



Issue Date May 20, 2010

Audit Report Number 2010-AT-1005

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

FROM: //signed//
James D. McKay, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: Lendamerica Home Loans, Coral Gables, FL, Did Not Follow HUD
Requirements in Originating Loans and Implementing Its Quality Control
Program

HIGHLIGHTS

What We Audited and Why

We performed an audit of Lendamerica Home Loans, Inc. (Lendamerica), a Federal Housing Administration (FHA)-approved direct endorsement lender, located in Coral Gables, FL. Our audit objectives were to determine whether the lender followed U.S. Department of Housing and Urban Development (HUD) requirements when (1) originating and underwriting loans and (2) implementing its quality control program. We selected Lendamerica because its 44.4 percent default rate significantly exceeded the local Miami HUD office default rate of 12.5 percent.

What We Found

Lendamerica did not follow HUD requirements when originating and underwriting all five FHA loans reviewed. This noncompliance occurred because the lender did not have adequate controls to ensure that the loans were processed in accordance with HUD requirements. As a result, Lendamerica approved loans for potentially ineligible borrowers and unnecessarily placed the FHA insurance fund at risk for more than \$1 million.

In addition, Lendamerica did not implement a quality control program that complied with HUD requirements. It did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain required elements. These conditions occurred because Lendamerica disregarded its responsibilities to ensure that its quality control reviews were conducted in compliance with HUD requirements and that deficiencies identified were corrected and documented. As a result, the effectiveness of Lendamerica's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Lendamerica to indemnify HUD more than \$1 million for the five insured loans with significant deficiencies, pay down the loan balance for the two overinsured loans, and implement and enforce controls to ensure that loans are processed in accordance with HUD requirements. We also recommend that HUD take appropriate measures to ensure that Lendamerica develops and implements a quality control program that complies with HUD requirements and refer it to the Mortgagee Review Board for consideration of taking appropriate administrative actions.

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 discussed our review results with Lendamerica and HUD officials during the audit. We provided a copy of the draft report to Lendamerica on April 13, 2010, for its comments. The lender chose not to have an exit conference but provided its written comments on April 24, 2010. Although the lender did not disagree with the findings, it disagreed with the recommendations. The complete text of Lendamerica'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

Lendamerica Home Loans, Inc. (Lendamerica) is a Federal Housing Administration (FHA)-approved nonsupervised direct endorsement lender based in Coral Gables, FL. Under the direct endorsement program, the U.S. Department of Housing and Urban Development (HUD) authorizes approved lenders to underwrite FHA loans without HUD's prior review and approval. A nonsupervised lender is an institution which has as its principal activity the lending or investing of funds in real estate mortgages. It may submit applications for mortgage insurance and may originate, purchase, hold, and service insured loans or sell mortgages.

Lendamerica became an FHA-approved lender in September 1998. It does not have any active branch offices. From November 1, 2007, through October 31, 2009, Lendamerica originated 144 loans in HUD's Miami office jurisdiction. During the same period, 64 of the loans (44.4 percent) went into default with mortgage amounts totaling more than \$16.5 million. Of the 64 loans, 41 had 6 or fewer payments before the first 90-day default was reported. Lendamerica's default rate significantly exceeded the Miami office jurisdiction's default rate of 12.5 percent and the national default rate of 6 percent.

On September 30, 2009, HUD notified Lendamerica of its intent to terminate the lender's origination approval agreement because of Lendamerica's high default and claim rate as of June 30, 2009. On January 14, 2010, after reviewing the lender's written response and discussions, HUD terminated Lendamerica's origination approval agreement in HUD's Miami office jurisdiction for 6 months, thereby terminating the lender's ability to originate new FHA loans.

In addition, Lendamerica is operational in name only. To conduct business, an FHA lender's home office must be in a location conducive to mortgage lending, be located in a commercial space, and be clearly identified to the public. The president and former employees stated that the business had closed. We visited Lendamerica's address listed in the loan files and found that it was no longer there. It had also changed its business address to the president's residence. Further, the president indicated plans to terminate Lendamerica's FHA lending activity.

Our audit objectives were to determine whether the lender followed HUD requirements (1) when originating and underwriting loans and (2) when implementing a quality control plan.

RESULTS OF AUDIT

Finding 1: Lendamerica Did Not Follow HUD Requirements When Originating and Underwriting FHA Loans

Lendamerica did not follow HUD requirements when originating and underwriting all five FHA loans reviewed. This noncompliance occurred because the lender did not have adequate controls to ensure that loans were processed in accordance with HUD requirements. As a result, Lendamerica approved loans for potentially ineligible borrowers and unnecessarily placed the FHA insurance fund at risk for more than \$1 million.

Loans Had Significant Underwriting Deficiencies

Lendamerica did not follow HUD requirements when originating and underwriting all five loans selected in our review. The five loans have original mortgage amounts totaling more than \$1.8 million. Lenders must follow HUD Handbook 4155.1, REV-5, “Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans,” when underwriting FHA loans. This handbook describes procedures for evaluating the borrower’s credit history, capacity to make payments, and available cash assets to close the mortgage loan. The lender is responsible for eliciting a complete picture of the borrower’s financial situation, source of funds for the transaction, and intended use of the property. The lender’s decision to approve the mortgage loan must be documented.

The following table summarizes the deficiencies we identified for the five loans.

FHA case number	Spouse not included to qualify loan	Inadequate credit analysis	Cash investment not made or supported	Inaccurate employment information	Qualifying ratios exceeded or not supported	Mortgage amount over-insured
095-0526683	X		X			
095-0655905		X	X			X
095-0720437		X	X	X	X	
095-0792179		X	X	X	X	
095-0840006		X	X	X		X
Totals	1	4	5	3	2	2

Examples of the underwriting deficiencies include the following:

Inadequate Credit Analysis

Lendamerica did not obtain written explanations or explain why the borrowers' credit liabilities were either not included or not consistent with the amount used in analyzing their credit history for four loans. HUD Handbook 4155.1, REV-5, paragraph 2-3, states that if major indications of derogatory credit exist (e.g., collections), the lender must require sufficient written explanation from the borrower, and the explanation must make sense and be consistent with the other credit information in the file.

For FHA loan 095-0840006, the lender failed to properly analyze the borrowers' credit history. One of the borrowers had a liability of \$18,605; however, the lender did not include this debt in its calculation of the borrower's liabilities or explain why it omitted the liability from the qualifying ratio calculation. In addition, the lender did not obtain a written explanation from the borrower regarding 10 collection accounts or from the coborrower on 1 collection account. By not obtaining a reasonable explanation, the lender did not properly examine the borrowers' pattern of credit behavior to understand why the accounts became delinquent or adequately determine their ability to make mortgage payments.

Cash Investment Not Made or Supported

Lendamerica did not maintain sufficient documentation to support borrowers' investment of funds into the property or that the borrowers invested 3 percent of the contract sales price into the property for the five loans. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. In addition, the lender must document the gift funds by obtaining a gift letter and must also document the transfer of funds from the donor to the borrower.

For FHA loan 095-0526683, the HUD-1 settlement statement showed that the borrower invested \$2,925 into the property (\$1,000 for the earnest money deposit, \$350 for the appraisal, and \$1,575 at closing) and obtained \$8,347 in gift funds. However, the loan file contained no evidence that the borrower paid for the appraisal or the cash at closing and no documentation to support the gift amount or the transfer of the gift funds from the donor.

Inaccurate Employment Information

Lendamerica did not accurately verify the borrower's employment information for three loans. HUD Handbook 4155.1, REV-5, chapter 2, section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Mortgagee Letter 2005-16 raised the front and back qualifying ratios to 31 and 43 percent.

For FHA loan 095-0720437, the borrower did not work at the place of employment listed in the loan file and submitted to HUD. Based on the documents found in the loan file, the borrower worked at a medical center and earned a gross monthly income of \$15,600. However, our verification of the information with the employer and the borrower indicated that the employment information found in the loan file was inaccurate. The borrower was not employed at the medical center but at a dental office, and the monthly gross income was estimated to be \$3,000. Our recalculation of the qualifying ratios equaled 130.8 and 211.8 percent, respectively. Accordingly, the borrower would not have qualified for the FHA loan, and the lender submitted inaccurate employment information to HUD.

Mortgage Amount Overinsured

Lendamerica did not properly calculate the mortgage amount for two loans. HUD Handbook 4155.1, REV-5, paragraph 1-11, states that for a “no cash out” refinance, if the property was acquired less than 1 year before the loan application and is not already FHA insured, the maximum mortgage is the lower of the (1) statutory loan limit, (2) loan-to-value ratio applied to the appraised value, (3) loan-to-value ratio applied to the original sales price, and (4) existing debt.

For FHA loan 095-0655905, the lender did not properly calculate the maximum allowable mortgage amount and thus overinsured the mortgage amount by \$9,404. The borrower refinanced the property from a conventional loan to an FHA loan within 1 year of purchase. This was a “no cash out” refinance. The lesser of the four amounts is \$383,180, which is the loan-to-value ratio applied to the original sales price. The lender calculated the maximum mortgage to be \$392,585, for an excess of \$9,405.

Appendix D details the underwriting deficiencies for each of the five loans.

Lendamerica Lacked Controls

Lendamerica did not have controls in place to ensure that loans were originated and underwritten in accordance with HUD requirements. It could not explain why the documentation was not in the loan files and why the underwriting deficiencies occurred. The president stated that the deficiencies occurred because during that time, one of the underwriters was under considerable stress and the other underwriter was inexperienced with FHA program requirements. However, it is the lender’s responsibility to elicit a complete picture of the borrower’s financial condition, source of funds for the transaction, and use of the property. Accordingly, we attribute the deficiencies to Lendamerica’s lack of adequate controls to ensure that the loans were processed in accordance with HUD requirements.

Conclusion

Lendamerica did not follow HUD requirements when originating and underwriting five FHA loans. The deficiencies occurred because the lender did not have adequate controls to ensure that the loans were processed in accordance with HUD requirements. As a result, Lendamerica approved and insured five loans for potentially ineligible borrowers. The loans unnecessarily placed the FHA insurance fund at risk for more than \$1 million in potential losses should the five properties be foreclosed upon and resold for less than the unpaid principal balances. In addition, HUD overinsured two loans. Therefore, HUD should seek indemnification from Lendamerica for the five loans and should require the lender to pay down the loan balance for the two overinsured loans.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

- 1A. Determine whether Lendamerica will continue to operate as an FHA-approved lender and require it to indemnify HUD \$1,098,683 for the five insured loans with unpaid principal balances totaling \$1,831,140. The estimated loss is based on the loss severity rate of 60 percent of the unpaid principal balance amount for fiscal year 2009.
- 1B. Determine the amount of the overinsured mortgage for FHA case numbers 095-0655905 and 095-0840006 and require the lender to pay down the loan balance and provide evidence of the principal reduction.
- 1C. Determine whether Lendamerica will continue to operate as an FHA-approved lender and require it to implement and enforce controls to ensure that the loans are processed in accordance with HUD requirements.
- 1D. Refer Lendamerica to the Mortgagee Review Board for consideration of taking appropriate administrative action against the lender for its noncompliance in originating and underwriting FHA loans.

Finding 2: Lendamerica Did Not Follow HUD Requirements When Implementing Its Quality Control Program

Lendamerica did not implement a quality control program that complied with HUD requirements. It did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain required elements. These conditions occurred because Lendamerica disregarded its responsibilities to ensure that the quality control program followed HUD requirements and accomplished its goals. As a result, the effectiveness of Lendamerica's quality control plan to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

Lendamerica must implement and continuously have in place a quality control plan for the origination and/or servicing of insured mortgages as a condition of receiving and maintaining FHA approval. HUD Handbook 4060.1, REV-2, paragraph 7-2, states that lenders must design their quality control program to meet the basic goals of ensuring compliance with FHA's and the lender's origination and servicing requirements; protecting FHA and the lender from unacceptable risk; guarding against errors, omissions, and fraud; and ensuring swift and appropriate corrective action. Lendamerica used an external contractor to conduct its quality control reviews. The lender's quality control program contained deficiencies in its quality control reviews and its written quality control plan.

Quality Control Reviews Did Not Comply With HUD Requirements

Lendamerica did not conduct its quality control reviews according to HUD requirements. We found the following seven deficiencies:

Ten Percent of the Originated Loans Not Reviewed

HUD Handbook 4060.1, REV-2, paragraph 7-6C, states that a lender who originates and or underwrites 3,500 or fewer FHA loans per year must review 10 percent of the FHA loans it originates. Lendamerica was responsible for providing the external contractor with a monthly list of closed loans from which the contractor would select loans for review. The HUD Neighborhood Watch system showed that the lender originated 131 FHA loans in 2008, requiring quality control reviews of at least 13 loans. However, quality control reviews were performed on 11 loans. This noncompliance occurred because the lender did not provide the contractor with the list of closed loans for the months of August, November, and December 2008. The lender closed a total of 30 FHA loans during those 3 months. The lender stated that it did not know why the lists of closed loans were not provided to the external contractor.

Early Payment Default Loans Not Reviewed

HUD Handbook 4060.1, REV-2, paragraph 7-6D, states that all early payment default loans must be reviewed. Early payment default loans are loans that have defaulted within the first six payments and become 60 days past due.

Lendamerica had 29 early payment default loans. Routine quality control reviews were performed on 4 of the 29 early payment default loans. Thus, 25 early payment default loans were not reviewed. This noncompliance occurred because the lender did not identify and submit a list of early payment default loans for the external contractor to review.

Credit Reports Not Obtained

HUD Handbook 4060.1, REV-2, paragraph 7-6E.1, states that a new credit report must be obtained for each borrower whose loan is included in a quality control review unless the loan was a streamline refinance or was processed and approved by an automated underwriting system. Of the quality control reviews performed on 11 loans, 2 were not approved by an automated underwriting system. Thus, for the two loans, credit reports should have been obtained for the borrowers. The lender stated that it was unaware that new credit reports were not obtained.

Document Reverifications Not Always Performed

HUD Handbook 4060.1, REV-2, paragraph 7-6E.2, states that documents contained in the loan file, such as documents relating to borrower's income, gifts, or sources of funds, should be checked for sufficiency and subjected to written reverification. We reviewed 3 of the 11 quality control reviews to determine whether reverification occurred on the documents in the loan files. Employment income, other income such as rental income, and sources of funds including bank accounts were not reverified. The lender stated that it was unaware that required documents were not reverified.

Underwriting Decision Not Evaluated

HUD Handbook 4060.1, REV-2, paragraph 7-6F, states that each direct endorsement loan selected for a quality control review must be reviewed for compliance with HUD underwriting requirements, sufficiency of documentation, and soundness of underwriting judgments. The external contractor indicated that the quality control review did not include an evaluation of the underwriting decision and that it relied on the reports generated from the automated underwriting system. HUD requires the quality control review to include a review of the underwriting decision whether the loan was approved manually or by an automated underwriting system. The lender stated that it was unaware that the underwriting decision was not evaluated.

Conditions Needed for Loan Clearance and Closing Not Verified

HUD Handbook 4060.1, REV-2, paragraph 7-6G, states that each loan selected for a quality control review must be reviewed to determine whether conditions required for closing were met, the seller was the owner of record or was exempt, the loan closed and funds were disbursed according to instructions, and the

closing and legal documents were accurate and complete. The external contractor indicated that verifying the conditions for loan clearance and closing was not part of the quality control review. The lender stated that it did not know that the closing conditions were not verified.

Corrective Actions Not Supported

HUD Handbook 4060.1, REV-2, paragraph 7-3I, states that the final quality control review report must identify actions being taken for findings, the timetable for their completion, and any planned follow-up activities. The lender stated that it addressed all of the quality control review findings but was not sure whether it had documented the corrective actions taken. The lender's loan files did not contain documentation or a final report that identified the corrective actions taken on findings from the quality control reviews.

Written Quality Control Plan Did Not Contain Required Elements

Lendamerica's written quality control plan did not contain the required elements prescribed by HUD Handbook 4060.1, REV-2, chapter 7. Specifically,

- Paragraph 7-3C states that lenders must properly train staff involved in quality control and provide them access to current guidelines relating to the operations that they review.
- Paragraph 7-3I states that findings or deficiencies need to be provided to the lender management within 1 month of completion of the initial report.
- Paragraph 7-3L states that the lender must review the employee list at least semiannually to determine that an employee is not restricted from participating in HUD programs.

The lender's written plan did not clearly define these three required elements. The lender said that although familiar with the requirements, it did not know why the requirements were not included in the written plan.

Lendamerica Disregarded Responsibilities

The conditions described above occurred because Lendamerica disregarded its responsibilities to ensure that the quality control program accomplished its goals. Specifically, Lendamerica did not evaluate the work of staff to ensure that a list of closed and early payment default loans were provided to the external contractor or that corrective actions were made and documented. It also did not evaluate the

work of the external contractor to ensure that the contractor obtained credit reports, reverified required documents, evaluated the soundness of underwriting decisions, and verified the conditions for loan clearance and closing. HUD Handbook 4060.1, REV-2, paragraph 7-3B, states that a lender contracting out any part of its quality control function is responsible for ensuring that the external contractor meets HUD's requirements. In addition, Lendamerica did not include required elements in its written quality control plan.

Conclusion

Lendamerica did not follow HUD requirements when implementing its quality control program. Overall, these deficiencies occurred because the lender disregarded its responsibilities to ensure that the quality control program complied with HUD requirements and accomplished its goals. As a result, the effectiveness of Lendamerica's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

- 2A. Determine whether Lendamerica will continue to operate as an FHA-approved lender and take appropriate measures to ensure that it develops and implements a quality control program that complies with HUD requirements.
- 2B. Refer Lendamerica to the Mortgagee Review Board for consideration of taking appropriate administrative actions against the lender for its noncompliance with HUD requirements in implementing its quality control program.

SCOPE AND METHODOLOGY

Lendamerica underwrote 144 loans within the jurisdiction of the Miami HUD office between the amortization dates of November 1, 2007, and October 31, 2009. Of the 144 loans, 64 loans with mortgage amounts totaling \$16.5 million had defaulted within the first 2 years. We did not perform a 100 percent selection or a representative selection using statistical or nonstatistical sampling. We selected 5 of the 64 loans that went into default based on various risk factors including loans with a low number of payments before default, large gift amounts, high back ratios, and high mortgage amounts. These five loans totaled more than \$1.8 million.

To accomplish the audit objectives, we reviewed applicable regulations, HUD handbooks, and mortgagee letters and obtained and reviewed Lendamerica's 2007 and 2008 audited financial statements. We interviewed Lendamerica's former employees to obtain an understanding of the procedures the lender followed to originate and underwrite FHA loans.

We reviewed FHA and Lendamerica's loan files for the five loans to analyze the borrowers' credit history, effective income, liabilities, and cash investment into the property. We interviewed borrowers to confirm the information in the loan files and verified borrowers' employment information. For the interviews, we visited borrowers' residences and an employer location. We also accessed the Neighborhood Watch system to obtain information about the lender and the loan status. The results of our review apply only to the loans reviewed and cannot be projected to the universe of loans.

We interviewed staff from the external contractor hired to perform the quality control reviews to gain an understanding of how the reviews were conducted and documented. We also reviewed the written quality control plan and tested the quality control reviews performed to determine whether they complied with HUD requirements.

We used data maintained by HUD in the Neighborhood Watch system for background information and in selecting our sample of loans for review. The system is intended to assist HUD staff in monitoring lenders and programs and to assist lenders and the public in self-policing the industry. The system is designed to highlight exceptions so that potential problems are readily identifiable. In particular, the system gives the ability to identify and analyze patterns, by geographic area or originating lender, in loans which became 90 days delinquent during the first 2 years.

We assessed the reliability of the computer-processed data reported in the Neighborhood Watch system related to the audit objective. To assess the reliability of the loan data reported in the system, we (1) reviewed the loan files; (2) interviewed borrowers, employers, and lender staff; and (3) compared the data to county public records for accuracy and completeness. We found that the qualifying ratios and gift information reported in the system were not accurate and supported by the loan files and interviews. Specifically, inaccurate employment information, unsupported cash investment, and inconsistent liability information were submitted to HUD. Therefore, we assessed that the information in HUD's Neighborhood Watch system was unreliable. The deficiencies found in the loan files are presented in finding 1 and appendix D.

Further, we clarified the HUD regulations and discussed the findings with the Atlanta Homeownership Center, Quality Assurance Division. We also discussed the findings with the owner of Lendamerica.

We classified more than \$1 million as funds to be put to better use. This is 60 percent of the \$1.8 million in unpaid principal balances for the five FHA-insured loans that did not meet HUD's requirements. We used 60 percent because it has been determined that upon sale of the mortgaged properties, FHA's average loss was about 60 percent of the unpaid principal balance for fiscal year 2009.

Our review generally covered the period November 1, 2007, through October 31, 2009, and was extended as necessary. We performed the work at our Miami office and also conducted site visits to borrowers and an employer. The work was performed from December 2009 through March 2010.

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 operation – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- 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.
- 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 of resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

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:

- Lendamerica did not follow HUD requirements when originating and underwriting FHA loans (see finding 1).
- Lendamerica did not follow HUD requirements when implementing its quality control program (see finding 2).

APPENDIXES

Appendix A

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

<u>Recommendation number</u>	<u>Funds to be put to better use 1/</u>
1A	\$1,098,683

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Implementation of our recommendation to require Lendamerica to indemnify HUD for the five materially deficient loans will reduce the risk of loss to the FHA insurance fund. The amount above reflects HUD's estimated loss of 60 percent of the unpaid principal balance of the loans.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1

April 23, 2010

U.S. Department of Housing and Urban Development
Region 4, Office of the Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3369

Ref: LendAmerica Home Loans, Inc.
HUD Id: 1253200007

To Whom It May Concern:

Normally I would welcome a HUD Audit as I have had many HUD Audits since first getting FHA approved in February 1986 with my first company Certified Mortgage Investments, Corp. which later became Certified Mortgage Bankers, Inc. when I first got my DE delegated authority back in 1990. I found I always learned a lot from a HUD Audits and helped me make positive changes and rarely did I ever have any serious problems in 24 years. My default ratio was never more than 5-7% and I used to worry when it got passed 5% as I could have gotten suspended by my Investors, but 44% is absolutely ridiculous, which by the way I closed in a year if I'm not mistaken 222 loans and default was 26% not 44% as stated.

But we need to look also at the big picture before pointing fingers and finding blame, why did this happen? And we all know some of the answers which one was "The NON Profit Nehemiah Program" which I do understand I did not have to participate in the program but "Big Banks, Big Lenders, HUD (Government), and Wall Street" dictated what we sold in the streets or you would go out of business, as you created the demand for the products we sold. I remember very clearly worrying just like HUD about that program which was creating serious problems and loses for HUD. I come from the old school of the less sweat equity you have in a transaction the most likely you are to default.

I had not done any FHA loans because of the Sub Prime boom since 2002, so myself and my Underwriter's were a little rusty as we rushed to get back into FHA late 2007 after the mortgage crisis started and everyone turned to FHA. I immediately contracted Diehl & Associates experts in FHA training to train all my Loan Officer's and staff, as this was a culture shock to them as they were used to No Income, No Asset, No Doc, 80/20's ALT A's (Liars Loans) if you had a 700 Fico score you were almost guaranteed a loan, in other words they were "order takers". So I had to start retraining and reprogramming the entire company how to do a full doc loan and change their mentality. Of course this also meant hiring new staff and re organizing and all this while I had to deal with the problems from the ALT A era, which left me with lots of problems.

Comment 2

Under different circumstances I would learn from an audit, make my changes like I did at the end of 2008 a year after we started originating FHA loans before we closed the company in January of 2009. I believe at the end I had the best staff I had ever had in 24 years in business, but it is obvious that it was too late.

My problems did not come from originating FHA loans, as a matter of fact it kills me to know I could be originating FHA loans under the present environment and I'm absolutely sure I would do a phenomenal job as I have the know how and experience to correct any of the findings from the audit and run a good company with normal and low default ratios like I did in the past or better because I have more experience.

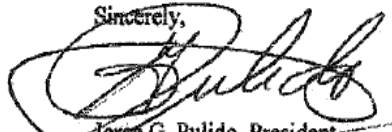
If you take a close look at my Audit you can tell at the beginning I had an inexperienced FHA underwriter and another one which was rusty and was under an incredible amount of stress, which of course I did notice and that is why I made the changes and hired new more experienced underwriter's, the mistakes made were basic that an experienced underwriter would not have made, yet they were both FHA Approved DE Underwriter's and certified by HUD. My Quality Control manager had 25 years in the business and I have no clue why she did not send to Adfitech the log to select the loans to audit for 3 months, which had never happened to me in 24 years. They were experienced professionals and should have known what to do while I was trying to save the company, as I could not be every where and do everything in the company.

I do take as an owner full responsibility for anything that happens or goes wrong because at the end of the day I was the President and CEO. The fact is that I did make drastic changes and that at the end of 2008 when HUD terminated the Nehemiah Program and with the changes I made most of this would not have happened.

I also want to congratulate HUD on the incredible job your team of auditors did, I have been going through HUD audits since the 1980's and I never in my life saw a group of professionals like you have now, they are thorough, detailed, extremely professionals and very courteous.

I do not though totally agree with their recommendation as I'm a business man of 40 years and know very well that their recommendations are a bit harsh as there is plenty of blame to go around during the worst financial crisis in 80 years.

Sincerely,



Jorge G. Pulido, President
LendAmerica Home Loans, Inc.

OIG Evaluation of Auditee Comments

- Comment 1** The lender disagreed with the 44 percent rate of default. We obtained the rate of default from HUD's Neighborhood Watch system. The system showed that Lendamerica insured 144 FHA loans within the Miami HUD Office jurisdiction for amortization dates between November 1, 2007, and October 31, 2009. Of the 144 loans, 64 loans had defaulted within the first two years, yielding a default rate of 44 percent.
- Comment 2** The lender did not agree with the recommendations. However, it did not provide documentation or other information to refute the findings or provide alternative resolutions. The existing recommendations adequately address the identified deficiencies.

Appendix C

SCHEDULE OF INDEMNIFICATION AMOUNTS

FHA case number	Unpaid principal balance	Loss percentage rate	Indemnification amount
095-0526683	\$366,637	60	\$219,982
095-0655905	\$396,652	60	\$237,991
095-0720437	\$399,367	60	\$239,620
095-0792179	\$380,922	60	\$228,553
095-0840006	<u>\$287,562</u>	60	<u>\$172,537</u>
Totals	<u>\$1,831,140</u>		<u>\$1,098,683</u>
<p>* We classified the \$1,098,683 as funds to be put to better use. This is 60 percent of the \$1,831,140 in unpaid principal balances for the five loans. The 60 percent is the estimated percentage of loss to HUD for fiscal year 2009 when the FHA property is resold for less than the unpaid principal balance.</p>			

Appendix D

LOAN DETAILS

Appendix D-1

FHA case #: 095-0526683

Mortgaged amount: \$368,091

Date of loan closing: 12/20/2007

Unpaid principal balance: \$366,637

Loan purpose: Purchase - existing home Default status: First legal action to commence foreclosure

Spouse Not Included to Qualify Loan

The lender did not consider the spouse when qualifying the loan even though the spouse also took title to the property. HUD Handbook 4155.1 Rev-5, paragraph 2-2, indicates that HUD does not permit an individual to take an ownership interest in the property at settlement without signing the mortgage note and all security instruments. In addition, the income, assets, liabilities, and credit history of the individual who takes ownership interest in the property should be considered in determining creditworthiness. County public records showed that both the borrower and the spouse took title to the property. The loan file showed that both signed the mortgage, but the spouse did not sign the note. According to the regulations, since the spouse also took title to the property, which was made evident to the lender in the loan application, the lender should have also considered the wife's income, assets, liabilities, and credit history in qualifying the loan.

Cash Investment Not Supported

The lender did not maintain sufficient documentation to support the borrower's cash investment in the property or that the borrower invested 3 percent of the contract sales price into the property. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. In addition, the lender must document the gift funds by obtaining a gift letter and must also document the transfer of funds from the donor to the borrower. The HUD-1 settlement statement showed that the borrower invested \$2,925 into the property (\$1,000 for the earnest money deposit, \$350 for the appraisal, and \$1,575 at closing) and obtained \$8,347 in gift funds. However, the loan file contained no evidence that the borrower paid for the appraisal or the cash at closing and no documentation to support the gift amount or the transfer of the gift funds from the donor.

FHA case #: 095-0655905

Mortgaged amount: \$398,473

Date of loan closing: 04/28/2008

Unpaid principal balance: \$396,652

Loan purpose: Refinance

Default status: Special forbearance

Inadequate Credit Analysis

The lender did not obtain written explanations about the borrower's delinquent accounts or bankruptcy. HUD Handbook 4155.1, REV-5, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. If major indications of derogatory credit exist (e.g., bankruptcy), the lender must require sufficient written explanation from the borrower, and the explanation must make sense and be consistent with the other credit information in the file. By not obtaining a reasonable explanation, the lender did not properly examine the borrower's pattern of credit behavior to understand why accounts became delinquent or why the borrower filed for Chapter 13 bankruptcy.

Mortgage Amount Overinsured

The lender did not properly calculate the mortgage amount. The borrower originally purchased the property for \$392,000 through a conventional loan in September 2007. The borrower refinanced the loan through FHA in April 2008, and the property obtained an appraised value of \$405,000.

This was a "no cash out" refinance. HUD Handbook 4155.1, REV-5, paragraph 1-11, states that for a "no cash out" refinance with an appraisal, the maximum mortgage is the lower of the loan-to-value ratio applied to the appraised value or the existing debt and may never exceed the statutory limit except by the amount of any new upfront mortgage insurance premium. However, if the property was acquired less than 1 year before the loan application and is not already FHA insured, the original sales price of the property also must be considered in determining the maximum mortgage. In essence, the maximum allowable mortgage amount would be the lesser of the following four amounts: (1) statutory loan limit, (2) loan-to-value ratio applied to the appraised value, (3) loan-to-value ratio applied to the original sales price, and (4) existing debt.

The lesser of the four amounts is \$383,180, which is the loan-to-value ratio applied to the original sales price. Thus, the maximum allowable mortgage amount is \$383,180. However, the lender allowed the mortgage amount of the refinance to be set at \$392,585. Thus, the mortgage amount exceeded the maximum allowable mortgage amount, and the mortgage loan was over insured by \$9,405.

Cash Investment Not Made

The lender did not ensure that the borrower invested at least 3 percent toward the refinancing of the FHA loan. Mortgagee Letter 98-29 states that HUD will insure the maximum mortgage amount provided that the borrower makes a cash investment of at least 3 percent into the property. Based on the review of the loan file and verification with the borrower, the borrower did not invest any funds in refinancing the property.

FHA case #: 095-0720437

Mortgaged amount: \$403,567

Date of loan closing: 06/13/2008

Unpaid principal balance: \$399,367

Loan purpose: Purchase - existing home Default status: Delinquent

Inadequate Credit Analysis

The lender did not explain why the borrower's monthly recurring payment amount was not consistent among the various documents contained in the loan file. The mortgage credit analysis worksheet showed \$2,428, the printout from the automated underwriting system showed \$2,203, the final loan application showed \$2,087, and the borrower's credit report showed \$3,766. The borrower's qualifying back ratio was calculated using the monthly recurring payment amount of \$2,428, but the lender did not explain why that amount was used or how it was calculated. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. Since the qualifying back ratio was used to support the lender's decision to approve the loan, documentation on how the lender calculated the ratio should be included in the loan file.

Cash Investment Not Supported

The lender did not maintain sufficient documentation to support the borrower's investment of funds into the property or that the borrower invested 3 percent of the contract sales price into the property. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. In addition, the lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, which specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. The lender must also document the transfer of funds from the donor to the borrower. The HUD-1 settlement statement showed that the borrower invested \$350 for the appraisal and obtained \$12,297 in gift funds. However, there was no documentation in the loan file to support that the borrower paid for the \$350 appraisal and no documentation of the gift letter and transfer of funds from the donor.

Inaccurate Employment Information

The lender did not accurately verify the borrower's employment income information. HUD Handbook 4155.1, REV-5, chapter 2, section 2, states that income may not be used in calculating the borrower's qualifying ratios if it comes from any source that cannot be verified, is not stable, or will not continue. Based on the documents found in the loan file such as the verification of employment and final loan application, the borrower worked at a medical center and earned a gross monthly income of \$15,600. However, our verification of the employment information with the employer and the borrower indicated that the employment information found in the loan file was inaccurate. The borrower was not employed at the medical center but at a dental office, and the monthly gross income was estimated to be \$3,000.

Ratios Exceeded

The lender did not properly perform the ratios analysis. As noted above, the borrower's monthly recurring payments amount was inconsistent among the documents in the loan file, and the lender provided no explanation. In addition, based on our verification of the borrower's employment and interview with the borrower, the employment information found in the loan file was inaccurate. Accordingly, the qualifying ratios were calculated using an unsupported monthly recurring payment amount (used to calculate the back ratio) and an inaccurate income amount (used to calculate the front and back ratios). Thus, the qualifying ratios calculated by the lender were inaccurate and unsupported.

We recalculated the qualifying ratios by using the \$3,000 income amount provided by the borrower with the other amounts remaining the same. The qualifying ratios equaled 130.8 and 211.8 percent, respectively. Mortgagee Letter 2005-16 raised the front and back qualifying ratios to 31 and 43 percent. Based on the recalculated ratios, the borrower would not have qualified for the FHA loan. The borrower's monthly housing payment and total debt exceeded the borrower's monthly income.

	Lender's calculation	Audit calculation
Mortgage payment expense to effective income (front) ratio ¹	25.2% (\$3,925 / \$15,600)	130.8% (\$3,925 / \$3,000)
Total fixed payment to effective income (back) ratio ²	40.7% [(\$3,925 + \$2,428) / \$15,600]	211.8% [(\$3,925 + \$2,428) / \$3,000]

¹ The mortgage payment expense considers the principal and interest, escrow deposits for real estate taxes, hazard insurance, mortgage insurance premium, homeowners' association dues, ground rent, special assessments, and payments for any acceptable secondary financing.

² The total fixed payment is the sum of the mortgage payment expense plus the monthly recurring payment.

FHA case #: 095-0792179

Mortgaged amount: \$383,028

Date of loan closing: 09/30/2008

Unpaid principal balance: \$380,922

Loan purpose: Purchase - existing home

Default status: First legal action to commence foreclosure

Inadequate Credit Analysis

The lender did not explain why the borrower's monthly recurring payment amount listed on the printout from the automated underwriting system and the final loan application was not consistent with the amount on the borrower's credit report. The first two documents showed monthly recurring liabilities of \$2,602; however, the borrower's credit report showed liabilities totaling \$2,784. The borrower's qualifying back ratio was calculated using the monthly recurring payment amount of \$2,602, but the lender did not explain why that amount was used or how it was calculated. HUD Handbook 4155.1, REV-5, paragraph 3-1, states that the application package must contain all documentation supporting the lender's decision to approve the mortgage loan. Since the qualifying back ratio was used to support the lender's decision to approve the loan, documentation on how the lender calculated the ratio should be included in the loan file.

Cash Investment Not Supported

The lender did not maintain sufficient documentation to support the borrower's investment of funds into the property or that the borrower invested 3 percent of the contract sales price into the property. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. In addition, the lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, which specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. The lender must also document the transfer of funds from the donor to the borrower. The HUD 1 settlement statement showed that the borrower invested \$2,044 into the property (\$300 for the appraisal and \$1,744 at closing) and obtained \$11,700 in gift funds. However, there was no documentation in the loan file to support that the borrower paid for the items and no documentation of the transfer of gift funds from the donor. In addition, the borrower stated that he did not invest any money to acquire the FHA property.

Inaccurate Employment Information

The lender did not accurately verify the borrower's employment information. Our review revealed that the borrower was paid commission versus a fixed salary. HUD Handbook 4155.1, REV-5, paragraph 2-7D, states that commission income must be averaged over the previous 2 years. The borrower must provide copies of signed tax returns for the last 2 years along with the most recent pay stub. However, the lender maintained documentation in the loan file, such as the verification of employment and a letter from the employer, which detailed the borrower's gross semimonthly income less Federal, Social Security, and Medicare taxes, to support that the borrower earned a fixed salary and calculated the borrower's income as a fixed salary. Based on

our verification with the employer and borrower, the verification of employment in the loan file contained inaccurate information, and the employer did not provide the employment letter. The letter was used to support the verification of employment and that the borrower had a fixed salary. The loan file did not contain the borrower's signed tax returns for the past 2 years and the most recent pay stub.

Unsupported Qualifying Ratios

The lender's calculated qualifying front and back ratios at 27 and 46 percent, respectively, were unsupported. The ratios were calculated based on an unsupported monthly gross income (used to calculate the front and back ratios) and an unsupported monthly recurring payment amount (used to calculate the back ratio). Since the lender did not maintain the proper supporting documentation to calculate the borrower's commissioned income, we could not confirm the borrower's income to recalculate the qualifying ratios.

In addition, Mortgagee Letter 2005-16 states that for a manually underwritten loan, the qualifying ratios should not exceed 31 and 43 percent without acceptable compensating factors. The loan was processed and approved by an automated underwriting system, so the higher back ratio may have been acceptable. However, we could not determine whether the automated underwriting system would have approved the loan given the correct employment information.

FHA case #: 095-0840006

Mortgaged amount: \$287,816

Date of loan closing: 09/30/2008

Unpaid principal balance: \$287,562

Loan purpose: Purchase - existing home

Default status: First legal action to commence foreclosure

Inadequate Credit Analysis

The lender failed to properly analyze the borrowers' credit history. The primary borrower had a liability of \$18,605 that the lender did not include in its calculation of the borrower's liabilities or explain why it omitted the liability from the qualifying ratio calculation. In addition, the lender did not obtain a written explanation from the borrower on 10 collection accounts or from the coborrower on 1 collection account. HUD Handbook 4155.1, REV-5, paragraph 2-3, states that past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. When delinquent accounts are revealed, the lender must document its analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. If major indications of derogatory credit exist (like collections), the lender must require sufficient written explanation from the borrower and the explanation must make sense and be consistent with the other credit information in the file. The loan file contained no written explanations about the collection accounts. By not obtaining a reasonable explanation, the lender did not properly examine the borrower's pattern of credit behavior to understand why the accounts became delinquent.

Cash Investment Not Supported

The lender did not maintain sufficient documentation to support the borrower's investment of funds into the property or that the borrower invested 3 percent of the contract sales price into the property. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. Specifically, paragraph 2-10C of the handbook states that the lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, which specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. The lender must also document the transfer of funds from the donor to the borrower. The HUD-1 settlement statement showed that the borrower invested \$2,338 into the property (\$300 for the appraisal, \$100 for the application fee, \$1,321 for the hazard insurance premium, \$306 for the flood insurance premium, and \$311 at closing) and obtained \$8,727 in gift funds. However, other than a gift letter, the loan file contained no evidence that the borrower paid for the items and no documentation to support the transfer of the gift funds from the donor.

Inaccurate Employment Information

The lender did not accurately verify the coborrower's employment income information. Our verification of the coborrower's employment showed inconsistencies in the income data from the

pay stubs and the Internal Revenue Service W-2 forms contained in the loan file. According to our verification, the coborrower earned more than was indicated in the loan file.

Mortgage Amount Overinsured

The lender did not properly calculate the mortgage amount. HUD Handbook 4155.1, REV-5, paragraphs 1-7A and 1-7B, state that seller contributions exceeding 6 percent of the property's sales price must be subtracted dollar-for-dollar from the sales price before applying the applicable loan-to-value ratio. The sales price of the property was \$290,900 and the loan-to-value ratio of the loan was 97.75 percent. Based on our review of the purchase and sale agreement and HUD-1 settlement statement, the seller contributed \$21,379 toward the borrower's closing costs, which exceeded the 6 percent limit of \$17,454 by \$3,925. Therefore, the maximum allowable mortgage amount should have been \$280,518 [(\$290,900 - \$3,925) x 97.75%]. Thus, the lender's calculated mortgage amount of \$282,173³ exceeded the maximum allowable mortgage amount of \$280,518 by \$1,655. In essence, the lender overinsured the mortgage amount by \$1,655.

Using the HUD-1 settlement statement, we calculated those costs that should have been paid by the borrower, according to the purchase and sale agreement, but were paid by the seller. The \$21,379 consisted of the following costs: loan origination fee, loan discount, administration fee, interest, settlement fee, title search, title insurance, endorsements, recording fees, city/county tax/stamps, state tax/stamps, maintenance assessment for September 30, 2008, maintenance assessment for October 2008 to September 2009, association initial capital contribution, seller administration fee, survey, cancelation fee and costs regarding the prior contract, soil treatment, and condo book.

³ HUD insured the loan for \$287,816, which consisted of the mortgage amount of \$282,173 and the upfront mortgage insurance premium of \$5,643.