worksheet

The mortgage credit analysis worksheet was not signed or dated by the underwriter.

Case number: 352-5564815
Loan amount: \$289,430
Unpaid balance: \$283,352
Closing date: April 10, 2007
Default status: Reinstated after loss mitigation intervention

Pertinent Details:

A. Excessive Debt-to-Income Ratios without Adequate Compensating Factors

The lender calculated the mortgage payment expense-to-income ratio (front) as 37.73 percent and the total fixed payment-to-income ratio (back) as 44.45 percent, which exceeded HUD's threshold; however, no compensating factors were listed. Mortgagee Letter 2005-16 states that if either or both ratios exceed 31 percent and 43 percent, respectively, the lender must describe the compensating factors used to justify the mortgage approval.

B. Inadequate Evaluation of Savings Pattern

The checking account statement indicated that the borrower had a nonpayroll deposit of \$3,640 on March 28, 2007. The available balance for the checking account statement was \$6,056 as of April 5, 2007. There was no explanation in the file by the borrower for this excessive deposit. HUD Handbook 4155.1, REV-5, section 2-10B, states that if there is a large increase in an account or if the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The lender had not obtained a credible explanation.

C. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The lender did not verify or document that the borrower had adequate funds to close. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement for the FHA loan indicated that the borrowers were required to pay \$6,297. The checking account statement available balance was \$6,056; however, if we do not include the unexplained nonpayroll deposit of \$3,640, the borrower would have \$2,416 (\$6,056 - \$3,640) in available funds. The borrower would have had a deficit of \$3,881 (\$6,297 - \$2,416) at closing. Since the funds to close were not verified as explained above, the borrower did not have sufficient funds to close.

Case number: 351-4842564
Loan amount: \$214,600
Unpaid balance: \$212,201
Closing date: December 28, 2006
Default status: Delinquent

Pertinent Details:

A. Inadequate Bank Account Documentation

In the file, there were bank statements from Andrews Federal Credit Union for the periods July 5 to August 4, 2006; September 5 to October 4, 2006; and November 25 to December 20, 2006. We were later provided the bank statements from July 5 through November 4, 2006. The Andrews Federal Credit Union bank documentation for November 5 through November 24, 2006, appeared to be missing. HUD Handbook 4155.1, REV-5, section 3-1F, states that a verification of deposit and most recent bank statement are to be provided. As an alternative to obtaining a verification of deposit, the lender may obtain from the borrower the original bank statements 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. The lender did not obtain bank statements for the two most recent, consecutive months.

B. Inadequate Evaluation of Savings Pattern

The files contained an Andrews Federal Credit Union bank statement for the period September 5 to October 4, 2006, in which there were two nonpayroll deposits totaling \$1,930 (\$980 + \$950). Also, there was a savings account statement for the period November 25 to December 20, 2006, with an ending balance of \$4,207. On December 6 and December 16, 2006, there were nonpayroll deposits for \$1,600 and \$1,900. The available balance for the savings account was \$4,207 as of December 20, 2006. In the file, there was no explanation by the borrower for these excessive nonpayroll deposits. HUD Handbook 4155.1, section 2-10B, states that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there is a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The lender did not obtain a credible explanation of the source of the nonpayroll deposits.

C. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The lender did not verify or document that the borrower had adequate funds to close. HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement for the FHA loan indicated that the borrowers were required to pay \$6,104. The savings account available balance was \$4,207; however, exclusion of the unexplained nonpayroll deposit of \$3,500 results in a \$707 (\$4,207 - \$3,500) balance for this account. The assets in the other savings account were

verified as \$3,432, thus leaving available funds of \$4,139. Therefore, the borrower would have had a deficit of \$1,965 ($\$6,104 - \$4,139$) at closing and would not have had sufficient funds to close the loan.

Case number: 351-4902260
Loan amount: \$226,446
Unpaid balance: \$225,411
Closing date: June 29, 2007
Default status: First legal action to commence foreclosure – Chapter 13
bankruptcy

Pertinent Details:

A. No Verification of Retirement Account

In the file, there was a 401(k) statement for the period January 1 through March 31, 2007. The statement balance was \$29,287; however, the maximum amount that can be used in the underwriting analysis is normally only 60 percent of the statement balance or \$17,572. There was no evidence of redemption of the 401(k) account. HUD Handbook 4155.1, REV-5, sections 2-10K, states that assets such as individual retirement accounts, thrift savings plans, and 401(k)s may be included in the underwriting analysis up to only 60 percent of value unless the borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and any withdrawal penalties. Evidence of redemption is required. The lender did not obtain evidence of redemption of the 401(k).

B. Inadequate Evaluation of Savings Pattern

The checking account transaction history indicated that the borrower had one nonpayroll deposit on March 26, 2007, totaling \$4,300. The available balance for the checking account statement was \$11,214 as of May 3, 2007. There was no explanation by the borrower for this excessive deposit in the file. HUD Handbook 4155.1, section 2-10B, states that if there are large increases in an account or the account was opened recently, the lender must obtain an explanation of the source of funds. The lender did not obtain a credible explanation for this deposit.

C. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement indicated that the borrowers were required to pay \$10,209. In the checking account transaction history, the available balance was \$11,214; however, if we do not include the unexplained nonpayroll deposit of \$4,300, the borrower would have had a \$6,914 (\$11,214 – \$4,300) balance in this account. The assets in the savings account were verified as \$1,054. Therefore, the borrower would have had a deficit of \$2,241 (\$10,209 – \$7,968) (\$6,914 checking balance + \$1,054 savings balance) and did not have sufficient funds to close the loan.

D. Inadequate Bank Account Documentation

The lender obtained only one savings account statement for the period March 27 through April 24, 2007. The other savings account statements appeared to be missing. HUD Handbook 4155.1, REV-2, section 3-1F, states that as an alternative to obtaining a verification of deposit, the lender may obtain the borrower's original bank statements covering the most recent three-month period, provided the bank statements show that the previous month's balance requirement was met by obtaining the two most recent, consecutive statements. The lender did not obtain or maintain bank statements for the two most recent, consecutive months.

Case number: 351-4900883
Loan amount: \$221,523
Unpaid balance: \$0
Closing date: May 24, 2007
Default status: Property conveyed to insurer,
Claim filed, HUD incurred loss of \$229,427

Pertinent Details:

A. Inadequate Support for Employment

The lender did not obtain the borrower's original pay stubs covering the most recent 30-day period. In the file, there were four statements of wages and earnings dated April 13, 2007, April 20, 2007, May 11, 2007, and May 18, 2007. HUD Handbook 4155.1, REV5, section 3-1E, states that as an alternative to obtaining a verification of employment, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period. The pay stub(s) must show the borrower's name, Social Security number, and year-to-date earnings. The lender did not obtain pay stubs covering the most recent 30-day period.

Case number: 352-5503273
Loan amount: \$232,200
Unpaid balance: \$229,938
Closing date: August 4, 2006
Default status: Chapter 13 bankruptcy

Pertinent Details:

A. Inadequate Evaluation of Savings Pattern

The First BankAmericano checking account statement indicated that the borrower had made four nonpayroll deposits from June to July 2007 totaling \$5,169. In the file, there was no explanation by the borrower for these excessive deposits. HUD Handbook 4155.1, REV-5, section 2-10B, states that if there was a large increase in an account, the lender must obtain a credible explanation of the source of those deposits. The lender did not obtain a credible explanation for the source of the funds.

B. No Verification of Retirement Account

The lender did not properly verify the borrower's available funds. In the mortgage credit analysis Worksheet, the lender listed assets available as \$47,219. The lender used the FHA Total Scorecard to process the loan and included the following assets in determining the available funds: mutual funds (\$14,376), checking (\$638), and retirement account (\$32,205). The lender used the borrower's personal retirement benefits statement for December 31, 2004, to obtain the retirement balance of \$32,205. The FHA Total Mortgage Scorecard User Guide requires the lender to obtain the most recent statements for each account to verify that there are sufficient funds to close and to document the terms and conditions for withdrawal and/or borrowing and that the borrower is eligible for these withdrawals. We noted that in the final loan application, there were total assets of \$15,014 (checking account \$638 and investment account \$14,376). The FHA Total Mortgage Scorecard User Guide states that the lender is responsible for the integrity of the data used to obtain the risk assessment and for resubmitting the loan when material changes are discovered or otherwise occur during loan processing. The lender is required to resubmit the loan through the automated underwriting system for an updated evaluation if the borrower's income and/or cash assets/reserves decrease. However, the lender did not resubmit the loan through the automated underwriting system although there had been a substantial decrease in the borrower's assets.

Case number: 352-5596824
Loan amount: \$177,120
Unpaid balance: \$177,120
Closing date: June 22, 2007
Default status: Foreclosure sale held

Pertinent Details:

A. Inadequate Evaluation of Savings Pattern

The United Investors Federal Credit Union statement indicated that the borrower had made one nonpayroll deposit on June 21, 2007, totaling \$900. The available balance for the checking account statement was \$5,865 as of June 21, 2007. The file contained no explanation from the borrower for this excessive deposit. HUD Handbook 4155.1, REV-5, section 2-10B, states that if there was a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds. The lender did not obtain a credible explanation as to the source of the funds.

B. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

HUD Handbook 4155.1, REV-5, section 2-10, requires that all funds for the borrower's investment in the property be verified and documented. The HUD-1 settlement statement indicated that the borrowers were required to pay \$5,749. For the savings account, the available balance was \$5,865; however, exclusion of the unexplained nonpayroll deposit of \$900 results in the borrower having savings of \$4,965 (\$5,865 - \$900) in this account. Therefore, the borrower would have had a deficit of \$784 (\$5,749 - \$4,965) and did not have sufficient funds to close the loan.

C. Inadequate Verification of Rent Payments

The mortgage credit analysis worksheet and the initial and final loan applications indicated that the borrower paid an \$800 monthly rent. However, a June 7, 2007, letter from the borrower stated that he did not pay rent. HUD Handbook 4155.1, REV-5, section 2-3A, states that the payment history of the borrower's housing obligation holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligation 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. The lender did not obtain a credible explanation regarding the discrepancy in the rental history of the borrower.

Case number: 352-5545714
Loan amount: \$274,800
Unpaid balance: \$268,008
Closing date: March 23, 2007
Default status: Delinquent

Pertinent Details:

A. No Verification of Retirement Account

The mortgage credit analysis worksheet and the loan application listed \$36,011 as assets, which appeared to be, respectively, the borrower's retirement account of \$34,612 and an Amboy National checking statement account of \$1,399. The lender obtained a copy of the retirement statement for the period October 1 through December 31, 2006. However, the lender did not obtain evidence of redemption. Also, the lender calculated the available assets using 70 percent of the value, yet there was no explanation provided. HUD Handbook 4155.1, REV-5, section 2-10K, states that assets such as individual retirement accounts, thrift savings plans, and 401(k)s may be included in the underwriting analysis up to only 60 percent of value unless the borrower provides conclusive evidence that a higher percentage may be withdrawn after subtracting any federal income tax and withdrawal penalties. Evidence of redemption is required.

B. Inadequate Verification of Funds to Close on HUD-1 Settlement Statement

The HUD-1 settlement statement indicated that the borrower was required to pay \$12,382 at closing. Due to the unsupported earnest money deposit of \$10,000 (explained in paragraph C), the borrower would have needed \$22,382 to close. Since the funds to close were not all verified, the borrower did not have sufficient funds to close the loan.

C. Inadequate Verification of Earnest Money Deposit

The HUD-1 settlement statement reported an earnest money deposit of \$10,000 that exceeded 2 percent of the sale price. The lender did not obtain supporting documentation for the deposit. HUD Handbook 4155.1, REV-5, section 2-10A, states that when the amount of the earnest money deposit exceeds 2 percent of sales price or appears excessive based on the borrower's history of accumulated savings, the lender must verify with documentation the deposit amount and source of funds. The lender did not obtain evidence of the source of funds including 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.

D. Inadequate Credit Analysis

The credit report indicated that several accounts were in collection. The FHA file contained no explanations from the borrower. HUD Handbook 4155.1, REV-5, section 2-3, states that major indications of derogatory credit including judgments, collections, and any other recent credit

problems require sufficient written explanation from the borrower. However, the lender did not obtain an explanation from the borrower.