

## **CHAPTER 8. HUD-APPROVED TITLE I NONSUPERVISED LENDERS AND LOAN CORRESPONDENTS AUDIT GUIDANCE**

8-1 Program Objective . HUD insures private lending institutions against losses sustained as a result of borrower defaults on Title I property improvement and manufactured home loans. HUD approves four categories of private lending institutions for participation in the Title I program:

A. Supervised lenders, which are financial institutions that are members of the Federal Reserve System or whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

B. Nonsupervised lenders, which are financial institutions whose principal activity is the lending or investment of funds in loans or mortgages, and which are neither supervised lenders nor governmental institutions.

C. Loan correspondents, which are financial institutions approved by HUD for the purpose of originating Title I direct loans for sale or transfer to a sponsoring Title I lender. A loan correspondent may be either supervised or nonsupervised.

D. Investing lenders, which are financial institutions approved by HUD to purchase, hold, and sell Title I loans that have been originated by another lender. An investing lender may not originate Title I loans in its own name, and it may not service such loans except with the prior approval of HUD.

Lending institutions are approved for participation in the Title I program on the basis of their financial capacity, experience, facilities, and other criteria as specified in HUD regulations at 24 CFR Part 202 and HUD Handbook 4700.2 . (NOTE: Except in paragraph 8-5.D. of this chapter, use of the term "lender" also includes the term "loan correspondent.")

8-2 Program Procedures. All mortgagees and loan correspondents, whether supervised or nonsupervised, must apply for initial or branch approval to participate in the HUD/FHA mortgage insurance programs through the Lender Approval and Recertification Division at HUD Headquarters, following the directions in HUD Handbook 4060.1 , Mortgagee Approval and Recertification. After a review of the application and clearance through certain Headquarters systems, the applicant, if approved, will be assigned a unique HUD/FHA identification number and notified that it may now originate FHA insured mortgages.

### 8-3 Reference Material

24 CFR Parts 201 Regulations Relating to Title I and 202 Property Improvement and Manufactured Home Loans HUD Handbook 4700.2 Title I Lender Approval Handbook

HUD Handbook 1060.2 Title I Property Improvement and Manufactured Home Loan Regulations, 24 CFR 201 and 202

### Title I Letters Various

If the program participant does not have this reference material, it may be obtained from HUD's Internet site (<http://www.hud.gov>) or may be ordered from HUD On Demand on the Internet web site, at 1-800-767-7468 (202-708-3151 in the Washington, DC area), or by fax at 202-708-7468.

8-4 Reporting Requirements. Every nonsupervised Title I lender or loan correspondent is required annually to submit one copy of the audit report to the Secretary within 90 days of the close of its fiscal year by 24 CFR Part 202. In addition to the report on the basic financial statements,

the audit report should include reports on internal control structure and compliance with specific requirements that have a direct and material effect on HUD-insured loans made by unsupervised Title I lenders and loan correspondents, including an opinion on compliance with specific requirements applicable to major HUD-assisted programs, or a report on compliance with specific requirements applicable to nonmajor HUD-assisted program transactions. In addition, an analysis of the lender's net worth is required. This net worth must be adjusted to reflect only those assets acceptable to the Secretary. A suggested format for the analysis of net worth and a list of unacceptable assets are shown in paragraph 8-6 of this chapter. The auditor's report on compliance and report on the internal control structure are required for every Title I lender or loan correspondent, regardless of the number of loans originated during the audit period. Material instances of noncompliance identified by the auditor must be reported as a finding, even in those cases where corrective action was taken by the auditee after the audit period. The report should be sent to:

Mailing address:

U.S. Department of HUD  
Lender Approval and Recertification Division  
Room B-133 3214 Plaza  
451 Seventh Street, SW  
Washington, DC 20410-8888

Delivery:

U.S. Department of HUD  
Lender Approval and Recertification Division Suite 3214  
490 L'Enfant Plaza East  
Washington, DC 20024-2118

A Title I lender who is also a Title II mortgagee may submit one set of audited financial statements for review, as long as they are clearly identified for both programs. Reports for Title I lenders who are also a Ginnie Mae issuers must be sent to both Ginnie Mae and the address above.

## 8-5 Compliance Requirements and Suggested Audit Procedures

### A. Branch Office Operations

1. Compliance Requirement. A lender may maintain one or more branch offices for the origination of Title I loans. Each branch office that is originating Title I loans must be approved by HUD following submission of the form for Branch Office Notification. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR Part 202 and HUD Handbook 4700.2.

### 2. Suggested Audit Procedures

a. Determine that HUD accepted the branch office as evidenced by a copy of Form HUD-92001LB, Branch Office Notification.

b. Test whether the branch is a true branch and is not a subsidiary, an agent of the lender or a separate entity, and that it has at least one employee, including a branch manager, that serves only that branch. The branch office should have its own telephone and maintain its own accounting records.

c. Review lender payroll records to determine that all branch office personnel, except the receptionist, are employed exclusively for one HUD-approved lender at any given time and conduct only the business affairs of that entity during normal business hours.

d. Determine that the branch office is located in space which is separated by a partition from any other entity and is clearly identified to the public, and that the branch office's operating costs are paid by the approved lender.

e. Determine that the present branch office manager is a corporate officer or an employee authorized to bind the corporation in matters involving loan origination and servicing.

## B. Loan Origination

1. Compliance Requirement. HUD expects that the lender will exercise prudence and diligence in determining whether the borrower is solvent and an acceptable credit risk, with a reasonable ability to make payments on the loan obligation. All documentation supporting this determination of creditworthiness shall be retained in the loan file (24 CFR 201.22).

### 2. Suggested Audit Procedure

a. Compare the lender's procedures for processing Title I loan applications and making a decision on the borrower's creditworthiness with the requirements in 24 CFR 201.22.

b. Obtain a sample of files for loans originated during the audit period, to be examined for the documentation required by the regulations. The sample should include loans originated at the lender's branch offices as well as the home office.

- c. Determine that the lender obtains a separate dated credit application on a HUD-approved form from the borrower and any co-maker or co-signer, and verifies the validity of the borrower's Social Security Number in accordance with Title I Letter TI-414 .
- d. Determine that all income and employment data is supported by written verification or other documentation, especially for self-employed applicants and those with non-employment income.
- e. Determine that the lender obtains a complete and current consumer credit report on the borrower and any co-maker or co-signer, and checks on any credit inquiries reported within the previous 90 days.
- f. Determine that the lender obtains written verification of the borrower's payment status on any senior mortgages or deeds of trust on the property to be improved.
- g. Determine that the lender checks HUD's Credit Alert System to verify whether the borrower is in default or a claim has been paid on any Federally insured or guaranteed loan, and records the Credit Alert Response Code for each person on the credit application.
- h. When the principal balance of the loan exceeds \$5,000 and the initial payment exceeds five percent of the loan amount, determine that the lender obtains written verification of the source of these funds through verifications of deposit, bank statements, gift letters or other evidence.
- i. Review the loan file documentation for evidence that the lender conducted a face-to-face or telephone interview with the borrower before making a final determination on the borrower's creditworthiness.
- j. Obtain a sample of files for rejected loans during the audit period. Review for the following:
  - (1) Determine that an individual review was provided for all applications

denied due to a statistical category or score (e.g. credit score, debt/income ratio). Ensure that the score accurately reflected the financial status (e.g. loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.

(2) Determine that the rejection was made based on established criteria and the reason for the rejection was provided to the applicant. Ensure that all procedures for accepting and processing the loan were followed.

### C. Loan Disbursement

1. Compliance Requirement. The lender has certain responsibilities to be carried out in connection with the disbursement of loan proceeds (24 CFR 201.26 and 201.40). These responsibilities vary widely, depending upon whether the loan is a property improvement or manufactured home loan, and whether the disbursement is made directly to the borrower or to a dealer. The disbursement of loan proceeds must be adequately documented in the lender's file. When dealer loans are involved, the lender must also maintain separate dealer files which reflect compliance with HUD's requirements concerning dealer approval and supervision (24 CFR 201.27).

#### 2. Suggested Audit Procedures

a. Review the lender's procedures for determining borrower eligibility and evaluating whether the loan proceeds are being used for eligible purposes (24 CFR 201.20 or 201.21 as appropriate). Also review the lender's procedures for documenting that the property improvements have been completed or the manufactured home has been satisfactorily delivered and installed (24 CFR 201.26(a) or (b) as appropriate).

b. Select a representative sample of property improvement loan files and determine whether each file contains the following:

(1) The note, security instrument (if the loan amount exceeds \$7,500), credit application, completion certificate, and the notice of HUD's role in the loan transaction required by 24 CFR 201.26 (a) (6).

(2) A contract or contract proposal between the borrower and a dealer/contractor, or a detailed written description of the work with a materials list and estimated costs if the borrower is carrying out the work without a dealer/contractor.

(3) Evidence of an on-site inspection to determine that the improvements were completed, if the loan is for \$7,500 or more.

c. Select a representative sample of manufactured home loan files. Review the files to determine that each file contains the following documents: note, security instrument, credit application, contract, manufacturer's invoice, statements of other costs, fees or evidence of the borrower's initial a placement certificate signed by the and dealer, the notice of HUD's role in transaction required by 24 CFR 201.26(b)(7), and copies of all other documents relating to the loan transaction. For each file reviewed, determine if the lender has documented a site-of-placement inspection within 60 days after disbursement of the loan proceeds.

d. Where the lender approves dealer loans, determine that the lender supervises and monitors each dealer and visits the dealer periodically. Determine that each dealer's approval is documented on a HUD-approved form

purchase itemized charges, payment, borrower the loan signed and dated by both parties. Determine that each file contains the dealer's current financial statement, including a determination that the dealer meets the minimum net worth requirements of 24 CFR 201.27(a)(1), and credit reports on the

dealership and its owners, principals and officers. The file should also contain documentation of the lender's experience with the dealer's Title I loans, including information on borrower defaults and borrower complaints and their resolution.

#### D. Loan Servicing.

1. Compliance Requirement. The lender shall service loans in accordance with accepted practices of prudent lending institutions. It shall have adequate facilities for contacting the borrower in the event of default, and shall otherwise exercise diligence in collecting the amount due. The lender shall remain responsible to the Secretary for proper collection efforts, even though actual loan servicing and collection may be performed by an agent of the lender. The lender shall have an organized means of identifying, on a periodic basis, the payment status of delinquent loans to enable collection personnel to initiate and follow-up on collection activities, and shall document its records to reflect its collection activities on delinquent loans. Modification agreements and repayment plans are permitted on defaulted loans (24 CFR 201.41).

Loan servicing procedures are to be followed consistently and should not vary based on any of the prohibited bases.

#### 2. Suggested Audit Procedures

a. Select a sample of delinquent and defaulted loans.

b. Test whether the lender documents its records to reflect its servicing on delinquent and defaulted loans.

(1) Obtain an understanding of the lender's servicing procedures.

(2) Test that the lender maintains individual servicing records documenting collection (loan servicing) activities.

(3) Review the servicing records for recorded collection contacts attempted and completed.

c. Test whether the lender communicates with the borrower or makes a reasonable effort to do so in order to determine the cause of default to seek its cure and prior to accelerating the maturity of the loan. Review the individual loan servicing records for recorded contacts of more than one type (i.e., telephone, letter, face-to-face interview, etc.) if one type of contact effort is unsuccessful.

d. Test whether the lender offers special relief measures such as modification agreements or informal repayment plans where such measures are appropriate. Review the selected loan files to ascertain whether such relief measures were considered.

e. Test whether the notice of default and acceleration used by the lender is in compliance with the regulations (24 CFR 201.50(b)) and Title I Letter TI-408 .

f. Obtain an understanding of the lender's procedures for paying loan insurance premiums to HUD. Determine that the lender follows the acceptable methods of making annual payments and that its practices comply with HUD regulations.

#### E. Eligible Fees and Charges .

1. Compliance Requirement. Title I Letter TI-440 , dated May 2, 1996 lists all fees and charges allowed in the program.

#### 2. Suggested Audit Procedures

a. Obtain the lender's general ledger, cash journal, canceled checks and supporting invoices for at least two months of the audit period.

b. Test disbursements to determine that they are supported by invoices and were not for unreasonable amounts in return for goods or services actually performed in connection with a Title I loan. Review and report on any differences.

c. During the review of loan origination and loan settlement documents, the auditor should be alert for any fees or other types of payments which may represent referral fees. If the auditor notes any



such referral fees, it should be reported as a finding. Ensure points and closing costs are accurate. Determine whether the differences may be due to discriminatory practices.

#### F. Federal Financial Reports.

1. Compliance Requirement. Lenders participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

#### 2. Suggested Audit Procedures

a. Identify all required financial reports by inquiry of the lender.

b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and lender records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

#### G. Financial Approval Requirements

1. Compliance Requirements. A nonsupervised lender shall have and maintain a net worth, of not less than \$250,000 in assets acceptable to the Secretary. It shall also have a reliable warehouse line of credit or other funding program acceptable to the Secretary of not less than \$500,000 for use in originating or

purchasing Title I loans.

A loan correspondent shall have and maintain a net worth of not less than the \$50,000 in assets acceptable to the Secretary, plus an additional \$25,000 for each branch office authorized by the Secretary, up to a maximum requirement of \$250,000.

## 2. Suggested Audit Procedures

a. Test whether the nonsupervised lender or loan correspondent maintained the required levels for adjusted net worth.

b. Test whether the nonsupervised lender maintained the required level for its warehouse line of credit.

## H. Quality Control Plan

### 1. Compliance Requirement.

HUD-approved lenders are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and comply with all relevant Departmental rules and regulations. Each HUD-approved lender is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4700.2 or the latest HUD guidance. Each approved lender must develop and implement a quality control plan consistent with its needs, and the above referenced guidance, to assist corporate management in determining whether HUD requirements and the lender's policies and procedures are being followed by its personnel. The monthly quality control procedures may be conducted by the entity itself internally or an external review, which may be performed by the independent auditor or other qualified organization. (24 CFR 202.5(h)).

### 2. Suggested Audit Procedures

a. Obtain a copy of the lender's quality control plan and compare it to the general and specific requirements contained in Handbook 4700.2.

b. Determine whether the lender has a procedure in place which assures that all employees involved in loan

origination and servicing understand the lender's quality control policies and procedures.

c. Inquire whether the lender relies on an internal or external quality control review of its origination, underwriting, and servicing functions. If the lender relies on the external review process and the IA's engagement includes the performance of the quality control review, the IA should report this as part of the additional information required under Chapter 2 of this guide. If the lender relies on an internal review, determine that it was performed by knowledgeable personnel with no direct responsibilities in the areas they reviewed.

d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample of at least ten percent of the number of insured mortgages originated or a statistically derived sample. It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review at least once during the year and that the plan includes coverage for

any loan correspondents and authorized agents of the lender.

e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4700.2 were included in the quality control review. The Quality Control Plan must provide for the written reverification of the lender's employment, deposits, gift letter or other sources of funds.

f. Obtain a written copy of the latest quality control report and determine that senior management officials also received a copy which included any deficiencies identified

during the review. Determine that the lender also notified the Quality Assurance Division of any violations, false statements or program abuses in the report.

g. Determine that senior management officials promptly initiated corrective action for all deficiencies noted.

#### 8-6 ADJUSTED NET WORTH

A. Requirement. An FHA computation of Adjusted Net Worth is required for all nonsupervised Title I lenders and loan correspondents, even if there were no loans originated during the period. The required amount which must be maintained throughout the year, varies by program participant type and approval data per the guidance in paragraph 8-5 G, Financial Approval Requirements. If an entity is both Title II and Title I, the adjusted net worth for the Title II is the only statement necessary.

8-13 8/97  
2000.04 REV-2

#### B. COMPUTATION

XYZ LENDER CORPORATION  
COMPUTATION OF ADJUSTED NET WORTH  
To Determine Compliance with  
HUD Net Worth Requirements  
March 31, 199X

Stockholders equity (net  
worth) per Balance Sheet \$17,500,000

Less Unacceptable Assets:  
Construction loans to  
related company - not  
secured by first  
mortgage \$12,000,000

Other - Goodwill 300,000 \$12,300,000

Adjusted net worth for HUD  
requirement purposes \$ 5,200,000 1

1 In the event adjusted net worth does not meet or exceed the minimum HUD requirement, an explanation of the steps taken to correct the adjusted net worth deficiency, along with any relevant documentation, must be submitted as part of the corrective action plan.

#### C. UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

Refer to Chapter 7, Section 7-6(C).

8/97 8-14  
2000.04 REV-2

#### Appendix

##### HUD District Inspectors General for Audit

New England District Inspector General for Audit  
Department of Housing and Urban Development  
Thomas P. O'Neill, Jr. Federal Building  
10 Causeway Street, Room 370  
Boston, MA 02222-1092  
Telephone number: (617)565-5259  
FAX number: (617)565-6878

CT, ME, MA, NH, RI, VT

New York/New Jersey District Inspector General for Audit  
Department of HUD  
26 Federal Plaza  
New York, NY 10278-0068  
Telephone number: (212)264-4174  
FAX number: (212)264-1400

NY, NJ

Mid-Atlantic District Inspector General for Audit  
Department of HUD  
The Wannamaker Building  
Philadelphia, PA 19107-3390  
Telephone number: (215)656-3401  
FAX number: (215)656-3409

DE, DC, MD, PA, VA, WV

Southeast/Caribbean District Inspector General for Audit  
Department of HUD  
Richard B. Russell Federal Building  
75 Spring-Street, SW, Room 700  
Atlanta, GA 30303-3388  
Telephone number: (404)331-3369  
FAX number: (404)730-2382

AL, FL, GA, KY, MS, NC, SC, TN

1 8/97  
2000.04 REV-2

Midwest District Inspector General for Audit  
Department of HUD  
77 West Jackson Boulevard - 26th Floor  
Chicago, IL 60604-3507  
Telephone number: (312)353-7832  
FAX number: (312)353-8866

IL, IN, MI, MN, OH, WI

Southwest District Inspector General for Audit  
Department of HUD  
1600 Throckmorton  
P.O. Box 2905  
Fort Worth, TX 76113-2905  
Telephone number: (817)885-5551  
FAX number: (817)885-2725

AR, LA, NM, OK, TX

Great Plains District Inspector General for Audit  
Department of HUD  
Gateway Tower II, 5th floor  
Kansas City Metropolitan area 66101-2406  
Telephone number: (913)551-5870  
FAX number: (913)551-5877

IA, KS, MO, NE

Rocky Mountains District Inspector General for Audit  
Department of HUD  
First Interstate Tower  
Denver, CO 80202-2349  
Telephone number: (303)672-5452  
FAX number: (303)672-5006

CO, MT, ND, SD, UT, WY

8/97 2  
2000.04 REV-2

Pacific/Hawaii District Inspector General for Audit  
Department of HUD  
450 Golden Gate Avenue, Room 8-5139  
San Francisco, CA 94102-3448  
Telephone number: (415)436-8101  
FAX number: (415)436-8107

AZ, CA, HI, NV

Northwest/Alaska District Inspector General for Audit  
Department of HUD  
909 First Avenue  
Seattle, WA 98104-1000  
Telephone number: (206)220-5360  
FAX number: (206)220-5162

AK, WA, ID, OR