Issue Date May 31, 2012	
Audit Report Number 2012-AT-1011	

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

//signed//

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

SUBJECT: Nationwide Mortgage & Associates, Inc., Fort Lauderdale, FL, Did Not Follow HUD Requirements in Approving FHA Loans and Implementing Its Quality Control Program

HIGHLIGHTS

What We Audited and Why

We audited Nationwide Mortgage & Associates, Inc., a Federal Housing Administration (FHA)-approved non-supervised direct endorsement lender located in Fort Lauderdale, FL. We selected this lender because its default rate of 4 percent was higher than the Miami U.S. Department of Housing and Urban Development (HUD) area average default rate of 2 percent. The audit objectives were to determine whether the lender followed HUD requirements when (1) originating and underwriting loans and (2) implementing its quality control program.

What We Found

Nationwide did not follow HUD requirements when it underwrote three of six loans reviewed for FHA insurance based on inaccurate and unsupported information. This condition occurred because the lender did not exercise due care when originating and underwriting these loans for FHA insurance. As a result, Nationwide increased the risk to the FHA insurance fund by $378,858.

In addition, Nationwide had not implemented 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 the required provisions. These conditions occurred because Nationwide relied on the expertise of its contractors to draft its quality control plan and perform its quality control reviews. As a result, the effectiveness of Nationwide's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished. Specifically, Nationwide increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

What We Recommend

We recommend that the Deputy Assistant Secretary for Single Family Housing require Nationwide to indemnify HUD for the three ineligible FHA loans with an estimated potential loss of $378,858. We also recommend that HUD review Nationwide within 9 months to determine whether its quality control program is being administered in accordance with HUD requirements. Finally, we recommend that Nationwide develop, implement, and enforce (1) written controls to ensure that loans are originated and underwritten in accordance with HUD requirements and (2) a quality control program that complies with HUD requirements.

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

Auditee's Response

We discussed the findings with Nationwide during the audit. We provided the draft report to the lender on April 6, 2012, for its comments and discussed the report with Nationwide at the exit conference on May 9, 2012. Nationwide provided its written comments to our draft report on May 8, 2012. In addition, Nationwide provided the written evaluation of an independent underwriter. In its response, the lender and the independent underwriter generally disagreed with finding 1 and did not address finding 2.

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

TABLE OF CONTENTS

Background and Objectives 4

Results of Audit

Finding 1: Nationwide Did Not Follow HUD Requirements When Originating and Underwriting Loans 5

Finding 2: Nationwide Did Not Follow HUD Requirements When Implementing Its Quality Control Program 10

Scope and Methodology 14

Internal Controls 16

Appendixes

A. Schedule of Funds To Be Put to Better Use 17
B. Auditee Comments and OIG's Evaluation 18
C. Schedule of Indemnification and Repayment Amounts for the Three Loans 27
D. Loan Details for the Three Purchase Loans 28
E. Missing Quality Control Plan Elements 31

BACKGROUND AND OBJECTIVES

Nationwide Mortgage & Associates, Inc., is a Federal Housing Administration (FHA)-approved nonsupervised direct endorsement lender based in Fort Lauderdale, 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.

Nationwide became an FHA-approved lender in August 2007 and does not have any active branch offices. In April 2011, Nationwide came under new ownership, and from April to August 2011, the lender did not originate or underwrite any FHA loans. At the time of our review, most of Nationwide's employees involved in originating and underwriting the loans from our audit period were no longer employed at Nationwide. Nationwide's management indicated that it was uncertain whether the company would continue its operations. In addition, as of January 2012, it had not originated or underwritten any loans.

According to HUD's Neighborhood Watch system,[1] from the amortization dates of October 1, 2009, through September 30, 2011, Nationwide originated 298 loans in HUD's Miami office jurisdiction. As of September 30, 2011, 12 of the 298 loans (or 4 percent) with mortgage amounts totaling more than $1.9 million were in default. Nationwide's default rate exceeded the Miami office jurisdiction's default rate of 2 percent.

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

[1] The HUD Neighborhood Watch is intended to aid HUD in monitoring lenders. 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 that became 90 days delinquent during the first 2 years.

RESULTS OF AUDIT

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

Nationwide did not follow HUD requirements when originating and underwriting loans for FHA insurance. It used inaccurate and unsupported information to qualify three borrowers for FHA loans. This condition occurred because the lender did not exercise due care when originating and underwriting these loans for FHA insurance. As a result, Nationwide increased the risk to the FHA insurance fund by $378,858[2].

Loans Had Originating and Underwriting Deficiencies

Nationwide did not follow HUD requirements when originating and underwriting three of six loans reviewed. Specifically, it used inaccurate employment information, and it did not properly support borrowers' gift funds, asset information, and nontraditional credit.

FHA lenders must follow all applicable statutes, regulations, and HUD's written instructions, including program handbooks and mortgagee letters. Specifically, lenders must follow HUD Handbook 4155.1, "Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans," when using automated underwriting systems or manually underwriting FHA loans. 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. Its decision to approve the loan must be documented, supported, and verifiable.

The table below shows the summary of deficiencies identified for the three loans.

Table 1

FHA case number	Inaccurate employment income	Gift funds not properly supported	Unsupported Assets	Insufficient verification of nontraditional credit
095-1320872	X		X	
095-1557431		X		X
095-1700690		X		
Total	**1**	**2**	**1**	**1**

[2] We classified $378,858 as funds to be put to better use. This is 66 percent of the $574,028 in unpaid principal balances for the three loans as of February 29, 2012. The 66 percent is the estimated percentage of loss HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2011. See appendix C for more details.

The following two sections discuss some examples of the originating and underwriting deficiencies.

Employment Income Calculation Was Inaccurate

The lender did not accurately calculate the borrower's monthly base income used to qualify the borrower for the loan. HUD Handbook 4155.1, paragraph 4.D.4.e, states that when qualifying a self-employed borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous 2 years using the borrower's tax returns. If the borrower provides 3 years of tax returns, the lender may average the income over the 3 years.

For FHA case number 095-1320872, the lender used $3,347 as the borrower's monthly income to qualify the borrower for an FHA-insured mortgage totaling $142,373. The lender used this income amount to calculate the borrower's qualifying debt-to-income ratios of 39.1 and 50.2 percent, respectively. The lender did not document how it computed the borrower's monthly income. Based on the tax returns contained in the loan file, we determined that the borrower's monthly income was $2,456 based on the average income for 2 years, which resulted in the borrower's qualifying ratios of 53.3 and 68.4 percent, respectively.

According to HUD Handbook 4155.1, paragraph 6.A.1.d, a loan must be rescored when verified income is more than 5 percent different from what the borrower reported on the loan application. Given that our recalculation resulted in a difference of 26.6 percent in the borrower's monthly income, this loan would trigger the rescoring requirements and may not have qualified for the FHA mortgage.

Table 2
Borrower's monthly income

In loan file	Recalculation *	Percentage change **
$3,347	$2,456	(26.6)

*****($4,971 net income from 2007 schedule C of tax return + $53,982 net income from 2008 schedule C of tax return) / 24 months = $2,456 monthly income.

****** ($2,456 - $3,347)/($3,347) = (26.6 percent)

The lender and HUD agreed with our method of computation. The lender indicated that since most of Nationwide's employees involved in originating and underwriting the loans from our audit period were no longer employed at Nationwide, it would be difficult to determine how it computed the borrower's monthly income.

After receiving the draft audit report, the lender stated that the borrower's income was derived from the 2007 and 2008 schedule C tax forms. Since the borrower's self employment status began on August 2007, the lender computed borrower's income for 17 months, instead of 24 months (see appendix B for auditee comments).

We accepted the lender’s explanation and considered this issue addressed. However, indemnification is still recommended for this loan due to insufficient documentation of source of funds used for closing (see appendix D for loan details).

Gift Funds Were Not Properly Supported

The lender did not properly document the transfer of gift funds. HUD Handbook 4155.1, paragraph 5.B.5.b, states that if the gift funds are in the borrower’s account, the lender must obtain (1) a copy of the withdrawal document showing that the withdrawal is from the donor’s account and (2) the borrower’s deposit slip and bank statement showing the deposit. In addition, HUD Handbook 4155.1, paragraph 5.B.4.d, states that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source and were the donor’s own funds.

For FHA case number 095-1700690, the borrower received gift funds of $6,000. The loan file included a cashier’s check and a copy of the borrower’s statement showing that the funds were received. However, none of the documents showed that the withdrawal came from the donor’s account. To ensure that the borrower did not receive funds from an unacceptable source, the lender should have obtained documentation showing the money coming from the donor’s account. As a result, without this gift, this loan would not have qualified for FHA insurance.

For FHA case number 095-1557431, the loan file included two personal checks from the gift donor to the real estate agent and a copy of the donor’s statement showing the gift funds of $10,000 being withdrawn. However, only $9,000 was accounted for in the gift letter. HUD Handbook 4155.1, paragraph 5.B.5.a., states that the borrower must list the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. In addition, HUD Handbook 4155.1 5.B.4.c and 4155.1 5.B.4.e, states that the lender has the responsibility to ensure that funds given by the gift donor are not provided by a person or entity with an interest in the sale of the property, such as the seller or real estate agent. Without a gift letter to account for the additional $1,000 there was no assurance that the gift funds came from an acceptable source.

HUD and the lender agreed that this loan file should have contained the missing information for the gift funds. The lender believed it was an oversight or that this information was once in the file but the integrity of the documents may have been compromised due to the number of individuals who handled the loan.

Nationwide Did Not Exercise Due Care in Approving Loans

Nationwide did not exercise due care when originating and underwriting these loans for FHA insurance to ensure compliance with HUD requirements. As a direct endorsement lender, Nationwide was allowed to endorse a mortgage loan for FHA insurance without a detailed technical underwriting review by HUD. In approving loans for FHA insurance, the lender certified that the mortgage loan documents were personally reviewed and the mortgage was found to be eligible for FHA insurance.

The lender agreed that the loan files should have contained the missing information. It believed that the documents were once in the files but the integrity of the file may have been compromised due to the number of individuals that handled the loan. In addition, the lender did not have adequate written policies and procedures to ensure that underwriting decisions complied with HUD requirements. Its written policies and procedures were missing specific procedures to address HUD requirements. For example, Nationwide's written policies and procedures did not specify how to compute the monthly income for a self-employed borrower or how to properly support and document the transfer of gift funds.

Conclusion

Nationwide did not follow HUD requirements when originating and underwriting three FHA loans. The deficiencies occurred because the lender did not exercise due care to ensure that the loans were originated and underwritten in accordance with HUD requirements. As a result, Nationwide unnecessarily placed the FHA insurance fund at risk by $378,858. As of February 29, 2012, one loan was in the foreclosure process, one was delinquent, and one was in special forbearance.

Appendix C contains a schedule of the indemnification and repayment amounts required for the three loans. Appendix D contains the loan details for the three loans.

Recommendations

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

1A. Indemnify three loans with an estimated loss of $378,858. The estimated loss was based on the loss severity rate of 66 percent of the total unpaid principal balance of $574,028 as of February 29, 2012.

1B. Develop, implement, and enforce written controls to ensure that loans comply with HUD requirements and underwriting decisions are properly supported.

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

Nationwide did not follow HUD requirements when implementing its quality control program. Specifically, it did not conduct quality control reviews in compliance with requirements, and its written quality control plan did not contain the required provisions. These conditions occurred because Nationwide relied on the expertise of its quality control contractors to draft its quality control plan and perform its quality control reviews. As a result, it increased the risk of loss to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

As a condition of receiving and maintaining FHA approval, Nationwide must implement and continuously have in place a quality control program. HUD Handbook 4060.1, REV-2, paragraph 7-2, states that lenders must design their quality control program to meet the basic goals of (1) ensuring compliance with FHA's and the lender's origination and servicing requirements; (2) protecting FHA and the lender from unacceptable risk; (3) guarding against errors, omissions, and fraud; and (4) ensuring swift and appropriate corrective action. 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

Nationwide outsourced its postclosing quality control reviews to three companies during our scope period of October 1, 2009, to September 30, 2011. For most of our review, we focused on the two companies that most recently performed the quality control reviews for Nationwide. We analyzed the reviews performed to determine whether Nationwide followed the five basic requirements when conducting its quality control reviews as required by HUD Handbook 4060.1, REV-2, paragraph 7-6(A) through (E). We analyzed quality control reports for 14 loans and determined that Nationwide did not perform its quality control reviews according to HUD requirements. Our review found the following deficiencies:

Loans Not Reviewed Within Time Limit

HUD Handbook 4060.1, REV-2, paragraph 7-6(A), states that loans must be reviewed within 90 days from the end of the month in which the loan closed. Nationwide's quality control reviews were not reviewed within the 90-day limit for 7 of the 14 loans reviewed. The elapsed time ranged from 152 to 576 days. The lender indicated that due to the change of ownership, some of the loans were not reviewed in a timely manner.

Frequency of Review Requirement Not Met

HUD Handbook 4060.1, REV-2, paragraph 7-6(B), states that for lenders closing more than 15 loans monthly, quality control reviews must be conducted at least monthly and must address 1 month's activity. Lenders closing 15 or fewer loans monthly may perform quality control reviews quarterly. Based on the lender's loan activity from 2009 through 2011, Nationwide should have performed, at a minimum, quarterly reviews. However, in 2009 Nationwide only performed two reviews in June 2009 and December 2009. In 2010, Nationwide did not conduct any reviews from January 2010 through April 2010. We were unable to contact the former quality control contractor to obtain further clarification. In 2011, Nationwide did not perform quality control reviews from February 2011 through September 2011. Nationwide did not hire a quality control contractor from February 2011 through April 2011, so no quality control reviews were done. In October 2011, Nationwide's new owners hired a quality control contractor to perform the missing reviews.

<u>Document Reverification Not Performed</u>

HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(2), states that documents contained in the loan file, such as the borrower's employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds, should be checked for sufficiency and subjected to written reverification. If the written reverification is not returned to the lender, a documented attempt must be made to conduct a telephone reverification.

For the 14 loans reviewed, the borrower's incomes, source of funds, and gift funds were not properly reverified. The reverifications for all 14 loans were either missing or not performed. In some instances, the quality control contractor indicated that a reverification was not performed because a fee was required. In other cases, the quality control contractor indicated that the verification was performed, but it did not have evidence to support this assertion. In addition, there was no documentation to show that it attempted telephone verifications.

Table 3
Document reverification missing or not performed for

FHA case number	Employment income	Source of funds	Gift funds	Other income
095-2159096	X	X		
095-2175785		X		X
095-2172562	X	X		
095-1979759	X	X		
095-1986113	X	X	X	X
095-1655317		X	X	X
095-1700690	X	X	X	
095-1578221	X	X		X
095-1548225	X	X	X	
095-1557431	X	X	X	
095-1671463	X	X		
095-1689514	X	X		
095-1958368	X	X		
095-1949358		X	X	
Total	**11**	**14**	**6**	**4**

Field Appraisal Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(3), states that lenders are expected to perform field reviews of 10 percent of the loans selected per year during the sampling process. Since the lender performed quality control reviews of 33 loans in 2010, at least 3 field appraisals would have been required in 2010. However, there were no field appraisals performed. In addition, the lender did not perform any field appraisal reviews in 2011.

Occupancy Verification Not Performed
HUD Handbook 4060.1, REV-2, paragraph 7-6(E)(4), states that in cases in which the occupancy of the subject property is suspect, lenders must attempt to determine whether the borrower is occupying the property. According to Nationwide's quality control plan, public records are checked for verification of occupancy. Therefore, we checked public records and found that 4 of the 14 loans reviewed included borrowers that owned multiple properties. However, the lender did not perform any occupancy reverifications. Given the multiple real properties owned by these borrowers, it would be reasonable to suspect occupancy issues; therefore, the lender should have performed occupancy verifications.

The Quality Control Plan Was Incomplete

Nationwide's quality control plan did not contain HUD-required provisions. Specifically, its plan lacked six elements required by HUD. For example, HUD Handbook 4060.1, REV-2, paragraph 7-3(H), states that the lender must ensure that its contractors, agents, and loan correspondents are acceptable to FHA and operate in compliance with FHA requirements. Nationwide's written quality control plan did not contain this element. In addition, paragraph 7-3(I) states that review findings must be reported to the lender's senior management within 1 month of completion of the initial report. However, this element was missing from the quality control plan. The lender indicated that it created its quality control plan with one of the quality control contractors and relied on its expertise to ensure that the plan complied with HUD requirements.

Appendix E contains the details of the six missing elements.

The Lender Relied on Quality Control Contractors

Nationwide did not implement and continuously have in place a quality control program compliant with HUD requirements. The lender did not evaluate the work of the external quality control contractors to ensure that the quality control reviews followed HUD requirements. It assumed that its quality control reviews were performed in compliance with HUD requirements.

Nationwide stated that it relied on the expertise of the quality control companies it hired and did not know that the reviews were not being performed in compliance with HUD requirements. The lender reviewed the quality control review reports but focused only on the findings cited in those reports. The quality control review reports were not reviewed for compliance with HUD requirements. Although the lender stated that it relied on the companies it hired to perform the quality control reviews in accordance with HUD requirements, according to HUD Handbook 4060.1, REV-2, paragraph 7-3(B)(2), the lender remains responsible for ensuring that the reviews comply with HUD requirements regardless of whether the reviews are performed by the lender or an external company.

Conclusion

Nationwide did not follow HUD requirements when implementing its quality control program. The lender did not implement and continuously have in place a quality control program compliant with HUD requirements. This condition occurred because Nationwide relied on the expertise of the quality control companies and did not evaluate their work. As a result, the effectiveness of Nationwide's quality control program to guard against errors, omissions, and fraud and to protect HUD from unacceptable risk was diminished. Specifically, Nationwide increased the risk to the FHA insurance fund because it did not have assurance regarding the accuracy, validity, and completeness of its loan origination and underwriting operations.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing

2A. Require Nationwide to develop, implement, and enforce a quality control program that complies with HUD requirements. Specifically, the lender needs to establish a written plan with the required provisions, ensure that quality control reviews meet HUD requirements, and continually enforce and maintain its quality control program.

2B. Review Nationwide's quality control program within 9 months to determine whether the required provisions have been included in its written plan and quality control reviews are conducted in compliance with HUD requirements.

SCOPE AND METHODOLOGY

To accomplish the audit objectives, we

- Reviewed applicable HUD handbooks and mortgagee letters,
- Reviewed Nationwide's written policies and procedures for originating and underwriting loans,
- Reviewed Nationwide's loan files,
- Verified the accuracy of the information from the loan files with the borrowers and borrowers' employers,
- Reviewed Nationwide's written quality control plan,
- Analyzed Nationwide's post closing quality control review reports, and
- Interviewed Nationwide's employees and external quality control contractors.

We accessed HUD's Neighborhood Watch system to obtain information about the lender and its loan. Nationwide underwrote 298 loans within the jurisdiction of the Miami HUD office with amortization dates between October 1, 2009, and September 30, 2011. As of September 30, 2011, 12 loans with mortgage amounts totaling more than $1.9 million were in default. We selected four loans for review of originating and underwriting based on various risk factors including loans (1) that defaulted within the first six payments, (2) with gift donors, and (3) with mortgage amounts over $100,000. These four loans were also reviewed in our assessment of quality control.

The seller of the property for one of the four loans reviewed was a former owner of Nationwide. As a result, we decided to expand our review to two additional loans that were in default and also had Nationwide's former owner as the seller. The original mortgages of the six loans reviewed totaled approximately $1.2 million, or 60 percent, of the $1.9 million in original mortgage amounts that were in default. The results of our review apply only to the loans reviewed and cannot be projected to the universe of loans.

Nationwide outsourced its post closing quality control reviews to three companies during our scope period of October 1, 2009, through September 30, 2011. During this period, Nationwide issued 17 quality control reports. We reviewed these 17 reports for compliance with HUD requirements related to frequency and early payment defaults. Due to time constraints, we selected 14 loans from the 17 quality control reports to evaluate for compliance with timeliness, document reverification, desk appraisal review, and occupancy verification requirements, as well as corrective action taken on material findings cited in the quality control review reports. These 14 loans were selected based on loans that (1) closed in the same month as the loans reviewed for origination and underwriting, (2) were last reviewed by the two most recent quality control companies, or (3) closed near the time of the transfer of ownership. In addition, we reviewed the quality control reports issued in 2010 for compliance with field appraisal reviews and sample size. The results of our review apply only to the quality control reports reviewed and cannot be projected to the universe of reports.

We used data from HUD's Neighborhood Watch system to identify the defaulted loans within our scope period for the Fort Lauderdale branch office and to obtain background information on selected loans. HUD's system is designed to highlight exceptions so that potential problems are readily identifiable. In particular, the system provides the ability to identify and analyze patterns, by geographic area or originating lender, in loans that became delinquent within the first 2 years of loan origination. Since we did not rely on the data from Neighborhood Watch as the basis for our findings and conclusions, we did not assess the reliability of data from this system.

During the course of the audit, we clarified HUD regulations and discussed potential issues with our headquarters and the Atlanta Homeownership Center's Quality Assurance Division. We also discussed the finding with the lender.

We classified $378,858 as funds to be put to better use. This is 66 percent of the total unpaid principal balances of $574,028 as of February 29, 2012, for the three loans. We used 66 percent because it has been determined that upon the sale of the mortgaged properties, FHA's average loss was about 66 percent of the unpaid principal balance.

Our review generally covered the period October 1, 2009, through September 30, 2011, and was extended as necessary. We conducted our fieldwork from November 2011 through March 2012 at Nationwide's office in Fort Lauderdale, FL, and at various other locations in the Miami-Dade and Broward County areas to conduct interviews with the borrowers, gift donors, and employers.

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

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

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

Relevant Internal Controls

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

- Program operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control 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 Deficiencies

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

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

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1A	$378,858
Total	$378,858

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 Nationwide to indemnify HUD for the three loans will reduce the risk of loss to the FHA insurance fund. The amount above reflects HUD's estimated loss of 66 percent of the loans' unpaid principal balance of $574,028 as of February 29, 2012.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation | **Auditee Comments**

NATIONWIDE MORTGAGE & ASSOCIATES, INC.
2962 Trivium Circle, #203
Fort Lauderdale, FL 33312

May 8, 2012

Lizzette M. Sorbille, Senior Auditor
U.S. Department of Housing and Urban Development
Office of Inspector General
909 SE 1st Ave Room 487
Miami, FL 33131

Re: Response to HUD audit 095-13200872

Comment 1

I obtained this file from your office for review to answer the allegations against the validity of the underwriting decision and offer the following comments in review.

The borrower's self employed status was verified existing 2 years at the time of application and closing. His start date as a 1099 employee (driver) began August 2007.

His self employment income was derived for the Schedule C portion of his 2007 income from August 2007 through 2008, or 17 months. Prior to the 1099 status of his current position he was a W2 employee during 2007 working as a driver for Willoughby.

Comment 2

Current guidelines at the time accept less than 2 years calculated income under these circumstances. Guidelines changes have occurred over the last 2 years; however, this remains an acceptable practice. The income was calculated for 17 months verified for 07 and 08 Schedule C disregarding prior income from the W2 employment. <u>A profit and loss statement was in the file at one time</u> although the income was not used from the profit and loss statement taking the most conservative approach. It does not seem reasonable to calculate the 7 months into the average that he did not hold this 1099 position but rather a W2 employment status. He was a driver, same occupation in that job. Had we done so, the income would have been essentially the same. If we had used the profit and loss income for 2009 the income would have been much higher and that did not meet guidelines or seem prudent at the time. The bank statements in the file showed regular deposits much larger than the income we used to qualify the loan and consistent with the profit and loss that was once in the file.

Comment 3

The transmittal indicates income calculation for a three year average, but this is a mistake. Even though the explanation of income calculation was inaccurate, it was in the file for review on the 92900LT as customary. The audit indicated that the explanation for income calculation was not found in the file. I suggest the auditors missed looking for it on the transmittal summary.

We documented the file for a full three years to validate the borrowers income stability as a driver even though prior to August 2007 he was working W2 status. I did not find the prior verifications of employment in the file that I can be fairly certain were there at the time of underwriting. Tax returns were in the file for 2006, 2007 and 2008. The same validated with the execution of 4506T to review the transcripts of the returns.

The only problem I see on this file is that the profit and loss statement can't be located that was used to qualify the loan. At this time Nationwide did not have an imaging system as normally used today to protect the data in the loan file from subsequent processes where paper documents can be misapplied to the wrong file from time to time. This is a common occurrence. The income used on the 1003 to approve the loan is slightly less than the calculated income of 3467.82 determined after review for 1099 income averaged for 17 months. Again, the self employment status was verified for 2 years and the profit and loss statement at the time indicated a larger increase in income for 2009 so it was not used in the calculation.

Sincerely yours,

Leonel Dorta
President

Comment 4

Comment 5

Comment 6

NATIONWIDE MORTGAGE & ASSOCIATES, INC.
2962 Trivium Circle, #203
Fort Lauderdale, FL 33312

May 8, 2012

Lizzette M. Sorbille, Senior Auditor
U.S. Department of Housing and Urban Development
Office of Inspector General
909 SE 1st Ave Room 487
Miami, FL 33131

Re: 095-1557432

The audit suggests non traditional credit was required for the co – borrower on this loan.

Prior to recent mortgagee letter Mortgagee Letter 10-29 that required all borrowers to have at least one score there was no requirement for co- borrower minimum scores or minimum trade line requirements.

This loan was underwritten to FHA guidelines though FHA's Total Scorecard with an Approve/ Eligible submitting the main borrower with substantial income and credit depth. At the time of this underwriting it was not required that the co borrower have a minimum credit score or minimum trade lines if we had an Approve Eligible though desktop underwriting. Often we did ask for supplementation for lack of credit although we were not required to downgrade to a manual underwrite and/or provide non traditional credit to approve. All credit requirements per the AUS feedback seem to have been met.

September 30, 2010 the mortgagee letter 10-29 came out that required all borrowers to have a least one minimum score. This loan was underwritten prior to this. I do not feel that this deficiency is accurate.

The gift letter in the file indicates a $ 9000 gift which is the amount the underwriting considered in loan approval. At a later time the additional $1000 was discovered and another gift letter should have been presented that's true. It was inadvertently missed. The borrowers asset s verified were substantial and funds to close from their own funds were available in excess of requirement. The additional gift letter and notation of 10,000 instead of 9000 in gift funds should have been demonstrated in the file. This was an unintentional oversight. If the gift funds were the entire funds available for funds to close I like to think it would have been more apparent, however, the borrowers seem to be able to provide funds to close from their own funds if gift funds were not given.

Sincerely yours,

Leonel Dorta
President

Comment 7

NATIONWIDE MORTGAGE & ASSOCIATES, INC.

2962 Trivium Circle, #203
Fort Lauderdale, FL 33312

May 8, 2012

Lizzette M. Sorbille, Senior Auditor
U.S. Department of Housing and Urban Development
Office of Inspector General
909 SE 1st Ave Room 487
Miami, FL 33131

Re: Response to HUD Audit 095-1700690

The audit indicated that the documentation for the gift funds were incomplete without the donors account statement and proof that gift funds were withdrawn. I reviewed the file you sent me and I do not see that documentation in the file.

It was in the file when the file was underwritten. I can be fairly certain of that because that is standard underwriting guidelines and procedures followed. It's a simple guideline and I can't imagine not requiring it.

I can say that it's standard procedure to include the donor's bank statement to show the ability to give and show evidence that the gift funds received by the borrower came from the donors account. This documentation must have inadvertently been misplaced in the final file; a mistake and error that happened unintentionally.

Sincerely yours,

Leonel Dorta
President

Comment 1

Comment 2

May 7th 2012

Response to FHA Audit / Nationwide Home Loans

Re : [redacted] 095-13200872

As review of the file we found the following conclusion

Borrowers income was calculated using his schedule c for 2007 and 2008 and not using the W2 income that he received in 2007. The underwriter did not take into account the W2 income that he received and only calculated the income for 17 months instead of 24 months. This is an acceptable way to calculate self employed income. We were unable to find a profit and Loss statement in the file and would need this document to insure that the income is correct from what we have with the tax returns for 2007 and 2008 the income was calculated correctly.

Sincerely,

Catherine Binninger

DE/ Underwriter

May 7th 2012

Response to FHA Audit / Nationwide Home Loans

Comment 4

Re: [redacted] 095-1557432

As review of the file we found the following conclusion

The loan was underwriting using FHA's total scorecard and received an Approve/ Eligible. The FHA guidelines state that the co borrower is not required to have minimum trade lines or a credit score if loan received an Approve/ Eligible through FHA total scorecard. All of the requirements were met as per FHA guidelines and FHA total scorecard.

Comment 5

FHA did not change their guidelines on this until September 30th 2010 and this file was underwritten prior to the guideline changes in September 2010.

Comment 6

As we can see the borrower had more than enough funds for closing and showed proper documentation for funds for closing and did not require that all of the gift funds be used for closing.

Sincerely,

Catherine Binninger

DE/ Underwriter

May 7th 2012

Response to FHA Audit / Nationwide Home Loans

Re: [redacted] 095-1700690

As review of the file we found the following conclusion

Comment 7

After review of the file we were unable to locate the donors account statement in the file. It is standard procedure to source the gift coming out of the Donors account and the ability for the Donor to give any gift funds. I would think that the original underwriter would have asked for this information and would not have signed off or approved the loan without this documentation.

Sincerely,

Catherine Binninger
DE/ Underwriter

OIG Evaluation of Auditee Comments

Comment 1 The lender and independent underwriter used the wrong FHA case number in its response. The correct number is 095-1320872.

Comment 2 The lender and independent underwriter stated that the borrower's income was derived from the 2007 and 2008 schedule C tax forms. Since the borrower's self employment status began on August 2007, the lender computed borrower's income for 17 months, instead of 24 months.

The income calculation provided by the lender and underwriter resulted in income of $3,468 per month. We accepted the lender's explanation and considered this issue addressed because it was $121 more than the monthly income amount used in qualifying the loan. During the audit, the lender did not provide this explanation. The lender indicated that since most of Nationwide's employees involved in originating and underwriting the loans from our audit period were no longer employed at Nationwide, it would be difficult to determine how it computed the borrower's monthly income. In addition, during the audit, the lender agreed with our income calculation.

In addition to this issue, the lender did not provide an explanation for two recent large deposits to ensure that funds used to purchase the property came from an acceptable source. Therefore, we maintain our recommendation to indemnify this loan.

Comment 3 The lender indicated that even though inaccurate, the income calculation explanation was on the FHA Loan Underwriting and Transmittal Summary.

The transmittal summary only stated that "self employment income was averaged over three years." It did not identify the amounts and source document used in the calculation. In addition, the loan file did not contain any information explaining the income calculation. Therefore, the information in the transmittal letter and loan file did not adequately explain how income was computed.

Comment 4 The lender and independent underwriter used the wrong FHA case number in its response. The correct number is 095-1557431.

Comment 5 The lender and independent underwriter indicated that prior to Mortgagee Letter 10-29, there was no requirement for the coborrower to have a minimum credit score or minimum trade lines if there was an Approved Eligible recommendation in the desktop underwriting. Since this loan was underwritten before this mortgage letter, the lender believed that it was not required to establish nontraditional credit history for the coborrower.

Mortgagee Letter 10-29 describes the new minimum credit scores and loan to value ratio requirements for FHA-insured loans. It does not state that lenders are required to establish a credit history for borrowers with a nontraditional credit history or insufficient credit, or that borrowers must have one credit score as a result of this mortgagee letter. According to HUD Handbook 4155.1 4.A.1.c., when determining creditworthiness of borrowers, co borrowers, or cosigners, the underwriter needs to take in consideration income, assets, liabilities, and credit history. In addition, HUD Handbook 4155.1, paragraph 4.C.1.e., states that lenders must document that the providers of nontraditional credit exist and verify the credit information. If a method other than a nontraditional credit report is used to verify credit information or rental references, all references obtained from individuals should be backed up with the most recent 12 months of cancelled checks. The lender was required to obtain more than one credit reference. Therefore, the lender did not adequately establish the co borrower's credit history through nontraditional means.

Comment 6 The lender and independent underwriter agreed that there should have been another gift letter for the additional $1,000 received and this was an unintentional oversight. The lender indicated that if the gift funds were the entire funds available for funds to close it may have been more apparent to the lender that there was a gift letter missing.

The lender had the responsibility to obtain documentation regarding the additional gift amount even if the borrowers seemed to be able to provide funds to close from their own funds. According to HUD Handbook 4155.1 5.B.4.c and 4155.1 5.B.4.e, the lender has the responsibility to ensure that funds given by the gift donor are not provided by a person or entity with an interest in the sale of the property, such as the seller or real estate agent. Without a gift letter there was no assurance that the gift funds came from an acceptable source.

Comment 7 The lender and independent underwriter agreed that the loan file was missing the document that showed that the withdrawal of the gift funds came from the donor's account. The lender believed that documentation was inadvertently misplaced.

The gift was not properly documented in the loan file and there was no documentation showing that the gift funds came from the donor's account. Therefore, this loan was not underwritten in accordance with HUD regulations.

Appendix C

SCHEDULE OF INDEMNIFICATION AND REPAYMENT AMOUNTS FOR THE THREE LOANS

No.	FHA case no.	Original mortgage amount	Unpaid mortgage balance	Indemnification amount[a]	Status of loan as of February 29, 2012
1	095-1320872	$ 142,373	$ 139,955	$ 92,370	Foreclosure process
2	095-1557431	$ 230,743	$ 228,306	$ 150,682	Delinquent
3	095-1700690	$ 207,209	$ 205,767	$ 135,806	Special forbearance
	Totals	**$ 580,325**	**$ 574,028**	**$ 378,858**	

[a] We classified $378,858 as funds to be put to better use. This is 66 percent of the $574,028 in unpaid principal balances for the three loans as of February 29, 2012. The 66 percent is the estimated percentage of loss HUD would incur when the FHA property is foreclosed upon and resold as supported by the HUD Single Family Acquired Asset Management System's case management profit and loss by acquisition as of December 2011.

Appendix D

LOAN DETAILS FOR THE THREE PURCHASE LOANS

FHA case #: 095-1320872

Date of loan closing: 09/23/2009

Loan purpose: Purchase - existing

Mortgage amount: $142,373

Unpaid principal balance: $139,955

Default status: First legal action to commence foreclosure

Inaccurate Employment Income

The lender did not accurately calculate the borrower's monthly base income. HUD Handbook 4155.1, paragraph 4.D.4.e, states that when qualifying a self-employed borrower for a mortgage loan, the lender must establish the borrower's earnings trend from the previous 2 years using the borrower's tax returns. If the borrower provides 3 years of tax returns, the lender may average the income over the 3 years. For this loan file, the lender used $3,347 as the borrower's monthly income to qualify the borrower for an FHA-insured mortgage. The lender used this income amount to calculate the borrower's qualifying debt-to-income ratios of 39.1 and 50.2 percent, respectively. The lender did not document how it computed the borrower's monthly income. We determined, based on the information on file that the borrower's monthly income was $2,456 based on the average of income for 2 years, which resulted in the borrower's qualifying ratios of 53.3 and 68.4 percent, respectively.

According to HUD Handbook 4155.1, paragraph 6.A.1.d, a loan must be rescored when verified income is more than 5 percent different from what the borrower reported on the loan application. Given that our recalculation resulted in a difference of 26.6 percent in borrower's monthly income, this loan would trigger the rescoring requirements and may not have qualified for an FHA mortgage.

After receiving the draft audit report, the lender stated that the borrower's income was derived from the 2007 and 2008 schedule C tax forms. Since the borrower's self employment status began on August 2007, the lender computed borrower's income for 17 months, instead of 24 months (see appendix B for auditee comments).

We accepted the lender's explanation and considered this issue addressed. However, indemnification is still recommended for this loan due to insufficient documentation of source of funds used for closing.

Unsupported Source of Funds

HUD Handbook 4155.1, paragraph 5.B.2.b., states that the lender must obtain an explanation and documentation for recent large deposits in excess of 2 percent of the property sales price. There were two large deposits into the borrower's bank account totaling $3,298 and $6,790, respectively. These deposits were made on June 18 and July 22, 2009. The lender did not provide an explanation for these deposits to show that the funds were from an acceptable source.

FHA case #: 095-1557431	Mortgage amount: $230,743
Date of loan closing: 01/29/2010	Unpaid principal balance: $228,306
Loan purpose: Purchase - existing	Default status: Delinquent

Unsupported Credit History

The lender did not exercise due care in verifying and analyzing the borrower's credit history. HUD Handbook 4155.1, paragraph 4.C.1.e., states that lenders must document that the providers of nontraditional credit exist and verify the credit information. To verify credit information, lenders must use a published address or telephone number for the credit provider and not rely solely on information provided by the applicant. Credit references may also be developed via independent verification directly to the creditor. If a method other than a nontraditional credit report is used to verify credit information or rental references, all references obtained from individuals should be backed up with the most recent 12 months of cancelled checks.

The lender established the coborrower's credit history through nontraditional means because the coborrower lacked established traditional credit. The lender established credit using two credit references from a cable television service and utility bill. The lender obtained a credit reference for the cable service via an independent verification company, which established that payments were made beyond 12 months. Regarding the utility service, the lender did not obtain an independent verification or retain 12 months of cancelled checks. In addition, HUD agreed that one or two credit references were not enough to establish that the coborrower had a positive credit history.

Unsupported Gift Funds

The lender did not properly document the borrower's gift funds. HUD Handbook 4155.1, paragraph 5.B.5.a., states that the borrower must list the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. The loan file included two personal checks from the gift donor to the real estate agent and a copy of the donor's statement showing the gift funds of $10,000 being withdrawn. However, only $9,000 was accounted for in the gift letter. The lender and HUD agreed that this information should have been documented.

FHA case #: 095-1700690

Mortgage amount: $207,209

Date of loan closing: 05/28/2010

Unpaid principal balance: $205,767

Loan purpose: Purchase - existing

Default status: Special forbearance

Unsupported Gift Funds

The lender did not properly document gift funds. HUD Handbook 4155.1, paragraph 5.B.5.b, states that if the gift funds are in the borrower's account, the lender must obtain (1) a copy of the withdrawal document showing that the withdrawal is from the donor's account and (2) the borrower's deposit slip and bank statement showing the deposit. In addition, HUD Handbook 4155.1, paragraph 5.B.4.d, states that regardless of when gift funds are made available to a borrower, the lender must be able to determine that the gift funds were not provided by an unacceptable source and were the donor's own funds. The borrower received gift funds of $6,000. The loan file included a cashier's check and a copy of the borrower's statement showing that the funds were received. However, none of the documents showed that the withdrawal came from the donor's account. To ensure that the borrower did not receive funds from an unacceptable source, the lender should have obtained documentation showing the money coming from the donor's account.

Appendix E

MISSING QUALITY CONTROL PLAN ELEMENTS

Nationwide's quality control plan did not contain the following six required elements according to HUD Handbook 4060.1, REV-2:

- The lender must expand the scope of the quality control review when fraud or patterns of deficiencies are uncovered and scope means both an increased number of files and more indepth review.

- The lender must ensure that its contractors, agents, and loan correspondents are acceptable to FHA and operate in compliance with FHA requirements.

- Review findings must be reported to the lender's senior management within 1 month of completion of the initial report. The final report or an addendum must identify the timetable for the completion of the actions being taken and any planned follow-up activities.

- The lender closing more than 15 loans monthly must conduct quarterly reviews at least monthly and must address 1 month's activity. The lender closing 15 or fewer loans monthly may perform quality control reviews on a quarterly basis.

- Loans must be reviewed from all branch offices and all sources including authorized agents and loan correspondents, and lenders must review the work of each of the loan processors, loan officers, and underwriters based on the sample selected. In addition, lenders must review the work of roster appraisers, real estate companies, and builders with whom they do a significant amount of business.

- Each loan selected for a quality control review must be reviewed to determine whether (1) the seller was the owner of record or was exempt from the owner of record requirement in accordance with HUD regulations and (2) the loan was closed and funds disbursed in accordance with the lender's underwriting and subsequent closing instructions.