



Allen Mortgage, Limited Liability Corporation,
Single Family Housing Mortgage Insurance Program

Centennial Park, AZ



Issue Date: September 30, 2012

Audit Report Number: 2012-CH-1015

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

Kelly Anderson

FROM: Kelly Anderson, Regional Inspector General for Audit, 5AGA

SUBJECT: Allen Mortgage, LLC, Centennial Park, AZ, Did Not Comply With HUD Requirements for Underwriting FHA Loans and Fully Implement Its Quality Control Program in Accordance With HUD's Requirements

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG), final report of our audit of Allen Mortgage's Underwriting of FHA-Insured Loans.

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

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (312) 353-7832.



September 30, 2012

Allen Mortgage, LLC, Centennial Park, AZ, Did Not Comply With HUD Requirements for Underwriting FHA Loans and Fully Implement Its Quality Control Program in Accordance With HUD's Requirements

Highlights

Audit Report 2012-CH-1015

What We Audited and Why

We audited Allen Mortgage, Limited Liability Company, a Federal Housing Administration (FHA) nonsupervised lender. We selected Allen Mortgage for review based on its high default and claim rate for the FHA-insured loans sponsored in Region 5.¹ Our objectives were to determine whether (1) Allen Mortgage complied with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans and (2) its quality control plan, as implemented, met HUD's requirements.

What We Recommend

We recommend that HUD's Deputy Assistant Secretary for Single Family require Allen Mortgage to (1) reimburse the FHA insurance fund \$811,163 for losses incurred on eight loans, and for any future losses for \$199,391 in claims paid on one loan, (2) indemnify HUD for 11 loans with material underwriting deficiencies, and (3) implement adequate policies and procedures to address the issues cited in this audit report.

What We Found

Allen Mortgage did not comply with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans. Specifically, of the 73 streamline refinanced loans reviewed, 23 (32 percent) contained material underwriting deficiencies.² Allen Mortgage also allowed borrowers to (1) skip mortgage payments due on their previous loans and (2) close their loans without paying settlement costs.

Further, Allen Mortgage (1) did not always ensure that FHA case binders sent to HUD contained complete and accurate information, (2) provided mortgage services to borrowers, such as paying their mortgage payments, to prevent them from defaulting on their mortgages within the first six payments.³ However, it sought reimbursement from the borrowers for the advanced payment, and (3) did not fully implement its quality control program in accordance with HUD's requirements.

As a result of the improperly underwritten loans, the risk to FHA's Mutual Mortgage Insurance Fund was increased by more than \$2 million. Additionally, HUD lacked assurance that Allen Mortgage acted in the best interests of FHA borrowers. Also, the risk to the FHA's Mutual Mortgage Insurance Fund was increased due to the lack of assurance of the accuracy, validity, and completeness of its loan underwriting activities.

¹ The region contains of five states: Illinois, Indiana, Ohio, Michigan, Minnesota, and Wisconsin.

² A deficiency is considered material when it affects the loan approval decision.

³ Loans that default within the first six payments are considered early payment defaults.

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BACKGROUND AND OBJECTIVES

The National Housing Act, as amended, established the Federal Housing Administration (FHA), an organizational unit within the U.S. Department of Housing and Urban Development (HUD). FHA provides insurance to private lenders against loss on mortgages financing homes. The basic home mortgage insurance program is authorized under Title II, section 203(b), of the National Housing Act and governed by regulations in 24 CFR (Code of Federal Regulations) Part 203. In 1983, HUD implemented the direct endorsement program, which authorizes approved lenders to underwrite loans without HUD's prior review and approval.

Allen Mortgage, Limited Liability Company, filed articles of organization pursuant to the laws of the State of Utah on May 23, 2001. The corporate office is located at 1675 South Berry Knoll Boulevard, Centennial Park, AZ. Allen Mortgage originates and underwrites loans, then sells the loans to lending institutions. It funds loans using a warehouse line of credit, on a short-term basis, until the loans are purchased by investors. Allen Mortgage received approval as a Title II nonsupervised lender with HUD on August 2, 2001.

For the period October 1, 2007, through September 30, 2009, Allen Mortgage originated 2,205 loans. Of the 2,205 loans, 960 (44 percent) were in default or claim status as of September 2010. One of Allen Mortgage's underwriters manually underwrote 2,115 of the 2,205 loans. The majority of loans originated and sponsored by Allen Mortgage were streamline refinances.⁴ Allen Mortgage outsources the quality control of loan production to its contractor, Tena Companies, Inc.

We selected Allen Mortgage for review based on its high default and claim rate for the FHA-insured loans sponsored in our region during the period October 1, 2007, through September 30, 2009. For instance, its default and claim rate (the total defaults and claims as a percentage of the total loans originated for a mortgagee) for loans originated in the State of Michigan was 23.72 percent, which was nearly four times the state average default and claim rate of 6.33 percent. The audit was part of the activities in our fiscal year 2010 annual audit plan. Our objectives were to determine whether (1) Allen Mortgage complied with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans and (2) its quality control plan, as implemented, met HUD's requirements.

⁴ A streamline refinance is a refinance of an existing FHA insured loan into a new FHA insured loan.

RESULTS OF AUDIT

Finding 1: Allen Mortgage Did Not Comply With HUD's Underwriting Requirements

Allen Mortgage did not comply with HUD's regulations, procedures, and instructions in the underwriting of FHA-insured loans. Specifically, for 23 of the 73 streamline refinanced loans reviewed (32 percent), it allowed borrowers to (1) skip mortgage payments due on their previous loans and (2) close on their loans without paying the amounts due at closing. It also did not always correctly calculate borrowers' maximum mortgage amounts or properly determine a borrower's eligibility to streamline refinance an existing FHA-insured loan. This noncompliance occurred because Allen Mortgage failed to exercise due diligence in underwriting the loans and disregarded HUD's underwriting requirements. As a result of the improperly underwritten loans, the risk to FHA's Mutual Mortgage Insurance Fund was increased by more than \$2 million.

Allen Mortgage Allowed Borrowers To Skip Mortgage Payments

Allen Mortgage allowed borrowers to skip mortgage payments for 17 streamline refinanced loans. For FHA case number 261-9338035, it was unable to provide documentation supporting that the borrowers' mortgage payments due on March 1 and April 1, 2008, were paid before closing on the loan or that the borrower made the payments at closing. The borrowers' settlement statement revealed that the refinance loan closed on April 29, 2008. HUD prohibits lenders from allowing borrowers to skip payments. A borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement.⁵

For FHA case numbers 261-9338035 and 151-8704674, the borrowers were permitted to make mortgage payments that were due at or before closing, using personal credit cards, after their loans had closed and settled. According to HUD's requirements, delinquent mortgages are not eligible for streamline refinancing until the loan is brought current.⁶

Allen Mortgage Did Not Require Borrowers To Pay Funds Due at Settlement

⁵ HUD Handbook 4155.1, REV-5, paragraph 1-10(E)

⁶ HUD Handbook 4155.1, REV-5, paragraph 1-12(D)

For nine loans reviewed, Allen Mortgage allowed the borrowers to close their loans without collecting the amounts that were due at settlement.⁷ It allowed borrowers to provide personal postdated checks to close on their loans, instead of bringing the required funds to closing.

For FHA case number 561-8818240, the borrower's settlement statement in the FHA case binder indicated that \$1,927 was needed to close the loan; however, the loan closed without the borrower making the payment. Allen Mortgage allowed the borrower to provide two checks, dated November 15 and November 30, 2008, that totaled \$3,848 to close on the loan, thus exceeding the required amount needed to close identified on the HUD-1 settlement statement in the FHA case binder by more than \$1,900. However, the title company's settlement statement showed that the borrower needed \$3,854 to close on the loan. The loan closed on October 27, 2008, and settled on October 31, 2008.

Further, in reviewing Allen Mortgage's financial records, we determined that the borrower's bank returned the checks because the borrower did not have sufficient funds. Allen Mortgage did not provide additional documentation to support that the borrowers' checks had cleared for payment. The following table identifies the closing deficiencies for the nine loans.

Case number	Loan closing date	HUD-1 settlement statement ⁸	Net payment amount ⁹	Payment date	Payment method
151-8681596	4/23/2008	\$1,219	\$1,219	5/3/2008	Personal check
151-8570534	2/19/2008	\$1,670	\$1,670	3/29/2008	Personal check
261-9356573	2/21/2008	\$1,112	\$1,112	3/3/2008	Personal check
561-8818240	10/27/2008	\$1,927	\$3,848	11/15/2008; 11/30/2008	Two personal checks
581-3334641	2/21/2009	\$803	\$770	3/4/2009	Personal check
105-4322752	12/22/2008	\$791	\$791	1/12/2009	Personal check
493-8825894	10/25/2008	\$1,263	\$1,263	10/31/2008	Personal check
292-5210194	1/12/2009	\$403	\$1,743	1/27/2009 2/24/2009	Two personal checks (less the refund)
491-9528744	5/16/2009	\$586	\$586	6/20/2009	Personal check

⁷ When loans are refinanced, the closing date is the date the borrower signs the loan documentation and the settlement date is the date that the funds are disbursed to pay off the old loan and create the new loan.

⁸ In some cases, the amount collected from the borrower does not correspond with the amount due on the borrower's HUD-1 settlement statement (see finding 2).

⁹ The net payment amount equals the total amount collected from the borrower(s) minus any amount(s) refunded to the borrower(s).

HUD requires for each transaction that the lender estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.¹⁰ Further, line 303 on the settlement statement must indicate either cash required from the borrower at settlement or cash payable to the borrower at settlement.¹¹ According to HUD's requirements, funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.¹²

Allen Mortgage Did Not Properly Determine a Borrower's Eligibility for Streamline Refinancing

Allen Mortgage did not properly determine a borrower's eligibility to streamline refinance an FHA-insured loan. For FHA case number 151-8624264, the primary borrower on the previous loan died in February 2008. The coborrower refinanced and settled the new loan in March 2008, which was less than 1 month after the death of the primary borrower. HUD Handbook 4155.1, REV-5, paragraph 1-12(D.9.b.), states that individuals may be deleted from the title on a streamline refinance only when (1) the assumption of the mortgage not containing a due-on-sale clause occurred more than 6 months previously and the assumptor can document that he or she has made the mortgage payments during this interim period or (2) following an assumption of a mortgage when a due-on-sale clause was not triggered and the assumption or quit-claim of interest occurred more than 6 months previously and the assumptor can document that he or she made the mortgage payments during this time.

The coborrower did not demonstrate the ability to make mortgage payments for at least 6 months before the loan closed. The coborrower did not make one payment on the previous mortgage on her own before the loan was streamline refinanced. The borrower defaulted on the mortgage, and the property was sold in a preforeclosure sale transaction; therefore, HUD paid a claim in the amount of \$55,296.¹³

¹⁰ HUD Handbook 4155.1, REV-5, paragraph 1-9

¹¹ 24 CFR Part 3500

¹² HUD Handbook 4155.1, REV-5, paragraph 2-10(D)

¹³ A preforeclosure sale is a sale of a property in which the proceeds from selling the property will fall short of the balance of debts secured by liens against the property. A notice of default has been recorded against the borrower.

Allen Miscalculated Borrowers' Maximum Mortgage Amounts

For three loans, Allen Mortgage overestimated the financing costs or included overdue principal and interest charges in determining borrowers' mortgage amounts. The three loans were funded in the amount of \$399,958 instead of the maximum amount of \$398,847. We calculated the maximum mortgage amount for each loan in accordance with HUD requirements.¹⁴ Therefore, these loans exceeded HUD's maximum mortgage limit by \$1,111. The following table identifies the overinsured loans.

FHA case number	Mortgage amount	Maximum mortgage amount	Over-insured amount
381-9331530	\$166,380	\$166,113	\$267
263-4211541	96,891	96,311	580
263-4186532	136,687	136,423	264
Totals	<u>\$399,958</u>	<u>\$398,847</u>	<u>\$1,111</u>

An FHA Borrower Received More Than \$500 Back at Settlement

For FHA case number, 562-2087147, Allen Mortgage required the borrower to pay a medical-related judgment as a condition to close; therefore, it included the amount of the judgment as a settlement charge on the borrower's HUD-1 settlement statement. Contrary to HUD's requirements, after the loan's settlement, Allen Mortgage provided the borrower with a check that exceeded the \$500 cash-back limit to pay off the judgment.¹⁵ The borrower received \$688 back at loan closing, which was \$188 more than the \$500 limit.

HUD's Quality Control Review Identified Similar Deficiencies

In March 2007, HUD's Quality Assurance Division performed a quality control review of Allen Mortgage and identified similar underwriting deficiencies. According to a letter from HUD, Allen Mortgage loaned or advanced funds to a borrower for closing, as evidenced by a promissory note in the borrower's loan file. The lender or other interested party may not provide the funds to the

¹⁴ HUD Handbook 4155.1, REV-5, paragraph 1-12(A) and HUD Mortgagee Letter 2005-43 require the maximum mortgage amount to be calculated as the lesser of (1) the old original mortgage amount plus the upfront mortgage insurance premium, or (2) the existing debt calculation.

¹⁵ HUD Handbook 4155.1, REV-5, paragraph 1-12 and HUD Mortgagee Letter 2005-43.

borrower to close the loan. HUD initially sought indemnification for the loan. However, the identified deficiencies were resolved.

Incorrect Underwriters' Certifications Were Submitted to HUD

We reviewed the certifications for the 22 loans with material underwriting deficiencies for accuracy. Allen Mortgage's direct endorsement underwriters incorrectly certified that due diligence was used in underwriting the loans. Under HUD's direct endorsement program, direct endorsement underwriters certify to the integrity of the data for automated or manually underwritten loans; the underwriter certifies that due diligence was used in underwriting the loans.

The Program Fraud Civil Remedies Act of 1986 (31 U.S.C. (United States Code) 3801) provides Federal agencies, which are the victims of false, fictitious, and fraudulent claims and statements, with an administrative remedy to (1) recompense such agencies for losses resulting from such claims and statements; (2) permit administrative proceedings to be brought against persons who make, present, or submit such claims and statements; and (3) deter the making, presenting, and submitting of such claims and statements in the future.

Conclusion

According to FHA requirements, a lender is required to establish that a borrower has the ability and the willingness to repay the mortgage debt, which should be based on sound underwriting principles consistent with the guidelines, rules, and regulations denoted in HUD Handbook 4155.1, REV-5. Additionally, the lender must support its decision to approve the mortgage with sufficient documentation. Regulations at 24 CFR 203.5(c) require a direct endorsement lender to exercise the same level of care it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment.

Allen Mortgage failed to follow FHA requirements in underwriting 23 of the 73 loans reviewed (32 percent).¹⁶ This noncompliance occurred because Allen Mortgage disregarded HUD's requirements and its underwriters did not exercise due diligence in underwriting the loans. According to Allen Mortgage, its loan officers or processors calculated borrowers' payoff amounts as though the borrowers' mortgage payments were up to date, including the payment due the month of closing. The underwriters would then review and approve the calculated amounts. This calculated amount would be the amount disclosed on borrowers' HUD-1 settlement statements.

¹⁶ See appendix E for narratives of loans with material deficiencies.

Allen Mortgage's loan officers or processors obtained borrowers' final mortgage payoff amounts after the loans closed. If borrowers did not make the payments due on their prior mortgage, including the one due for the month of closing, borrowers' HUD-1 settlement statements and loan payoff amounts would be inaccurate. According to Allen Mortgage's president, the underwriter would manually calculate the maximum mortgage amount allowed on a streamline refinance. After the loans closed, the underwriter finalized and approved the borrowers' mortgage credit analysis worksheets and the direct endorsement approval.

Additionally, the president said that the loan officers or processors mathematically calculated borrowers' payoff amounts as though the borrowers had made all payments due on their existing mortgages, including the payment due for the month the refinanced loan was expected to close. Allen Mortgage obtained updated payoff statements for the borrowers at a later time. If a borrower did not make the payments due on the existing loan as expected, that borrower's settlement statement and the loan payoff amount would be inaccurate. Consequently, Allen Mortgage would have to update the borrower's payoff amount due on the existing loan and on the settlement statement after the borrower's closing date. Allen Mortgage would then seek reimbursement from the borrower for the skipped mortgage payments.

Allen Mortgage believed that it was helping borrowers by allowing them to skip mortgage payments and provide postdated checks or use credit cards to pay their settlement costs. However, borrowers' financial obligations were increased because the lender actively sought repayment from them after their loans closed. In some instances, Allen Mortgage referred borrowers that were unable to repay the advanced funds to collection agencies.

As a result of the improperly underwritten loans, the risk to FHA's Mutual Mortgage Insurance Fund was increased by more than \$2 million. See appendices C and D for summaries of loans' deficiencies and associated costs.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family require Allen Mortgage to

- 1A. Reimburse the FHA insurance fund \$811,163 for the losses incurred on eight loans since the associated properties have been sold.¹⁷
- 1B. Reimburse HUD for a \$55,296 claim paid for FHA case number 151-8624264 since the associated property was sold during a preforeclosure sale.

¹⁷ Loss on the sale of the property identified in HUD's Single Family Data Warehouse system

- 1C. Reimburse the FHA insurance fund for any future losses from \$199,361 in claims paid on one loan once the associated properties have been sold.
- 1D. Indemnify HUD for the 11 loans with material underwriting deficiencies. The estimated loss to HUD, based on its default loss rate of 66 percent of the unpaid principal balance, is \$1,000,042. This will result in funds to be put to better use (other savings) by the FHA insurance fund not having to pay future claims on the loans if the loans default.
- 1E. Buy down the three loans that were overinsured by \$1,111 and the one loan in which the borrower received \$188 in excess funds back from closing (\$1,111 + \$188 = \$1,299).
- 1F. Implement adequate policies and procedures to ensure compliance with HUD's underwriting requirements.

We also recommend HUD's Associate General Counsel for Program Enforcement

- 1G. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Allen Mortgage, its principals, or both for incorrectly certifying that due diligence was exercised during the underwriting of 21 loans.¹⁸

¹⁸ Two improperly underwritten loans were paid in full; therefore, they no longer pose a risk to FHA insurance fund. As a result, the number of loans decreased from 23 to 21.

Finding 2: Allen Mortgage Did Not Ensure That It Provided Complete and Accurate Information to HUD and Borrowers

Allen Mortgage did not ensure that it provided complete and accurate information to HUD. Specifically, it did not ensure that it included borrowers' final settlement statements in the FHA case binders submitted to HUD. It also collected funds from borrowers that were not disclosed on the HUD-1 settlement statements and paid borrowers' mortgage payments after their loans settled and were sold to investors. The problems occurred because Allen Mortgage lacked adequate procedures and controls to ensure that it complied with HUD's and other Federal requirements regarding loan originations. As a result, HUD lacked assurance that Allen Mortgage acted in the best interests of FHA borrowers and did not have complete and accurate information on borrowers' FHA streamline refinances to aid in monitoring Allen Mortgage for compliance with its requirements.

Borrowers' Settlement Statements in the FHA Case Binders Were Not Final Documents

Allen Mortgage did not always ensure that it included borrowers' final HUD-1 settlement statements in the FHA case binders sent to HUD. For 6 of the 73 loans reviewed (8 percent), the amount of funds borrowers needed to close on the settlement statements in Allen Mortgage's files increased from the amounts disclosed on the settlement statements in the FHA case binders. Allen Mortgage changed the borrowers' settlement statements after the loans closed and the borrowers' rescission periods¹⁹ had expired. However, the borrowers' settlement statements in the FHA case binders did not reflect the changes. For instance, for FHA case number 581-2884051, the borrower's settlement statement in the FHA case binder showed that the borrower did not pay or receive funds at closing. However, according to the settlement statement in the borrower's loan file, the borrower needed \$1,326 to close. The loan closed on October 27, 2007, yet Allen Mortgage collected a personal check from the borrower in the amount \$1,567 on November 27, 2007, a month after the loan closed.

We contacted one of the six borrowers and were informed that his signed settlement statement showed that funds were not needed to close. However, at closing, he was required to pay off a credit card and sign a promissory note agreeing to make the last payment due under his previous mortgage. He mentioned that he was unaware that he had to make these payments. Additionally, the borrower's good faith estimate in Allen Mortgage's loan files did not include these payments as part of the borrower's

¹⁹ Title 12, Part 226—Truth in Lending, states that the borrower may exercise the right to cancel the refinance transaction within 3 business days.

settlement charges. Further, Allen Mortgage sent the borrower a letter indicating that it would send the borrower's account to a collection agency if the payments were not received.

The borrower's settlement statement in Allen Mortgage's files showed that the borrower needed to pay \$742 at closing, which was the amount of the borrower's mortgage payment under the streamline refinanced loan. HUD requires for each transaction that the lender estimate the settlement requirements to determine the cash required to close the mortgage transaction.²⁰ Further, RESPA requires that the HUD-1 settlement statement shows the actual settlement costs of the loan transaction.

Allen Mortgage Collected Funds From Borrowers When Settlement Statements Did Not Identify That Cash Was Needed To Close

Allen Mortgage collected cash from borrowers to close on their loans, which was not disclosed on the borrowers' settlement statements. For 7 of the 73 loans (10 percent), the settlement statements in Allen Mortgage's files and the FHA case binder did not identify that borrowers needed cash to close. However, Allen Mortgage collected more than \$6,100 from the borrowers as follows:

FHA case number	Loan closing date	Borrower's cash due at settlement	Loan settlement date	Amount collected from borrower	Payment date	Payment method
262-1731385	4/14/08	(\$500)	4/30/08	\$820	6/22/08	Credit card
292-4835727	12/20/07	\$0	12/26/07	\$1,149	1/3/08	Personal check
011-5930328	7/11/08	(\$400)	7/31/08	\$781	8/15/08	Personal check
491-9085385	12/22/07	\$0	12/31/07	\$917	4/7/08	Electronic check
483-4074768	3/13/09	\$0	3/18/09	\$887	4/10/09	Personal check
291-3657749	3/18/08	\$0	3/30/08	\$1,004	4/7/08	Credit card
581-2985846	3/20/08	\$0	3/31/08	\$554	4/24/08	Unknown
Total				<u>\$6,112</u>		

The Real Estate Settlement Procedures Act (RESPA), enacted in 24 CFR Part 3500, appendix A, states that the settlement agent shall complete the settlement statement to itemize all charges imposed upon the borrower and the seller by the lender and all sales commissions, whether to be paid at settlement or outside of

²⁰ HUD Handbook 4155.1, REV-5, paragraph 1-9

settlement, and any other charges which either the borrower or the seller will pay for at settlement. Further, RESPA requires that the HUD-1 settlement statement shows the actual settlement costs of the loan transaction. Where it is not the practice that the borrower and the seller both attend the settlement, the HUD-1 should be mailed or delivered as soon as practicable after settlement.

Allen Provided Credit Counseling to Borrowers After Loans Were Sold

Allen Mortgage provided credit counseling services to borrowers after their loans were sold. In reviewing Allen Mortgage's loan files, we determined that its loan officers made monthly mortgage payments on behalf of two borrowers as follows:

- For FHA case number 482-3900230, the borrower's loan closed on March 25, 2008. The first payment on the loan was due May 1, 2008. The borrower's loan file contained a letter from one of Allen Mortgage's loan officers, stating that he had identified that the borrower was having difficulty making mortgage payments. Therefore, he made the borrower's July and August mortgage payments in accordance with Allen Mortgage's credit counseling program that lasted for 6 months after loans closed.
- For FHA case number 581-3168167, the borrower's loan closed on September 11, 2008. The borrower's first payment on the new mortgage was due November 1, 2008. According to documentation in the borrower's loan file, Allen Mortgage made the borrower's mortgage payment that was due December 1, 2008, on February 25, 2009. The payment prevented the borrower's mortgage from being 90 days late. We confirmed that one of Allen Mortgage's loan officers made the borrower's mortgage payment.

Conclusion

Allen Mortgage did not ensure that it provided complete and accurate information to HUD. This condition occurred because Allen Mortgage lacked adequate procedures and controls to ensure that it complied with HUD's and other Federal requirements regarding loan originations. As previously mentioned, Allen Mortgage's underwriter finalized and approved borrowers' mortgage credit analysis worksheets and the direct endorsement approval after loans closed; therefore, if changes to borrowers' settlement charges were needed, it had to seek repayment from the borrowers.

Additionally, Allen Mortgage's president acknowledged that the lender performed credit counseling for borrowers that were having trouble making their mortgage payments. It helped a lot of borrowers, but many of them were not able to repay

Allen Mortgage for making mortgage payments on their behalf. According to the president, Allen Mortgage had discontinued its credit counseling program. He acknowledged that Allen Mortgage started the credit counseling program because its compare ratio²¹ was high.

As a result of the conditions described above, HUD lacked assurance that Allen Mortgage acted in the best interests of FHA borrowers and did not have complete and accurate information on borrowers' FHA streamline refinances to aid in monitoring Allen Mortgage for compliance with its requirements.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family require Allen Mortgage to

- 2A. Provide borrowers' final settlement statements for inclusion in HUD's FHA case binders for HUD to effectively monitor for lender compliance.
- 2B. Implement adequate procedures and controls to ensure that HUD and borrowers receive all final documentation in connection with the loans.
- 2C. Discontinue advancing funds to borrowers to pay funds needed to settle their loans.

We also recommend that HUD's Deputy Assistant Secretary for Single Family

- 2D. Take appropriate administrative action against Allen Mortgage, its principals, or both for the issues cited in this report once the affirmative civil enforcement action cited in recommendation 1G is completed.
- 2E. Ensure that Allen Mortgage has discontinued its credit counseling program, in particular making mortgage payments for FHA borrowers and then seeking reimbursement.

²¹ According to HUD's Neighborhood Watch system, the compare ratio measures the percentage of seriously delinquent loans and claims divided by the percentage of seriously delinquent loans and claims for a particular area.

Finding 3: Allen Mortgage Did Not Fully Implement Its Quality Control Program in Accordance With HUD Requirements

Allen Mortgage did not implement its quality control program in accordance with HUD's requirements. Specifically, it did not conduct quality control reviews in accordance with HUD's requirements, and its written quality control plan initially did not contain all of the necessary provisions. The problems occurred because Allen Mortgage disregarded HUD's requirements and did not monitor its contractor to ensure compliance with HUD's requirements. As a result, it increased the risk to FHA's Mutual Mortgage Insurance Fund due to the lack of assurance of the accuracy, validity, and completeness of its loan underwriting activities.

Allen Mortgage Did Not Ensure That Its Contractor-Performed Routine Quality Control Reviews Were Performed in a Timely Manner

Allen Mortgage did not ensure that routine quality control reviews were performed in a timely manner. Its contractor performed 192 routine quality control loan reviews during our audit period, October 1, 2007, to September 30, 2009. Of the 192 reviews, 147 (77 percent) were not performed in a timely manner. Allen Mortgage's contractor reviewed the loans an average of 162 days after the loans closed. According to HUD's requirements, loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected before closing are identified as early after closing as possible.²² Further, according to Allen Mortgage's quality control plan, loans were to be reviewed and reported to its senior management no later than 90 days from the loans' origination dates and randomly selected by the quality control contractor for audit within 30 days after loan closing.

According to documentation provided by the contractor, Allen Mortgage failed to provide the loans to the contractor in a timely manner. Of the 192 routine reviews, 117 were received by the contractor more than 90 days after the end of the month in which the loan closed. Further, a lender contracting out any part of its quality control function is responsible for ensuring that the outside source is meeting HUD's requirements.²³ Therefore, Allen Mortgage was responsible for ensuring the reviews were performed on time.

²² HUD Handbook 4060.1, REV-2, paragraph 7-6(A)

²³ HUD Handbook 4060.1, REV-2, paragraph 7-3(B)

Routine Reviews Were Not Always Performed for the Correct Period

Allen Mortgage did not ensure that its contractor performed routine quality control reviews in accordance with HUD's requirements. HUD requires that lenders closing more than 15 loans per month perform quality control reviews at least monthly and address 1 month's activity.²⁴ However, Allen Mortgage's contractor performed quarterly quality control reviews on FHA-insured loans. Therefore, the reviews addressed loan production for each quarter instead of 1 month's activity with the exception of November and December 2007. Additionally, the contractor did not perform quality control reviews on the loans that were originated during October 2007.

The Sample Size of Routine Reviews Was Not Always Sufficient

Allen Mortgage did not ensure that its contractor used the appropriate sample size in determining the number of loans for review in accordance with HUD's requirements and its own plan. The contractor failed to review 10 percent of the loans that were originated and as previously mentioned, did not perform quality control reviews on loans that were originated in October 2007. HUD requires that lenders that originate or underwrite 3,500 or fewer FHA loans per year review 10 percent of the FHA loans they originate.²⁵

Additionally, Allen Mortgage's contractor did not review loans that were denied. HUD requires lenders to review a minimum of 10 percent the total number of loans that were denied.²⁶ Further, Allen Mortgage's plan stated that a minimum of 10 percent of all rejected loans were to be reviewed and evidence that senior staff concurred with the rejection was to be documented in the loan file.

Early Payment Defaults Were Not Always Reviewed

Allen Mortgage did not ensure that its contractor reviewed all early payment defaults as required by HUD. HUD requires lenders to review all loans going into default within the first six payments, in addition to the loans selected for routine quality control reviews. Early payment defaults are defined as loans that become 60 days past due within the first six payments.²⁷

²⁴ HUD Handbook 4060.1, REV-2, paragraph 7-6(B)

²⁵ HUD Handbook 4060.1, REV-2, paragraph 7-6(C)

²⁶ HUD Handbook 4060.1, REV-2, paragraph 7-8(A)

²⁷ HUD Handbook 4060.1, REV-2, paragraph 7-6(D)

Using HUD's Single Family Data Warehouse system, we identified 212 loans that were originated or sponsored by Allen Mortgage that were 60 days past due within the first six payments, which were early payment defaults. These 212 loans closed from September 2007 to October 2009. However of the 212 loans, 115 (55 percent) had not been reviewed as of June 30, 2010.

Allen Mortgage's Quality Control Plan Did Not Meet HUD's Requirements

Allen Mortgage's quality control plan, as written, did not meet HUD's requirements. The plan was in effect during our audit period, October 1, 2007, through September 30, 2009. Specifically, in accordance with HUD Handbook 4060.1, REV-2, the plan did not include provisions that²⁸

- The office does not employ or have a contract with anyone currently under debarment or suspension, subject to a limited denial of participation, or otherwise restricted from participation in HUD-FHA programs. Lenders must periodically check their employee list, at least semiannually (7-3L).
- Reports, which identify deficiencies, are provided to senior management within 1 month of completion, and management must take prompt action on all material findings. The final report must identify actions taken, a timetable, and follow-up activities (7-3I).
- The lender reports findings of fraud or serious violations to the appropriate HUD Homeownership Center within 60 days of initial discovery via the Lender Reporting feature in the Neighborhood Watch Early Warning System (7-3J).
- Lenders must identify patterns of early defaults by location, program, and loan characteristic. Lenders must identify commonalities among participants in the mortgage origination process to learn the extent of their involvement in problem cases. Loans involving appraisers, loan officers, processors, underwriters, etc., who have been associated with problems, must be included in the review sample (7-5C).
- The quality control sample selection includes loans from all loan officers, loan processors, and underwriters and from roster appraisers, real estate agents or companies, and builders with whom they do significant business (7-6C).
- Loans, which go into default within the first six payments, are submitted for quality control review. Loans which are 60 days past due within the first six payments are early payment defaults (7-6D).

During the audit, Allen Mortgage updated its quality control plan. We reviewed the updated plan and determined that it complied with HUD's requirements.

²⁸ All of the provisions missing from Allen Mortgage's quality control plan are not listed in this report.

Conclusion

Allen Mortgage did not fully implement its quality control program in accordance with HUD's requirements. The problems occurred because Allen Mortgage disregarded HUD's requirements for quality control. Additionally, it did not monitor its contractor to ensure that quality control reviews were performed in accordance with HUD's requirements. Allen Mortgage did not always provide loan files for quality control review in a timely manner. Consequently, the loans were not always reviewed in accordance HUD's 90-day requirement.

Recommendations

We recommend that HUD's Deputy Assistant Secretary for Single Family require Allen Mortgage to

- 3A. Implement policies and procedures to ensure that quality control reviews of FHA-insured loans are performed in accordance with HUD's requirements and its revised plan, which includes but is not limited to the performance of routine and early payment default quality control reviews and rejected or cancelled loans.

SCOPE AND METHODOLOGY

We performed our audit work between August 2010 and April 2011. We conducted our audit work at Allen Mortgage's office in Centennial Park, AZ, and HUD Chicago regional office. The audit covered the period October 1, 2007, to September 30, 2009, but was expanded as necessary.

To accomplish our objectives, we reviewed applicable HUD handbooks, regulations, mortgagee letters, and other reports and policies related to FHA's mortgage insurance program. Further, we reviewed Allen Mortgage's quality control plan, electronic loan files, and quality control documentation. We interviewed Allen Mortgage's current and former employees, its quality control contractor, and HUD staff. We also contacted borrowers to confirm information in their loan files.

Using HUD's data maintained in its Single Family Data Warehouse system, we determined that Allen Mortgage sponsored 89 loans that went to claim in 30 months or fewer during the period October 1, 2007, through September 30, 2009. Of those 89 loans, 21 were for properties located in Region 5. We selected all 21 for review to determine whether Allen Mortgage complied with HUD's underwriting requirements. All of the 21 loans reviewed were streamline refinances.

We assessed the reliability of the computerized data and determined that the information was sufficiently reliable for our purposes. For instance, in reviewing Allen Mortgage's quality control program, we compared loans we identified in HUD's Single Family Data Warehouse system as early payment default loans to determine the universe of 212 loans that defaulted within the first six payments. We corroborated the information with other HUD systems, such as HUD's Neighborhood Watch system. Further, Allen Mortgage uses HUD's Neighborhood Watch system to determine the loans that result in early payment defaults; therefore, the same data were used by both the Office of Inspector General (OIG) and Allen Mortgage. Then we compared hardcopy documentation of loans reviewed by Allen Mortgage's contractor to the universe we determined and verified two loans reviewed were not early payment defaults in HUD's Neighborhood Watch system. As a result, only 97 of 99 reviews were completed out of the 212 loans we identified as early payment default.

However, to reach our conclusions for underwriting, we relied on hardcopy documentation maintained in HUD's FHA case binders and imaged hardcopy documentation maintained in Allen Mortgage's electronic files.

Further, using quality control review reports provided by Allen Mortgage and its quality control contractor, we identified 271 loans which were subjected to quality control reviews. Of the 271 reviews, 183 loans²⁹ were routine quality control reviews, and the remaining 88 loans were early payment defaults. Using a stratified attribute sample, we identified the universe of 271, an

²⁹ Allen Mortgage's contractor reviewed 192 loans routinely for quality control. Nine loans were reviewed as part of a routine and early payment default review; thus increasing the number from 183 to 192 loans reviewed routinely for quality control. Although Allen Mortgage's contractor reviewed 271 loans, 9 loans were reviewed twice. Therefore, it performed 280 quality control reviews during our audit period.

assumed failure rate of 50 percent, a confidence interval of 90 percent, and a precision of 10 percent. We systematically selected a statistical sample originating from a randomly selected start point generated by the RAT STATS 2007 statistical sampling software application. The sample consisted of 54 loans which were subjected to quality control reviews by Allen Mortgage's quality control contractor. We selected this sample to review whether the quality control reviews were conducted in accordance with HUD's requirements regarding the review of underwriting, document reverification, and condition clearance and closing. Two of the fifty-four loans were previously selected as a part of our underwriting review universe of 21 loans in claim status, thus reducing the total number of loans reviewed from 75 to 73.

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:

- Effectiveness and efficiency of operations – Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Reliability of financial reporting – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with applicable 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:

- Allen Mortgage did not always comply with HUD's requirements when underwriting FHA-insured loans (see finding 1).
- Allen Mortgage did not ensure that it provided complete and accurate information to HUD and borrowers (see finding 2).
- Allen Mortgage's quality control program did not meet HUD's requirements (see finding 3).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Unsupported 2/	Funds to be put to better use 3/
1A	\$811,163		
1B	\$55,296		
1C		<u>\$199,361</u>	
1D			<u>\$1,000,042</u>
1E	<u>\$1,299</u>		
Total	<u>\$867,758</u>	<u>\$199,361</u>	<u>\$1,000,042</u>

- 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 polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures. We classified loans in which HUD paid a claim and the lenders have conveyed the associated properties to HUD as unsupported costs since HUD would not realize a loss or gain on the sale of these properties until they are sold. Therefore, the costs associated with these loans are undetermined.
- 3/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance the funds to be put to better use represent savings by the FHA insurance fund realized by not having to pay future claims on loans that default.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1



1675 S. Central Street, P.O. Box 1168
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Phone (928) 608-5108 www.amlc.net

November 4 , 2011

TO: Kelly Anderson,
Regional Inspector General for Audit- Region V
Ralph H. Metcalfe Federal Building
77 West Jackson Blvd., Suite 2646
Chicago , IL 60604

SUBJECT: Response to the findings of Discussion Draft Report number 2012-CH-10XX

Dear Ms. Anderson:

We at Allen Mortgage, LLC are in receipt of the Discussion Draft of your audit, dated October of 2011. We sincerely appreciate this opportunity to respond in this matter. It is our hope to clarify our position on the issues mentioned here as well as to justify our actions.

The main goal of our response is to explain our position on the issues brought up in the discussion draft as clearly and succinctly as possible. The Discussion Draft brings up several complex issues, and they are tied together in such a way that the same point will come up in different areas throughout the body of the Discussion Draft. We have attempted to keep the continuity between the Discussion Draft and our Response by following the OIG's outline in our response. However, where the issues appeared to us to be especially confusing, we felt like the most clarity would be achieved by pulling excerpts directly from the discussion draft and distinguishing them in *bold italics*. Then we could follow these up directly with our responses in regular type.

Comment 1

HIGHLIGHTS

What We Audited and Why

Before we get into the specific issues, we feel like it is noteworthy to address that this audit was instigated by the OIG because of our high default and claim rate during the period between October 1, 2007 and September 30, 2009. We acknowledge that our default and claim rate was high, and that this audit was justified, however it should be noted in our favor that Allen Mortgage was proactive in our approach to the problem and we made the necessary changes to our system independent of an auditor's findings.

As we make this response, Allen Mortgage's national Compare Ratio is down to 139%. This number is within guidelines, and an audit would not have been necessary using today's compare ratios. We point this out to show how seriously Allen Mortgage takes the quality of its work and our reputation.

Recently, HUD has recognized these efforts themselves with regard to other issues. Specifically, on July 8, 2010, HUD withdrew its termination of our Origination Approval Agreement in the Atlanta, GA and Indianapolis, IN Field Office Jurisdictions. HUD also issued a new Origination Approval Agreement in the Dallas Field Office Jurisdiction on September 29, 2011. In its letter granting this new Origination Approval Agreement, HUD states, "We have reviewed Allen Mortgage's request for a new Agreement in the Dallas field office jurisdiction and based on this review and my understanding of your corrective measures, Allen Mortgage's request has been approved." We look at this OIG audit as an opportunity for further learning and improvement, at the same time, we hope that our response here will gain HUD's confidence and this issue can be closed.

What We Found

The Discussion Draft lists several issues in this section that it will be bringing up in more detail elsewhere in the report. The OIG feels like these issues show that Allen Mortgage did not comply with HUD's regulations and procedures. Our rebuttal will address each of the specific issues brought up by the OIG, but overall, we will show that our actions were within the guidelines established by HUD.

What we Recommend

The several recommendations by OIG in this section of the Discussion Draft are repeated throughout other sections of the Discussion Draft where they can be tied to the specific finding

Comment 2

that they relate to. Most of the findings by the OIG in this Discussion Draft are the result of differing interpretations of guidelines.

With regard to the issues brought up by the OIG that we do not dispute, they were the result of human error and there was no intent to commit fraud or to harm anyone.

Auditee's Response

Allen Mortgage will use this opportunity granted by the OIG and HUD to respond to the findings in this Discussion Draft. We believe that the key to reaching an understanding with regard to these findings is to address the issues as clearly and succinctly as possible. Where necessary we will pull quotations from the Discussion Draft, and indicate them in *bold italics*.

BACKGROUND AND OBJECTIVES

This section of the Discussion Draft outlines the details of Allen Mortgage's corporate structure, and the date that it was approved as a title II lender. Next are details about Allen Mortgage's Operations and the methods used to close and fund loans. This information was accurate, and there were no issues that needed clarification, with one small exception. The OIG states that we originate and underwrite loans primarily in the Centennial Park, AZ, Metropolitan and surrounding areas. Though our offices are located in Centennial Park, most of Allen Mortgage's lending activity is within the several states in which it is licensed.

This section of the Discussion Draft also gives details regarding Allen Mortgage's high default and claim rate which necessitated this audit. It is true that during the audit time period Allen Mortgage did have an unacceptable default and claim rate. Our default and claim numbers were very concerning to us, and here we would like to give a detailed description of the actions that we took to correct this problem as well as a time line for these actions.

What Happened and How We Fixed It

Allen Mortgage has enjoyed many years functioning as a full Direct Endorsement FHA lender. We enjoyed excellent tier one investor relationships in the secondary market, to whom we sold our loans. We also had three different warehouse banks that we used for the interim funding.

Comment 3

In 2008, our FHA compare ratio started to escalate to unacceptable levels. The FHA compare ratio is an indicator that HUD, as well as warehouse lenders and investors, use as an indicator of our delinquency and default ratio. When OIG refers to our delinquency and default ratio in this discussion draft, they have used the Neighborhood Watch system and our compare ratio as its main indicator.

The delinquencies were only on FHA streamline refinances. We determined that our biggest problem with credit quality was that we were doing any refinance that would pass FHA and investor guidelines. We raised our FICO floor to 580 before other lenders in the secondary market did. We believed that this would correct the problem. The compare ratio continued to climb each quarter. We did a few other credit layers that, in retrospect, we realize were not sufficient to correct the problem.

In 2009, some of our investors terminated their Purchase Agreements with us due to our compare ratio. This hurt. We went from being courted and sought out by the secondary market.

In 2009, Allen Mortgage received a Termination Notice from HUD due to the high compare ratio. It was for the Dallas HUD Office jurisdiction which was only a small part of our market. Still, it felt like another huge blow. We requested a hearing and presented our corrective actions, however HUD sustained their termination. We were able to continue doing business in the many other jurisdictions that we were approved in.

We have now improved our credit quality dramatically. We did this by instigating our own, much stronger, credit layers for FHA streamlines. We are now requiring each streamline refinance to be full income and credit qualified as if it were an FHA purchase. Our FICO floor is 640, however most of our transactions are above 700. We are also doing a CMA or an AVM on each property to determine LTV. These stronger credit layers have worked, and the compare ratio has come back down nicely.

It takes time for the older, lower quality loans to fall out the old end of the two year pipeline. Our two year compare ratio eventually went up to 376%.

In 2010, we received a Termination Notice for the Atlanta and Indianapolis HUD Office jurisdictions. We requested a hearing for this as well, and presented our corrective actions. This time we were able to point to some improvement as a result of the changes. This time they agreed with our plan and what we had already done to correct the credit quality. HUD withdrew their termination. This time, we rejoiced! This was the first ray of sunlight that came to us from all our focused efforts.

Our new improvements in credit quality started to show proof via our FHA compare ratio returning to normal levels. The one year ratio dropped first, and then about a year later, the two year ratio dropped. It just took time to get that older period of poor credit quality out of our two year pipeline. Our one year compare ratio is now at 0%. The two year compare ratio has dropped from 376% to 139%. The delinquent loans that are causing the compare ratio today to be at 139% are in the oldest two months of the 24 month pipeline.

The compare ratio that is currently shown on the Neighborhood Watch Site as of the October 17, 2011 data refresh is 139%. This can be duplicated by selecting all of the data for our company wide mortgagee number, 17646. We have attached this screen print here as Appendix A.

The FHA Compare ratio, and the above data, is based on the 90 day or more delinquent loans including claims. We also watch the 60 and 30 day delinquent loans to see what could be hurting us in the future. The newest 22 months are holding strong.

By watching the 60s and 30s, and by knowing the data that is dropping out of the oldest end of the pipeline, I am able to calculate what the next two monthly reports will be. Our compare ratio will be approximately 132% on the 11/21/11 data refresh. It will be under 100% on the 12/19/11 data refresh. At this point we will have stepped out into full sunshine.

This has been a harrowing experience for us at Allen Mortgage. Our livelihood is based on maintaining a clean standing with FHA and a sterling reputation in the secondary market. We have learned some extremely valuable lessons from this, but I think the experience has been worthwhile. We are now incredibly conscientious about each credit decision. It has been hard work to fully income qualify streamline loans when investor or FHA guidelines don't require it. It has been an exertion of will to decline otherwise eligible loans that we think will probably perform, but are not good enough to meet our credit quality goals. With any delinquent loan that does show up in our compare ratio, we re-study our credit decision that we made on that file. We retest the logic of that decision and the credit policies that were in place when it was originated.

The hard lessons and hard work are paying off now. We believe that the data shows that we have fixed the problem. We are excited that we have established new relationships in the secondary market. It feels great to see our new, lower compare ratios when each data refresh comes out. On Sunday evening of the data refresh weekends, the President of Allen Mortgage is usually pulling up the Neighborhood Watch site with bated breath.

In September of 2011, HUD was kind enough to recognize our efforts to improve our compare ratio by reinstating our approval for the Dallas HUD Office jurisdiction. Each of HUD's actions

were in regard to the specific field office jurisdiction. Dallas was the only one that was turned off, and now it is back on. Our overall Direct Endorsement authority stayed intact.

Throughout the period of time that the compare ratio worsened, and subsequently improved, our originations were done in compliance with the FHA guidelines and the guidelines of the investors to which we sold. It was our fault that we did not instigate credit overlays of our own sooner, and we have learned this lesson. We will diligently watch our compare ratio closely from now on, and adjust our credit layers as needed.

We selected Allen Mortgage for review based on its high default and claim rate for the FHA insured loans sponsored in our region during the period October 1, 2007, through September 30, 2009.

The most important background information relevant to this report is that every one of the loans reviewed here was made under HUD's streamline refinance program. This is a program implemented by HUD in the '80s with the intent of giving borrowers who already had FHA loans the ability to take advantage of improvements in the lending environment by refinancing to loans that improve their rate or other terms of the mortgage with a minimum of documentation. HUD's philosophy behind the streamline refinance program was that a borrower's willingness and ability to pay the mortgage payments on the new loan is documented by a timely payment history on his previous loan. With strict limits on what can be included in the new loan amount calculations, and the amount of cash back allowed, these loans represent a minimal increase to the Mortgage Insurance Fund, and there is no need to re-document information on a borrower and property that HUD is already insuring. For these reasons, the documentation and underwriting requirements on a streamline refinance are very different from a standard loan with traditional documentation. These differences seem to be the basis for most of the findings in this Discussion Draft.

RESULTS OF AUDIT

Response to Finding 1

Allen Mortgage did not comply with HUD's Underwriting requirements.

This finding is the most complex and involved of the OIG's findings. It involves several issues that could be classified almost as sub findings, and this is where there is the greatest need to quote directly from the OIG's Discussion Draft in order to frame a coherent response.

Issue 1: Allen Mortgage Allowed Borrowers to Skip Payments

"Allen Mortgage Allowed borrowers to skip mortgage payments for 17 streamline refinanced loans."

Section 4, Part 1-10 Paragraph A, of the 4155.1 REV 5 states, "Lenders are not permitted to allow borrowers to "skip" payments. The borrower must either make the payment when it is due or bring the monthly payment to settlement." However, a later section of the 4155, Part 1-12, states, "The existing first lien may include the interest charged by the servicing lender when the payoff is not received on the first day of the month as is typically assessed on FHA Mortgages". To reconcile these two parts of the 4155, we needed interpretation from HUD. Therefore, we relied upon the HOCs for interpretation. It has been HUD's policy to allow the additional interest to be added to the loan amount. We offer the following three examples of instances where this practice was allowed by HUD.

- 1- Recently, HUD has issued Mortgagee letter 11-11 which clarifies and changes many of HUD's policies for streamline refinances. The issue of including 60 days of interest into the loan is addressed here, and the FAQ's that accompany this mortgagee letter include #18 which states; "On a non credit qualifying streamline without an appraisal, how much interest may the lender include in the payoff amount of the refinanced mortgage; may the lender add in up to 60 days of interest and up to one month of prorated mortgage insurance?" HUD's answer is as follows; "Unless the borrower pays off the refinanced mortgage on the installment due date, the payoff amount of the refinanced mortgage may include the unpaid principal balance plus 60 days of interest which consists of the interest due for the month prior to the closing of the refinancing mortgage, plus the interest due for the month in which the closing occurs, less refund (if

Comment 4

Comment 5

any) plus new Upfront MIP" We understand that Mortgagee Letter 11-11 is dated after the period covered in this audit, but this particular issue is merely a clarification of a policy that existed during the audit time period. It does not represent a new policy.

Comment 6

2- On several occasions, the HUD outreach center and the Homeownership Centers were consulted regarding this issue, and these centers specifically allowed the inclusion of 60 days of interest when the loan was not closed on the installment due date. Recently, we have contacted the Santa Ana Homeownership Center and spoke to [REDACTED] for confirmation of the fact that they were allowing us to add 60 days of interest into the loan amount during the audit time period. Their response was that the OIG can contact [REDACTED] for confirmation of the fact that the policy regarding including 60 days of interest existed during the audit time period.

Comment 7

3- As noted by the OIG in a later part of this discussion draft, HUD conducted a QAD audit of Allen Mortgage in 2007. The file number for this audit was 19898. The OIG quotes the findings of this QAD audit, in order to show HUD's interpretation of its guidelines. HUD reviewed case # 105-2507386 as a part of this audit, and in this case the loan amount was calculated with the 60 days of interest allowed in part 1-12 of the 4155.1 REV 5. After a complete review of the file including recalculation of the loan amount, HUD made no findings regarding the inclusion of 60 days of interest into the loan amount.

For FHA Case # 292-4835727, Allen Mortgage was unable to provide documentation supporting that the borrower's mortgage payments due on November 1 and December 1, 2007, were paid before closing on the loan or that the borrower made the payments at closing

Comment 8

This loan funded on December 28, 2007. In the loan file for 292-4835727 there was an updated payoff that shows due for the December payment. This payoff documents that the November payment was made prior to funding the loan. The November and December interest were included in the loan amount according the guidelines discussed above. A copy of this payoff is attached to this response (**Appendix B**) This loan was not delinquent at closing.

For FHA case numbers 261-9338035 and 151-8704674, the borrowers were permitted to make mortgage payments that were due at or before closing using personal credit cards after their loans had closed and settled. According to HUD's requirements, delinquent mortgages are not eligible for streamline refinancing until the loan is brought current.

Comment 9

First, with regard to case # 261-9338035, This loan was signed on April 24, 2008. We disbursed this loan on April 29, 2008. The payoff on this HUD-1 included the March interest and the April

interest. Both months of interest were included in the loan amount as we have discussed previously. When we funded on 4/29, the loan was due for the April payment, meaning that the payments were not delinquent. Line 303 of this HUD-1 Settlement Statement shows an amount due of 890.70. We charged this amount to the borrower's credit card, though we did transpose the numbers to 870.90. Handbook 4155.1 REV 5 section 1-12, part D-2 states that the source of funds do not need to be verified on a streamline refinance, therefore a credit card was an acceptable form of payment. Case # 151-8704674 signed on May 12, 2008 and funded on May 30, 2008. The payoff for this loan showed that the loan was due for the May 1 payment. It was not delinquent at the time of funding. This loan also included two months of interest in the loan amount calculation in accordance with the guidelines previously referred to. While it is true that charges to the borrower's credit card were made, we believe that we have shown that, on a streamline refinance, a credit card was an acceptable form of payment for the closing costs as shown in the 4155.1 REV 5 section 1-12, part D-2 We also collected 812.63 after closing. This was for the first payment due on the new loan. We had to collect that because we had not sold the loan as fast as we had wanted to.

Issue 2: Allen Mortgage Did Not Require Borrowers to pay funds due at settlement

For nine loans reviewed, Allen Mortgage allowed the borrowers to close their loans without collecting the amounts due at settlement. It allowed borrowers to provide personal postdated checks to close on their loans, instead of bringing the required funds to closing.

It is true that in some instances, Allen Mortgage did collect personal post dated checks from the borrowers at settlement. When HUD issued mortgagee letter 09-32, we interpreted it to mean that this practice would no longer be allowed, and we discontinued this practice at that time. As for the time period covered in this audit, we are not aware of any specific guidelines that were violated with this practice. During our last interview with OIG, we sought clarification regarding which statute specifically disallows bringing postdated checks to closing. [REDACTED] confirmed that this practice did not violate any statutes or regulations. Instead, they were relying on a finding in our 2007 QAD audit, number 19898 as evidence that HUD didn't allow this practice. Consequently, we went back to the findings letter of this QAD audit, and the only finding that appeared related to this issue that we could find was the following. "Allen Mortgage loaned or advanced funds to the borrower for closing which was evidenced in the loan file by a promissory note." This was in reference to case # 105-2574981, and in this file there was an actual Promissory Note to Allen Mortgage. This is not the same as collecting a post dated check for funds due at settlement. What's more, this note was for payment of a judgment that appeared on the title report and not for closing costs at all. We would also like to add that upon receiving our response to this finding, HUD was satisfied with our explanation

Comment 10

Comment 11

Comment 12

Comment 13

and they decided not to re-classify this loan as something other than a streamline refinance, as well as withdrawing the request for indemnification.

Furthermore, in this same QAD audit, HUD reviewed the following case numbers ; 105-2523287, 483-3641122, 561-8278422, 105-2566282, 151-8148043, 431-4196992, 151-8156965, 105-2507386, 105,2574981, 105-2574975, 261-9030652, 491-8754683. Each of these loans showed amounts due from the borrowers in either the 200's section of the HUD-1, line 303, or both. Most of these payments were made with personal, post dated checks, and this went without comment by HUD.

Further, in reviewing Allen Mortgage's financial records, we determined that the borrower's bank returned the checks because the borrower did not have sufficient funds. Allen Mortgage did not provide additional documentation to support that the borrowers' checks had cleared for payment.

Comment 14

This statement is in reference to case number 561-8818240. This borrower brought in checks for the corrected HUD-1. We have attached the HUD-1 to this response (Appendix C) in the amounts of \$3,853, and an escrow check for 350.00. Both of his checks bounced. We made several unsuccessful attempts to collect on these checks, but we weren't successful and in the end we wrote this off as a loss. There was no malice or fraud committed here as the situation worked to our disadvantage and benefitted the borrower greatly. It should also be noted that this situation is not likely to happen again since we no longer permit this practice.

The Discussion Draft goes on to list a table of loans identified by case number. This table was meant to outline closing discrepancies in nine of the loans that they reviewed. This table appears to address two separate concerns. The first concern is that of a discrepancy in the amount of money disclosed on line 303 of the HUD-1 and actual amounts collected. The second concern is that of the payment date being later than the settlement date of the loan. Regarding the first concern, the OIG table confirms that the amounts collected from our borrowers are the same as the amounts disclosed on the HUD-1 Settlement Statement with only three exceptions. We would like to address those three exceptions here:

Comment 15

1. Case # 561-8818240- In this instance, the wrong HUD-1 was referenced on this chart. The payoff on the HUD-1 referenced by OIG in this table was incorrect, and a corrected HUD -1 was issued prior to funding the loan. The corrected HUD-1 showed the borrowers needing to bring in \$3,853, which is the amount that we collected from them according to OIG's table. The corrected Settlement Statement reflecting this change was in the file, and I have attached it here for reference.(See Appendix C)

Comment 16

2. Case # 581-3334641- The lender credit on the HUD changed by thirty three dollars .This dropped the amount owed on line 303 from \$803 to the \$770 that we actually collected. This \$33 change actually benefited the borrowers. The corrected Settlement Statement reflecting this change was in the file, and I have attached it here for reference. (See Appendix D)

Comment 17

3. Case # 292-5210194- The HUD-1 does show line 303 in the amount of \$403, but on line 205 it shows the borrower bringing in a payment for \$1,340. This is why two checks were collected, as noted on the OIG table. The total of the two checks equal \$1,743 which is the amount that OIG shows we collected.

Comment 18

The second concern, which is that the funds collected from the borrowers were being paid after the settlement date, is part of the personal post dated check issue that we have addressed in this response above. Resolution of this question where it is mentioned in relation to the other issues, should also settle the question with regard to this issue.

HUD requires for each transaction that the lender estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA insured mortgage..... determines the cash needed for closing a loan eligible for FHA mortgage insurance.

Comment 19

This excerpt from the Discussion Draft references the HUD 4155.1 REV 5, Paragraph 1-9 as its basis. This part of the 4155.1 REV 5 falls under the heading, "Settlement Requirements" and it isn't necessarily related to a streamline refinance. Furthermore, we were unable to find any loans where the HUD-1 did not show that an amount of cash to close had not been determined. Line 303 of the HUD-1 had an amount disclosed in every case. It is true that some of those amounts were either \$0 or in the negative (cash back to the borrower), but as long as the cash back doesn't exceed \$500, this is allowed.

According to HUD's requirements, funds can be borrowed provided that the funds are fully secured by investment accounts or real property other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

Comment 20

Here is another instance where the section of the Handbook referenced by the OIG (4155.1, REV-5 Paragraph 2-10) does not apply to streamline refinances. The guidelines for a streamline refinance are found in 4155.1 REV 5 section 1-12. There in Paragraph D.2 it states, "Cash to Close. Borrowers are not required to provide evidence of cash to close." It is understandable that there might be some confusion regarding this issue since Mortgagee Letter 09-32 eliminates this provision, but during the time period covered in the audit, this guideline existed.

Comment 21

Issue 3: Allen Mortgage Did Not Properly Determine a Borrower's Eligibility for Streamline Refinancing

The findings regarding case #151-8624264 are unfortunately correct. While the death of the co-borrower did not trigger the due on sale clause, she had not proven that she had been making the last 6 payments on her own. This was our accident, and we have learned from it. The underwriter who approved this loan no longer works here. In addition, Allen Mortgage has put its current staff through more extensive training as well as re-structuring operations so that some redundancy has been built into the system. We are committed to keeping something like this from happening again. With regard to punitive damages, we would like to point out that Allen Mortgage merely Streamline Refinanced a loan that was already FHA insured. If the death of the spouse brought about this claim, then FHA would have been paying a claim here whether Allen Mortgage had gotten involved or not. It is our hope that the proactive steps that we took to correct this problem will show as an example of our commitment to improvement and perhaps leniency can be shown when considering whether or not further sanctions are needed.

Comment 22

Issue 4: Allen Mortgage Miscalculated Borrower's Maximum Mortgage Amounts.

Three loans are listed here in which the OIG asserts that the financing Costs were overestimated or that overdue principal and interest charges were added. We agree with the finding that the loan amounts were miscalculated, and we are willing to pay the loans down by the amount that OIG is recommending. In our examination of these three loans, we were unable to find any instances where overdue principal and interest charges were added into the loan amount. To address the miscalculation of loan amounts, we attribute this to the fact that during this period, the loan officers were not in the habit of submitting calculation worksheets with their underwriting packages to clarify how they came to their loan amount. This left the underwriter trying to second guess things and in these three cases, she made a mistake. One of the underwriting improvements that Allen Mortgage has instituted, is that every loan now has to use a standardized loan calculation form when it goes through underwriting here. This ensures that the underwriter, the closer, and even future auditors can see exactly where our figures came from.

Comment 23

Issue 5: An FHA Borrower Received More than \$500 Back at settlement

Technically, the HUD-1 on case # 562-2087147 shows the borrowers receiving no cash back at closing. The issue of a cash refund on this loan centers around a medical judgment that appears on the preliminary title report. The underwriter made it a prior to funding condition that we show the collection account as paid off. The safest way to do this was to put the amount to pay this judgment on the HUD-1 settlement statement and have the title company

Comment 24

disburse the funds themselves. The Discussion Draft says that the amount of this medical judgment was included as a settlement charge on the borrower's HUD-1 settlement statement however, the problem here is that the judgment was not included on the HUD-1 Settlement Statement. The charges on the HUD-1 were all structured around the idea that the title company would disburse these funds, so when it wasn't included on the HUD-1 Settlement Statement, the title company could not balance with their disbursements. For this reason, the title company was forced to void their disbursement check for the collection and refund the money to Allen Mortgage. From there, Allen Mortgage issued check number 5317 to St. Mary's Medical Center in order to pay off the judgment. However, check 5317 was never cashed. Apparently, the borrowers had already paid the collection account with their own funds. As a result, Allen Mortgage voided check 5317 to St. Mary's Medical Center and issued check 5402 to the borrowers in order to reimburse them for their payment of this account. This was simply an accounting error, not an attempt to subvert HUD guidelines. This is the only loan we have that has an issue like this and Allen Mortgage is willing to issue a principal reduction in the amount of \$188.

Issue 6: HUD's Quality Control Review Identified Similar Deficiencies

In March 2007, HUD's Quality Assurance Division performed a quality control review of Allen Mortgage and identified similar underwriting deficiencies. According to a letter from HUD, Allen Mortgage loaned or advanced funds to a borrower for closing. As evidenced by a promissory note in the borrower's loan file.

In reviewing the closeout letter from HUD regarding their audit number 19898, we find the following passage. "Further, AM (Allen Mortgage) loaned or advanced funds to the borrower for closing which was evidenced by a promissory note." As we stated before, this case involved an actual promissory note signed by the borrower. This is not the same as post dated checks being brought to closing. This is clear from the fact that on the HUD-1 for this same case, (105-2574981) we collected a personal check from the borrower for an advance of escrow funds. Line 303 of this HUD-1 also shows that a personal check from the borrower in the amount of \$1,897.58 to cover closing costs was collected. HUD had no findings regarding these issues. It should also be noted that upon hearing our rebuttal to this finding, HUD determined that the promissory note in the file was not for closing costs, and they withdrew their request for indemnification.

Using the theory that this QAD audit can be read as an interpretation of HUD's stance regarding the issues brought up in the OIG's Discussion Draft, I would like to point out the following:

1. As we mentioned in the part of this response that addressed the inclusion of 60 days of interest in the loan amount, HUD reviewed case # 105-2507386 as part of this QAD

audit. In this case, the loan amount was calculated using the 60 days of interest in question here. After re-examining this file and re-calculating the loan amount, HUD supported the loan amount figures as calculated, and made no comment regarding the 60 days of interest.

2. With regard to the question of whether HUD allowed borrowers to bring personal, post dated checks to closing, we have cited 12 case numbers that were re-reviewed by HUD as part of this 2007 audit. In these files, borrowers paid closing costs with personal checks, many of them were post dated. HUD made no findings regarding this issue.

Issue 7: Incorrect Underwriters' Certifications Were Submitted to HUD

We reviewed the certifications for the 22 loans with material underwriting deficiencies for accuracy. Allen Mortgage's Direct Endorsement underwriters incorrectly certified that Due Diligence was used in underwriting loans.

In order to determine whether this statement by the OIG is correct, there needs to be some definition of the minimum standards of "Due Diligence" with which to measure Allen Mortgage's certifications. These minimum standards are established by the Federal Government in section 24 of its code of Federal Regulations. Subsection 203.5(C) states, "The Secretary shall publish guidelines for Direct Endorsement underwriting procedures in a handbook, which shall be provided to all mortgagees approved for the Direct Endorsement procedure. Compliance with these guidelines is deemed to be the minimum standard of due diligence in underwriting mortgages." This issue hinges on whether the other actions brought up by the OIG were within the guidelines established in the 4155, its accompanying Mortgagee Letters, and requested HOC interpretation. If HUD finds that Allen Mortgage's actions with regard to the other issues mentioned were compliant with HUD's guidelines as outlined above, then it follows that the underwriter did meet the standards of due diligence set by HUD. It is our hope that we have provided solid evidence that with the exception of a few errors, our actions were within the guidelines set by HUD as outlined in the guiding documents listed above.

The Program Fraud Civil Remedies Act of 1986 (31 U.S.C. (United States Code) 3801 provides Federal agencies, which are the victims of false, fictitious and fraudulent claims and statements with an administrative remedy.

It seems to us that the best time to address this issue is after a determination has been made with regard to Allen Mortgage's actions in the other issues. If HUD finds that Allen Mortgage was acting within HUD's guidelines, then further administrative remedies should not be considered. If HUD finds that some of Allen Mortgage's actions were not supported by HUD

Comment 25

Comment 26

guidelines, then we would like to point out that administrative remedies are meant to punish the actions of individuals who acted with a certain amount of malice and intent to defraud. Allen Mortgage had no intention of committing fraud. Allen Mortgage thought their actions were within guidelines. Therefore, the level of intent to harm or commit fraud that would call for administrative remedies clearly doesn't exist.

Conclusion

Since this Conclusion delves into all the other issues mentioned above, it seems especially important here to use excerpts from the OIG's Discussion Draft as we have done in other places. This should make it easier to keep track of the issues as well as clarifying our rebuttal to the issue.

According to FHA requirements, a lender is required to establish that a borrower has the ability and the willingness to repay the mortgage debt.

As we stated in the beginning of our response, all of the loans reviewed by the OIG were streamline refinances. During the audit time period, our policies were pretty much dictated by HUD's guidelines. The 4155.1 REV5 section 1-12 Paragraph D.4 s states, " Underwriting. Mortgage credit underwriting is not required except for credit qualifying streamline refinance. The loan application and form HUD 92900-WS must be submitted; however, the sections regarding income, assets, and debts and obligations need not be completed (unless the borrowers are credit qualified)." None of the loans reviewed by OIG were credit qualifying streamlines. HUD's theory behind a regular streamline refinance is that the borrower's previous payment history is documentation of his willingness and ability to pay. We have added overlays of our own since then, but we were still sticking to the philosophy that underlies HUD's guidelines for a streamline refinance during the audit period.

Which should be based on sound underwriting principles consistent with the guidelines, rules and regulations denoted in HUD Handbook 4155.1 REV-5. Additionally the lender must support its decision to approve the mortgage with sufficient documentation.

In this statement, the OIG concurs with our previous statement that Handbook 4155.1 REV-5 should be the standard by which they measure our due diligence. We have shown how our actions were compliant with guidelines in the 4155.1 REV-5 with the exception of a few of our errors noted elsewhere in this Response. Allen Mortgage required all the documentation appropriate to a streamline refinance in order to support its decision.

Comment 27

Comment 28

Comment 29

Regulations at 24 CFR 203.5(c) require a Direct Endorsement Lender to exercise the same level of care it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment.

This question is somewhat tricky, since the streamline refinance program allows borrowers to forgo much of the verification process that is normally required. In fact, in the 4155.1 REV-5 Section 1-12 part D.4 it states, "Mortgage Credit underwriting is not required except for credit qualifying streamline refinance. The loan application and form HUD 92900-WS must be submitted; however, the sections regarding income, assets, and debts and obligations need not be completed (Unless the borrowers are credit qualified.)" While it is hard to argue that Allen Mortgage would make this same loan without the backing of FHA insurance, it is an accepted loan program through HUD, and it represents minimal risk to HUD since these are loans that are already part of the Mutual Mortgage Insurance Fund

Allen Mortgage failed to follow FHA requirements in underwriting 23 of the 73 loans reviewed (32 percent). This noncompliance occurred because Allen Mortgage disregarded HUD's requirements and its underwriters did not exercise due diligence in underwriting the loans.

Comment 30

Allen Mortgage hopes that it has shown that it has followed the 4155 and that it has been the basis for our actions, with few exceptions for the errors noted elsewhere in this Response. This should show that Allen Mortgage did not disregard HUD's requirements, and the fact that our loans conformed to the guidelines for a streamline refinance should show that our underwriters did meet the level of due diligence required.

According to Allen Mortgage, the underwriters calculated borrower's payoff amounts as though the borrower's mortgage payments were up to date, including the payment due the month of closing. This calculated amount would be the amount disclosed on borrowers' HUD-1 settlement statements.

Comment 31

This statement represents a misunderstanding that occurred during a conversation between Allen Mortgage and the OIG auditors. We will explain it again here. Essentially, what would happen was that borrowers would inform us that they had made the payment due for the month on their loan. Allen mortgage would then call the servicer for an updated payoff, and if the payment was not yet reflected on the new payoff statement, Allen mortgage would extrapolate the new principal balance and the new payoff figures based on our knowledge that the payment had been made. The math to make these calculations is not difficult, and all the information needed to do the calculation was in our loan file. It was rare for our payoff calculations to differ significantly from the actual updated payoff that would be received prior to funding.

Comment 32

These estimated payoff figures would then be used on the HUD-1 Settlement Statement at closing, based on the fact that we knew that the payment had been made and the servicer's payoff in the file was not accurate. We required that the updated payoff, reflecting the payment being made, be obtained prior to funding, and if the figures on this updated payoff differed from the figures used on the signed HUD-1, then a corrected HUD-1 would be prepared and sent to all parties concerned. It is true that when extrapolating the new principal balance and payoff figures, we worked on the assumption that the payment had been made on time. The reason is because if the payment were to show as delinquent somehow, Allen Mortgage would not be able to fund the loan, therefore a payoff that had delinquent interest killed the loan and was of no use to us. The most important thing to note with regard to this issue is that we decided that this practice, though not illegal, was sloppy. We decided that we would rather forgo the closing of these loans than to continue doing this, and we eliminated the policy all together as part of our tightening up on closing procedures.

According to Allen Mortgage's president, the underwriter would receive a stack of about 50 mortgage payoff statements for prospective borrowers to process and then use Allen Mortgage's computer system to calculate the maximum mortgage amount allowed on a streamline refinance. After the loans closed, the underwriter completed the borrower's mortgage credit analysis worksheets and the Direct Endorsement Approval

This statement does not reflect how things happen at Allen Mortgage. We are not sure what we could have said that caused this misunderstanding, but we want to clarify the process here. First, with regard to the calculation of payoff figures when a borrower had made a payment, we believe that the explanation in the previous response gives a detailed description of how and why this was done. Furthermore, these calculations were done by the Loan Officer or Processor prior to underwriting and then double checked by the Underwriter. There was never a time when an underwriter had a stack of 50 payoff statements and used Allen Mortgage's computer system to calculate either the new payoff figures or the maximum mortgage amount. The next issue raised by this statement has to do with the calculation of maximum mortgage amounts. With regard to the calculation of maximum mortgage amounts, it is true that the maximum mortgage amount calculations were done on each file during underwriting. This was to ensure that our loans did not exceed the maximum allowed, and we were successful in this with the exception of the three loans previously noted. The calculation of the maximum loan amounts was done by the underwriter, manually, on each individual loan. Allen Mortgage doesn't have an application in its system that calculates maximum mortgage amounts, so the underwriter has never used Allen Mortgage's computer system to calculate a maximum mortgage amount.

This statement from the Discussion Draft goes on to say that our underwriters would complete their Credit Analysis Worksheets and Direct Endorsement Approvals after the loans had closed.

Comment 33

We do think we know what the OIG is basing this statement on, and we want to clarify this. Our underwriter wanted to ensure that when a loan funded that she had underwritten, the figures being used and the conditions received were in agreement with the figures she had used and the conditions that she had made at underwriting. For this reason, she would hold off on SIGNING the MCAW and DE until she had a chance to review the figures at funding. The proper analysis of the MCAW and DE were done at underwriting. The underwriter's withholding her signature was meant as a control measure to ensure that a loan hadn't closed with different figures than the ones she used at underwriting. This statement by the OIG in its discussion draft seems to leave the impression that our underwriters would take the closed loan and then fill out their MCAWs and DEs to accommodate what was on the HUD-1. This was not the case.

Additionally, the president said that the underwriter mathematically calculated borrowers' payoff amounts as though the borrowers had made all the payments due on their existing mortgages, including the payment due for the month the refinanced loan was expected to close.

It is true that Allen Mortgage's president said that when the Loan Officers or Processors calculated the updated payoff amounts, they assumed that the borrowers had made the payment due on their existing mortgage. It was the Loan Officers and Processors, not the Underwriters who calculated updated payoff amounts. As long as the amount of the payoff was confirmed prior to funding, and the amounts on the HUD-1 Settlement Statement were correct, then we were able to confirm the borrower's eligibility before funding on the loan. As we mentioned before, it was not common for the estimated payoff figures to be significantly different than the final payoffs obtained from the servicer prior to funding. When these figures were different, either the loan could not fund because it was delinquent, or a corrected HUD would be issued and sent out prior to funding.

Allen Mortgage's underwriters obtained updated payoff statements for the borrowers at a later time. If a borrower did not make the payments due on the existing loan as expected, that borrower's settlement statement and loan payoff amount would be inaccurate.

Comment 31

It is true that sometimes Loan Officers would receive updated payoff statements for the borrowers at a later time, but this "later time" was always prior to funding. If it came time to fund a loan and the payoff showed that the payment was delinquent, then the loan didn't fund. On the occasions where the figures were on the HUD-1 Settlement Statement were inaccurate, a corrected HUD would be issued prior to funding and sent to all interested parties. We did not go back to borrowers for money that didn't show on their settlement statement after funding.

Allen Mortgage believed that it was helping borrowers by allowing them to skip mortgage payments and provide post dated checks or use credit cards to pay their settlement costs.

Comment 34

However, borrower's financial obligations were increased because the lender actively sought repayment from them after their loans closed.

The benefits that Allen Mortgage gave the borrowers were in the form of lower interest rates, lower P&I payments, or moving an adjustable rate to a fixed rate. Allen Mortgage did provide these benefits to the borrowers. If the borrower wrote a check for an amount shown on the HUD-1 settlement statement, and then bounced the check, then that is the point where the borrower has done himself a disservice. The borrower still received the benefit of the lower rate or a lower payment or a fixed rate that got him off of his ARM loan. It should also be noted that there were times when Allen Mortgage was unable to collect from the borrower, and we were forced to charge off this debt. This provided an even bigger benefit to the borrowers. On the occasions when Allen Mortgage actively sought repayment from a borrower, it was only for amounts that the borrower agreed to pay before hand as outlined on the HUD-1 Settlement Statement.

Allen Mortgage would then seek reimbursement from the borrower for the skipped mortgage payments.

Allen Mortgage did not seek reimbursement from borrowers for skipped mortgage payments. The most common reason for Allen Mortgage to seek reimbursement from borrowers was for bounced checks that were written to us, or for interest free advances that we gave the borrowers in accordance with Section 1-12 Paragraph D.7 of the 4155.1 REV 5. These amounts would be reflected on the borrower's HUD-1 Settlement Statement. We've never asked a borrower to reimburse us for any interest that we've added into their loan amount. We'd also like to point out that our current policies have eliminated the practice of collecting post dated checks from the borrower for the amounts shown in line 303. However, we do still advance funds to borrowers to set up their new escrow accounts, as it is still allowed by Section 1-12 Paragraph D.7 of the 4155.1 as it stands currently.

Comment 35

As a result of the improperly underwritten loans, the risk to FHA's Mutual Mortgage Insurance Fund was increased by more than \$ 2 million.

We feel like the estimate of 2 million dollars is inflated given that Streamline Refinances actually represent a minimal risk to the Mutual Mortgage Insurance Fund. Furthermore, if HUD finds that Allen Mortgage acted within the guidelines of the 4155, then it can also be argued that any additional risk to the Mutual Mortgage Insurance Fund was not the result of improperly underwritten loans.

Comment 36

Recommendations

We'd like to address each of the OIG's recommendations in turn. The OIG is recommending that HUD's Acting Deputy Assistant Secretary require the following from Allen Mortgage:

1A. Reimburse the FHA insurance fund \$395,054 for the losses incurred on for loans since the associated properties have been sold.

In examining the OIG table entitled, "Summary of Loans with Material Underwriting Deficiencies (monetary impact to HUD)" it appears that this recommendation is based on deficiencies in four case numbers; 263-4128155, 261-9338035, 262-1731385, 011-5930328. In examining the individual case summaries on these case numbers, OIG's main concern was the addition of the 60 days of interest into the loan amounts. The narratives on these individual case summaries also mention that post dated escrow checks were collected on these loans, as well as a claim that a bottom line amount wasn't figured in case # 261-9338035. We have addressed these issues elsewhere in this response, with the exception of the amount calculated on line 303 on the HUD-1 on case # 261-9338035, which we will address specifically in our response to the individual case summaries. If it is found that Allen Mortgage's actions in these matters were within the guidelines established by HUD, then these claims to the mutual mortgage insurance fund aren't the result of Allen Mortgage's disregard for HUD guidelines.

1B. Reimburse HUD for a \$55,297 claim paid for FHA case number 151-8624264 since the associated property was sold during a preforeclosure sale.

Allen Mortgage does not deny that we made mistakes on this loan, however the reason that this loan went to a claim status was due to the death of the primary wage earner. This would have been the case whether Allen Mortgage had done a streamline refinance on the loan or not, since the previous loan was already insured by FHA. We would like to argue that it was the death of the primary wage earner, rather than errors by Allen Mortgage that caused the \$55,297 loss to the Mutual Mortgage Insurance Fund.

1C. Reimburse the FHA insurance fund for any future losses from \$466,413 in claims paid on three loans once the associated properties have been sold.

This recommendation centers around the claim that there were underwriting deficiencies in 4 loans; 261-9356573, 151-8681596, 151-8704674, and 151-8624264. An examination of the Individual Case Summaries finds that the deficiencies that OIG is claiming with regard to these loans are as follows; 1- Allen Mortgage added 60 days of interest into these loan amounts, 2- the cash that was needed from the borrower was paid with post dated checks and credit cards, and 3- that these funds were received from the borrower after the closing date.

Comment 37

Comment 38

Comment 39

Comment 40

These issues are being considered throughout the Discussion Draft and this Response, and a rebuttal to the individual case summaries will be given in the section of our response that corresponds with those. It is our hope that these actions were allowable, and it was not our disregard for underwriting guidelines that caused these losses.

1D. Indemnify HUD for the 14 loans with material underwriting deficiencies. The estimated loss to HUD, based on its default loss rate of 59 percent of the unpaid principal balance is \$1,137,330. This will result in funds to be put to better use (other savings by the FHA insurance fund not having to pay future claims on the loans if the loans default.

Allen Mortgage believes that this recommendation, as well as recommendations 1A, 1C, and 1G would all be more appropriately dealt with after HUD has made its determination as to the validity of our responses. These recommendations are all based on OIG's assertion that Allen Mortgage was deficient in underwriting and closing these loans. Our response to this discussion draft includes several rebuttals to this assertion, and the evidence from the 4155 to support those rebuttals. While these issues are yet to be settled by HUD, discussion of these penalties seems premature.

1E. Buy down the three loans that were overinsured by \$1,111 and the one loan in which the borrower received \$188 in excess funds back from closing (\$1,111+\$188=\$1,299)

Allen Mortgage did miscalculate the maximum mortgage amounts on three of its loans. The details regarding these loans are outlined elsewhere in this Response. We are willing to buy down the three loans that were over insured by \$1,111 due to our miscalculation of the maximum mortgage amounts. We are also willing to do the principal reduction of \$188 on case number 561-2087147. This amount represents funds in excess of \$500.00 that were part of a refund check for a judgement that Allen Mortgage sent to the borrower.

Comment 41

1F. Implement adequate policies and procedures to ensure compliance with HUD's underwriting requirements

Allen Mortgage's policies and procedures have changed drastically between the audit time period and now. Most of these changes were done with the goal of preventing delinquencies and defaults, improving the quality of our loans, and ensuring better compliance with HUD, Investor, and Federal Guidelines. At the beginning of this Response, we have provided a detailed description of the policy changes that we have made in the section of Background and Highlights called, "What happened and What We Did to Fix It." Recognizing that the intent of this audit by the OIG was to identify problems that could be causing our high default and claim ratio, we would like to take the issues they have brought up in their discussion draft and address how these specific issues are handled under Allen Mortgage's current policies.

Comment 42

- Adding 60 days of interest to the new loan amount, which the OIG was referring to as “Skipping Payments”: Allen Mortgage still engages in this practice. With the publication of Mortgagee Letter 11-11 and its accompanying FAQs, it seems pretty clear that this practice is currently allowed by HUD.
- Bringing in Post Dated Checks for line 303 of the HUD-1 Settlement Statement: Allen Mortgage has discontinued this practice since the audit time period.
- Advancing funds to borrowers to set up their new escrow accounts: We have continued with this practice, as it is still allowed under the current version of the 4155.
- Allowing borrowers to use credit cards or other unsecured funds to pay for line 303 of the HUD-1: This practice has been discontinued for some time . HUD disallowed this practice in 2009 with the issuance of Mortgagee Letter 09-32.
- Calculating an updated payoff for use on the HUD-1 settlement statement at closing when the borrower’s payment has not yet been credited: Allen Mortgage no longer engages in this practice, if the payment does not show as made, then we require the loan officer to wait to close the loan until a corrected payoff can be obtained.
- Calculation of maximum mortgage amounts: Loan Officers now submit a mortgage calculation worksheet in their underwriting packages that detail exactly what is being added into the loan amount. These mortgage calculation worksheets are changed anytime HUD changes policies so that they can also be a guide to the Loan Officers and Processors. Underwriters review these mortgage calculation worksheets.
- Signing MCAWs and DE’s after closing but prior to funding: Though we understood the underwriter’s position regarding this action, we no longer allow any underwriter to do this.
- Issuing reimbursements to borrowers after funding. Our funders and our accounting department have had more in depth training about allowable charges. They are better aware of things like this and though errors like this did not happen often before, they happen even less now.

If HUD reviews this Discussion Draft and our corresponding response, and finds suggestions for further improvement, we will be grateful for the input.

16. Determine legal sufficiency and if legally sufficient, pursue remedies under the Program Fraud Civil Remedies Act against Allen Mortgage, its principals, or both for incorrectly certifying that due diligence was exercised during the underwriting of 22 loans.

First of all, we hope that Allen Mortgage has shown that it did exercise due diligence in underwriting 21 of the 22 loans referred to by the OIG, the one exception that we are referring to was case # 151-8624264 where the primary wage earner died and we did not get evidence that the co-borrower had been making the payments herself. We also hope that we have

Comment 43

Comment 44

shown that our actions were made in good faith and there was no intent to commit fraud. We sincerely hope that HUD will find that there is not legal sufficiency to pursue remedies under the Program Fraud Civil Remedies Act.

Findings 2 and 3:

Due to the number of issues to be addressed in Finding 1, and the time and research involved in framing a coherent response, it was not possible to respond to Findings 2 and 3 in this discussion draft within the time period allotted.

We have every intention of responding to these two additional findings when given the opportunity by HUD. Our research into the issues continues, and when the OIG sends its final report to HUD, we will have responses to these additional findings.

Once again we would like to thank everyone involved in this process, not only for their professionalism, but their willingness to give us this chance for a rebuttal. If there are any questions or matters that you would like to discuss, you can always contact me by phone at [REDACTED], or by e-mail to [REDACTED].

Sincerely

Allen Zitting
President
Allen Mortgage, LLC

OIG Evaluation of Auditee Comments

Comment 1 The audit was initiated by HUD-OIG as a result of Allen Mortgage's high default and claim rate for the FHA-insured loans sponsored in our region during the period October 1, 2007, through September 30, 2009. We acknowledge that as of November 2011, it had reduced its national compare ratio to 139 percent. However, for the purpose of this audit, the ratio was not a factor in the decision to perform our audit. The audit focused on the loans sponsored only in the region.

Comment 2 We agree and modified the report accordingly.

Comment 3 We commend Allen Mortgage for taking initiatives to improve its operations, and reducing its compare ratio.

Comment 4 HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. Further, paragraph 1-12 of the handbook addresses what is permissible to be included in the existing debt to determine the maximum insurable mortgage amount. The existing lien may include the interest charged by the servicing lender when the payoff is not received on the first day of the month as is typically assessed on FHA mortgages, but may not include delinquent interest, late charges, or escrow charges. Therefore, if the borrower makes a mortgage payment during the month of closing, the interest portion of that payment is for the month before. If the loan does not settle on the first day of the month (the date the borrower's mortgage payment becomes due), interest accrues per day, and that accrued interest is allowed to be included as part of the borrower's existing debt.

Comment 5 HUD Mortgagee Letter 2011-11 was not issued until February 14, 2011, which was after the scope of our audit. Further, HUD Handbook 4155.1 REV-5, paragraph 1-10, which was in effect during our audit period, specifically states that lenders are not permitted to allow borrowers to "skip" payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments "skipped" by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

In 2008, HUD issued Mortgagee Letter 2008-40, which revised the maximum mortgage calculation to include, in determining of a borrower's existing debt, accrued late charges and escrow shortages. It further states that the mortgage being refinanced must be current for the month due. For example, a refinance of a mortgage anytime in November must have had the October payment made. Of the 32 loans that we reviewed during the audit, only four loans were closed in

2009; thus they were evaluated based on the requirements set forth in this mortgagee letter which became effective on January 1, 2009.

- Comment 6** As previously mentioned in comment 5, we determined the criteria that were applicable for the loans reviewed during our audit period.
- Comment 7** We acknowledge that the report makes reference to the findings letter issued to Allen Mortgage from HUD's Quality Assurance Division (QAD). Although there were several loans reviewed by HUD, FHA case number 105-2507386 was not part of that review. Further, Allen Mortgage did not provide any documentation or correspondence with HUD to determine if the loan it cited contained the same underwriting deficiencies, and if so, how the deficiencies were resolved.
- Comment 8** We agree that the updated payoff identified that the borrower made the mortgage payment that was due on November 1, 2008. However, the mortgage payment due on December 1, 2008, was not made in accordance with HUD Handbook 4155.1, REV-5, which was the applicable guidance at the time this loan closed. We will modify the audit report accordingly.
- Comment 9** See comment # 4. We agree that for a streamline refinance, borrowers do not have to provide evidence of cash to close. The report mentioned the borrowers' form of payment to present the complete picture of how borrowers were settling their newly refinanced loans one or more months after closing. However, allowing borrowers to use credit cards created an additional liability and potentially impaired their ability to make their mortgage payments.

For FHA case numbers 261-9338035 and 151-8704674, the borrowers paid the funds that were due at closing one and two months, respectively, after their loans closed. Further, since the borrowers did not pay the necessary funds to close their loans, Allen Mortgage paid the funds; thus creating a conflict of interest relationship. It also created a potential first lien or short-term loan financing arrangement between Allen Mortgage and the borrowers. According to HUD, lenders may not provide cash advances to borrowers other than those made to establish escrow accounts.

Additionally, according to documentation maintained in the loan file for FHA case number 151-8704674, the borrower made two separate payments which totaled \$696. Allen Mortgage did not provide documentation to support its statements regarding the collection of an additional \$812.63 from the borrower as the first payment under their new loan or when the loan was sold. However, according to HUD Handbook 4155.1, REV-5, paragraph 2-21, borrowers are not to be required to write postdated checks, give cash, or otherwise make mortgage payments to the lender in advance of the borrower's mortgage payment required under the security instruments.

Comment 10 Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the HUD-1 settlement statement must indicate either the cash required from the borrower at settlement (the usual case in a purchase transaction) or cash payable to the borrower at settlement. Therefore, borrowers were required to bring funds to close, if needed, on their loans at settlement. Further, in reviewing Mortgagee Letter 2009-32, HUD requires borrowers to provide evidence of cash to close for streamline refinance transactions. As mentioned in the report, our audit period was from October 1, 2007, through September 30, 2009. Therefore, only 4 of the 32 loans reviewed were impacted by this mortgagee letter. HUD Handbook 4155.1, REV-5, was in effect for the remaining 28 loans.

The audit report does not question whether or not the borrowers provided evidence of funds to close; it addresses the fact that the borrowers provided postdated checks to settle their loans. Therefore the mortgagee letter did not change the requirement that borrowers must bring cash/funds to closing, if applicable. Further, since Allen Mortgage did not require borrowers to pay the cash required to close, it would provide the required funds then seek reimbursement.

Comment 11 During the audit, the audit team held several discussions with Allen Mortgage and provided applicable criteria that supported the findings cited in the audit report. The results of the audit were based on violations of Federal regulations or HUD handbooks. The HUD review was only used to disclose that HUD had identified similar issues when performing a review of Allen Mortgage.

Comment 12 The review performed by HUD's Quality Assurance Division reported that Allen Mortgage loaned or advanced funds to the borrower for closing which was evidenced by a promissory note in the borrower's loan file. The report did not state that the borrower provided postdated checks at settlement. It stated that HUD identified similar deficiencies in regards to Allen Mortgage advancing borrowers funds to close. We acknowledge that the loan was not indemnified and revised the report accordingly. However, Allen Mortgage did not provide any documentation to support the resolution of the deficiencies cited.

Allen Mortgage asserted that it did not advance funds to borrowers for closing costs. However, contrary to its assertions, it did allow borrowers to close their loans without paying the required funds to close. Further, borrowers were required to execute promissory notes agreeing to repay Allen Mortgage for the advanced funds as discussed in the audit report. HUD Handbook 4155.1, REV-5, paragraph 2-10, states that an independent third party must provide the borrowed funds to close. The seller, real estate agent or broker, lender, or other interested party may not provide such funds.

Comment 13 An audit performed by HUD OIG is independent of the review performed by HUD's Quality Assurance Division.

Comment 14 The table in the audit report was provided to show that the borrowers did not pay cash at settlement. Further of the nine loans listed, three identified discrepancies between the HUD-1 settlement statements maintained in the FHA case binders and HUD-1 settlement statements maintained by Allen Mortgage.

Comment 15 For FHA case number 561-8818240, the borrower's HUD-1 settlement statement (HUD-1) referenced in the table was the statement that was received by HUD and maintained in the FHA case binder. The HUD-1 referred to by Allen Mortgage was the one it maintained in its electronic loan files. However, the information contained on Allen Mortgage's version of the HUD-1 did not contain the same information as the HUD-1 settlement statement in the FHA case binder (as discussed in finding 2). We determined during the audit that the HUD-1 settlement statements sent to HUD were not always accurate. At closing, Allen Mortgage allowed borrowers to pay funds that were due at closing after their loans settled. However, the HUD-1 settlement statement maintained in the FHA case binder did not show that the borrowers needed funds to close.

Comment 16 For FHA case number 581-3334641, the borrower was permitted to pay the cash that was due at closing, after the loan settled. Further, the amount represented on the HUD-1 settlement statement maintained by HUD was not accurate.

Comment 17 For FHA case number 292-5210194, the borrower was permitted to pay the cash that was due at closing, after the loan settled. Further, the amount represented on the HUD-1 settlement statement maintained by HUD was not accurate.

Comment 18 See comments 15, 16, and 17.

Comment 19 The settlement requirements in HUD Handbook 4155.1, REV-5, are applicable to each transaction. Further, regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the HUD-1 settlement statement must indicate either the cash required from the borrower at settlement (the usual case in a purchase transaction) or cash payable to the borrower at settlement. This requirement is applicable for all real estate settlement transactions. The audit report included the verbiage to emphasize that the settlement statement indicates either cash required from the borrower at settlement or cash payable to the borrower at settlement.

Further, the lender must determine the amount of funds the borrower needs to close the loan. As mentioned in the audit report, one borrower was not aware that he needed funds to close.

Comment 20 We acknowledge that HUD Handbook, 4155.1, REV5, paragraph 1-12(d), for streamline refinance transactions states that borrowers are not required to provide evidence of cash-to-close. However, this does not mean that borrowers do not

have to bring cash that was needed to settle the refinance transaction to closing. Further, see comment 10 regarding the mortgagee letter.

Comment 21 Allen Mortgage acknowledged that it did not properly determine a borrower's eligibility for streamline refinancing. The remaining borrower should be credit qualified. We commend Allen Mortgage's commitment to address this issue cited in the audit report.

Comment 22 Allen Mortgage acknowledged that it did not properly calculate borrowers' maximum mortgage amounts. We commend Allen Mortgage's commitment to address this issue cited in the audit report.

Comment 23 Although Allen Mortgage did not provide documentation to support its statements, we commend Allen Mortgage's willingness to buydown the borrower's loan by \$188.

Comment 24 See comments 12 and 13

Comment 25 HUD's regulations at 24 CFR 203.5, states that direct endorsement lenders must exercise the same level of care which it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment. The Secretary should publish guidelines for direct endorsement underwriting procedures in a handbook, which should be provided to all lenders approved for the direct endorsement procedure. Compliance with these guidelines is deemed to be the minimum standard of due diligence in underwriting mortgages. Further, HUD's Direct Endorsement program lenders certify that they complied with all HUD's regulations and that due diligence was used in underwriting the loans. Therefore, since HUD's handbooks and guidance sets the minimum standards for underwriting loans, deviations from a HUD regulations would constitute a lack of due diligence as cited in the audit report.

Comment 26 The Program Fraud Civil Remedies Act of 1986, codified at 31 U.S.C. 3801-3812, established an administrative remedy against any person who makes, or causes to be made, a false claim or written statement to any of certain Federal agencies. Administrative actions recompense Federal agencies for losses, not necessarily to punish individuals. Regulations at title 24 CFR 25.6 list the violations creating grounds for administrative actions which include but are not limited to (1) violation of the requirements of any contract or agreement with (HUD), or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction, (2) submission of false information to HUD in connection with any HUD/FHA insured mortgage transaction; (3) business practices which do not conform to generally accepted practices of prudent mortgagees or which demonstrate irresponsibility, (4) violation by an approved mortgagee of the requirements or prohibitions of the Real Estate Settlement Procedures Act, and (5) failure to properly perform

underwriting functions in accordance with instructions and standards issued by the (HUD).

Therefore, violations of HUD's regulations, and mortgagee letters are subject to administrative actions. The appropriateness of the administrative action will be determined by HUD.

Comment 27 We agree that the loans reviewed were streamline refinances, and mortgage credit underwriting is not required except for credit qualifying streamline refinances. This sentence was included in the report due to the one loan that was streamline refinanced FHA case number 151-8624264 instead of being credit qualified. See comment 21. In performing the audit, HUD-OIG relies on laws, regulations, and written guidance applicable to HUD program participants.

Comment 28 As previously mentioned, HUD Handbook 4155.1 REV-5, paragraph 1-10, which was in effect during our audit period, specifically states that lenders are not permitted to allow borrowers to "skip" payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments "skipped" by the homeowner in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount. For 17 of the loans, Allen Mortgage did not require borrowers to make their mortgage payment(s) when they were due or bring their monthly mortgage payments to settlement. Therefore, all the documentation necessary to approve the loans were not provided.

Comment 29 See comment 21 and 27. Allen Mortgage acknowledged that it would be hard to argue that it would make this same loan without the backing of FHA insurance. However, HUD regulations at 24 CFR 203.5(c) require a direct endorsement lender to exercise the same level of care it would exercise in obtaining and verifying information for a loan in which the lender would be entirely dependent on the property as security to protect its investment.

Comment 30 See comments 4, 9, 19, and 21

Comment 31 Allen Mortgage acknowledged that it calculated borrowers' payoff amounts based on borrowers stating that they made all the payments due on their mortgages. It did not confirm this information with the borrowers' servicers or wait to receive updated payoff statements. Additionally, HUD and at least one borrower did not receive accurate and updated HUD-1 settlement statements. The borrower received a HUD-1 settlement statement that showed that he did not pay funds at closing, which was the same as the one submitted to HUD. However, based on the documentation in Allen Mortgage's loan files, we determined that the borrower actually paid funds after the loan had closed.

Therefore, contrary to Allen Mortgage's statements, accurate HUD-1 settlement statements were not always provided to all concerned parties.

Allen Mortgage's failure to provide complete and accurate information to borrowers is a potential RESPA violation. RESPA requires that HUD-1 settlement statements show the actual settlement costs of the loan transaction which should be provided by the borrower within 45 days after settlement. Further, at least seven borrowers received settlement statements that disclosed that no funds were due at closing. However, the settlement statements maintained by Allen Mortgage showed that the borrowers had to pay funds at closing.

Comment 32 We adjusted the report accordingly.

Comment 33 We adjusted the report to state that loan officers and processors calculated the payoff amounts, not underwriters. However, Allen Mortgage's underwriters are responsible for approving loans. Further, see comment 31

Comment 34 Contrary to Allen Mortgage's assertions, borrowers did not always benefit from streamline refinancing because it actively sought reimbursement from the borrowers to recoup the skipped payments or settlement costs. Therefore, the benefits that the borrowers should have received were diminished due to the newly acquired liability. Borrowers' good faith estimates did not always disclose that funds were needed to close. For instance, one borrower was not informed that funds were needed to close until settlement.

Comment 35 Lenders are permitted to grant interest free advances to establish new escrow accounts for borrowers in accordance with HUD Handbook of the 4155.1, REV-5. However, the handbook does not state that lenders are permitted to grant interest free loans to borrowers for the amount of the cash due at closing, which was often the case according to the documentation maintained by Allen Mortgage. The guidance in HUD Handbook 4155.1, REV-5, states that lenders or other interested third parties may not advance cash to borrowers for cash to close in paragraph 2-10 (D). Further as mentioned in the audit report, one borrower informed the auditors that he executed a promissory note, which was included in his loan file, with Allen Mortgage to pay the amount due on his previous mortgage. The funds that the borrower had to pay were not represented on his copy of the settlement statement or the settlement statement maintained in the FHA case binder.

Comment 36 The \$2 million is the estimated loss that HUD could potentially incur based on the 21 loans with underwriting deficiencies regardless of whether the loans were refinances or purchases.

Comment 37 Based on the deficiencies identified in this audit report, we believe our recommendations are appropriate. Further, see comments 5, 9, and 12.

- Comment 38** We disagree. Allen Mortgage refinanced this loan after the death of the primary borrower. The remaining borrower should have been credit qualified. Further, see comment 21.
- Comment 39** Based on the deficiencies identified in this audit report, we believe our recommendations are appropriate. Further, see comments 4, 10, 14, and 19.
- Comment 40** Based on the deficiencies identified in this audit report, we believe our recommendations are appropriate.
- Comment 41** We commend Allen Mortgage for agreeing to buydown the loans.
- Comment 42** We have not evaluated Allen Mortgage's implementation of its changed policies or procedures, or its implementation of HUD Mortgagee letter 2011-11.
- Comment 43** Based on the deficiencies identified in this audit report, we believe our recommendations are appropriate.
- Comment 44** We provided our results of our underwriting and quality control reviews to Allen Mortgage on an ongoing basis throughout the audit. Therefore, the information presented in the audit report, was provided to Allen Mortgage several months prior to the issuance of this audit report. Further, after the issuance of the discussion draft audit report, we provided Allen Mortgage nearly 30 days to prepare its written response.

Appendix C

SUMMARY OF LOANS WITH UNDERWRITING DEFICIENCIES

FHA case number	Skipped payment	Funds not paid at closing	Settled loans using credit cards ³⁰	Eligibility not properly determined	Miscalculated maximum mortgage amount	Borrower received more than \$500 at settlement	Material underwriting deficiencies
151-8681596	X	X					X
561-8818240	X	X					X
261-9356573	X	X					X
292-5210194	X	X					X ³¹
263-4128155	X						X
261-9338035	X		X				X
262-1731385	X		X				X
581-2985846	X						X
491-9085385	X						X
292-4835727	X						X
291-3657749	X						X
151-8704674	X		X				X
291-3690893	X						X
493-8933804	X						X
011-5930328	X						X
581-2884051	X						X
483-4074768	X						X
491-9528744		X					X
105-4322752		X					X ³²
493-8825894		X					X
581-3334641		X					X
151-8570534		X					X
151-8624264				X			X
562-2087147						X	
263-4211541					X		
263-4186532					X		
381-9331530					X		
Total	17	9	3	1	3	1	23

³⁰ The borrowers' personal credit were charged after their loans closed.

³¹ This loan was streamline refinanced.

³² This loan was streamline refinanced.

Appendix D

SUMMARY OF LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

Count	FHA case number	Loss to HUD	Claim paid	Unpaid principal balance	Estimated loss to HUD (66 percent of unpaid principal balance)
1	263-4128155	\$132,281			
2	261-9338035	112,112			
3	262-1731385	106,450			
4	011-5930328	44,193			
5	261-9356573	-	\$199,361		
6	151-8681596	69,269			
7	151-8704674	107,103			
8	151-8624264	-	55,296 ³³		
9	561-8818240	-	-	\$257,525	\$169,966
10	491-9528744	-	-	196,333	129,580
11	581-2884051	-	-	156,824	103,504
12	581-2985846	-	-	151,758	100,161
13	491-9085385	120,260	-		
14	292-4835727	-	-	130,084	85,855
15	291-3657749	-	-	119,567	78,914
16	493-8825894	-	-	117,435	77,507
17	483-4074768	-	-	115,781	76,415
18	581-3334641	119,496	-		
19	291-3690893	-	-	91,713	60,531
20	493-8933804	-	-	90,939	60,020
21 ³⁴	151-8570534	-	-	87,256	57,589
Totals		\$811,163	\$199,361³⁵	\$1,528,873	\$1,000,042

³³ The amount was a preforeclosure claim.

³⁴ There were 23 loans with material underwriting deficiencies; however, FHA case numbers 105-4322752 and 292-5210194 were paid in full. The borrowers streamline refinanced their loans.

³⁵ This amount does not include the \$55,296 claim paid for the property that was sold through a preforeclosure sale.

Appendix E

NARRATIVES OF LOANS WITH MATERIAL UNDERWRITING DEFICIENCIES

FHA case number: 263-4128155

Mortgage amount: \$168,457

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement January 31, 2008

Status: Claim

Payments before first 90-day delinquency reported: Four

Loss to HUD: \$132,281

Area of Noncompliance: Skipped payment

Summary:

The borrower's mortgage payoff statement, dated January 11, 2008, indicated that the borrower had not made the mortgage payment due on January 1, 2008. According to the borrower's mortgage payoff statement, the total due on the loan was \$166,940, which included accrued interest from December 1, 2007, to January 31, 2008. Allen Mortgage's loan files did not contain documentation indicating that the borrower made the final mortgage payment that was due on January 1, 2008, on the previous loan before or at closing as required by HUD. Further, Allen Mortgage paid more than \$659 to assist with the settlement of this loan.

Criteria

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the borrower in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.

FHA case number: 151-8681596

Mortgage amount: \$142,789

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: April 29, 2008

Status: Claim

Payments before first 90-day delinquency reported: Five

Loss to HUD: \$69,269

Areas of noncompliance: Skipped payment, funds not paid at closing

Summary:

The borrower's credit report indicated that the borrower's mortgage was current as of March 2008. However, the borrower's payoff statement, dated April 22, 2008, showed that the loan was due for the April 1, 2008, payment and as a result, incurred late charges. Allen Mortgage's loan files or the FHA case binder did not contain documentation to determine whether the borrower made the payment that was due on the previous mortgage before or at closing as required by HUD.

Additionally, the borrower's HUD-1 settlement statement indicated that the borrower was required to pay \$1,219 to close on the new loan. However according to the Allen Mortgage's records, the borrower did not provide funds at closing. Instead, the borrower provided a personal check, dated May 3, 2008, made payable to Allen Mortgage after the loan had closed and settled. According to HUD's requirements, line 303 of the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the borrower in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Paragraph 1-9 states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference

between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

Regulations at 24 CFR 203.330 state that a mortgage account is delinquent any time a payment is due and not paid.

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 must indicate either the cash required from the borrower at settlement (the usual case in a purchase transaction) or cash payable to the borrower at settlement.

FHA case number: 261-9338035

Mortgage amount: \$101,429

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: April 29, 2008

Status: Claim

Payments before first 90-day delinquency reported: Four

Loss to HUD: \$112,112

Area of noncompliance: Skipped payment

Summary:

The borrowers' mortgage payoff statement, dated April 14, 2008, indicated that the borrowers' mortgage payments due on March 1 and April 1, 2008, were not paid. The borrowers' executed HUD-1 settlement statement in the FHA case binder and the HUD-1 settlement statement maintained in Allen Mortgage's loan files did not indicate that the borrowers were required to pay cash to close the loan. Additionally, Allen Mortgage's loan files and the FHA case binder did not contain documentation to determine whether the borrowers made the payments due under the borrowers' previous mortgage before or at closing as required by HUD.

According to the borrowers' HUD-1 settlement statement generated by the title company, the borrowers were required to pay \$891 at closing. According to Allen Mortgage's financial documentation, the borrowers were required to pay \$891 to close the loan and \$3,000 down to establish an escrow account. The borrowers paid Allen Mortgage the \$891 that was needed to close the loan on May 12, 2008, using a credit card, and paid two-thirds of the escrow in two installment payments of \$1,000 on May 16 and May 19, 2008, respectively, also using a credit card. Therefore, the borrowers charged \$2,891 to a credit card during the month of May 2008; however, the borrowers' loan closed and settled in April 2008. According to HUD's requirements, funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. Additionally, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement to close the loan.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated,

FHA does not permit the inclusion of mortgage payments skipped by the borrower in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Paragraph 2-10(D) states that regarding collateralized loans, funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. Such assets may include stocks, bonds, real estate (other than the property being purchased), etc. An independent third party must provide the borrowed funds. The seller, real estate agent or broker, lender, or other interested third party may not provide such funds.

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

FHA case number: 262-1731385

Mortgage amount: \$120,124

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: April 30, 2008

Status: Claim

Payments before first 90-day delinquency reported: Zero

Loss to HUD \$106,450

Area of noncompliance: Skipped payment

Summary:

The borrower's mortgage payoff statement included accrued interest from March 1 to May 1, 2008, which meant that the borrower's April 1, 2008, mortgage payment had not been made before the loan closed. The HUD-1 settlement statement maintained in Allen Mortgage's loan files showed a customer deposit in the amount of \$820 in the borrower financing section (section 200). In addition, Allen Mortgage's wire calculation sheet showed that Allen Mortgage collected \$820 from the borrower to close. However, the borrower's executed HUD-1 settlement statement in the FHA case binder did not show that the borrower needed \$820 to close the loan; instead, it showed that the borrower received \$500 cash back at closing. According to HUD's requirements, lenders are not permitted to allow borrowers to skip payments.

According to Allen Mortgage's financial reports and supporting records, the borrower paid \$820 to close the loan on June 22, 2008, using a credit card. According to HUD's requirements, funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. Additionally, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement to close the loan. The loan closed on April 14, 2008, and settled on April 30, 2008.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

Paragraph 2-10(D), regarding collateralized loans, states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property. Such assets may include stocks, bonds, real estate (other than the property being purchased), etc. An independent third party must provide the borrowed funds. The seller, real estate agent or broker, lender, or other interested third party may not provide such funds.

FHA case number: 151-8624264

Mortgage amount: \$138,367

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: March 28, 2008

Status: Claim

Payments before first 90-day delinquency reported: Five

Claim paid: \$55,296³⁶

Area of noncompliance: Eligibility not properly determined

Summary:

The primary borrower died, and the coborrower streamlined refinanced the FHA-insured loan. Allen Mortgage's underwriter did not determine the coborrower's ability to repay the loan before refinancing the loan. The primary borrower on the previous loan died on February 26, 2008, according to a death certificate in the Allen Mortgage's loan file. However, the closing date of the new loan was March 21, 2008, which was less than 1 month following the death of the coborrower's spouse, the previous primary borrower. Allen Mortgage's underwriter did not show that the coborrower could make the mortgage payments without the primary borrower for at least 6 months before the new loan closed in accordance with HUD's requirements. The coborrower did not make one payment on the previous mortgage after the primary borrower died, which was before the loan was streamline refinanced.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-12(D), states that individuals may be deleted from the title on a streamline refinance only when (1) the assumption of the mortgage not containing a due-on-sale clause occurred more than 6 months previously and the assumptor can document that he or she has made the mortgage payments during this interim period or (2) following an assumption of a mortgage when a due-on-sale clause was not triggered and the assumption or quit-claim of interest occurred more than 6 months previously and the assumptor can document that he or she made the mortgage payments during this time.

³⁶ The claim was paid as a result of a preforeclosure sale.

FHA case number: 561-8818240

Mortgage amount: \$271,463

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: October 31, 2008

Status: Active

Payments before first 90-day delinquency reported: One

Unpaid principal balance: \$257,525

Areas of noncompliance: Skipped payment, funds not paid at closing

Summary:

The borrower's loan closed on October 27, 2008, and the loan was settled on October 31, 2008. Allen Mortgage's underwriter approved the loan on October 28, 2008. The borrower's HUD-1 settlement statement generated by the title company was different from the settlement statement maintained in the FHA case binder. The title company's settlement statement showed that the mortgage payoff amount on the borrower's previous loan was \$269,301 and the cash required from the borrower to close on the new loan was \$3,854. The borrower's HUD-1 settlement statement in the FHA case binder had a payoff amount of \$267,609, and the total cash required from the borrower to close was \$1,927.

Allen Mortgage's financial records did not support that the borrower paid the \$1,927 that was due at closing. The borrower provided Allen Mortgage with three postdated checks after the loan had closed and settled. It received the first check in the amount of \$1,921 on November 17, 2008, the second check in the amount of \$350 on December 2, 2008, and the last check in the amount of \$1,927 on December 2, 2008. Therefore, Allen Mortgage received a total of \$4,198 from the borrower after the loan closed. Additionally, according to Allen Mortgage's financial records, all three of the postdated checks did not clear the borrower's bank account because of insufficient funds. According to HUD's requirements, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

The borrower's mortgage payoff statement indicated that the borrower's loan payoff amount included accrued interest for the period September 1 to November 1, 2008. However, Allen Mortgage's loan files did not contain documentation to support that the borrower made the mortgage payment due on October 1, 2008, under the previous loan. According to HUD's requirements, lenders are not permitted to allow borrowers to skip payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

Paragraph 1-9 states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

FHA case number: 491-9528744

Mortgage amount: \$206,834

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: May 22, 2009

Status: Active

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: \$196,333

Area of noncompliance: Funds not paid at closing

Summary:

The borrower's loan closed May 16, 2009, but was approved by Allen Mortgage's underwriter on May 20, 2009, which was after the borrower signed the settlement statement. The underwriter did not obtain the borrower's mortgage payoff statement until after the borrower closed on the new loan. Additionally, the borrower's HUD-1 settlement statement in Allen Mortgage's loan files and the FHA case binder showed that the borrower was required to pay \$586 to close on the newly refinanced loan. However, contrary to HUD's requirements, the borrower paid Allen Mortgage the funds needed to close using a personal check, dated June 20, 2009, in the amount of \$586, after the loan had closed and settled.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

FHA case number: 261-9356573

Mortgage amount: \$181,770

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: February 28, 2008

Status: Active

Payments before first 90-day delinquency reported: Eight

Claim paid \$199,361

Areas of noncompliance: Skipped payment, funds not paid at closing

Summary:

The borrower's mortgage payoff statement, dated February 13, 2008, included accrued interest from January 1 to March 1, 2008. Therefore, the borrower did not make the mortgage payment that was due on February 1, 2008, before the loan was streamline refinanced. Allen Mortgage's loan files did not contain documentation to determine whether the borrower made the mortgage payment before or at closing. The borrower's HUD-1 settlement statement indicated that the borrower needed \$1,112 to close the loan. Allen Mortgage's financial records, in particular its ledger, disclosed a debit to undeposited funds and a credit to receivables on March 3, 2008, for \$1,112, the exact amount the borrower needed to close. Therefore, Allen Mortgage's records did not support that the borrower paid the needed funds to close the loan. The borrower's new loan closed on February 21, 2008, and settled on February 28, 2008. HUD requires that borrowers either pay the mortgage payment when it is due or bring the final mortgage payment to closing.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the borrower in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

FHA case number: 581-2985846

Mortgage amount: \$161,487

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: March 31, 2008

Status: Active

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: \$151,758

Area of noncompliance: Skipped payment

Summary:

The borrower's payoff statement included interest accrued from February 1 to May 1, 2008. However, the loan was funded in March 2008. The borrower's payoff amount identified on the HUD-1 settlement statement reflected the accurate payoff amount by reducing it by the borrower's March 1, 2008, mortgage payment. However, Allen Mortgage's loan files did not contain documentation to support whether the borrower made the mortgage payment due March 1, 2008, before the loan closed. The title company's payment ledger identified that no funds were collected from the borrower at closing. However, Allen Mortgage's financial records showed that it received the borrower's personal check in the amount of \$554 on April 24, 2008. However, the borrower's principal and interest mortgage payment on the new loan was \$968.20. Further, according to the Allen Mortgage's title ledger, it paid \$669.90 on behalf of the borrower to close the mortgage transaction.

According to Allen Mortgage's settlement disbursement calculation worksheet, the borrower needed \$1,324 to close the loan. However, the borrower's HUD-1 settlement statements in Allen Mortgage's loan files and the FHA casebinder did not indicate that the borrower was required to pay funds to close. According to HUD's requirement, lenders are not permitted to allow borrowers to skip payments. Additionally, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to

settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

FHA case number: 292-5210194

Mortgage amount: \$148,210

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: January 16, 2009

Status: Terminated

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: Paid in full

Areas of noncompliance: Skipped payment, funds not paid at closing

Summary:

The borrower's new loan closed January 12, 2009. However, the loan was approved by Allen Mortgage's underwriter on January 26, 2009. Additionally, according to the borrower's HUD-1 settlement statement, the borrower needed \$650 to close. The borrower's payoff statement showed that the borrower's previous loan was due for the January 1, 2009, payment.

Further, the borrower's HUD-1 settlement statement contained a description, "Jan. Pmnt Paid At Closing," on line item 205 for \$1,341. According to Allen Mortgage, this amount represented the funds the borrower needed to close and should have been on line 303. Further, according to Allen Mortgage's financial records, it received two personal checks from the borrower in the amounts of \$1,341 on February 9, 2009, and \$650 on February 23, 2009. However, the checks were dated January 27 and February 24, 2009, respectively. On July 20, 2009, Allen Mortgage issued the borrower a refund of \$247. Contrary to HUD's requirements, the lender allowed the borrower to skip payments and close on the loan without paying the required cash to close.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any

upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

FHA case number: 105-4322752

Mortgage amount: \$141,903

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: December 29, 2008

Status: Terminated

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: Paid in full

Area of noncompliance: Funds not paid at closing

Summary:

Allen Mortgage's underwriter approved the loan on December 24, 2008. However, the new loan closed on December 22, 2008. According to the borrower's HUD-1 settlement statement prepared by the title company, the borrower was required to pay \$791 to close the loan. According to Allen Mortgage's financial records, the borrower provided a personal check, dated January 12, 2009, in the amount of \$791 to close the loan. However, the funds were provided after the loan had already closed and settled. Contrary to HUD's requirements, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

FHA case number: 491-9085385

Mortgage amount: \$141,402

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: December 27, 2007

Status: Claim

Payments before first 90-day delinquency reported: Seven

Loss to HUD: \$120,260

Area of noncompliance: Skipped payment

Summary:

The borrowers' mortgage payoff statement, dated December 5, 2007, indicated that the borrowers had accrued interest from November and December 2007. Therefore, as of the date of the statement, the borrowers had not paid their mortgage payment due on December 1, 2007. In addition, the borrowers' HUD-1 settlement statement signed by the borrowers on December 22, 2007, did not require the borrowers to bring cash to close. Allen Mortgage's loan files did not contain documentation to determine whether the borrowers made the mortgage payment due on their previous loan before or at closing. According to HUD's requirements, lenders are not permitted to allow borrowers to skip payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

FHA case number: 292-4835727

Mortgage amount: \$138,420

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: December 27, 2007

Status: Active

Payments before first 90-day delinquency reported: Seven

Unpaid principal balance: \$130,084

Area of noncompliance: Skipped payment

Summary:

The borrowers' mortgage payoff statement indicated that the borrowers did not pay their mortgage payments due December 1, 2007. The loan closed on December 20, 2007. According to the borrowers' HUD-1 settlement statement, the borrowers were not required to bring funds to close. Additionally, Allen Mortgage's loan files did not contain documentation to determine whether the borrowers made the payments that were due on their previous loan before or at closing. According to HUD's requirements, lenders are not permitted to allow borrowers to skip payments.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment check to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

FHA case number: 291-3657749

Mortgage amount: \$127,232

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: March 30, 2008

Status: Active

Payments before first 90-day delinquency reported: 11

Unpaid principal balance \$119,567

Area of noncompliance: Skipped payment

Summary:

The borrower's new streamline refinanced loan closed on March 18, 2008, and was funded on March 30, 2008. The borrower's HUD-1 settlement statement generated by the title company contained the line item description, "March Pmt Reimbursement Check," for \$857 on line 205. This line item was not on the HUD-1 settlement statement in the FHA case binder. According to Allen Mortgage, the borrower's March reimbursement check amount was the amount of funds the borrower needed to close. Therefore, it should have been on line 303 of the settlement statement, representing the funds needed from the borrower to close.

According to Allen Mortgage's financial records, it did not collect the \$857 that was due at closing from the borrower. Its ledger showed that a reimbursement payment of \$1,004 was received and debited to the account, entitled "Undeposited Funds," and credited to its accounts receivable on April 7, 2008. According to the borrower's mortgage credit analysis worksheet, the new loan's monthly mortgage payment was \$1,004, which was the amount of the payment that was debited to its undeposited funds account.

Additionally, the borrower's mortgage payoff statement included accrued interest from February 1 to March 31, 2008. The payoff statement was dated March 18, 2008. According to Allen Mortgage's records, the borrower made a payment to Allen Mortgage using a credit card on April 7, 2008, which was after the loan closed and was funded.

According to HUD's requirements, borrowers are not allowed to skip payments, and lenders may not advance cash to borrowers for funds to close. Also, lines 204–209 on the HUD-1 settlement statement should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

Paragraph 2-10(D) states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

FHA case number: 493-8825894

Mortgage amount: \$123,791

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: October 30, 2008

Status: Active

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: \$117,435

Area of noncompliance: Funds not paid at closing

Summary:

Allen Mortgage's underwriter approved the mortgage on October 27, 2008; however, the borrowers' loan closed on October 25, 2008. The borrowers' HUD-1 settlement statement indicated that \$1,263 was due from the borrowers at closing. However, according to Allen Mortgage's financial records, the borrowers paid \$1,263 to Allen Mortgage with a personal check, dated October 31, 2008, which was after the loan had closed and settled. Allen Mortgage did not receive the borrowers' check until November 3, 2008. According to HUD's requirements, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

FHA case number: 581-3334641

Mortgage amount: \$114,942

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: February 27, 2009

Status: Claim

Payments before first 90-day delinquency reported: Four

Loss to HUD: \$119,496

Area of noncompliance: Funds not paid at closing

Summary:

The borrower's HUD-1 settlement statement in the FHA case binder and from the title company identified that \$803 was due from the borrower to close on the new refinanced loan. Allen Mortgage's financial records showed that \$770 was recorded as "BH" (bottom hold)³⁷ in Allen Mortgage's undeposited funds account on March 5, 2009. Additionally, its records identified an adjustment on March 9, 2009, that increased the amount in its receivables account to \$33. The increase was called "underpaid bottom hold" ($\$33 + \$770 = \$803$).

Allen Mortgage's financial records did not indicate that the borrower paid the funds that were due at closing. However, the borrower provided Allen Mortgage with a check, dated March 4, 2009, in the amount of \$770 after the loan had closed and settled. HUD's requirements state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

³⁷ According to Allen Mortgage, a bottom hold check represents the amount that the borrower paid to close the loan.

FHA case number: 151-8704674

Mortgage amount: \$108,225

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: May 31, 2008

Status: Claim

Payments before first 90-day delinquency reported: 12

Loss to HUD: \$107,103

Area of noncompliance: Skipped payment

Summary:

The borrowers' previous loan was due for the May 1, 2008, payment at the time of refinancing. The HUD-1 settlement statement in Allen Mortgage's loan files indentified that the borrowers were required to pay \$878 to close on the new loan. However, the HUD-1 settlement statement in the FHA case binder showed that the borrowers did not need funds to close. The borrowers made two payments to Allen Mortgage, using a credit card, in the amounts of \$500 on July 1, 2008, and \$196 on July 3, 2008. Thus, the borrowers charged a total of \$696 to their credit card in July 2008 to pay a portion of the funds that were supposedly due at closing after the loan had closed and settled.

According to HUD's requirements, borrowers are not allowed to skip payments, and lenders may not advance cash to borrowers for funds to close.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is

either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

Paragraph 2-10(D) states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

FHA case number: 291-3690893

Mortgage amount: \$97,459

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: April 29, 2008

Status: Active

Payments before first 90-day delinquency reported: 25

Unpaid principal balance: \$91,713

Area of noncompliance: Skipped payment

Summary:

The borrower's new loan closed April 23, 2008 and settled on April 29, 2008. However, Allen Mortgage's underwriter approved the loan on April 25, 2008. The borrower's mortgage payoff statement showed that the loan was due for the April 1, 2008, payment. The HUD-1 settlement statement indicated that the borrower did not have to pay funds to close. Additionally, Allen Mortgage's loan files did not contain documentation to determine whether the borrower made the mortgage payment due on the previous loan at or before closing as required by HUD.

Criteria:

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

FHA case number: 493-8933804

Mortgage amount: \$95,917

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: January 31, 2009

Status: Active

Payments before first 90-day delinquency reported: 18

Unpaid principal balance: \$90,939

Area of noncompliance: Skipped payment

Summary:

The loan closed on January 21, 2009, but was approved by the underwriter on January 27, 2009. The borrower's HUD-1 settlement statement in the FHA case binder indicated that the borrower did not need funds to close. The borrower's HUD-1 settlement statement in Allen Mortgage's loan files indicated that the borrower needed \$742 to close on the newly refinanced loan. The borrower's signature on the HUD-1 settlement statement in Allen Mortgage's investor files was misspelled, and this HUD-1 settlement statement also required the borrower to pay \$742 at closing.

The borrower's loan file contained a notarized promissory note executed between the borrower and Allen Mortgage in which the borrower promised to reimburse Allen Mortgage \$742 for paying the borrower's mortgage payment due on February 1, 2009, under the previous loan. Since the loan closed in January 2009, the first payment would not have been due on the new mortgage until March 1, 2009. Further, the borrower's loan file contained a collection letter, dated December 22, 2009, stating that the borrower owed \$742 for the downpayment and \$160 to start the borrower's escrow account. However, as of the date of the letter, the borrower had paid Allen Mortgage only \$371 on February 27, 2009. The collection letter further stated that if Allen Mortgage did not hear from the borrower by January 5, 2010, the borrower's account balance would be forwarded to a collection company, and a lien will be placed on the borrower's property.

According to HUD's requirements, borrowers are not permitted to skip payments, lenders may not provide funds to borrowers for cash to close, and borrowers may not secure funds to close when the real property being financed is used for collateral.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

HUD Handbook 4155.1, REV-5, paragraph 2-10(D), states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

FHA case number: 151-8570534

Mortgage amount: \$92,977

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: February 28, 2008

Status: Active

Payments before first 90-day delinquency reported: Six

Unpaid principal balance: \$87,256

Area of noncompliance: Funds not paid at closing

Summary:

The borrower's new streamline refinanced loan closed on February 19, 2008, and settled on February 28, 2008. The borrower's mortgage payoff statement, dated February 12, 2008, indicated that the borrower's mortgage payment due on February 1, 2008, was not paid. The HUD-1 settlement statement identified that \$737 was financed for the borrower as a "March Payment Hold Check" on line 206 of the HUD-1 settlement statement and that the borrower needed \$1,670 to close the loan. According to the borrower's mortgage payoff statement, the borrower's mortgage payment was not due since the borrower had made all payments under the mortgage to the previous servicer. As a result, the first payment was not due on the new loan until April 1, 2008, and there should not have been a payment due for the month of March 2008.

Additionally, according to the Allen Mortgage's wire calculation sheet in the borrower's loan file, it anticipated collecting \$737 to establish a new escrow account and \$1,670 as the HUD-1 bottom line 303 payment, which was due at closing from the borrower. A review of the borrower's payment documentation in the loan file showed that the borrower paid Allen Mortgage with two personal checks. The first check for \$1,670 was dated March 29, 2008, and the second check for \$737 was dated March 26, 2008. Therefore, the borrower did not pay the funds needed to close until after the loan closed and settled.

According to HUD's requirements, line 303 on the settlement statement must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new

loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

FHA case number: 011-5930328

Mortgage amount: \$103,573

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: July 31, 2008

Status: Claim

Payments before first 90-day delinquency reported: Four

Loss to HUD: \$44,193

Area of noncompliance: Skipped payment

Summary:

The new loan closed on July 11, 2008, was approved by the underwriter on July 28, 2008, and settled on July 31, 2008. The borrower's mortgage payoff statement, dated July 8, 2008, showed that the loan was due for the July 1, 2008, payment. The borrower's HUD-1 settlement statement showed that the borrower received \$400 cash back at closing. The settlement statement also contained a description of a payment in the amount of \$781 ("Aug Paycheck from borrower") that was due from or on behalf of the borrower on line 205.

According to Allen Mortgage, the amount on line 205 should have been on line 303 (cash to or from borrower) and netted against the \$400 that was due to the borrower at closing. Allen Mortgage's loan file did not contain documentation to support that the borrower made the payment due on July 1, 2008, before or at closing. Further, according to the title company's ledger, the borrower received \$400 back at closing on July 31, 2008, when the loan settled. However, in reviewing Allen Mortgage's financial documentation, we determined that the borrower paid Allen Mortgage \$781 using a personal check on August 15, 2008, after the loan closed and settled.

According to HUD's requirements, borrowers are not permitted to skip payments when refinancing, and lenders are not allowed to advance funds to borrowers for cash to close.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 2-10(D), states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

HUD Handbook 4155.1, REV-1 paragraph 1-10(E), states that lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of mortgage payments skipped by the borrower in the new mortgage amount. For example, a borrower whose mortgage payment is due June 1 and who expects to close the refinance before the end of June is not permitted to roll the June mortgage payment into the new FHA loan amount.

FHA case number: 581-2884051

Mortgage amount: \$167,084

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: October 30, 2007

Status: Active

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance \$156,824

Area of noncompliance: Skipped payment

Summary:

The borrower's mortgage payoff statement indicated that the borrower had not met the mortgage payment due on October 1, 2007, as of October 31, 2007. The HUD-1 settlement statement prepared by the title company indicated that the borrower needed \$1,326 to the close on the new loan. However, the HUD-1 settlement statement prepared by the closing agent did not state that the borrower was required to pay funds to close the loan. The borrower signed the closing documents on October 25, 2007, and was provided a 3-day rescission period. The last day the borrower could have withdrawn from the loan agreement was October 29, 2007. Allen Mortgage did not obtain the borrower's mortgage payoff statement until October 31, 2007, which was after the borrower's rescission period. The borrower's settlement statement was modified to include a downpayment amount at that time.

The borrower's loan file did not contain documentation showing that the borrower brought the final payment due on the previous loan to closing. Further, Allen Mortgage's wire calculation sheet indicated a correction to the new loan's settlement disbursement; therefore, the borrower had to pay \$1,085 to close the loan. According to Allen Mortgage's financial records, the borrower paid Allen Mortgage using a personal check, dated November 26, 2007, in the amount of \$1,567. In Allen Mortgage's ledger, the payment described as "bottom hold check" was debited to undeposited funds and credited from the accounts receivable on January 2, 2008.

According to HUD's requirements, borrowers are not permitted to skip payments when refinancing, and line 303 of the settlement statement must indicate the cash required from the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 on the settlement statement are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premium, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

HUD Handbook 4155.1, REV-5, paragraph 2-10(D), states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.

FHA case number: 483-4074768

Mortgage amount: \$122,338

Section of Housing Act: 203B (Mutual Mortgage)

Loan purpose: Streamline refinance

Date of loan settlement: March 30, 2009

Status: Active

Payments before first 90-day delinquency reported: Not applicable

Unpaid principal balance: \$115,781

Area of noncompliance: Skipped payment

Summary:

Allen Mortgage's underwriter approved the loan on March 17, 2009. The loan closed on March 13, 2009, and settled on March 30, 2009. Therefore, the loan was approved after it had closed. The borrower's HUD -1 settlement statement in the FHA case binder showed on line item 205 an item, described as "MARCH PMT REIMBURSEMENT CHECK," for \$877.

According to the borrower's mortgage payoff statement, the borrower had made all of the mortgage payments due on the previous loan including the payment due March 1, 2009. Thus, there was not a payment due for the month of March 2009. According to Allen Mortgage, line item 205 on the settlement statement and the corresponding amount should have been on line 303 of the statement as cash to be received from the borrower at closing.

Allen Mortgage's loan files showed that the borrower paid \$887 using a personal check, dated April 10, 2009, to Allen Mortgage after the loan closed and settled. According HUD's requirements, line 303 of the settlement statement must indicate the cash required from the borrower at settlement.

Criteria:

Regulations at 24 CFR Part 3500, Real Estate Settlement Procedures Act, appendix A, state that lines 204–209 are used for other items paid by or on behalf of the borrower. Lines 204–209 should be used to indicate any financing arrangements or other new loan not listed in line 202. Line 303 must indicate either the cash required from the borrower at settlement or cash payable to the borrower at settlement.

HUD Handbook 4155.1, REV-5, paragraph 1-9, states that for each transaction, the lender must estimate the settlement requirements to determine the cash required to close the mortgage

transaction. The difference between the amount of the FHA-insured mortgage, excluding any upfront mortgage insurance premiums, and the total cost to acquire the property, including these expenses, determines the cash needed for closing a loan eligible for FHA mortgage insurance.

HUD Handbook 4155.1, REV-5, paragraph 1-10E, states that skipped payments are not acceptable. Lenders are not permitted to allow borrowers to skip payments. The borrower is either to make the payment when it is due or bring the monthly mortgage payment to settlement. When the new mortgage amount is calculated, FHA does not permit the inclusion of any mortgage payments skipped by the homeowner in the new mortgage amount.

HUD Handbook 4155.1, REV-5, paragraph 2-10 (D), states that funds can be borrowed for the total required investment as long as satisfactory evidence is provided that the funds are fully secured by investment accounts or real property, other than the property being purchased. An independent third party must provide the borrowed funds. The lender or other interested third party may not provide such funds.