



FHA's Single Family Housing Loan Quality Assessment Methodology (Defect Taxonomy)

Proposed Draft Posted for Feedback

September 16, 2014





Overview

Overarching Initiative Objectives – Provide a loan quality assurance framework approach that:

1. Communicates a clear policy message
2. Encourages lending to FHA targeted populations
3. Provides feedback on the effectiveness of our underwriting policies

Process To Date –

1. Studied our existing processes in depth to determine how to achieve the above objectives
2. Focused on simplifying and clarifying our approach
3. Solicited input from across the industry
4. Incorporated working group feedback to the extent feasible



FHA is considering key changes to the way it identifies and enforces loan defects

Today

The majority of current defect codes focus on causes, often leading to multiple codes all describing a small piece of a single fundamental issue (e.g., borrower income not being sufficient)

2 levels of severity for each defect, causing knife-edge enforcement. For example, being over the statutory limit by \$11 is coded the same as being over the limit by \$1100

Much of the detail of the sources and causes of defects is captured only in loan reviewer's notes, which prevents data analysis on why defects are occurring at the aggregate level

Alternative

There are a limited number of defects, capturing the fundamental issues that impact a loan's insurability, credit quality, and compliance. Although there are significantly fewer defects, each defect employs between 15-30 "reason codes" to capture rich detail about why a defect occurred

Multiple levels of severity for each defect. For example, being over the statutory limit by \$11 is coded as less severe as a loan over the limit by \$1100

The sources and causes of defects are captured as part of the Basis of Ratings code, allowing FHA to analyze the reason why defects are occurring at the aggregate level



The proposed methodology centers on three core concepts

I Identifying a defect

- There are nine fundamental characteristics of loan insurability that impact a loan's insurability, credit quality, and compliance
- Each of these fundamental characteristics would have one defect associated with it, for a total of nine defects

II Assessing the severity of a defect

- Severity is assigned to the individual instance of the defect, not to each individual source and cause
- Severity is driven by the impact to loan insurability

III Capturing the sources and causes of the defect

- A "defect" may be composed of one or many sources and causes found in the loan or in the input of loan file data into TOTAL
- Potential sources and causes of a defect vary by defect type



I There are nine proposed defects

	Defect (Code)	Representative examples	Primary drivers of severity
Under-writing	1 Borrower Income (BI)	<ul style="list-style-type: none"> DTI ratio and/or inability to calculate DTI due to income error Income not supported by provided documentation Borrower employment history not satisfied 	<ul style="list-style-type: none"> Front end / back end DTI (because of income)
	2 Borrower credit / liabilities (BC)	<ul style="list-style-type: none"> Credit report provided is not acceptable Borrower does not have an established payment history Missing/misstated liabilities 	<ul style="list-style-type: none"> Back end DTI (due to debt) and derogatory credit issues
	3 Loan to value and max mortgage amount (LM)	<ul style="list-style-type: none"> LTV/CLTV is over the statutory / program limit Mortgage amount exceeds statutory or location based limit HECM principal limit exceeded Failure to follow TOTAL Scorecard guidelines 	<ul style="list-style-type: none"> LTV / CLTV / max mortgage
	4 Borrower Assets (BA)	<ul style="list-style-type: none"> Minimum required investment not met Gifts from unacceptable sources or the transfer not appropriately documented 	<ul style="list-style-type: none"> Assets to cover MRI and closing costs
Valuation process	5 Property eligibility (PE)	<ul style="list-style-type: none"> Structural soundness of the property is in question Necessary repairs not completed or documented 	<ul style="list-style-type: none"> Qualitative issues of eligibility
	6 Property appraisal (PA)	<ul style="list-style-type: none"> Value not supported 	
Eligibility	7 Borrower eligibility and qualifications (BE)	<ul style="list-style-type: none"> Borrower identity or residency status cannot be verified Borrower does not appear to occupy as primary residence Borrower is delinquent on a federal debt 	<ul style="list-style-type: none"> Qualitative issues of eligibility
	8 Mortgage eligibility (ME)	<p>Forward Mortgages:</p> <ul style="list-style-type: none"> Loan does not meet FHA/program eligibility requirements Restrictive covenants on loan Loan delinquent before lender submitted loan for endorsement <p>HECM Mortgages:</p> <ul style="list-style-type: none"> Eligibility requirements not satisfied/acceptably documented 	<ul style="list-style-type: none"> Qualitative issues of eligibility Qualitative issues of eligibility
Operations	9 Lender operations (LO)	<ul style="list-style-type: none"> Loan originator permitted misuse of escrow funds Lender/Loan Officer/Sponsored Third Party is not registered in NMLS as of time of loan origination 	<ul style="list-style-type: none"> Qualitative issues of compliance





II There are four different severity tiers for any given defect

Example criteria for tiers

Decreasing degree of severity	Tier 1	<ol style="list-style-type: none"> 1. Loan was submitted for endorsement with information which the lender knew (or should have known) was misrepresented; 2. Loan was submitted for endorsement with information which the lender did not know (or could not have known) was misrepresented²; 3. Loan information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, which makes it impractical to determine whether the loan is compliant and approvable; or 4. Loan contains a material violation of a statutory requirement
	Tier 2	<p>Errors are present in loan file that, when identified and corrected, lead the loan to be unapprovable, either by:</p> <ul style="list-style-type: none"> ▪ Causing the loan to exceed approval limits by a <u>large margin</u>¹ or ▪ Causing the loan to breach loan guidelines by a <u>large degree</u>¹
	Tier 3	<p>Errors are present in loan file that, when identified and corrected, lead the loan to be unapprovable, either by:</p> <ul style="list-style-type: none"> ▪ Causing the loan to exceed approval limits by a <u>small margin</u>¹ or ▪ Causing the loan to breach loan guidelines by a <u>small degree</u>¹
	Tier 4	<p>Errors are present in loan file that impact key calculations or inputs, but which <u>do not</u> lead the loan to be unapprovable based on FHA limits and guidelines</p>

- Tier 1 and 2 defects will equate to an overall loan rating of “Unacceptable”
- Tier 3 and 4 defects will equate to an overall loan rating of “Deficient”

1 Tolerance threshold to differentiate small and large errors may only be appropriate in certain cases, if at all. Applicable and appropriate thresholds are to be determined.

2 Lenders will only be held accountable for those instances of fraud where it was determined they knew or should have known.



III

Loan Rating Outcomes

Lender Mitigation

- As is the case today, Lenders will be afforded the opportunity to respond to any unacceptable loan findings. With the new defect taxonomy, this would equate to loans with Tier 1 and 2 violations.
- The defect code with the highest tier severity will determine the overall loan rating
- All findings of fraud will be assigned a Tier 1 severity level; **HOWEVER**, if FHA determines that the lender did not know, or could not have known about the fraud, and has adhered to FHA’s requirements, the defect will be assigned a cause code¹ which clears the lender of responsibility.

Recording Outcomes

- The proposed taxonomy will allow for the recordation of the final outcome at the loan level. The possible outcomes are:
 - Indemnification
 - Mitigated: Lender has successfully resolved the defect(s)
 - Reversal: Used in instances where FHA misapplied a defect code

Determining Defect Rates

- Any finding that is reversed due to misapplication of policy will be excluded in the determination of a lender’s defect rate
- Any finding of fraud that is determined not to be attributable to a lender will be excluded in the determination of a lender’s defect rate

1 Note that each defect description slide has a “cause” code G which will be applied if it is determined that the lender did not know, or could not have known about the fraud.



Defects Codes Sources Causes Severity Tiers



1

Defect: Borrower Income (BI)

Source of defect	Cause of defect				
	A. Amount not supported by documentation	B. Stability not supported	C. Source is ineligible	F. Possible misrepresentation or fraud— lender knew or should have known	G. Possible misrepresentation or fraud – lender did not know or could not have known
Issues with:					
1. Standard employment					
2. Part-time and seasonal employment					
3. Overtime, bonus, and commission income					
4. Self-Employment income					
5. Pension and retirement income					
6. Rental income					
7. Social Security income					
8. Other _____					

LOAN REVIEWER FINDINGS EXAMPLE
 Salary stated in W-2 was \$75K, but did not agree with the wage information on statement on verification of employment that stated an annual salary of \$95K (there were no other sources of wage income from part-time/seasonal or overtime/bonus/commission wages)
HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS
1A Free text: Not supported by YTD income on paystubs/verification of employment

➤ Current Basis of Ratings Codes: IC02, IC20, IC22, and IC30





1

Severity: Borrower Income (BI)

Tier criteria

Examples

Tier 1

- Income information was provided that was potentially misrepresented and which the lender knew or should have known, OR
- Income information was provided that was potentially misrepresented and which the lender did not know or could not have known at underwriting, OR
- Income information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, and DTI cannot be calculated

- W2 and other pertinent documentation not provided for sole source of employment

Tier 2

- AUS:** Errors are present in the sources/calculation of income, which when corrected change TOTAL decision to “refer,” but front and back end ratios exceed qualifying ratios by more than 5 percentage points (added to base DTI limit), without acceptable compensating factors
- Manual:** Loan was originally a TOTAL refer; errors, when corrected, result in the front and back end ratios exceeding the qualifying ratios by more than 5 percentage points (added to base DTI limit), without acceptable compensating factors

- Salary income level was not stable for two years in accordance with handbook requirement and cannot be considered as a source of income, and there are no compensating factors; once corrected, DTI ratio exceeded by 10 percentage points

Tier 3

- AUS:** Errors are present in the sources/calculation of income, which when corrected change TOTAL decision to “refer,” but front and back end ratios exceed qualifying ratios by less than 5 percentage points (added to allowed ratio), without acceptable compensating factors
- Manual:** Loan was originally a TOTAL refer; errors related to income, when corrected, result in the front and back end ratios exceeding the qualifying ratios by less than 5 percentage points (added to allowed ratio), without acceptable compensating factors

- Loan file incorrectly included \$30K of unqualified income, resulting in claimed DTI of 30/42; once corrected, DTI ratio was 34/46, resulting in TOTAL refer due to DTI exceeding qualifying ratio by less than 5 percentage points added to the DTI limit, and loan was approved on manual review

Tier 4

- AUS:** Errors are present in the sources/calculation of income, but they were within allowed tolerances, or the sources/calculation of income were outside of tolerances but still returned as “accept” when rerun through TOTAL, or still results in a manual “refer” within policy
- Manual:** Errors are present in the sources of income, but they were either within allowed variance, or when corrected, front and back end ratios are within policy or have acceptable compensating factors

- Loan income includes \$5K of overtime wages not properly documented, but other sources of income total \$100K, errors are within allowed tolerances and TOTAL still returns accept





2

Defect: Borrower Credit / Liabilities (BC)

Source of defect	Cause of defect			
	A. Insufficient or unverified data or information	B. Credit documentation sufficient, but incorrect conclusion drawn	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/fraud – lender did not know or could not have known
<ol style="list-style-type: none"> Credit report does not meet requirements or missing (e.g., ID number for report does not match number on final AUS feedback) Non-traditional credit verification does not meet requirements or missing Issues in calculating borrower debt (e.g., not all debts included, TOTAL input does not match credit report, debt documentation inadequate) Payment history not established (e.g., history of housing payments, installment, others) Inquiries and recent debt not properly verified (e.g., pattern of recent credit inquiries, evidence that new debt may have been taken in connection with the FHA loan, credit report revealed inquiries with auto dealerships that resulted in the purchase of an auto prior to closing) Derogatory credit information does not support approval (bankruptcies, judgments, liens and/or foreclosures that are not sufficiently remedied) Elements of borrower’s credit not captured in loan application (e.g., unrated account) Other 				

LOAN REVIEWER FINDINGS EXAMPLE
 Loan contained credit report, but loan originator did not seek additional information on events since final report, resulting in failure to identify new credit cards with maximum balances of \$50K charged

HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS
5A Free text: Borrower credit report contained four inquiries from various credit providers. Lender failed to obtain written explanation for recent inquiries on manually underwritten loan.

➤ Current Basis of Ratings Codes: CH03, CH10, CH21, CH40, CH42, and LA04





2

Severity: Borrower Credit / Liabilities (BC)

Tier criteria

Both AUS and Manual:

Tier 1

- Error(s) present in the credit report and credit/debt history that are potential misrepresentations by the borrower/lender, which lender knew or should have known, OR
- Error(s) are present in the credit report and credit/debt history that are potential misrepresentations by the borrower/lender which the lender did not know or could not have known, at the time the loan was underwritten OR
- Borrower credit information provided is significantly inconsistent and cannot be trusted, or is completely missing, and borrower credit worthiness cannot be assessed and/or DTI cannot be calculated

Errors are present in the credit report and/or credit/debit history, payment history, and the loan is not approvable:

Tier 2

AUS:

- Loan was originally a TOTAL accept, and when corrected, TOTAL outputs a “refer.” The loan is not approvable on a manual basis based on information in the file and exceeds allowed DTI ratios by more than 5 percentage points (and there are no compensating factors), OR
- Loan cannot be approved via TOTAL due to derogatory information (e.g., bankruptcy) or unrated accounts, and the loan is not approvable on a manual basis based on information in the file

Manual:

- Back-end ratios are 5 percentage points or more over the maximum back-end ratios, OR
- Loan does not qualify based on unacceptable payment history, unrated accounts, serious deficiencies, derogatory credit information, or potential undisclosed debts

Tier 3

AUS:

- Loan was originally a TOTAL accept, and when errors are corrected, TOTAL outputs a “refer”; the loan is approvable manually based on information in the file or is within 5 percentage points of allowed DTI ratio, OR
- Loan was originally a TOTAL accept, but had unrated accounts, serious deficiencies, derogatory credit information, or potential undisclosed debts that would make the TOTAL accept invalid; however, loan is approvable on manual basis based on information in file

Manual:

- Errors are present that (1) when corrected result in back end ratios greater than allowed DTI ratios by less than 5 percentage points (and absent compensating factors, if QAD review) and (2) there are no concerns about undisclosed debts or payment history

Errors are present in the credit report, payment history, and credit/debit history, but there are other sources of borrower credit that are both acceptable and sufficient and FHA assesses borrower creditworthiness:

Tier 4

AUS: Loan was originally a TOTAL accept and had minor errors that when corrected still results in a TOTAL accept, and there are no meaningful concerns about unrated accounts or undisclosed debts, or results in a manual “refer” that was still within policy

Manual: Back end DTI ratios are within approval criteria, as adjusted for credit score (and appropriate compensating factors, if QAD review), and payment history is acceptable and there are no concerns about undisclosed debts/unrated accounts





3

Defect: Loan to Value and Maximum Mortgage Amount (LM)

Source of defect	Cause of defect					
	A. Amounts provided cannot be confirmed due to inconsistent or incomplete data	B. Issues related to identity of interest	C. Issues related to inducements to purchase	D. Other incorrect application of policy	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
Issues with:						
1. Maximum mortgage amount						
2. LTV						
3. CLTV						
4. HECM – Principal limit and Max Claim amount						
5. Other						

LOAN REVIEWER FINDINGS EXAMPLE
 The property value on a \$200k forward loan included \$5k in inducements to purchase, which, led to the actual LTV to exceed 96.5%

HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS
 2C Free text: 5k of inducements included moving costs and decorating allowances; guide requires a dollar for dollar reduction before applying LTV factor.

➤ Current Basis of Ratings Codes: HM07, HM11, HM13, HM14, MA04, MA05, MA06





3

Severity: Loan to Value and Maximum Mortgage Amount (LM)

Tier criteria

Examples

Tier 1

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL regarding the calculation of the loan to value or maximum loan amount that represent misrepresentation on the part of the lender or the borrower, which the lender knew or should have known, OR
- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL regarding the calculation of the loan to value or maximum loan amount that are misrepresented on the part of the lender or the borrower, which the lender **did not know or could not** have known at the time the loan was underwritten, OR
- Loan and mortgage information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, and LTV cannot be calculated
- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that lead the mortgage to:
 - Exceed the maximum loan amount (i.e., based on statutory limits) by more than \$500

- Lender willfully obscured an identity of interest issue in order to close a loan at 96.5% LTV rather than at 85%

Note: for all tiers, LTV and statutory loan limit severity should be assessed based upon corrected loan amounts. Errors regarding whether assets were sufficient for the original stated loan amount should be treated as part of borrower assets defect

Tier 2

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that lead the mortgage to:
 - Exceed the principal limit or maximum claim amount (for a HECM)
 - Exceed the maximum loan amount by less than \$500, and the lender did not pay down the principal

- The property value on a \$200k loan included \$5k in inducements to purchase, which, when corrected, led to the actual LTV to exceed 96.5% by \$480, and lender did not pay down the principal

Tier 3

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that lead to mortgage exceeding maximum loan amount (i.e., based on LTV limits or statutory loan limit) by less than \$500 AND for which the lender paid down the principal

- The lender incorrectly calculated the loan amount off the sales price of \$100,490, when the appraised value was lower (\$100,000), resulting in an LTV of 96.98% vs. 96.5% and the loan amount was \$482 more than permitted by the proper calculation.

Tier 4

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL, but the mortgage does not exceeded the maximum loan limit (i.e., based on LTV limits or statutory loan limit)

- The reviewer adjusted a Section 248 mortgage amount that was \$5,000 below the maximum due to repair costs of \$2,000, leading to a mortgage value that is still below 96.5% limit





4

Defect: Borrower Assets (BA)

Cause of defect							
Source of defect	Cause of defect						
	<table border="1"> <tr> <td>A. Amount not supported by documentation (e.g., amount presented in bank statement doesn't match amount used)</td> <td>B. Gift funds are not documented in accordance with policy</td> <td>C. Secondary financing is documented, but not in accordance with policy</td> <td>D. Other breach of policy (e.g., includes assets from unacceptable sources¹)</td> <td>F. Possible misrepresentation /fraud– lender knew or should have known</td> <td>G. Possible misrepresentation/ fraud – lender did not know or could not have known</td> </tr> </table>	A. Amount not supported by documentation (e.g., amount presented in bank statement doesn't match amount used)	B. Gift funds are not documented in accordance with policy	C. Secondary financing is documented, but not in accordance with policy	D. Other breach of policy (e.g., includes assets from unacceptable sources ¹)	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
A. Amount not supported by documentation (e.g., amount presented in bank statement doesn't match amount used)	B. Gift funds are not documented in accordance with policy	C. Secondary financing is documented, but not in accordance with policy	D. Other breach of policy (e.g., includes assets from unacceptable sources ¹)	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known		
<ol style="list-style-type: none"> Minimum required investment not met Minimum required investment is met, but closing costs and other (e.g., reserves, escrows) not met 	<div style="border: 2px solid blue; border-radius: 20px; padding: 10px; background-color: #4a86e8; color: white;"> <p>LOAN REVIEWER FINDINGS EXAMPLE Loan reviewer determines that the loan has \$4K in gifts without documentation, which may actually be a loan</p> <p>HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS 1B Free text: Gift funds are not documented in accordance with requirements; funds may be from an unacceptable source.</p> </div>						

➤ Current Basis of Ratings Codes: FD10, FD20, FD30, FD60





4

Severity: Borrower Assets (BA)

Tier criteria

Examples

Tier 1

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that represent misrepresentation on the part of the borrower or the lender, which the underwriter knew or should have known, OR
- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that are misrepresented on the part of the borrower or the lender, which the lender did not know or could not have known at the time of underwriting
- Asset information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, and MRI cannot be calculated
- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL and lead to MRI being too low by more than \$500

- Lender misrepresented unallowable third-party fees by concealing them in mislabeled closing cost statements

Note: For all tiers, the sufficiency of borrower assets should be based upon the original stated loan amount listed in loan, regardless of whether reviewer discovers errors in loan size; errors in loan value should be treated as part of LTV and max mortgage amount defect

Tier 2

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL and lead to statutory Minimum Required Investment being too low by no more than \$500 AND the lender does not pay down the principal

- Borrower used 3rd party contributions for MRI, however these exceeded the maximum allowable contribution amounts. As a result, the borrower is \$400 short on MRI and the lender did not pay down the principal

Tier 3

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL that, once corrected:
 - lead to statutory Minimum Required Investment being too low in proportion to the loan amount AND the lender pays down the principal sufficiently
 - show sufficient funds for MRI but not closing costs, and the loan reviewer does not have confidence that borrower has sufficient funds to cover shortage through paycheck or other means

- Borrower is \$300 short of the amount required to settle the loan, and the lender paid down the principal on this amount

Tier 4

- Error(s) are present in the loan or loan file or in the input of loan file data into TOTAL, that, once corrected, show sufficient funds for MRI but not closing costs, however loan reviewer has confidence that borrower has sufficient funds to cover shortage through paycheck or other means

- Loan originator counted funds as a gift inappropriately, and remaining funds are sufficient for MRI, but short \$300 for closing costs, however borrower's paycheck of \$3100/month is sufficient to cover shortfall





5

Defect: Property Eligibility (PE)

Source of defect	Cause of defect			
	A. Determinations are not supported by documents provided	B. Determinations supported by documentation, but FHA policy is improperly applied	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
<ol style="list-style-type: none"> Minimum Property Requirements and General Acceptability Criteria Property zoning does not meet policy Property flood requirements not met Manufactured home ineligible New Construction ineligible Property fails to adhere to flipping guidelines Condo project not approved or withdrawn Condo – loan level issues Repairs not completed or repair escrow account not established (not to include MPR) Required compliance inspections not completed Other – Property not acceptable Other – Non-MPR Property repair issues & escrow account not established 				

LOAN REVIEWER FINDINGS EXAMPLE
 Loan reviewer reviews the file, and determines that property repairs were not completed as required.

HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS:
9A Free text: Appraisal conditioned value upon completion of property repairs and underwriter approved loan without documenting reason for override.

➤ Current Basis of Ratings Codes: CN01, CN02, FP01, FP02, HM25, VA02, VA04, VA06, VA08, VA23, VA24, VA29, VA34





5

Severity: Property Eligibility (PE)

Tier criteria

Examples

Tier 1

- Error(s) are present in the appraisal report data that represent misrepresentation on the part of the appraiser/lender, which the lender knew or should have known, OR
- Error(s) are present in the appraisal report data that are misrepresented on the part of the appraiser /lender, which the lender did not know or could not have known at the time the loan was underwritten, OR
- Appraisal information provided is significantly inconsistent and cannot be trusted, or is completely missing, and property eligibility cannot be assessed

- Appraiser or other party intentionally falsified appraisal report, resulting in a property being approved for a loan improperly

Tier 2

- Error(s) are present in the appraisal report that cause major concerns about the property’s eligibility for insurance, OR
- Required Repairs not complete, OR
- No evidence of condo approval

- Appraiser determines that property has substantial issues that prevent it from meeting Minimum Property Requirements
- Appraiser determines house in flood plain but lender did not document that flood insurance was provided

Tier 3

- N/A

- N/A

Tier 4

- Error(s) are identified with the property, but do not render the property ineligible.

- The appraiser failed to indicate that all faucets worked properly, but took photos of working faucets





6

Defect: Property appraisal (PA)

Source of defect

1. Appraisal valuation not supported (e.g., analysis of comparable properties not done according to standard)
2. Appraisal missing or expired
3. Appraisal report does not meet FHA standards (e.g. missing inspection, low quality appraisal)
4. New Construction, Construction to Permanent, or Build on own land – Appraisal review has not confirmed maximum financing permitted

Cause of defect

A. Determinations are not supported by documents provided	B. Determinations supported by documentation, but FHA policy is improperly applied	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
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LOAN REVIEWER FINDINGS EXAMPLE
 Loan reviewer reviews the file, and determines that the appraisal expired prior to the loan closing.

HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS
 2B





6

Severity: Property Appraisal (PA)

Tier criteria

Examples

Tier 1

- Error(s) are present in the appraisal that represent misrepresentation on the part of the appraiser/lender, which the lender knew or should have known, OR
- Error(s) are present in the appraisal that are misrepresented on the part of the appraiser /lender, which the lender did not know or could not have known at the time the loan was underwritten
- Appraisal information provided is significantly inconsistent and cannot be trusted, or is completely missing, and valuation cannot be assessed

- Appraiser or other party intentionally falsified appraisal report, resulting in a property being approved for a loan improperly

Tier 2

- Error(s) are present in the appraisal report that cause major concerns about the accuracy of the valuation

- Appraiser determines that property has substantial issues that prevent it from meeting Minimum Property Requirements
- Appraiser determines house in flood plain but lender did not document that flood insurance was provided

Tier 3

- N/A

- N/A

Tier 4

- Error(s) are present in the appraisal report, but do not change the valuation to a substantive degree

- Misstatement from appraiser. HUD 92051 is missing required signatures, yet other documentation indicates the work has been completed





7

Defect: Borrower Eligibility and Qualification (BE)

Source of defect	Cause of defect		
	A. Eligibility/qualification not supported by documentation	F. Possible misrepresentation /fraud— lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
1. Issues with borrower or non-borrowing spouse’s identity (SSN or TIN)			
2. Borrower or non-borrowing spouse lacks legal residency status and/or work authorization			
3. Borrower age does not meet requirement (e.g., under 18 for Forward and under 62 for HECM are not eligible)			
4. Borrower has another property already under HECM rule			
5. Borrower credit score (e.g., under 500)			
6. Principal occupancy guidelines not met			
7. CAIVRS, LDP/GSA authorization and/or court-ordered judgment issues and/or delinquent federal debt issues			
8. Valid first lien for refinance			
9. Borrower removed co-borrower for streamline refinance without credit qualifying			
10. Other _____			

LOAN REVIEWER FINDINGS EXAMPLE
 Loan file submitted without SSNs for co-borrower husband of primary borrower

HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS
 1A Free text: Loan file lacking SSNs for co-borrower

➤ Current Basis of Ratings Codes: CH41, EQ01, EQ02, EQ03, EQ05, HM01





7

Severity: Borrower Eligibility and Qualification (BE)

Tier criteria

Examples

Tier 1

- Error(s) are present in the loan, loan file, or input of loan file into TOTAL that are misrepresented on the part of the borrower or the lender, which the lender knew or should have known, OR
- Error(s) are present in the loan, loan file, or input of loan file into TOTAL that are misrepresented on the part of the borrower or the lender, which the lender did not know or could not have known at the time the loan was underwritten, OR
- Borrower eligibility information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, and borrower eligibility cannot be determined, OR
- Borrower fails to meet HUD requirements on principal residency, OR
- Borrower appears on HUD's LDP and/or excluded parties list

- Personal information for borrower not congruent cross file, including SSN and other status information, indicating possibility of misrepresentation

Tier 2

- FHA is able to determine that the borrower is ineligible through evidence in the loan file; evidence may be missing, but there is sufficient evidence to make a determination

- FHA reviewer determines that CAIVRS code is ineligible
- For HECM, lender is unable to provide evidence that borrower received mandatory counseling prior to loan origination

Tier 3

- Evidence that supports the eligibility and qualification of the borrower for an FHA loan is insufficient or missing, and loan is ineligible due to a minor issue (e.g., failure to clear past delinquencies or debts, even though borrowers have sufficient assets to address)

- Bankruptcy cleared but for a value of <\$2K, but otherwise eligible

Tier 4

- Evidence that supports the eligibility and qualification of the borrower for an FHA loan is insufficient or missing, however FHA is able to determine that the borrower is eligible through other supporting evidence in the loan file

- Borrower failed to include Social Security cards for each borrower, but did include other acceptable documents confirming legal residency status and eligibility to borrow





8

Defect: Mortgage Eligibility (ME)

Source of defect

1. URLA FNMA 1003 and/or HUD-92900-A is missing or not properly executed (i.e., enforceability is impaired due to lack of lender certifications)
2. Mortgage delinquent at endorsement
3. Loan does not meet mortgage product eligibility issues (e.g., ARM loan [section 251] does not adhere to FHA allowable interest rate adjustments and caps; or normal 203(k) treated inappropriately as streamline)
4. Lender has not performed program specific insurability obligations (e.g., HECM counseling and anti-churning, QM requirements)
5. Restrictive covenants are present in the contract
6. Conditions to title of property not acceptable
7. Mortgage, note, riders, or allonges are missing, improperly executed, or not executed in compliance with FHA guidance
8. Other

Cause of defect		
A. Eligibility/qualification not supported by documentation	F. Possible misrepresentation /fraud— lender knew or should have known	fraud – lender did not know or could not have known
<p>LOAN REVIEWER FINDINGS EXAMPLE Borrower closed using a ‘power of attorney’ and the power of attorney document is not properly signed</p> <p>HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS 8A Free text: Original document not signed by both parties</p>		

➤ Current Basis of Ratings Codes: : HM04, HM05, HM06, HM08, HM26, LP10, PG10, PG11, PG20, PG21, PG22, PG30, PG40, PG41, PG42, UW20, UW22, UW23, UW24, UW25, VA18





8

Severity: Mortgage Eligibility (ME)

Tier criteria

Examples

Tier 1

- Information related to the eligibility of the mortgage for FHA insurance was provided that was misrepresented and which the lender knew or should have known, OR
- Information related to the eligibility of the mortgage for FHA insurance was provided that was misrepresented and which the lender did not know or could not have known at the time the loan was underwritten
- Loan and mortgage information provided in the loan file or in the input of loan file data in TOTAL is significantly inconsistent and cannot be trusted, or is completely missing, and mortgage eligibility cannot be determined

- Ineligible loan officer used archived report to represent self as not excluded

Tier 2

- FHA is able to determine that the mortgage is ineligible through evidence in the loan file; evidence may be missing, but there is sufficient evidence to make a determination, OR
- Closing documentation unacceptable to the degree that it could prevent enforcement of mortgage

- Loan has restrictive covenant in violation of policy

Tier 3

- Lender selected inappropriate FHA loan product, however loan complies with rules for correct FHA loan product when adjusted and there is no reason to believe misrepresentation intended

- Loan originator inaccurately selected 203(k) streamline option for a normal 203(k) loan that would qualify under normal 203(k) rules (HUD Employee Loan)

Tier 4

- Some evidence that supports the eligibility and qualification of the mortgage for FHA endorsement is insufficient or missing, however FHA is able to determine that the mortgage is eligible through other supporting evidence in the loan file

- List of parties on contract differs from that presented in remainder of loan binder, but reviewer is able to determine accurate parties to transaction and that they are eligible





9

Defect: Lender Operations (LO)

Source of defect

1. NMLS registration information incorrect or missing (e.g., Lender or Sponsored Third party registration information in FHA Connection has incorrect NMLS number)
2. Unallowable, undisclosed, or excess fees or costs to borrower (e.g., HUD-1, Good Faith Estimate)
3. Misuse of escrow
4. Issues with late endorsement certification
5. Lender compliance issues (e.g., loan binder is missing or contains discrepancies with what has been entered into FHAC)
6. Failure to follow TOTAL Mortgage Scorecard guide process when entering a loan to TOTAL or interpreting results from TOTAL²
7. Other parties to the transaction are ineligible (e.g., party, other than borrower, is on the LDP/GSA list; identity of interest rules not met)
8. AUS Feedback Certificate missing
9. Other

Cause of defect		
A. Violation of FHA policy	F. Possible misrepresentation /fraud– lender knew or should have known	G. Possible misrepresentation/ fraud – lender did not know or could not have known
<div style="background-color: #4a86e8; color: white; padding: 10px; border-radius: 15px; margin: 10px auto; width: 80%;"> <p>LOAN REVIEWER FINDINGS EXAMPLE Loan Officer originating loan has inaccurate information listed in the loan application, but is registered in the NMLS</p> <p>HOW THE LOAN REVIEWER WOULD EXPRESS THESE FINDINGS 1A Free text: Loan Officer has inaccurate information listed in the loan document, but is accurately listed in the NMLS.</p> </div>		

➤ Current Basis of Ratings Codes: AU02, AU05, CL32, CL33, DC12, DC15, DC17, HM29, LI01, LI03, LO80, LO81, LP05, LP11, RC99, UW16, VA22, VA27





9

Severity: Lender Operations (LO)

	Tier criteria	Examples
Tier 1	<ul style="list-style-type: none"> Lender/Loan Officer/Sponsored Third Party misrepresents themselves as registered, OR Misrepresentation in closing escrow funds or in closing fees 	<ul style="list-style-type: none"> Lender/Loan Officer/Sponsored Third Party has been barred from issuing loans, and uses registration of another registered party
Tier 2	<ul style="list-style-type: none"> Lender/Loan Officer/Sponsored Third Party is not registered or has improper relationship with borrower, OR Misuse of escrow, OR finds Late endorsement certification is false based upon information from the file, OR Lender never submitted loan binder or submitted loan binder that has “significant” data discrepancies with what the lender entered into FHAC Failure to follow TOTAL Mortgage Scorecard User Guide and loan is <u>not</u> insurable when loan is rescored through TOTAL 	<ul style="list-style-type: none"> Lender/Loan Officer/Sponsored Third Party let loan registration lapse as of time of loan origination, but there is no indication of attempted misrepresentation
Tier 3	<ul style="list-style-type: none"> Binder Illegible – Quality of imaged documentation insufficient for review Unallowable or excess fees and charges were charged, and need to be corrected by the lender, OR Lender failed to submit loan binder within 10 days, but submitted after 10 days Failure to follow TOTAL Mortgage Scorecard User Guide, but loan is insurable when loan is appropriately rescore through TOTAL 	<ul style="list-style-type: none"> Fees listed on the HUD-1 exceed fees disclosed on the GFE, in excess of the allowable tolerance
Tier 4	<ul style="list-style-type: none"> Errors are made with regards to the Lender/Loan Officer/Sponsored Third Party information in the loan documentation or FHA Connection system, but the Lender/Loan Officer/Sponsored Third Party has proper registration status, OR Minor late endorsement issues that cannot be categorized as false certification, OR Lender submitted loan binder that has minor data discrepancies with what the lender entered into FHAC 	<ul style="list-style-type: none"> Errors are made with regards to the Lender/Loan Officer/Sponsored Third Party information on loan documentation or FHA Connection, but the Lender/Loan officer has appropriate registration status in NMLS





The defect code system allows FHA reviewers to capture a defect’s severity and its sources and causes in a single code

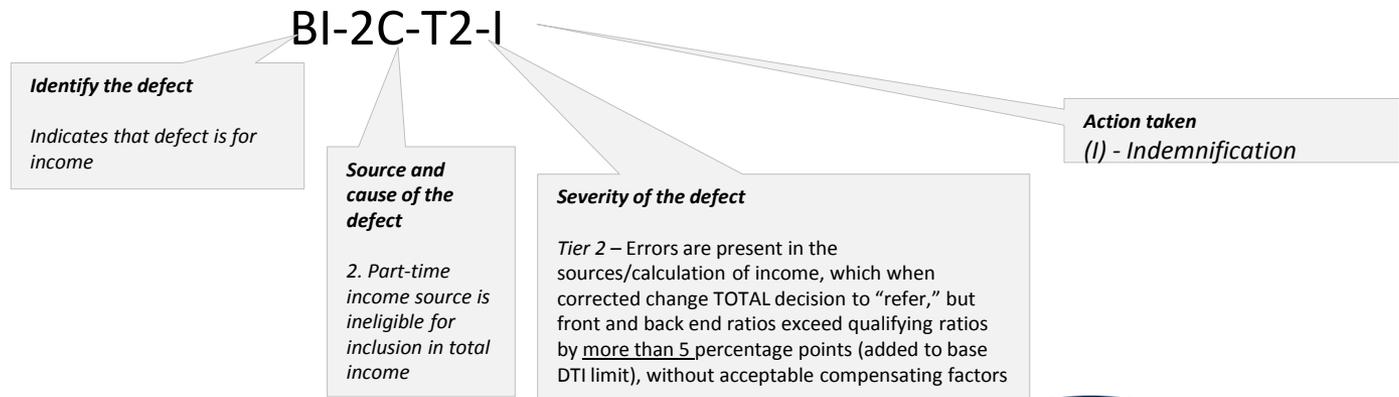
Loan Rating

- A loan will only receive one initial overall rating regardless of how many defects are noted
 - Unacceptable
 - Deficient
 - Conforming
- The defect code with the highest tier severity will determine the overall loan rating

Example of a loan with an income defect

- A loan reviewer makes an income related finding¹ on an AUS loan that was originally a TOTAL “approve” loan:
 - Part-time income was not eligible for inclusion as it was not uninterrupted for the past two years;
- As a result of this finding, the total income decreased from \$8K/month to \$6K/month for the borrower, on a loan with a monthly payment of \$2400, resulting in the front-end DTI ratio changing from 30% to 40%, in excess of the permitted front-end ratio of 31%; the back-end ratio was also in excess of the permitted 41%.

How reviewers would describe the loan with the income defect in the new defect coding system



¹ Loan example is hypothetical, and assumed to be post-mitigation

