



Issue Date December 17, 2010
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Audit Report Number 2011-FW-1003
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TO: Vicki B. Bott, Deputy Assistant Secretary for Single Family Housing, HU

//signed//

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

SUBJECT: WR Starkey Mortgage, LLP, Plano, TX, Did Not Follow HUD Underwriting Requirements for 13 of 14 Loans Reviewed

## **HIGHLIGHTS**

### **What We Audited and Why**

We performed an audit of WR Starkey Mortgage, LLP (WR Starkey), located in Plano, TX, a Federal Housing Administration (FHA) direct endorsement lender. We selected WR Starkey for audit because of its high default rate of nearly 4.5 percent as compared to the average default rate for all FHA loans in Fort Worth, TX, of 4.1 percent. Our objective was to determine whether WR Starkey complied with U. S. Department of Housing and Urban Development (HUD) and FHA loan origination requirements for loans endorsed between April 1, 2008, and April 30, 2010.

### **What We Found**

WR Starkey did not follow HUD/FHA underwriting requirements in 13 of 14 loan originations reviewed. This noncompliance occurred because WR Starkey's underwriters failed to exercise due diligence in underwriting the loans and its internal control system did not detect or prevent the underwriters from originating the faulty loans. As a result, WR Starkey improperly originated four loans that resulted in losses to FHA's Mutual Mortgage Insurance Fund (insurance fund) of \$360,032 and nine loans that increased the risk to the insurance fund by \$905,803.

## What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family require WR Starkey to (1) reimburse the FHA insurance fund \$360,032 in actual losses on four loans and (2) indemnify nine loans that placed the FHA insurance fund at unnecessary risk with unpaid balances of \$905,803, thereby putting an estimated \$543,482<sup>1</sup> in funds put to better use.

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

## Auditee's Response

We provided our discussion draft report to WR Starkey on November 12, 2010, and held the exit conference on November 30, 2010. We requested a written response by December 3, 2010. WR Starkey requested an extension and provided its response on December 7, 2010.

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

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<sup>1</sup> According to the Actuarial Review of the FHA Mutual Mortgage Fund for Fiscal Year 2009, FHA's average loan experience is about 60 percent of the unpaid principal balance upon sale of a mortgaged property.

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## BACKGROUND AND OBJECTIVE

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WR Starkey Mortgage, LLP (WR Starkey), began operations on January 27, 2000, and is engaged in the business of processing, underwriting, originating, and selling mortgage loans and the related servicing rights. According to the U.S. Department of Housing and Urban Development's (HUD) Neighborhood Watch,<sup>2</sup> WR Starkey received approval as a direct endorsement lender on February 17, 2000. WR Starkey originates loans from offices located throughout Texas as well as offices located in Colorado, Oklahoma, Tennessee, South Carolina, North Carolina, Georgia, Kentucky, and Alabama.

WR Starkey was initially formed as a limited liability corporation in the State of Delaware. Effective January 1, 2002, WR Starkey filed for and received approval to convert the limited liability corporation to a limited liability partnership.

The direct endorsement program simplified the process for obtaining Federal Housing Administration (FHA) mortgage insurance by allowing lenders to underwrite and close the mortgage loan without prior HUD review or approval. WR Starkey was responsible for complying with all applicable HUD/FHA regulations and was required to evaluate the borrower's ability and willingness to repay the mortgage debt. WR Starkey was protected against default by FHA's Mutual Mortgage Insurance Fund (insurance fund), which is sustained by borrower premiums. FHA's mortgage insurance programs help low- and moderate-income families become home owners by lowering some of the costs of their mortgage loans. FHA mortgage insurance also encourages lenders to approve mortgages for otherwise creditworthy borrowers that might not be able to meet conventional underwriting requirements by protecting the lender against default.

During the audit scope, WR Starkey maintained a relationship with Genesis Housing Development Corporation (Genesis). Genesis purported to be a nonprofit entity that provided downpayment assistance to WR Starkey borrowers. Genesis provided the funding for 13 of the 14 loans reviewed, thus allowing the borrowers to purchase the property without using personal funds.

From April 1, 2008, to March 31, 2010, WR Starkey underwrote 2,530 FHA loans in the Fort Worth area with a total origination value of nearly \$322.9 million. During the same period, 113 of the loans (nearly 4.5 percent) with a total origination value of more than \$14.5 million defaulted.<sup>3</sup>

Our objective was to determine whether WR Starkey followed HUD and FHA loan origination requirements for loans endorsed between April 1, 2008, and April 30, 2010.

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

<sup>3</sup> HUD defines a default as the inability to make timely monthly mortgage payments or otherwise comply with mortgage terms. A loan is considered in default when no payment has been made 30 days after the due date. Once in default the lender can exercise legal rights defined in the contract to begin foreclosure proceedings.

## RESULTS OF AUDIT

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### Finding: WR Starkey Did Not Follow HUD/FHA Requirements for 13 of 14 Loans Reviewed

WR Starkey did not follow HUD/FHA requirements for 13 of 14 loans reviewed.<sup>4</sup> The 13 loans each contained multiple underwriting deficiencies. This noncompliance occurred because WR Starkey's underwriters failed to exercise due diligence in underwriting the loans and its internal control system did not detect or prevent underwriters from originating the faulty loans. As a result, WR Starkey caused the FHA insurance fund losses totaling \$360,032 and increased the risk to the insurance fund by \$905,803.

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#### **WR Starkey Did Not Follow HUD/FHA Requirements**

WR Starkey did not follow HUD/FHA requirements for 13 of 14 loans reviewed. The 13 loans contained multiple underwriting deficiencies. Specifically, WR Starkey did not

- Verify that Genesis was a valid nonprofit organization,
- Document the transfer of gift funds for 11 of the loans,
- Document compensating factors for three loans,
- Obtain required payroll documentation for two loans,
- Obtain required explanation for derogatory credit items for two loans,
- Obtain an itemized sales contract on one manufactured home loan, and
- Include earnest money paid on a settlement statement for one loan.<sup>5</sup>

Also, WR Starkey

- Obtained borrower information from the seller for three loans,
- Marked on the loan application that two borrowers did not file for bankruptcy when the borrowers' credit report showed a bankruptcy,
- Used discount points to calculate minimum investment, and
- Overinsured one loan.

We included case narratives describing the underwriting deficiencies for each loan in appendix D.

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<sup>4</sup> Appendix C contains a summary of the deficiencies and questioned costs.

<sup>5</sup> This is a violation of the Real Estate Settlement Procedures Act (RESPA), which requires that all funds paid by a borrower toward the sales price of the property be shown on the settlement statement.

### **WR Starkey Did Not Document Gift Funds**

WR Starkey did not verify that Genesis was a qualified, valid nonprofit. FHA requires<sup>6</sup> that the lender ensure and document that the entity is a charitable organization using an Internal Revenue Service website. Genesis was not found on the Internal Revenue Service website. WR Starkey stopped using Genesis in August 2008. Thirteen of the fourteen loans reviewed contained this underwriting deficiency.

Further, WR Starkey did not document the gift wire transfer as required on 11 of 14 loans reviewed. FHA regulations<sup>7</sup> required that WR Starkey document the transfer of the funds from the donor to the borrower.

### **WR Starkey Did Not Provide Permissible Compensating Factors**

WR Starkey did not provide permissible compensating factors for 3 of the 14 loans reviewed. When loans exceed the standard debt-to-income ratio, FHA regulations<sup>8</sup> required WR Starkey to obtain and document compensating factors to justify originating the loan. WR Starkey thought that it followed sufficient processes, but it did not.

### **Seller Obtained Documents for WR Starkey**

For three loans, the seller obtained documentation from the borrower and sent the information to WR Starkey. All of the sellers were manufactured home sales offices. In one instance, the manufactured home sales representative requested rental verification from the potential borrower's mother. Other manufactured home sales representatives obtained payroll and other documentation and then forwarded it to WR Starkey. FHA regulations<sup>9</sup> prohibit lenders from accepting documentation collected and sent by the seller.

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<sup>6</sup> Mortgage Letter 2006-13

<sup>7</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>8</sup> HUD Handbook 4155.1, paragraph 4.F.3.b

<sup>9</sup> HUD Handbook 4155.1, paragraph 1.2.d

### **WR Starkey Did Not Always Obtain Required Income Documentation**

For two loans, WR Starkey did not obtain the required payroll documentation. The automated underwriting system required WR Starkey to obtain documentation supporting 1 month of income. In both instances, WR Starkey only obtained 1 payroll cycle or 2 weeks' worth of income information. In one instance, the borrowers began new employment 60 days before closing with one of the co-borrowers changing jobs eight times, and the other co-borrower changing jobs seven times from November 2005 to May 2007. FHA requirements state that all documentation on which the lender bases its credit decision must be in the loan file.<sup>10</sup> WR Starkey agreed that it failed to follow up on the payroll documentation.

### **WR Starkey Did Not Obtain Explanations for Derogatory Credit**

For two other loans, WR Starkey did not obtain explanations for derogatory credit items. In one instance, the borrower did not explain a judgment on his credit report. In the second instance, the borrower's credit report contained five unexplained derogatory items. FHA requirements state that the borrower must provide sufficient reasonable written explanation regarding the reasons for derogatory credit.<sup>11</sup>

### **A Sales Contract Was Not Itemized**

The sales contract for one loan did not contain itemization of the sales price. FHA required<sup>12</sup> the sales contract to support the sales price on the settlement statement. Further, if the manufactured home dealer was the general contractor, as in this instance, the cost for the foundation, installation, and any additional charges must be itemized on the sales contract. WR Starkey's underwriter should have ensured that the sales contract included the required itemization.

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<sup>10</sup> Mortgage Letter 2004-47

<sup>11</sup> HUD Handbook 4155.1 paragraph 4.C.1.c

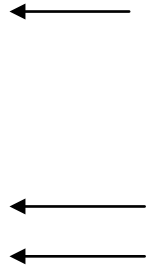
<sup>12</sup> HUD Handbook 4155.1, paragraph 2.B.8.i

**WR Starkey Inappropriately Included Discount Points as Downpayment Funds**

In one instance, WR Starkey inappropriately included discount points in a borrower's downpayment. The original mortgage credit analysis worksheet,<sup>13</sup> showed the required statutory investment as \$3,118, the downpayment as \$2,064, and the discount points as \$2,047. According to FHA regulations,<sup>14</sup> the downpayment must meet or exceed the statutory investment. When WR Starkey recalculated the mortgage credit analysis worksheet it deleted the discount points from the mortgage credit analysis worksheet and added that amount to the downpayment line, increasing the downpayment by \$2,047 to \$4,111. FHA regulations<sup>15</sup> prohibit discount points from being used to meet the borrowers' minimum investment.

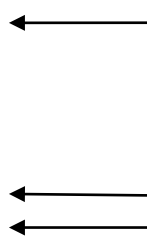
Original mortgage credit analysis worksheet

<b>10. Statutory Investment Requirements</b>	
a. Contract Sales Price	103,948.00
b. Borrower-Paid Closing Costs (from 5c)	-1,055.07
c. Unadjusted Acquisition (10a + 10b)	102,892.93
d. Statutory Investment Requirement (10a x 0.03)	3,118.38
<b>11. Maximum Mortgage Calculation</b>	
a. Less of Sales Price (10a) or Value (from 4)	103,948.00
b. Required Adjustments (+/-)	
c. Mortgage Basis (11a + 11b)	103,948.00
d. Mort Amt. (11c x LTV Factor 97.750 % or Less)	100,827.00
<b>12. Cash Investment Requirements</b>	
a. Minimum Down Payment (10c-11d) (This amount must equal or exceed 10d)	2,063.93
b. Prepaid Expenses	1,938.88
c. Discount Points	2,048.78
d. Repairs/Improvements (Non-Financeable)	
e. Upfront MIP Paid in Cash	0.41
f. Non-Realty and Other Items	
g. Total Cash to Close (Sum of 12a thru 12f)	6,048.00



Final mortgage credit analysis worksheet

<b>10. Statutory Investment Requirements</b>	
a. Contract Sales Price	103,948.00
b. Borrower-Paid Closing Costs (from 5c)	991.71
c. Unadjusted Acquisition (10a + 10b)	104,939.71
d. Statutory Investment Requirement (10a x 0.03)	3,118.38
<b>11. Maximum Mortgage Calculation</b>	
a. Less of Sales Price (10a) or Value (from 4)	103,948.00
b. Required Adjustments (+/-)	
c. Mortgage Basis (11a + 11b)	103,948.00
d. Mort Amt. (11c x LTV Factor 97.750 % or Less)	100,827.00
<b>12. Cash Investment Requirements</b>	
a. Minimum Down Payment (10c-11d) (This amount must equal or exceed 10d)	4,110.71
b. Prepaid Expenses	1,938.88
c. Discount Points	
d. Repairs/Improvements (Non-Financeable)	
e. Upfront MIP Paid in Cash	0.41
f. Non-Realty and Other Items	
g. Total Cash to Close (Sum of 12a thru 12f)	6,048.00
h. Amount Paid (Earnest Money, etc.)	



<sup>13</sup> Lenders use the mortgage credit analysis worksheet to calculate the mortgage amount.

<sup>14</sup> HUD Handbook 4155.1, paragraph 2.A.2.c

<sup>15</sup> HUD Handbook 4155.1, paragraph 2.A.2.d



### **WR Starkey Overinsured One Loan by \$6,500**

The manufactured home dealer provided one borrower a downpayment assistance gift of \$8,100. This downpayment assistance gift totaled 6 percent of the sales price. However, according to the borrower,<sup>16</sup> the manufactured home dealer also gave the borrower \$6,500 cash after closing. The \$6,500 exceeded the allowed 6 percent contribution to the sales price and should have been considered a sales inducement. FHA regulations<sup>17</sup> required WR Starkey to reduce the loan dollar for dollar for this sales inducement.

### **The Settlement Statement Did Not Show an Earnest Money Deposit**

The borrower gave the seller, a manufactured home dealer, a \$500 money order. WR Starkey's loan file contained a copy of the money order. However, the settlement statement did not show earnest money or other downpayments made by the borrower. The Real Estate Settlement Procedures Act (RESPA)<sup>18</sup> required the settlement statement reflects any amounts paid against the sales price. WR Starkey's underwriter stated that she did not review the settlement statement to verify that earnest money was reflected on the settlement statement.

### **WR Starkey's Quality Assurance Plan Lacked a Requirement**

WR Starkey's quality assurance plan lacked policies to ensure that employees were trained and that WR Starkey provided access to current guidelines. FHA regulations state that the lender must properly train staff and provide access to current FHA guidelines.<sup>19</sup> When brought to its attention, WR Starkey personnel prepared a quality control department bulletin correcting its quality control plan. No further recommendation will be made.

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<sup>16</sup> We did not interview all of the borrowers to determine the extent of this condition.

<sup>17</sup> HUD Handbook 4155.2, paragraph 4.8.c

<sup>18</sup> 24 CFR (Code of Federal Regulations) Part 3500, appendix A

<sup>19</sup> HUD Handbook 4060.1, REV-2, paragraph 7 3.C

## Conclusion

WR Starkey did not follow HUD/FHA requirements for 13 of 14 loans reviewed. The 14 loans had original values totaling more than \$1.5 million. All thirteen loans cited had multiple underwriting deficiencies. This noncompliance occurred because WR Starkey's underwriters failed to exercise due diligence in underwriting the loans and its internal control system did not detect or prevent the underwriters from originating the faulty loans. WR Starkey caused FHA insurance fund losses totaling \$360,032 on four of the loans. Another nine loans, totaling \$905,803 put the FHA insurance fund at increased risk of loss.

## Recommendations

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

- 1A. Reimburse the FHA insurance fund \$360,032 for losses incurred on the following loan numbers: 492-8085148, 492-8084142, 492-8051404, and 492-8041804.
- 1B. Indemnify HUD for nine insured loans with unpaid principal balances of \$905,803 thereby putting an estimated \$543,482 to better use based on the FHA insurance fund average loss rate of 60 percent of the unpaid principal balances.

## SCOPE AND METHODOLOGY

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To accomplish our objective, we

- Reviewed applicable HUD regulations, requirements, and mortgagee letters;
- Reviewed reports and information on HUD's Neighborhood Watch and Single Family Data Warehouse;<sup>20</sup>
- Reviewed WR Starkey's files, quality control plan, quality control reports, and independent audit reports;
- Conducted interviews with applicable WR Starkey staff; and
- Conducted onsite visits to nine properties and conducted interviews with one borrower, one set of co-borrowers, and one occupant who purchased the foreclosed-upon property and lived at the property with the prior borrower.

Using HUD's Neighborhood Watch system, we determined which FHA lenders originated defaulted loans in the Fort Worth, TX, area. We obtained a download of defaulted loans with six or fewer payments originated by the lender and endorsed from April 1, 2008, to April 30, 2010. We determined that WR Starkey originated 2,530 loans, 113 (nearly 4.5 percent) of which later defaulted. We selected a random nonstatistical sample of 14 loans with original loan values totaling more than \$1.5 million and reviewed the loan documents. We used a nonstatistical random sample because we were determining what types of errors might exist and did not intend to project the test results on the population of loans. We did not evaluate the reliability of HUD's Neighborhood Watch or Single Family Data Warehouse systems because we used the data for background purposes only.

We performed our fieldwork between June 9, 2010, and October 1, 2010, at WR Starkey's office and our office in Fort Worth, TX.

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

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<sup>20</sup> Single Family Data Warehouse is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of single-family housing data. It consists of database tables structured to provide HUD users easy and efficient access to single-family housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics.

# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

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

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## Relevant Internal Controls

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

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

We assessed the relevant controls identified above.

A deficiency in internal controls exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

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

- WR Starkey did not have effective controls in place to ensure that its underwriters complied with HUD regulations in originating, underwriting, and closing FHA loans (finding).

## APPENDIXES

### Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A	\$360,032	
1B		\$543,482

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. Implementation of our recommendation to require WR Starkey to indemnify HUD for the nine loans that were not originated in accordance with HUD/FHA requirements will reduce FHA's risk of loss to the insurance fund. The amount reflects that, upon the sale of the mortgaged property, FHA's average loss experience is about 60 percent of the unpaid principal balance (see footnote 1).

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



December 7, 2010

Via email [wnixon@hudoig.gov](mailto:wnixon@hudoig.gov)  
& [pgraf@hudoig.gov](mailto:pgraf@hudoig.gov)  
and First Class U.S. Mail

Mr. Gerald Kirkland  
Regional Inspector General for Audit  
Office of Inspector General, Region VI  
819 Taylor Street, Suite 13A09  
Fort Worth, Texas 76102

RE: WR Starkey Mortgage, L.L.P (the "Company")  
Audit 2011-FW-100X

Dear Mr. Kirkland:

Thank you for the opportunity to provide these comments and alternative recommendations to the referenced draft audit report. Our comments are divided into two sections: first, an update on relevant corrective actions taken by the Company and second, comments and alternative recommendations on four of the specific loans at issue in this audit.

We note from the outset that on May 20, 2010, in order to resolve a Notice of Violation ("NOV") issued by the United States Department of Housing and Urban Development ("HUD") on December 28, 2009, the Company and HUD entered into a Settlement Agreement. The terms of the Settlement Agreement required the Company to indemnify HUD for any losses which may be incurred in connection with thirty-two (32) loans that were originated between March 2007, and December 2008. Each of the fourteen (14) loans reviewed as part of the subject audit were originated during the same period of time as those covered in the Settlement Agreement.

In January 2010, in its initial response to the NOV, the Company identified several corrective actions that were either underway or planned to address the issues raised therein. Inasmuch as the loans subject to this audit are virtually identical in vintage and product type as those, for which the corrective actions were initiated we will take this opportunity to restate and update those corrective actions and report on their effectiveness.

5055 W. Park Blvd., Suite 300 Plano, TX 75093 Phone: 972/599-5510 Fax: 972/758-7939

**Comment 1**

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Office of Inspector General, Region VI

Details are set forth below, but perhaps the best evidence of the effectiveness of the corrective actions undertaken is that as of October 31, 2010: (1) the Company's default rate in Fort Worth is 1.45 percent as compared to the average default rate for all FHA loans in Fort Worth of 2.1 percent, and (2) the Company's two year compare ratio for seriously delinquent loans in the Ft. Worth market is 69% even as the Company is the third largest (by origination volume) FHA lender in the market.

**Corrective Actions Undertaken Since Subject Loans Were Originated**

- The Company has eliminated manufactured homes as an eligible property for FHA insured loans;
- Since December 2009, the Company has installed a new CEO [REDACTED] continued to build out and staff a Quality Control Department under the direction of an experienced QC Professional [REDACTED] and hired a new EVP and Chief Compliance Officer who is an attorney and has more than twenty years of industry experience [REDACTED]. Just recently, the Company added a VP and Regional Compliance Officer to further strengthen the Company's compliance presence in the field and there are plans to hire a second regional Compliance officer in 2011.
- The Company has completely revised its Quality Control Plan to include, among other things, scheduled audits of all branch offices, third party post-closing review featuring mandated follow-up requirements and unannounced targeted reviews on an ad hoc basis. Additionally, the Company is implementing a pre-funding system to review a sampling of cases before these loans are closed. Cases will be selected by new branches, new loan officers, and new processors and reviewed to assure that all FHA requirements, both as to substance and documentation have been satisfied. This will be done independently of the underwriting function.
- The Company has revised its reporting structure to segregate the production and operations (processing and underwriting) functions. Each now reports to a different executive officer to further reduce the risk of potential conflicts of interest or exertion of undue influence on underwriters.
- The Company has eliminated the authority of production management to clear underwriting conditions and instituted systemic locks to prevent unauthorized personnel from clearing underwriting conditions. Only operations managers, underwriters and closers may clear underwriting conditions.



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Office of Inspector General, Region VI

- The Company has integrated ComplianceAnalyzer® into its loan production system and does not allow loans to close unless they pass review.
- The Company hired a new VP of Underwriting and increased the number of underwriting personnel by approximately 20%. The Company's Chief Credit Officer regularly issues training memoranda on specific issues such as compensating factors and counsels individual underwriters as warranted. In addition, the Company's underwriting staff regularly participates in FHA training, web-based training and conference calls conducted by third party trainers.
- The Company has developed an Income Calculation Worksheet that must be fully completed prior to underwriting submission for additional validation of income used to calculate debt to income ratios.
- The Company has implemented a policy that all manually underwritten government loans require the signature of two underwriters.
- The Company has implemented a policy and borrower disclosure/acknowledgement to ensure that discount points result in a bona fide and documented rate reduction for its customers.
- The Company has engaged Abacus Mortgage Training and Education to present a training course entitled "Embracing the Compliance Culture" to each field office. Thus far the training has been held in North Carolina, Georgia and Colorado. Our Texas offices will receive the training in January 2011. This training session serves as the base on which annual refresher training will be based.

**Comments and Alternative Recommendations on the Subject Loans**

The Company has undertaken a thorough re-review of the audited files and respectfully submits an alternative recommendation for loans where the delinquency is not attributable to the issues cited.

Loan Number 492-8076934

The audit recommendation for loan number 492-8076934 is indemnification in the amount of \$65,176.00. The issues cited for this claim are that 1) the Company did not verify the validity of the down payment assistance provider and 2) the FHA case binder did not contain the gift funds wire transfer documentation.

**Comment 2**



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The Company does not dispute the requirement to independently verify the nonprofit status of charitable organizations that provided down payment assistance to borrowers. Nor does the Company dispute the requirement that the FIA case binder contain the gift funds wire documentation.

However, the gift funds were, in fact, received and the Company has provided evidence of the gifts fund wire to the auditor. As a practical matter then, the underwriting decision would have been no different and this loan would have performed no differently if the proper documentation had been part of the FIA case binder.

Without questioning or attempting to diminish the importance of strict adherence to each and every FIA documentation requirement, the Company respectfully submits that the delinquency of this loan cannot reasonably be attributed to the failure to place a copy of the gift funds wire transfer documentation in the FIA case binder or a lack of independent verification of the non-profit status of the gift giver.

Because the delinquency of the loan is not attributable to the audit findings for this claim, the Company respectfully submits that indemnification is not warranted.

## **Comment 2**

### Loan Number 492-8203384

The audit recommendation for loan number 492-8203384 is indemnification in the amount of \$46,491.00. The issues cited for this claim are that 1) the Company did not verify the validity of the down payment assistance provider and 2) the FIA case binder did not contain the gift funds wire transfer documentation.

The Company does not dispute the requirement to independently verify the nonprofit status of charitable organizations that provided down payment assistance to borrowers. Nor does the Company dispute the requirement that the FIA case binder contain the gift funds wire documentation.

However, the gift funds were, in fact, received and the Company has provided evidence of the gifts fund wire to the auditor. As a practical matter then, the underwriting decision would have been no different and this loan would have performed no differently if the proper documentation had been part of the FIA case binder.

Without questioning or attempting to diminish the importance of strict adherence to each and every FIA documentation requirement, the Company respectfully submits that the delinquency of this loan cannot reasonably be attributed to the failure to place a copy of the gift funds wire transfer documentation in the FIA case binder or a lack of independent verification of the non-profit status of the gift giver.

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**Comment 2**

Because the delinquency of the loan is not attributable to the audit findings for this claim, the Company respectfully submits that indemnification is not warranted.

Loan Number 492-8080548

The audit recommendation for loan number 492-8080548 is indemnification in the amount of \$59,939.00. The issues cited for this claim are that 1) the Company did not verify the validity of the down payment assistance provider and 2) the FHA case binder did not contain the gift funds wire transfer documentation.

The Company does not dispute the requirement to independently verify the nonprofit status of charitable organizations that provided down payment assistance to borrowers. Nor does the Company dispute the requirement that the FHA case binder contain the gift funds wire documentation.

However, the gift funds were, in fact, received and the Company has provided evidence of the gifts fund wire to the auditor. As a practical matter then, the underwriting decision would have been no different and this loan would have performed no differently if the proper documentation had been part of the FHA case binder.

Without questioning or attempting to diminish the importance of strict adherence to each and every FHA documentation requirement, the Company respectfully submits that the delinquency of this loan cannot reasonably be attributed to the failure to place a copy of the gift funds wire transfer documentation in the FHA case binder or a lack of independent verification of the non-profit status of the gift giver.

Because the delinquency of the loan is not attributable to the audit findings for this claim, the Company respectfully submits that indemnification is not warranted.

Loan Number 492-8051404

**Comment 2  
Comment 3**

The audit recommendation for loan number 492-8051404 is reimbursement in the amount of \$110,599.00. The issues cited for this claim are that 1) the Company did not verify the validity of the down payment assistance provider; 2) the FHA case binder did not contain the gift funds wire transfer documentation and 3) the loan application was not completed correctly.

The Company does not dispute the requirement to independently verify the nonprofit status of charitable organizations that provided down payment assistance to borrowers. Nor does the Company dispute the requirement that the FHA case binder contain the gift funds wire documentation.

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Regional Inspector General for Audit  
Office of Inspector General, Region VI

However, the gift funds were, in fact, received and the Company has provided evidence of the gifts fund wire to the auditor. As a practical matter then, the underwriting decision would have been no different and this loan would have performed no differently if the proper documentation had been part of the FHA case binder.

The audit also cites a failure to indicate the borrower had previously filed a bankruptcy. While the Company does not dispute the requirement to correctly complete the mortgage loan application, there is clear evidence the underwriter was fully aware of and gave adequate consideration to the borrower's bankruptcy. The borrower had re-established credit with several trade lines that were at a minimum of twelve months reporting at the time. The underwriting decision was fully informed and would have been the same if the correct box had been checked on the application. Additionally, with respect to the townhome residence listed in the application, the monthly PITI was, in fact taken into consideration when deriving the applicant's debt-to-income ratio.

Without questioning or attempting to diminish the importance of strict adherence to each and every FHA documentation requirement, the Company respectfully submits that the delinquency of this loan cannot reasonably be attributed to the failure to place a copy of the gift funds wire transfer documentation in the FHA case binder, a lack of independent verification of the non-profit status of the gift giver or failing to check the correct box in response to the bankruptcy question in the application. It also appears that the monthly obligation for the borrower's town home residence was considered in calculating their debt-to-income ratio.

Because the delinquency of the loan and subsequent loss to the FHA insurance fund is not attributable to the audit findings for this claim, the Company respectfully submits that reimbursement is not warranted.

The company acknowledges the audit's remaining findings, however, in an effort to reach resolution we have contained our comments and alternative recommendations to the four loans set forth above.

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Office of Inspector General, Region VI

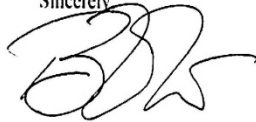
**Conclusion**

The Company appreciates the opportunity to restate the corrective actions it has taken to mitigate the risk of repeating the errors cited in this audit and the previously resolved NOV and to highlight the evidence of the effectiveness of these actions.

Based on the foregoing analyses, with respect to the findings of this audit the Company respectfully suggests an alternative to Recommendations 1A and 1B as follows:

- 1A. Eliminating loan number 492-8051404 from the reimbursement requirement thereby reducing the overall reimbursement amount to \$249,433.00.
- 1B. Eliminating loan numbers 492-8076934, 492-8203384 and 492-8080548 from the indemnification requirement thereby reducing the overall indemnification amount to \$371,876.00.

Sincerely,



Brett L. Foster  
EVP & Chief Compliance Officer

**Comment 4**

## OIG Evaluation of Auditee Comments

**Comment 1** We appreciate the update and actions taken by WR Starkey to address the identified problems.

**Comment 2** WR Starkey provided the gift wire transfer at the exit conference. However, the FHA regulations require that the gift wire transfer be maintained in the loan file. WR Starkey agreed in its response that the gift wire transfers should have been in the loan files. Despite the wire transfer evidencing the gift funds, the gift funds were not from an acceptable source. Further, without the gift funds the borrower would not have had the minimum cash investment. Therefore the borrower would not have qualified for the loan.

Genesis, the entity that provided the downpayment assistance, was not a valid 501(c)(3) as defined by the Internal Revenue Service.<sup>21</sup> Thus, Genesis was not an acceptable source of gift funds. HUD required WR Starkey to determine that the gifts were from sources acceptable to FHA.<sup>22</sup> FHA regulations<sup>23</sup> state that the donor of any such gift must be the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. FHA defines charitable organizations as those nonprofits exempt from income taxation under section 501(a) of the Internal Revenue Service Code of 1986 pursuant to section 501(c)(3) of the Internal Revenue Service Code.

In its response, WR Starkey provided no documentation to support its contention that Genesis was a valid 501(c)(3). Since Genesis was using another entity's tax identification number, WR Starkey could not support its contention. WR Starkey should not have accepted downpayment assistance from an entity that was not an acceptable source. Without the downpayment assistance, the borrowers did not provide the minimum required investment.

Case number	Gift amount	Minimum required amount	Amount paid by borrower	Amount received at closing <sup>24</sup>
492-8076934	\$6,100	\$4,575	\$0	\$0
492-8203384	\$4,800	\$4,800	\$0	\$0
492-8080548	\$6,245	\$4,842	\$0	\$0
492-8051404	\$9,705	\$8,090	\$1,000	\$1,000

<sup>21</sup> When entered into the website, the tax identification number listed another organization than Genesis.

<sup>22</sup> Mortgage Letter 2006-13

<sup>23</sup> HUD Handbook 4155.1, paragraph 5.B.4

<sup>24</sup> This is addressed in Comment 3

Since the downpayment assistance was not appropriate, the borrowers did not meet the required minimum investment; thus, we maintain our position that the questioned loans warrant indemnification or reimbursement as appropriate.

**Comment 3** We agree that WR Starkey considered the mortgage in its calculation of the borrower's debts and that WR Starkey responded that the borrower reestablished credit with several trade lines. While the underwriter may have been aware of the bankruptcy, it was not disclosed properly. Further, regarding the reestablishment of the credit, the loan file showed that WR Starkey had to request that the borrower make his car payment just prior to closing. The borrower carried debt of \$143,772 with monthly payments, including the mortgage, of \$3,241. Reestablishment of credit includes making payments on time. In this instance, the borrower defaulted without making any loan payments.

The borrower received a \$9,705 gift from Genesis and received \$1,000 at closing. We disagree that if the underwriter had appropriately considered all of these items that it would have underwritten the loan. Insisting that the borrower make a car payment prior to loan closing was not adequate justification. We maintain our position that the deficiencies warrant reimbursement to FHA for the losses on this loan.

**Comment 4** As discussed in comments 2 and 3, we maintain our position that WR Starkey should indemnify the loans or reimburse the FHA insurance funds as appropriate. Thus, we did not revise our recommendations.

## Appendix C

### LOAN UNDERWRITING DEFICIENCIES

Claim number	Mortgage amount	Unpaid principal amount	HUD loss on loan <sup>25</sup>	Computed benefit of indemnification <sup>26</sup>	Underwriting deficiency
492-8076934	\$111,302	\$108,627		\$65,176	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> </ul>
492-8203384	\$79,152	\$77,485		\$46,491	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> </ul>
492-8029766	\$98,455	\$95,629		\$57,378	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No derogatory credit explanation</li> <li>• Required compensating factors not provided</li> <li>• Loan application not completed correctly</li> </ul>
492-8037040	\$132,914	\$129,431		\$77,659	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Seller obtained documents for WR Starkey</li> <li>• No derogatory credit explanation</li> <li>• Sales contract not itemized</li> </ul>
492-8158455	\$93,937	\$91,863		\$55,118	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Seller obtained documents for WR Starkey</li> </ul>
492-8085148	\$79,918		\$76,230		<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• Seller obtained documents for WR Starkey</li> <li>• Earnest money paid not included on HUD-1 settlement statement</li> </ul>
492-8084142	\$101,735		\$83,881		<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Sufficient payroll documents not obtained</li> </ul>
492-8180867	\$105,371	\$103,447		\$62,068	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Required compensating factors not provided</li> </ul>
492-8182658	\$121,397	\$118,955		\$71,373	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• No derogatory credit explanation</li> <li>• No documentation of required payroll</li> </ul>

<sup>25</sup> This is amount HUD lost after paying all claims on this property.

<sup>26</sup> FHA's average loss experience is about 60 percent of the unpaid principal balance (see footnote 1).

## Appendix C

### LOAN UNDERWRITING DEFICIENCIES (Cont.)

Claim number	Mortgage amount	Unpaid principal amount	HUD loss on loan	Computed benefit of indemnification	Underwriting deficiency
492-8080548	\$102,478	\$99,899		\$59,939	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> </ul>
492-8041804	\$102,339		\$89,322		<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Discount points used to meet minimum investment</li> </ul>
492-8023788	\$82,845	\$80,467		\$48,280	<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Required compensating factors not provided</li> </ul>
492-8051404	\$268,538		\$110,599		<ul style="list-style-type: none"> <li>• No documentation of nonprofit's eligibility</li> <li>• No gift wire documentation</li> <li>• Loan application not completed correctly</li> </ul>
<b>Totals</b>	<b>\$1,480,381</b>	<b>\$905,803</b>	<b>\$360,032</b>	<b>\$543,482</b>	



## Appendix D

### CASE NARRATIVES

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#### Case Narrative—Loan Number 492-8076934

Mortgage amount: \$111,302

Date of loan closing: May 30, 2008

Status as of August 31, 2010: Claim paid<sup>27</sup> in the amount of \$112,800 on August 4, 2010

Payments before first default reported: Three

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift funds transfer not documented by lender

Summary:

#### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>28</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

#### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>29</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

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<sup>27</sup> The lender presents a claim to HUD for payment after the foreclosure sale.

<sup>28</sup> Mortgagee Letter 2006-13

<sup>29</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

## Case Narrative—Loan Number 492-8203384

Mortgage amount: \$79,152

Date of loan closing: September 16, 2008

Status as of August 31, 2010: Evicted<sup>30</sup>

Payments before first default reported: Two

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift funds transfer not documented by lender

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>31</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>32</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

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<sup>30</sup> The lender evicted the borrower.

<sup>31</sup> Mortgagee Letter 2006-13

<sup>32</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

## Case Narrative—Loan Number 492-8029766

Mortgage amount: \$98,455

Date of loan closing: April 21, 2008

Status as of August 31, 2010: Commencement of foreclosure<sup>33</sup>

Payments before first default reported: Six

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Required compensating factors not provided
- Loan application not completed correctly and not reviewed by WR Starkey personnel
- No explanation of derogatory credit item

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>34</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **No Explanation of Derogatory Credit Items**

The borrower did not explain or provide documentation on a judgment filed in 2004. FHA regulations state<sup>35</sup> that major indications of derogatory credit, such as judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The explanation must make sense and be consistent with other credit information in the file.

### **Required Compensating Factors Not Provided**

WR Starkey did not document any acceptable FHA compensating factor(s) when the borrower exceeded the front-and the back-end ratios. Specifically, on the Mortgage Credit Analysis Worksheet, WR Starkey documented that the borrower was purchasing an existing manufactured home, did not have exclusions, and used borrower's funds plus a grant to close. None of those items met FHA's list of compensating factors. FHA

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<sup>33</sup> Commencement of foreclosure for HUD's purposes is the first public action required by law such as filing a complaint or petition, recording a notice of default, or publication of a notice of sale.

<sup>34</sup> Mortgagee Letter 2006-13

<sup>35</sup> HUD Handbook 4155.1, paragraph 4.C.1.c

regulations<sup>36</sup> required WR Starkey to obtain supporting documentation from the borrower and document the compensating factor(s) when borrowers exceed mortgage and debt repayments-to-income ratios to justify mortgage origination.

### **Loan Application Not Completed Correctly**

The borrower filed bankruptcy in 2004. However the loan application showed that the borrower did not file bankruptcy. Also, the borrower owned a residence. WR Starkey personnel did not follow up on the disposition of the residence. The underwriter stated that she was responsible for incorrectly marking the loan application. The loan application contained a certification signed by the underwriter stating that to the best of the lender's knowledge, the statements in the application were true and correct.

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<sup>36</sup> HUD Handbook 4155.1, paragraph 4.F.3.b

## Case Narrative—Loan Number 492-8037040

Mortgage amount: \$132,914

Date of loan closing: April 29, 2008

Status as of August 31, 2010: Commencement of foreclosure

Payments before first default reported: Five

### Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift funds transfer not documented by lender
- Documents for WR Starkey obtained by seller
- No explanation of derogatory credit item
- Sales contract not itemized

### Summary:

#### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>37</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

#### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>38</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

#### **Documents for WR Starkey Obtained by Seller**

The borrower stated that they provided all documentation to the manufactured home sales office. This documentation included payroll and tax documents. FHA regulations<sup>39</sup> state that the lender may not accept documents transmitted by the seller.

#### **No Explanation of Derogatory Credit Items**

The borrower did not explain five derogatory items on her credit report. The borrower first stated the five derogatory items belonged to her husband then stated later in another explanation

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<sup>37</sup> Mortgage Letter 2006-13

<sup>38</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>39</sup> HUD Handbook 4155.1, paragraph 1.2.d

that she was not married. FHA regulations<sup>40</sup> state that major indications of derogatory credit, such as judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The explanation must make sense and be consistent with other credit information in the file.

### **Sales Contract Not Itemized**

The borrower's sales contract did not contain an itemization of the foundation and installation costs. The entire sales contract only contained aggregate amounts. FHA regulations<sup>41</sup> state that if the manufactured home dealer is the general contractor for the foundation and installation, the cost of the unit and additional charges must be itemized on an invoice. Aggregate amounts for total costs are not acceptable.

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<sup>40</sup> HUD Handbook 4155.1, paragraph 4.C.1.c

<sup>41</sup> HUD Handbook 4155.1, paragraph 2.B.8.i

## Case Narrative—Loan Number 492-8158455

Mortgage amount: \$93,937

Date of loan closing: August 18, 2008

Status as of August 31, 2010: Commencement of foreclosure

Payments before first default reported: Six

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Documents for WR Starkey obtained by seller

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>42</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>43</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Documents for WR Starkey Obtained by Seller**

The borrower stated that he provided documentation to the manufactured home sales office. This documentation included payroll and tax documents. FHA regulations<sup>44</sup> state that the lender may not accept documents transmitted by the seller.

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<sup>42</sup> Mortgagee Letter 2006-13

<sup>43</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>44</sup> HUD Handbook 4155.1, paragraph 1.2.d

## Case Narrative—Loan Number 492-8085148

Mortgage amount: \$79,918

Date of loan closing: May 30, 2008

Status as of August 31, 2010: Claim

Payments before first default reported: Two

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Documents for WR Starkey obtained by seller
- Earnest money not on settlement statement

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>45</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Documents for WR Starkey Obtained by Seller**

The manufacturing home sales office personnel contacted the mother of the borrower. The mother sent documentation directly to the manufactured home sales personnel regarding the verification of rent. FHA regulations<sup>46</sup> state that the lender may not accept documents transmitted by the seller.

### **Earnest Money Not on Settlement Statement**

The loan file contained a money order made out to the seller in the amount of \$500. The settlement statement did not include earnest money. RESPA<sup>47</sup> provides instructions for completion of the settlement statement, including any money paid against the sales price before settlement.

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<sup>45</sup> Mortgagee Letter 2006-13

<sup>46</sup> HUD Handbook 4155.1, paragraph 1.2.d

<sup>47</sup> 24 CFR Chapter XX Part 3500, appendix A



## Case Narrative—Loan Number 492-8084142

Mortgage amount: \$101,735

Date of loan closing: June 10, 2008

Status as of August 31, 2010: Claim paid in the amount of \$107,443

Payments before first default reported: Three

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Sufficient payroll documents not obtained

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>48</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>49</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Sufficient Income Documents Not Obtained**

The automated underwriting system required WR Starkey to obtain 1 month's worth of income documentation from the borrowers. WR Starkey only obtained income documentation covering a 2-week period. Therefore, it did not meet the 1 month's income documentation requirement. FHA requirements<sup>50</sup> state that all documentation on which the lender bases its credit decision must be in the loan file. WR Starkey agreed that it failed to follow up on the income documentation.

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<sup>48</sup> Mortgagee Letter 2006-13

<sup>49</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>50</sup> Mortgagee Letter 2004-47

## Case Narrative—Loan Number 492-8180867

Mortgage amount: \$105,371

Date of loan closing: September 12, 2008

Status as of August 31, 2010: Claim paid totaling \$106,391

Payments before first default reported: Zero

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Required compensating factors not provided

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>51</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>52</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Required Compensating Factors Not Provided**

WR Starkey did not document an acceptable FHA compensating factor when the borrower exceeded the front-and the back-end ratios. Specifically, on the Mortgage Credit Analysis Worksheet, Starkey documented that there were no exclusion, the borrower made house payments timely, and had job stability. None of those items met FHA's list of compensating factors. FHA regulations<sup>53</sup> required WR Starkey to obtain supporting documentation from the borrower and document the compensating factor(s) when borrowers exceed mortgage and debt repayments-to-income ratios to justify mortgage origination.

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<sup>51</sup> Mortgage Letter 2006-13

<sup>52</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>53</sup> HUD Handbook 4155.1, paragraph 4.F.3.b

## Case Narrative—Loan Number 492-8182658

Mortgage amount: \$121,397

Date of loan closing: September 2, 2008

Status as of August 31, 2010: Bankruptcy

Payments before first default reported: Two

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift funds transfer not documented by lender
- No explanation of derogatory credit item
- Sufficient payroll documents not obtained

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>54</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>55</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **No Explanation of Derogatory Credit Items**

The borrower did not explain or provide documentation on derogatory items found on credit report. FHA regulations<sup>56</sup> state that major indications of derogatory credit, such as judgments, collections, and other recent credit problems, require sufficient written explanation from the borrower. The explanation must make sense and be consistent with other credit information in the file.

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<sup>54</sup> Mortgage Letter 2006-13

<sup>55</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>56</sup> HUD Handbook 4155.1, paragraph 4.C.1.c

### **Sufficient Income Documents Not Obtained**

The automated underwriting system required WR Starkey to obtain 1 month's worth of income documentation from the borrowers. WR Starkey only obtained income documentation covering a 2-week period. Therefore, it did not meet the 1 month's income documentation requirement. FHA requirements<sup>57</sup> state that all documentation on which the lender bases its credit decision must be in the loan file.

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<sup>57</sup> Mortgagee Letter 2004-47

## Case Narrative—Loan Number 492-8080548

Mortgage amount: \$102,478

Date of loan closing: May 30, 2008

Status as of August 31, 2010: Special forbearance<sup>58</sup>

Payments before first default reported: Five

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>59</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>60</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

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<sup>58</sup> Special forbearance is a written repayment agreement between a borrower and a lender, which contains a plan to reinstate the mortgage when a minimum of three mortgage payments are due and unpaid.

<sup>59</sup> Mortgagee Letter 2006-13

<sup>60</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

## Case Narrative—Loan Number 492-8041804

Mortgage amount: \$102,339

Date of loan closing: April 30, 2008

Status as of August 31, 2010: Claim paid totaling \$109,970

Payments before first default reported: Two

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Discount points used to meet minimum downpayment requirement

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>61</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>62</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Discount Points Used to Meet Minimum Downpayment Requirement**

WR Starkey originally prepared the mortgage credit analysis worksheet showing the statutory investment required as \$3,118, the downpayment as \$2,064, and \$2,047<sup>63</sup> in discount points. FHA regulations<sup>64</sup> state that the downpayment must meet or exceed the statutory investment. When WR Starkey recalculated the Mortgage Credit Analysis Worksheet, it deleted the discount points from the Mortgage Credit Analysis Worksheet and added that amount to the downpayment line, increasing the downpayment by \$2,047 to \$4,111. FHA regulation state that discount points may not be used to meet minimum investment.<sup>65</sup>

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<sup>61</sup> Mortgagee Letter 2006-13

<sup>62</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>63</sup> Numbers rounded to nearest dollar

<sup>64</sup> HUD Handbook 4155.1, paragraph 2.A.2.c

<sup>65</sup> HUD Handbook 4155.1, paragraph 2.A.2.d

## Case Narrative—Loan Number 492-8023788

Mortgage amount: \$82,845

Date of loan closing: April 16, 2008

Status as of August 31, 2010: Bankruptcy plan confirmed

Payments before first default reported: Four

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Required compensating factors not provided

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>66</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>67</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Required Compensating Factors Not Provided**

WR Starkey did not document an acceptable FHA compensating factor when the borrower exceeded the front-and the back-end ratios. Specifically, on the Mortgage Credit Analysis Worksheet, WR Starkey only documented that there were no exclusions. FHA's list of compensating factors did not include exclusions. FHA regulations<sup>68</sup> required WR Starkey to obtain supporting documentation from the borrower and document the compensating factor(s) when borrowers exceed mortgage and debt repayments-to-income ratios to justify mortgage origination.

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<sup>66</sup> Mortgage Letter 2006-13

<sup>67</sup> HUD Handbook 4155.1, paragraph 5.B.5.b

<sup>68</sup> HUD Handbook 4155.1, paragraph 4.F.3.b

## Case Narrative—Loan Number 492-8051404

Mortgage amount: \$268,538

Date of loan closing: July 23, 2008

Status as of August 31, 2010: Claim paid in the amount of \$285,435

Payments before first default reported: Zero

Underwriting deficiencies:

- Validity of nonprofit not documented by lender
- Gift transfer of funds not documented by lender
- Loan application not completed correctly

Summary:

### **Validity of Nonprofit Not Documented by Lender**

WR Starkey did not document that it ensured Genesis was a charitable organization. Specifically, WR Starkey did not verify the validity of Genesis, the nonprofit that provided downpayment assistance for the loan. FHA regulations<sup>69</sup> required WR Starkey to verify the nonprofit on an Internal Revenue Service website for this purpose.

### **Gift Funds Transfer Not Documented by Lender**

The FHA case binder did not contain the gift funds wire transfer documentation. FHA requirements<sup>70</sup> state that the lender must document the transfer of the funds from the donor to the borrower. WR Starkey did not document the transfer of the gift funds as required by FHA.

### **Loan Application Not Completed Correctly**

The borrower filed bankruptcy in 2006. However, the loan application showed that the borrower did not file bankruptcy. Also, the borrower owned a residence. WR Starkey personnel did not follow up on the disposition or rental of the residence. The loan application contained a certification signed by the underwriter stating that to the best of the lender's knowledge, the statements in the application were true and correct.

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<sup>69</sup> Mortgage Letter 2006-13

<sup>70</sup> HUD Handbook 4155.1, paragraph 5.B.5.b