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UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF APPEALS
Washington, D.C.

In the Matter of: **ERIKA ETZEL,** Respondent.	HUDOA No. 10-H-005-D5 OGC Case No. 10-3616-DB Administrative Judge Vanessa L. Hall

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INITIAL DETERMINATION

Statement of the Case

This proceeding arose as a result of a notice issued by Henry S. Czauski, Acting Director for the Office of General Counsel Departmental Enforcement Center for the U.S. Department of Housing and Urban Development ("HUD" or "Government"), on October 20, 2009 in which Erika Etzel, ("Etzel" or "Respondent") was notified that in order to protect the public interest, HUD was proposing Respondent's debarment as either a participant or principal from future participation in procurement and nonprocurement transactions with HUD and throughout the Executive Branch of the Federal Government for a period of five years from the notice date. In addition, pending final determination of the debarment, Respondent was immediately suspended from further participation in such transactions. The suspension and proposed debarment was based upon information indicating alleged irregularities of a serious nature in Respondent's dealings with the Government.

Respondent appealed the proposed debarment and requested a hearing before a debarring official. Upon a Joint Motion for Referral by both parties, the Debarring Official referred the

matter to this Court pursuant to 2 C.F.R. § 180.845(c) on February 26, 2010. A hearing in accordance with 2 C.F.R. Part 180 and 24 C.F.R. Part 26, Subpart A was conducted on November 22, 2010 through November 24, 2010 and continued on December 17, 2010. The following witnesses testified at the hearing: Joyce Tate-Cech, a housing specialist with HUD's Quality Assurance Division; Patricia Peiffer, a housing specialist with HUD's Quality Assurance Division; and Respondent.

The parties filed Post-Hearing Briefs on April 4, 2011. On April 19, 2011 each party filed a Post-Hearing Reply Brief. On April 28, 2011, Government's Counsel filed a Motion for Permission to File a Surreply, which was opposed by Respondent's Opposition to Government's Motion for Permission to File a Surreply, filed April 29, 2011. On August 20, 2011, this Court denied the Government's Motion for Permission to File a Surreply. Accordingly, this case is ripe for decision.

Relevant HUD Handbook Requirements

Direct endorsement underwriters are required to comply with the guidelines set forth by HUD as "the minimum standard of due diligence in underwriting mortgages." 24 C.F.R. § 203.5(c) (2010). Such requirements include: a) adequate documentation; b) credit history analysis; c) income analysis; d) source of funds; and e) cash-out and no cash-out refinance eligibility.

A. Adequate Documentation.

The HUD Handbook states:

> The lender is responsible for asking sufficient questions to elicit a complete picture of the borrower's financial situation, source of funds for the transaction, and the intended use of the property. All information must be verified and documented.

HUD MORTGAGE CREDIT ANALYSIS FOR MORTGAGE INSURANCE, HANDBOOK 4155.1 REV-5 Chapter 3, 3-1 (2003) [hereinafter HUD HANDBOOK 4155.1 REV-5]. It further provides:

> When standard documentation does not provide enough information to support [the lender's decision to approve the mortgage loan], the lender must provide additional explanatory statements, consistent with other information in the application to clarify or to supplement the documentation submitted by the borrower.

HUD HANDBOOK 4155.1 REV -5, Ch. 3, Section 1, ¶ 3-1.

B. Credit History Analysis

The HUD Handbook states that, "[p]ast credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions." HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 1, ¶ 2-3 (2003). Underwriters are instructed to "examine the overall pattern of credit behavior, rather than isolated occurrences of unsatisfactory or slow payments." Id. A borrower with a credit history that reflects a period of financial difficulty may still be approved if the borrower has "maintained a good payment record for a considerable time period since the difficulty." Id. Underwriters are required to "document their analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower. Id. "Major indications of derogatory credit—including judgments, collection, and any other recent credit problems—require sufficient written explanation from the borrower...[and] the borrower's explanation must make sense and be consistent with other credit information in the file." Id. The HUD HANDBOOK lists the following requirements for analyzing a borrower's credit:

> **Previous Rental or Mortgage Payment History.** The payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity-of-interest with the borrower) or verification of mortgage directly from the mortgage servicer, or through canceled checks covering the most recent 12-month period.
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> **Recent and/or Undisclosed Debts.** The lender must ascertain the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment on the property being purchased. Similarly, the borrower must provide a satisfactory explanation for any significant debt that is shown on the credit report but not listed on the loan application. The borrower must explain in writing all inquiries shown on the credit report in the last 90 days.
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> **Collections and Judgments.** Court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. (An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment and documentation is provided that the payments have been made in accordance with the agreement.) FHA does not require that collection accounts be paid off as a condition of mortgage approval. Collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness with the lender documenting its reasons for approving a mortgage where the borrower has collection accounts or judgments. The borrower must explain in writing all collections and judgments.

HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 1, ¶ 2-3(A)-(C).

> **Bankruptcy.** A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the discharge of the bankruptcy. Additionally, the borrower must have re-established good credit or chosen not to incur new credit obligations. The borrower also must have demonstrated the ability to responsibly manage his or her financial affairs.

HUD HANDBOOK 4155.1 REV-5, Ch. 2, Section 1, ¶ 2-3(E).

C. Income Analysis.

The HUD Handbook requires that

> [t]he anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 2. Underwriters should analyze a borrower's income "to determine whether it can reasonably be expected to continue through at least the *first three years* of the mortgage loan." HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 2, ¶ 2-7. (emphasis in original)

The HUD HANDBOOK also requires verification of employment (VOE) from lenders to verify the borrower's employment for the most recent two full years. HUD HANDBOOK 4155.1 REV-5, Ch. 2, Sec. 2, ¶ 2-6. "VOEs and the borrower's most recent pay stub are to be provided ... As an alternative to obtaining a VOE, the lender may obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original IRS W-2 Forms for the previous two years." Id. at Chapter 3, Section 1, ¶ 3-1(E). (emphasis omitted)

The HUD HANDBOOK also notes that, "[i]n most cases, the borrower's income will be limited to salaries or wages. Income from other sources can be included as effective income with proper verification by the lender." Id. The HUD Handbook requires lenders to document stable rental income if rent received for properties owned by the borrower is to be used as income. HUD HANDBOOK 4155.1 REV-5, Ch. 2, Section 2, ¶ 2-7(M). Stability of rental income may be determined by a current lease, an agreement to lease, a rental history over the previous 24 months that is free of unexplained gaps greater than three months, or tax returns. Id. All rental income must be verified by the Schedule E of the IRS Form 1040 or a current lease if the property was acquired since the last income tax filing and is not shown on the Schedule E. Id.

D. Verification of Source of Funds

The HUD HANDBOOK requires that "[a]ll funds for the borrower's investment in the property must be verified and documented." HUD HANDBOOK 4155.1 REV-5, Ch. 2, Section 3, ¶

2-10. HUD recognizes savings accounts, checking accounts, and gift funds as acceptable sources of funds a borrower needs to close the loan. Id. The HUD Handbook allows outright gifts from a relative of the borrower, however the lender "must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift ...In addition, the lender must document the transfer of funds from the donor to the borrower ..." HUD HANDBOOK 4155.1 REV-5, Chapter 2, Section 3, ¶ 2-10(C).

The borrower must list the name, address, telephone number, relationship to the homebuyer, and the dollar amount of the gift on the loan application or in a gift letter for each cash gift received. If sufficient funds required for closing are not already verified in the borrower's accounts, document the transfer of the gift funds to the homebuyer in accordance with instructions described in HUD HANDBOOK 4155.1 REV-5. (HUD Mortgagee Letter 04-01, dated Jan. 6, 2004, FHA Total Mortgage User Scorecard User Guide, at 15.)

E. Cash Out and No-Cash Out Refinance Eligibility

Mortgagee Letter 05-43 states that FHA "will insure a cash-out refinance of up to 95% of the appraiser's estimate of value." (HUD Mortgagee Letter 05-43, dated Oct. 31, 2005.) Mortgagee Letter 05-43 goes on to state that in order for a loan to be eligible for FHA insurance all of a borrower's mortgage payments must be made "within the month due for the previous 12 months, i.e., no payment may have been more than 30 days late and is current for the month due." Id.

Findings of Fact

1. Ms. Etzel has worked in the mortgage industry since 1981. (Tr. 415:7-16.) Ms. Etzel has been an FHA underwriter since 1992. (Tr. 416.) In her career, Ms. Etzel has underwritten thousands of loans. (Tr. 418:6-9; Tr. 419:22-420:1-3; Tr. 421:7-14; Tr. 424:6-11; Tr. 425; Tr. 426.)

2. HUD's Quality Assurance Division (QAD) is responsible for reviewing FHA approved lenders for compliance with regard to the origination and the servicing of FHA insured loans. (Tr. 33:2-7.) The role of the QAD is to protect HUD's FHA from unacceptable risk by assessing lenders' performance and compliance with FHA requirements. (Tr. 33:7-10.)

3. HUD publishes handbooks and mortgagee letters that are to be used by HUD-approved lenders and underwriters as guidance in underwriting FHA insured loans. (Tr. 35) The handbooks and mortgagee letters are the minimum requirement for FHA underwriters. (Tr. 37:2-6.) The underwriter is required to certify on the 92900A that HUD guidelines were complied with and that the loan met all the requirements. (Tr. 33:7-10.)

4. HUD directed its QAD within its Philadelphia Homeownership Center to conduct a review of loans originated by Lend America, an FHA approved lender. (Tr. 21:18-19.) The purpose of the review was to review the Lend America loans for compliance with the standards that HUD set forth in HUD handbooks and mortgagee letters. (Tr. 173:2-4.) The QAD conducted its review from December of 2008 to February of 2009. (Tr. 21:18-19.)

5. The Notice of Debarment was based upon alleged irregularities discovered during the QAD Review in the following thirteen loans underwritten by Respondent: FHA CASE NO. 249-5068168 ("Asson Loan"); FHA CASE NO. 094-5297537 ("Blaise Loan"); FHA CASE NO. 352-5669060 ("Colon Loan"); FHA CASE NO. 249-5069222 ("Gnassounou Loan"); FHA CASE NO. 105-3437512 ("Hunter Loan"); FHA CASE NO. 352-5691459 ("Jeffers/Dundas Loan"); FHA CASE NO. 441-8037441 ("Kaylani Loan"); FHA CASE NO. 061-3082765 ("Lewis Loan"); FHA CASE NO. 061-3066972 ("Martin, Gilman Loan"); FHA CASE NO. 201-3740417 ("Martin, Jackie Loan"); FHA CASE NO. 352-5671064 ("Meremikwu Loan"); FHA CASE NO. 095-0470946 ("Veal Loan"); FHA CASE NO. 461-4159949 ("Windham Loan").

A. FHA CASE NO. 249-5068168 ("Asson Loan")

6. The loan was closed as a cash-out refinance. (Tr. 450.) The borrower's credit report indicated he was over 30 days late paying his second mortgage on two occasions: May 2006 and June 2006. (Government's Exhibit 30.) The borrower's payoff statement for his second mortgage payment indicated that the borrower had been at least 30 days late for May and June of 2006. (Tr. 176:5-7.) The payoff required over two months interest. (Respondent's Ex. 1.) Borrower paid $444.00 per month in interest. (Gov't Ex. 30.)

B. FHA CASE NO. 094-5297537 ("Blaise Loan")

7. The VOE from the borrower's primary employer, Central Florida Family Health Center included inconsistencies between the amount earned by the borrower in 2005 and 2006. (Resp't Ex. 2; Tr. 190-91.) When Ms. Peiffer contacted the borrower's primary employer about the inconsistencies in the VOE, she was informed that the borrower had quit her employment prior to the loan's closing. (Tr. 191.) The case file also included a VOE purported to be from the borrower's second employer, M&M Consulting and Inspections, Inc. (Gov't Ex.17.) The M&M VOE included inconsistencies between the amounts the borrower actually earned, her average hours per week, and her monthly gross pay figure. (Id.) The case file also included documents listing the second employer's address as 7856 Falabella Court and 7874 Falabella CT. (Gov't Exs.17, 18, 19, and 20.) Respondent cross-referenced different documents and verified that the second employer's address was 7856 Falabella Court. (Resp't Exs.13 and 14.) During the QAD Review, Ms. Peiffer contacted the second employer about the discrepancies and was informed that the M&M VOE and letter certifying the borrower's employment were both false and that the borrower never worked for the company. (Tr. 188-9.)

C. FHA CASE NO. 352-5669060 ("Colon Loan")

8. The borrowers had a Chapter 13 bankruptcy that was discharged in July, 2005. (Gov't Ex. 44.) Since the discharge of their bankruptcy, the borrowers were over 30 days late paying their mortgage with AMC Mortgage Services on three occasions, before they refinanced and obtained a mortgage with Washington Mutual. (Id.) After taking out the Washington Mutual

loan, the borrowers were over 30 days late paying their mortgage in August, October and November and over 60 days late paying in September of 2007. (Id.) The borrowers' credit report also indicated at least one collection account for Sprint was opened after the discharge of the bankruptcy. (Id.; Tr. 506.) The borrowers' housing payment would increase from $2612.00 to $3,324.47 under the new loan. (Tr. 316:2-8; Resp't Exs. 21, 22, 23.) The case file also included a Death Transcript and copies of plane tickets supporting the borrowers' undocumented explanation that they had to travel to Houston because of a death in the family. (Resp't Exs. 19, 20; Tr. 495-97.)

D. FHA CASE NO. 249-5069222 ("Gnassounou Loan")

9. Respondent admits underwriting the Gnassounou Loan. (Tr. 846.) The address of the property being refinanced was 1236 Elm Grove Circle, Silver Spring, Maryland. (Gov't Ex. 1 and 2; Tr. 197.) The case file for this loan included the borrower's driver's license issued by the State of Maryland on April 10, 2002. (Resp't Ex. 24.) The driver's license identified the borrower's address as 6731 New Hampshire Avenue, Takoma Park, Maryland. (Joint Ex. 1.) The driver's license expired prior to the loan closing and was not relied upon as evidence of the borrower's current address. (Tr. 519:1-9.) Respondent used the borrower's pay stub to verify that the borrower lived at the property being refinanced. (Tr. 520:3-15; Resp't Ex. 25.)

10. The case file for this loan also included the appraisal report, borrower's homeowner's insurance policy and bill, Real Quest Report, and Occupancy Certification, all of which showed the borrower's address as 1236 Elm Grove Circle, Silver Spring, Maryland. (Resp't 26, 27, 28, 29, and 30.) However, during the QAD review, Ms. Peiffer was informed by the co-borrower that he and the borrower were separated and that the borrower was living in an apartment in Takoma Park, Maryland, and that the loan officer actually went to that apartment to take the loan application. (Tr. 201.)

11. The borrowers' credit report indicated several accounts with late payments occurring throughout 2005 and 2006. (Gov't 6.) Respondent did not obtain the borrowers' explanation for their derogatory credit. (Id.) The case file for this loan also included a Loan History Summary for the borrower's previous mortgage with Ideal Mortgage Bankers, Ltd. that had late payments in March, April and May of 2007 that were paid on May 18, 2007. (Gov't 5; Resp't 34.) The late payments were caused by servicing errors on the part of Lend America, for which the borrowers had no control. (Resp't 31, 32, 33, 34.) Although Respondent's explanation for the late payments on the mortgage was not included in the case file for this loan, Respondent included documents that generally support her explanation. (Id.)

E. FHA CASE NO. 105-3437512 ("Hunter Loan")

12. The borrower's VOE for this loan indicated that the borrower received $16,480 in overtime income, and $1,140 in bonus income for 2007. (Gov't Ex. 8.) The case file for this loan included three paystubs (Tr. 561.) The borrower's paystub indicated only $6,084.74 in year-to-date overtime income and $1,375 in year-to-date bonus income for the last period on 2007. (Gov't Ex. 9; Resp't Ex. 37.) However, the borrower's paystub also indicated that the borrower's overtime hours were paid at the regular hourly rate and added to overtime pay at

half the hourly rate. (*Id.*) With regards to the borrower's overtime pay, the discrepancy between the VOE and paystub was only in the manner of calculating overtime pay and not in the actual amount of overtime pay received by the borrower. (Tr. 558.) Respondent acknowledged the discrepancy between the VOE and paystubs. (Tr. 558.) During the QAD Review, Ms. Peiffer contacted the borrower's employer who informed her that the VOE was prepared by someone that was not authorized to do it and that the amounts were incorrect on the VOE but the paystubs were correct. (Tr. 391.)

F. FHA CASE NO. 352-5691459 ("Jeffers/Dundas Loan")

13. The borrowers' credit report indicated the borrower only had one account with an acceptable payment history. (Gov't Ex. 41; Tr. 220.) The case file for this loan included an explanation letter from the borrower stating, "[t]he reason for my derogatory credit is due to the fact that I was disputing a collection for Macy's and I fell behind on some monthly obligation due to personal reasons that dealt with medical payments that needed to be made." (Resp't Ex. 38.)

14. The case file for this loan also included a rental verification indicating the borrower satisfactorily paid $840 in monthly rent from March 2006 through December 2007. (Resp't Ex. 39.) Respondent considered the borrower's positive rental history to be a compensating factor for her derogatory credit. (Tr. 586.) Respondent also used the fact that the borrower had a second job as a compensating factor. (Tr. 587.) The credit report for the co-borrower indicated the co-borrower had acceptable credit history with only one account having late payments and three collection accounts that were for medical payments. (Tr. 584-5; Resp't Ex. 41.)

G. FHA CASE NO. 441-8037441 ("Kaylani Loan")

15. The case file for this loan included a copy of the borrower's credit report. (Gov't Ex. 28.) The credit report indicated the borrower had derogatory credit beginning as early as 2001, with most of the accounts being paid in full, settled, or charge offs. (Id.) The case file also included an explanation from the borrower generally stating that his derogatory credit was a result of a series of health issues beyond his control that began in 2004 and affected the borrower's ability to work. (Resp't Ex. 43.) The explanation letter did not discuss the collection accounts that came about prior to 2004. (Tr. 592:2-22; Tr. 593:1-12; Resp't Ex. 43.) The borrower also stated in his explanation letter that he has since "recovered fully" and is "not only pain free and able to work not only a full day, but overtime as well." (Id.)

16. A VOE from the borrower's employer confirmed that the borrower was on short-term disability for a period of time. (Resp't Ex. 44.) The case file included a partially completed Tenancy (Rental) Verification that was signed by the borrower's previous landlord, and indicated the borrower satisfactorily paid rent in the amount of $1,500 a month from January 2005 through June 2007. (Resp't Ex. 46.) The case file also included a letter from the borrower's mother stating that the borrower had been living with her since June 30, 2007 and contributed "$1,500 each month to expenses." (Resp't Ex. 47.)

H. FHA CASE NO. 061-3082765 ("Lewis Loan")

17. The case file for this loan included a typed letter from the Housing Authority of the City of Norwalk verifying that the borrower is a current tenant. (Resp't Ex. 52, Gov't Ex. 21.) The letter contained a hand-written statement of monthly rent in the amount of $473. (Id.) The numbers "473" were hand-written between the dollar sign and ".00" which were type-written (Id.) The rental amount listed was consistent with the amount stated on the initial application and market rents. (Resp't Ex. 51.) However, during the QAD Review, Ms. Peiffer was able to determine that that letter was false during the QAD Review of this loan. (Tr. 344.) The letter also identified the borrower as Michelle Vargas and not Michelle Lewis. (Id.) The co-borrower's credit report indicated that Michelle Vargas was the co-borrower's maiden name. (Resp't Ex. 48.)

18. The "Date Issued" date on the co-borrower's credit report referred to the date the credit report was re-issued and not when it was initially issued. (Tr. 597-600; Resp't Ex. 48.) The credit report for the borrower, Eric Lewis, indicated a history of late payments and collection accounts with only one account having an acceptable payment history. (Gov't Ex. 24.) The credit report also indicated that the borrower has since paid off or brought current all accounts with the exception of a collection account. (Id.; Resp't Ex. 53.)

19. The case file for this loan included an explanation from the borrower stating that the derogatory credit was due to him losing employment several years ago and not receiving bills because of a change of address. (Resp't Ex. 53.) A letter from the borrower's employer stated that he was not working for two months during the summer of 2007 due to building renovations. (Resp't Ex. 56.)

20. The loan application indicated the borrower had been living at the same address for the past five years and that his mailing address was the same as his present address. (Resp't Ex. 51.) Michelle Lewis is currently working. (Tr. 633:2-16).

I. FHA CASE NO. 061-3066972 ("Martin, Gilman Loan")

21. The borrowers filed for Chapter 13 bankruptcy, which was dismissed on September 2004. (Gov't Ex. 38). The borrowers also filed for Chapter 7 bankruptcy and were granted a discharge on December 20, 2004. (Resp't Ex. 62.) The borrowers' credit report indicates that since the discharge of their Chapter 7 bankruptcy on December 20, 2004, the borrowers opened 5 lines of credit. (Gov't Ex. 37.) Of the five newly incurred lines of credit, only one, an auto loan from Chrysler Financial opened four months prior to the credit report, was continuously paid on-time. (Id.) The case file included a letter from the borrowers explaining that their bankruptcy and derogatory credit after the discharge were the result of a series of financial and medical hardships. (Resp't Exs. 63 and 64.)

J. FHA CASE NO. 201-3740417 ("Martin, Jackie Loan")

22. The case file for this loan included a letter which was purported to be from the co-borrower's employer. (Gov't Ex. 10.) The letter identified the employer as Phillip R. Hall Trucking, Inc. and included 13060 HWY 7S, Kite Kentucky as the employer's address. (Id.) The signature block in the letter identified the signer as Philip P. Hall, but the signature itself read Phillip R. Hall. (Id.) A printout from the Kentucky Secretary of State website erroneously listed the employer's address as 13060 HWY 75, Kite, KY. (Gov't Ex. 11.) During the QAD Review, Ms. Tate-Cech contacted the employer and was informed by Phillip Hall that the co-borrower wasn't employed by Phillip R. Hall Trucking. (Tr. 157.)

23. The borrowers' credit report indicated three revolving accounts that were over 30 days late in the months preceding the loan closing. (Gov't Ex.13; Resp't Ex. 66.) A bank statement with Community Trust Bank indicated the account was overdrawn in the amount of (-$50.22) on July 11, 2007. (Gov't Ex. 14.) The borrowers explained that they were late on their payments because the co-borrower was hospitalized from May through July of 2007. (Resp't 67.) While the co-borrower was hospitalized, he continued to receive Social Security payments that began in 1999 when he became permanently disabled. (Resp't Ex. 68.)

K. FHA CASE NO. 352-5671064 ("Meremikwu Loan")

24. The borrower's loan application indicated that the borrower had an investment property. (Tr. 247; Gov't Ex. 46.) The borrower's mortgage credit analysis worksheet (MCAW) showed a $1,275.00 net income amount from real estate. (Tr. 247-48; Gov't Ex. 45.) Respondent calculated rental income in the amount of $1,275. (Tr. 247.) The IRS transcript indicated that there were rental losses of $10,367 and $7,079 and during the 2005 and 2006 tax years. (Tr. 249; Gov't Ex. 48.) Respondent did not rely on the schedule E in the borrower's tax return to determine rental income. (Tr. 960.) The borrower's file did not contain a copy of the lease and Respondent stated that a lease was unnecessary. (Tr. 687-688.)

L. FHA CASE NO. 095-0470946 ("Veal Loan")

25. The case contained an earnings statement for the period ending December 5, 2007 but did not contain a VOE. (Tr. 66-67; Tr. 691-692.) The co-borrower's credit report included an installment loan with Tropical Federal Credit in the amount of $2,000.00 which also indicated a monthly payment of $52.00. (Gov't Ex. 52; Resp't Ex. 89.) The underwriter's findings take into account the monthly payment of $52.00 associated with the Tropic Federal Credit Union debt. (Resp't Ex. 88; Tr. 702-03.) Respondent states that the $52.00 liability should have been included in the borrower's liabilities. (Tr. 701-702; 755-756.)

26. The case file also included the co-borrower's credit report showing a student loan that was deferred from the University of Mobile in the amount of $5,971.00. (Gov't Ex. 51; Tr. 68.) The credit report indicated that the student loan would be deferred until October 1, 2008. (Gov't Ex. 51; Tr. 68.) The deferment period expired within ten months from the date of

closing. (Notice of Docketing 5; Tr. 704-05.) Respondent did not include the monthly payment as part of her credit analysis. (Tr. 704-05.)

M. FHA CASE NO. 461-4159949 ("Windham Loan")

27. The case file contained a Request for Verification of Deposit. (Gov't Ex. 55; Resp't Ex. 91.) The Request for Verification of Deposit listed two outstanding loans in the amount of $309.00 and $405.00. (Gov't Ex. 55; Resp't Ex. 91.) Loan statements identified the loans as originating from Founders Federal Credit Union. (Resp't Ex. 93.)

28. The loan statements also listed the name "Holly Windham," raising the inference that the loans belonged to the borrower's wife. (Tr. 708-10; Resp't Ex. 93.) Respondent concluded that Holly Windham, rather than the borrower, was responsible for the loans. (Tr. 709-10.) Respondent stated that FHA regulations did not require an explanation of the discrepancy in the documents that she relied upon in completing her analysis. (Tr. 711.)

Discussion

HUD has the burden to prove, by a preponderance of the evidence that a cause for Respondent's debarment exists by a preponderance of the evidence. 2 C.F.R. §§ 180.850(a) and 180.855(a) (January 1, 2011). Thereafter, the burden is shifted to Respondent, who must demonstrate "to the satisfaction of the debarring official that [Respondent is] presently responsible and that debarment is not necessary." 2 C.F.R. § 180.855(b). LDPs, debarments, and suspensions are serious sanctions that should only be utilized for the purposes of protecting the public interest and may not be used as punishment. 2 C.F.R. § 180.125(c). The test for determining whether a proposed sanction is warranted is the "present responsibility of the participants " and "a finding of a lack of present responsibility may be based on past acts." *In the Matter of Stephen J. Ferry, Beth An Ferry, and Ferry Financial, Inc.*, HUDBCA No. 90-5228-D17 (October 31, 1990). *See also Stanko Packing Co. v. Bergland,* 489 F. Supp. 947, 949 (D.D.C. 1980)) ("the central purpose of the regulations, as plaintiff concedes, is to protect both the public and the integrity of the procurement process from those contractors whose continued business practices become suspect as a result of prior wrongful acts.")

For the purpose of protecting the public interest by ensuring the integrity of federal programs, the federal government only conducts business with responsible persons. 2 C.F.R. § 180.125(a) (2005). The term "responsible," as used in the context of administrative sanctions such as LDPs, debarments and suspensions, is a term of art that includes not only the ability to perform a contract satisfactorily, but the honesty and integrity of the participant as well. *William D. Muir and Metro Community Development Corp.*, 00-2 BCA ¶ 31.140, HUDBCA No. 97-A-121-D15 (citing 48 Comp. Gen. 769 (1969)).

Under 2 C.F.R. §180.800(b), HUD may debar Respondent for:

> (b) Violation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as –

> (1) A willful failure to perform in accordance with the terms of one or more public agreements or transactions;
> (2) A history of failure to perform or of unsatisfactory performance of one or more public agreements or transactions; or
> (3) A willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction;

2 C.F.R. § 180.800(b).

Respondent may also be debarred under 2 C.F.R. § 180.800(d) for "[a]ny other cause of so serious or compelling a nature that it affects [Respondent's] present responsibility." Serious sanctions such as debarment, LDP, and suspension were found to be warranted in cases where: a loan officer falsified loan documents, forged signatures on loan documents, and made false statements for the purpose of influencing loan underwriting decisions in which HUD insured the loans, *Marcus Payne*, HUDBCA No. 99-9014-DB, 1999 WL 356299 (May 14, 1999); a respondent made a misrepresentation, that even if it was an "honest mistake, [was], nevertheless, a very serious mistake because HUD must rely upon the truthfulness of the representations made by those who participate in its program and who certify to the accuracy of their representations," *William D. Muir and Metro Community Development Corp.*, HUDBCA No. 97-A-121-D15, 1997 WL 690183 (Nov. 6, 1997); a participant, who had previously been issued an LDP, did nothing to correct the deficiency and admitted to misusing funds to the detriment of HUD who became liable for the money, *Otis Stewart Jr.*, HUDALJ 98-8054-DB (Nov. 8, 2001); an executive director of a HUD participant had a duty to discourage the participant's board members from taking actions that violated HUD regulations, but failed to do so, *McKinley V. Copeland,* HUDBCA No. 00-C-113-D14, 2001 WL 1635127 (Nov. 29, 2001); a participant's false certification was a material misrepresentation even when there was a lack of intent to mislead HUD, *Gabe Brooks*, HUDBCA No. 99-A-104-D3, 2000 WL 1460775 (Sept. 15, 2000); respondents were found to have "failed, repeatedly, to meet their contractual and programmatic obligations to HUD" when they entered into four sales contracts with HUD that never went to closing, *M. Brett Young and Allied Housing Group, Ltd.*, HUDALJ 96-0036-DB (Sept. 13, 1996).

On the other hand, participants were not so sanctioned in cases where: a respondent made good-faith efforts to remedy a difficult and disorganized situation and bring her office into compliance with HUD regulations but was unable to do so because she lacked the staff and resources necessary, *Marilee Jackson,* HUDBCA No. 05-K-112-D7, 2005 WL 3739729 (Nov. 29, 2001); a lender's remedial measures demonstrated that they were acting as responsible contractors and in good faith as they attempted to correct the deficiencies caused by their subcontractors, *First Capital Home Improvements*, HUDBCA No. 99-D-108-D7, 1999 WL 33486726 (Nov. 24, 1999).

Direct endorsement underwriters are required to comply with the guidelines set forth by HUD as "the minimum standard of due diligence in underwriting mortgages." 24 C.F.R. § 203.5(c) (2010). Direct endorsement underwriters "shall exercise the same level of care which it would exercise in obtaining and verifying information for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment." Id. As such, HUD

relies upon the mortgage lender to properly perform its underwriting functions in determining the creditworthiness and financial responsibility of the borrower. *In the Matter of Hector J. Garcia*, HUDALJ 90-1531-DB (April 10, 1991). The key to ensuring the lender's success in this regard is its underwriter. *Id.* As HUD/FHA depends upon the lender the lender must depend upon its underwriter. Accordingly, an underwriter's willful failure to comply with HUD guidelines is a willful violation of HUD regulations for underwriting FHA insured loans and a cause for debarment.

The severity of underwriting deficiencies is discussed in HUD Handbook 4000.4 REV-1 CHG-2[1] in which it lists three classes of underwriting deficiencies and "parameters to consider the seriousness of noncompliance actions." HUD Handbook 4000.4, REV -1, CHG-2, ¶ 5-3. Level One deficiencies are generally minor and do not "change the eligibility determination of the property, the mortgagor, the mortgage amount or the term" and may also include "more serious deficiencies which the mortgagee is able and willing to correct." Id., at ¶ 5-3(A)(1)-(2). A Level Two deficiency is one that "results in a significant increase in mortgage risk, through either greater credit risk or a decrease in property security." Id. at ¶ 5-3(B)(1). Level Three deficiencies are the most serious and involve "an action by the mortgagee to misrepresent either the financial capacity of the applicant-mortgagor or the condition of the property offered as security for the mortgage." Id. at ¶ 5-3(C)(1).

Here, the Government claims that "Respondent approved [the] loans for insurance endorsement in violation of HUD requirements, and that Respondent's violations of HUD requirements constitute cause for debarment under 2 C.F.R. § 180.800(b)...and 2 C.F.R. § 180.800(d)." (Gov't Post-Hr'g Br., 1.) The alleged violations are:

A. **Failure to question or resolve irregularities contained in documentation used to qualify the borrowers.**

In the Blaise Loan, Gnassounou Loan, Hunter Loan, Lewis Loan, and Jackie Martin Loan, HUD alleges that "documentation used to qualify the borrowers contained discrepancies and/or inconsistencies [Respondent] failed to question and/or resolve. [Respondent's] failure to resolve these discrepancies/inconsistencies prior to approving the mortgage is a violation of HUD requirements." (Notice of Proposed Debarment, 2.) The HUD Handbook requires lenders to ask "sufficient questions to elicit a complete picture of the borrower's financial situation, source of funds for the transaction, and the intended use of the property."[2] HUD Handbook 4155.1, REV-5, Ch. 3, at 3-1.) [hereinafter HUD HANDBOOK 4155.1 REV-5]. The HUD Handbook further provides that, "[a]ll information must be verified and documented." (*Id.*) "Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue." HUD HANDBOOK 4155.1 REV-5, Ch.

[1] Although HUD Handbook 4000.4, REV-1, CHG-2, was incorporated into HUD Handbook 4155.1 and therefore did not govern Respondent's underwriting obligations to HUD at all relevant times, it serves as a helpful guide for determining the severity of Respondent's acts and omissions.

[2] This chapter of the HUD Handbook is entitled, "Documentation and Other Processing Requirements" and it "describes the documentation requirements for each loan submitted for mortgage insurance and the specific requirements lenders must observe in processing and underwriting FHA-insured mortgages."

2, sec. 2, at 2-13. The HUD Handbook states that a borrower's "anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt." Each of these loans involved irregularities that were reflected in the documentation provided by the borrowers. While Respondent acknowledged the existence of such irregularities, it remains to be determined whether Respondent resolved such irregularities to the extent necessary to avoid violating HUD underwriting requirements.

The Blaise Loan, Hunter Loan, and Jackie Martin Loan included employment documents that contained inconsistencies. (Finding of Fact [hereinafter FF], ¶¶ 5,10, and 19.) The Blaise loan involved a discrepancy regarding a letter that purported to certify the borrower's place of employment for the borrower's primary and secondary employer. The record shows that the borrower's primary employer indicated that the borrower had quit her employment prior to the loan's closing, and further that the borrower's second employer indicated that the letter certifying the borrower's employment there was not only false but that the borrower, in fact, never worked for the company. In the Blaise Loan, Respondent relied upon a document drafted and produced by the borrower to explain the reflected income that was admittedly "a little low." (Tr. 479-80.) The Hunter loan involved a discrepancy between the borrower's paystub and VOE regarding the borrower's overtime pay. While the Respondent acknowledged the discrepancy existed, there was no evidence of Respondent inquiring further why this discrepancy existed. The Jackie Martin loan also involved a discrepancy regarding a letter purporting to be from the co-borrower's employer that reflected both an erroneous address and erroneous name for the employer. (Tr. 670-678.) Further inquiry during the QAD Review revealed that the co-borrower was not even employed by Philip R. Hall Trucking. In the Jackie Martin Loan, the record does not indicate that Respondent failed to reconcile the misspelling of the employer's name, or to resolve these discrepancies but instead concluded that it was probably a "typographical error, and was accepted as such." (Tr. 46: 4-7.) In this regard, while Respondent acknowledged the discrepancies identified for these loans, she failed to exercise the due diligence by seeking additional documentation or asking further questions about the inconsistencies that existed in this case. This level of due diligence was necessary in order to ensure that the borrowers did not present a greater credit risk to HUD. See HUD HANDBOOK 4155.1 REV-5, Ch. 3, § 1, ¶ 3-1.

In the Gnassounou Loan, the discrepancy involved the difference between the borrower's address on her driver's license from the address the borrower claimed to be her residence. (Tr. 188:11-14.) The borrower's license was issued in 2002 and expired before loan closed in 2007. (Tr. 519:1-15.) As a result, the license could not be relied upon to verify address so any inconsistency was largely irrelevant. But in this case, Respondent confirmed the borrower's address by relying on additional documentation such as the borrower's appraisal report, homeowner's insurance policy, RealQuest Report, and occupancy certification to verify the borrower's address. (Tr. 519-524; Resp't Ex. 26-30.)

In the Lewis Loan, the loan documentation involved a discrepancy that existed in a typed letter from the Housing Authority of the City of Norwalk to the Respondent that verified the borrower as a current tenant. (Resp't Ex. 52, Gov't Ex. 21.) The letter contained a hand-written statement of monthly rent in the amount of $473.00 (Id.) The numbers "473" were hand-written between the dollar sign and ".00" which was type-written (Id.) The rental amount listed was consistent with the amount stated on the initial application and market rents. (Resp't Ex. 51.)

However, during the QAD Review, Ms. Peiffer was able to determine that that letter was false. (Tr. 344; FF 15.) The Government acknowledged the fact that the handwritten rental amount was in violation of HUD guidelines. (Tr. 344.) Ms. Peiffer also testified that "it should have raised a red flag." (Tr. 348.) Respondent claimed that the handwritten rental amount was "consistent with the amount stated on the initial application." (Tr. 604:19-22; 605:1-3.) The Court finds that this fact alone is unpersuasive because the information contained in the initial application was produced by the borrower instead of the Housing Authority of the City of Norwalk, and thus the amount on the initial application could be considered self-serving.

It is possible that even the most diligent of underwriters will not be able to detect every fraudulent document or false piece of information that is submitted during the loan application process. In this case, the record shows that Respondent tried to resolve the questions raised about the inconsistencies reflected in the employment documentation from the borrowers as she attempted to reconcile those documents with other documentation contained in the case file. However, based on the testimonies of record and additional supporting documentation, a simple inquiry to the source of the information would have given Respondent notice of the false and fraudulent documentation contained in the documentation provided by the borrowers for these loans. (FF 15.)

Accordingly, the Court finds that Respondent failed to exercise due diligence by failing to resolve the inconsistencies and discrepancies in the documentation provided by borrowers seeking loan approval, and such failure is a violation of the HUD guidelines and consequently is a cause for debarment.

B. **Approved loans with poor credit histories without strong offsetting (compensating) factors and supporting documentation.**

In the Kaylani Loan, Asson Loan, Gilman Martin Loan, Jeffers/Dundas Loan, Colon Loan, Lewis Loan, Gnassounou Loan, and Jackie Martin Loan, HUD alleges that "[Respondent] approved loans with credit histories that reflected continuous slow payments, and delinquent accounts without strong offsetting (compensating) factors and supporting documentation, in violation of HUD requirements." (Notice of Proposed Debarment 3.) HUD also alleges that Respondent "failed to document [her] analysis of how the previous derogatory credit did not represent a risk of mortgage default to justify approval of the mortgage in violation of HUD requirements." (Id.)

Underwriters are instructed to "examine the overall pattern of credit behavior, rather than isolated occurrences of unsatisfactory or slow payments." HUD HANDBOOK 4155.1 REV-5, ch. 2, sec. 1, subsec. 2-3, at 2-5. A borrower with a credit history that reflects a period of financial difficulty may still be approved if the borrower has "maintained a good payment record for a considerable time period since the difficulty." Id. "[M]ajor indications of derogatory credit—including judgments, collection, and any other recent credit problems—require sufficient written explanation from the borrower...[and] the borrower's explanation must make sense and be consistent with other credit information in the file." Id.

In the Lewis, Jackie Martin, Jeffers, Kaylani, and Gnassounou Loans, Respondent failed to obtain adequate documentation so support her conclusion that the risk in approving these loans would not be unacceptable, despite the apparent derogatory credit histories of the borrowers involved. In the Lewis Loan, the documentation provided was insufficient to support the borrower's explanation that his derogatory credit was the result of his short-term unemployment and his inability to receive mail due to a change of address. (Resp't Ex.53; Tr. 236:11-22; Tr. 237:1-13). Instead, the evidence of record shows that his separation from work occurred after the delinquent accounts were reported, and that his loan application indicated that he had been residing at the same address for the past five years. (FF 74 and 75; Gov't Ex. 24 (credit report).) There is no indication from the record that, consistent with the HUD Handbook provision, Respondent documented her analysis of the borrower's explanation to determine if such explanation was consistent with other credit information in the file. (See HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 1, ¶ 2-3 (2003) (stating that "Major indications of derogatory credit...require sufficient written explanation from the borrower...[and] the borrower's explanation must make sense and *be consistent with other credit information in the file.*".) (emphasis added).

Likewise, in the Jeffers and Kaylani Loans, the case files also lacked sufficient documentation to verify the explanations provided by the borrowers regarding their derogatory credit histories. The case files for the Jeffers and Kaylani loans included a copy of the borrower's credit report. In the Jeffers loan the borrower had only one account from a department store that reflected an acceptable payment history in his entire credit history. The explanation provided by Jeffers only addressed the delinquencies of the debt collection from the department store, but it did not explain the reason for the remaining delinquent accounts on the credit report. In the Kaylani loan the borrower had derogatory credit that began as early as 2001, but the borrower's explanation claimed that his derogatory credit began as a result of a series of health issues beyond his control that began in 2004 that affected the borrower's ability to work. (Resp't Ex . 43.) The explanation letter provided by the borrower only explained the derogatory credit of the borrower since 2004, but failed to "discuss the collection accounts that came about *prior to 2004*." (Tr. 592:2-22; Tr. 593:1-12; Resp't Ex. 43.) (emphasis added.) The record does not reflect that the borrowers in either case provided explanations that were consistent with other credit information in the file. Moreover, the record lacks sufficient evidence to persuade the Court that Respondent exercised the level of due diligence that was necessary to ensure that the borrowers seeking approval in this case did not present a greater credit risk to HUD.

Next, in the Gnassounou Loan, the case file included the borrower's credit report that showed several accounts with late payments occurring from 2005 through 2006. Respondent did not obtain an adequate explanation from the borrowers regarding the late payments on their credit report, but Respondent now claims that "[b]ecause the credit history, in and of itself, showed that the derogatory credit was limited to a specific period, it evidenced that the borrowers had experienced a hardship event which they had since overcome" and that no explanation was required. (Tr. 533-543.) The Respondent also claims that "the late payments were caused by servicing errors on the part of Lend America, for which the borrowers had no control." Without an explanation and or documentation from the borrower, Respondent could not have reasonably deduced at that time that the derogatory credit was the result of a hardship event beyond the borrower's control and not a merely a disregard for financial obligations or inability to manage debt. See HUD HANDBOOK 4155.1 REV-5, Ch. 2, sec. 1, subsec. 2-3, at 2-5

(stating that underwriters are required to "document their analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower.)

The position claimed by Respondent again is unpersuasive. Respondent's decision to approve loans without conducting a thorough credit history analysis of derogatory credit apparent on the face of the borrower's credit report is considered to be adequate evidence of Respondent's lack of present responsibility. (Id.)

In the Gilman Martin and Colon Loans, the case files involved the approval of loans without Respondent conducting a full assessment of the borrower's credit history. even though the borrowers had not fulfilled HUD requirements regarding the credit of borrowers with bankruptcy history, Respondent approved their loans without assessing whether the borrower had re-established good credit or chosen not to incur new credit. See HUD HANDBOOK 4155.1 REV-5, Chapter 2, Section 1, ¶ 2-3(E). The HUD Handbook states that "a Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the discharge of the bankruptcy. Additionally, the borrower must have re-established good credit or chosen not to incur new credit obligations. The borrower also must have demonstrated the ability to responsibly manage his or her financial affairs." HUD Handbook 4155.1 REV-5, ch. 2, sec. 1, subsec. 2-3(E), at 2-7. For Chapter 13 bankruptcies, borrowers are not disqualified from obtaining FHA-insured mortgage provided, "the lender documents that one year of the payout period under the bankruptcy has elapsed and the borrower's payment performance has been satisfactory (i.e., all required payments made on time.)" *Id.*

In the Gilman Martin Loan, the borrowers' Chapter 7 bankruptcy was discharged on December 20, 2004. (FF 19.) Since the discharge, the credit report indicated the borrowers incurred several new accounts which were paid over 30 days late on numerous occasions. (Gov't Ex. 37.) Respondent approved this loan despite the fact that the borrowers had not re-established good credit since the bankruptcy. (Tr. 649:9-20, Tr. 115-116; Resp't Ex. 63.) Respondent justified her decision based on an explanation letter provided to her by the borrowers that explained the financial and physical hardships they faced before and after their bankruptcy discharge. (Tr. 649:5-13; Resp't Ex. 63.)

Similarly, in the Colon Loan, the borrowers had a Chapter 13 bankruptcy that was discharged in July 2005. (Gov't Ex. 44.) Since the discharge of their bankruptcy, the borrowers were, on three occasions, over 30 days late paying their mortgage with AMC Mortgage Services, before they refinanced and obtained a mortgage with Washington Mutual. (Id.) Then, after acquiring the Washington Mutual loan, the borrowers were over 30 days late paying their mortgage in August, October and November and over 60 days late paying in September of 2007 with Washington Mutual. (Id.) Respondent, in her credit history analysis, relied upon an explanation from the borrowers that death in the family and costs associated with that travel caused the late payments on their mortgage after the Chapter 13 bankruptcy discharge. (Resp't Exs. 19 and 20.) Respondent also offered her own opinion that the borrowers' late mortgage payments over the last four months were the result of one late payment that carried over month to month. (Tr. 495-96.) The record did not, however, contain evidence that supported

Respondent's own opinion. Even if such evidence did exist, the HUD Handbook is unambiguous in its requirement that, for cases involving bankruptcy, "all required payments [must be] made on time." HUD HANDBOOK 4155.1 REV-5, Ch. 2, sec. 1, subsec. 2-3(E), at 2-7.

Respondent did make an effort to justify her decisions by acknowledging instances in which the borrowers seeking loan approvals made timely payments and paid their accounts in full, despite the generally poor credit histories of those borrowers. (Tr. 496:22; Tr. 497:1-20; Tr. 499:1-5.) However, the manner in which Respondent conducted her credit history analysis was largely inconsistent. She stressed, on one hand, the importance of a borrower's payment history with regards to housing obligations. (Tr. 519:1-15; Tr. 519-524; Resp't Ex. 26-30.) On the other hand, she failed to acknowledge: 1) late payments on a conventional loan involving delinquency in payments for nearly four months. (Gov't Ex. 44.); and, 2) late payments on an AMC Mortgage Service in February and April of 2007, and December 2006 and late payments on a department store account and a cell phone account. (Tr. 195:3-4; Tr. 195:11-21.) The explanation from the borrowers did not even account for the delinquencies and the late payments reflected on their credit reports, all of which occurred after the borrowers' discharge from bankruptcy. (Tr. 499-96; Resp't Ex. 18.)

Respondent's credit history analysis fails to reflect, sufficiently, a thorough examination of the overall pattern of credit behavior of the borrowers involved in the Kaylani Loan, Asson Loan, Gilman Martin Loan, Jeffers/Dundas Loan, Colon Loan, Lewis Loan, Gnassounou Loan, and Jackie Martin Loan, and thus is a violation of HUD HANDBOOK 4155.1 REV-5, Ch. 2, §1, ¶ 2-3 (2003). As a result, the Court finds that such violation is cause for debarment.

C. **Failure to obtain adequate documentation for income**

In the Meremikwu Loan, Lewis Loan, and Veal Loan, HUD alleges that "[Respondent] did not obtain adequate documentation of the borrower's income and/or stability of income in violation of HUD requirements." (Notice of Proposed Debarment 4.) With regards to the calculation and verification of income, the HUD Handbook states:

> The anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue.

HUD HANDBOOK 4155.1 REV -5, Ch. 2, Sec. 2.

Underwriters should analyze a borrower's income "to determine whether it can reasonably be expected to continue through at least the *first three years* of the mortgage loan." (Tr. 22:24-25.) HUD HANDBOOK 4155.1 REV-5, Ch. 2, Sec. 2-6, ¶ 2-7.

In the Meremikwu Loan, the case file contained the borrower's loan application that indicated the borrower owned an investment property. (Tr. 247; Gov't Ex. 46.) HUD alleges Respondent inadequately documented the borrower's rental income as the case file did not

contain a copy of a lease and the borrower's 2005 and 2006 tax records reflected losses of $10,367 and $7,079 respectively. (Notice of Proposed Debarment 4.) The borrower's mortgage credit analysis worksheet (MCAW) showed a $1,275.00 net income amount from real estate. (Tr. 247-48; Gov't Ex. 45.) Respondent calculated rental income in the amount of $1,275.00 (Tr. 247.) Despite the HUD Handbook requirements to rely on Schedule E or a current lease for rental income determinations, Respondent elected not to rely on a the Schedule E in the borrower's tax return to determine rental income. (Tr. 960.) HUD HANDBOOK 4155.1 REV-5, Chapter 2, Section 2, ¶ 2-7(M) (states all rental income must be verified by the Schedule E of the IRS Form 1040 or a current lease if the property was acquired since the last income tax filing and is not shown on the Schedule E.) In fact, Respondent even indicated that "the lease was not required." (Tr. 688:6-12.)

HUD also raised issues with the lack of employment verification documentation in the Lewis and Veal Loans. In the Lewis loan, the Government alleged insufficient documentation of co-borrowers prior employment. (Notice of Proposed Debarment 4; Tr. 236:5-16.) Respondent relied upon Exhibit 57, a VOE for Lewis, that was submitted as evidence of the co-borrower's income. (Tr. 630:13-22; Resp't Ex. 57.) Respondent admitted that the original VOE must have been lost because she insisted that she would not have verified the co-borrower's employment without using a VOE. (Tr. 629:17-21.) Respondent's Exhibit 57 was inadequate as verification of the co-borrower's employment because it was issued on November 16, 2009, after the loan closing that occurred in September 2007. (Tr. 240:1-7.) This inconsistency makes it highly unlikely and improbable that such documentation was relied upon since it was issued after the loan closing date.

In the Veal loan, the Government claims the borrower's income was not documented for the past two years. (Notice of Proposed Debarment 5.) Respondent claims she relied on Exhibit 83 that is a VOE. (Tr. 690:12-22; Tr. 691:1-7.) However, the record indicates that this document was faxed from an unknown source in violation of HUD requirements. HUD HANDBOOK 4155.1 REV -5, Ch. 3, Sec. 1, ¶ 3-1, at 3-1. (Tr. 22:24-25.) As such, this document cannot be relied upon as a VOE.

While the Government failed to provide sufficient evidence that the borrower's income was not documented for the past two years for the Veal loan, the Government has presented adequate evidence to establish that Respondent did not obtain adequate documentation of the borrower's income and stability of such income in the Meremikwu Loan and Lewis loans as required under HUD Handbook 4155.1 Rev-5, Ch. 3, Sec. 1, ¶ 3-1. Such violation is cause for debarment.

D. **Failure to document source of funds**

In the Gnassounou Loan, HUD also alleges that "[Respondent] failed to document the source of funds used to close the loan." (Notice of Proposed Debarment 5.) The HUD Handbook states that "[a]ll funds for the borrower's investment in the property must be verified and documented." HUD HANDBOOK 4155.1 REV-5, Ch. 2, Sec. 2, ¶ 2-10, at 2-24.

Respondent justifies her failure to document the source of funds by stating that she was never informed that funds were needed to close. (Resp't Post Hr'g Br. 9.) Specifically, Respondent states that the "closing agent failed to provide notification of the shortfall, and the file was never returned to [her] for approval." (Id.) Respondent also relies upon Respondent's Exhibits 35 and 36 which allegedly indicate that no funds were needed for closing and that the lender would be "[p]icking up all fees." (Id.; Resp't Exs. 35, 36.)

A review of Exhibit 35 indicates, however, that closing funds were needed. After subtracting $312,644.61, the old loan amount, from the new loan amount, $317,695.00 , the result is $5,050.39. Additional expenses listed on page two of Exhibit 35 would then be subtracted, and would result in a negative balance that should have required the borrower to provide nearly $2,500.00 in closing costs. While Exhibit 36 states, "Lender Picking up all fees," the document does not indicate whether closing funds were included in those fees that would be paid by the lender. Respondent therefore made an assumption that the fees paid by the lender included the closing costs, without a careful examination of the fees necessary for the closing in this case.

The HUD Handbook states that "[t]he loan *must* close in the same manner in which it was underwritten and approved." HUD HANDBOOK 4155.1 REV-5, Ch. 3, Section 2, ¶ 3-10, at 3-8. Further, the government's witness, Joyce Tate-Cech, stated that underwriters are required to certify compliance with HUD's requirements on the Form 92900A, the addendum to the loan application. (Tr. 37:4-22; 38:1-3.) Underwriters must certify that they have evaluated the loan, reviewed it, and found it to meet all HUD requirements. (Id.) See also HUD HANDBOOK 4000.4, Ch. 3, ¶ 3-20 (stating that the Direct Endorsement underwriter must certify and submit the loan package to HUD for endorsement). Since Respondent was required to certify the loan package, she cannot excuse her responsibility for investigating closing costs by claiming that the file was never returned to her for approval. (Resp't Post Hr'g Br. 9.) Pursuant to HUD guidelines, it was her responsibility to ensure that the loan was closed in the manner in which it was underwritten and approved, which she admitted included closing costs. (Id.)

Respondent could not in good faith certify a loan package that she had not received back from the closing agent. Such conduct is in violation of 24 C.F.R. § 203.5(c) as Respondent failed to exercise "the minimum standard of due diligence in underwriting mortgages."

E. **Omitted liabilities without documentation**

In the Veal Loan and Windham Loan, HUD alleges that "[Respondent] omitted liabilities from the underwriting analysis without documentation to support the omission." (Notice of Proposed Debarment 5.)

The HUD Handbook requires underwriters to consider all "projected obligations." More specifically:

> [i]f a debt payment, such as a student loan, is scheduled to begin within twelve months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis, unless the borrower provides

> written evidence that the debt will be deferred to a period outside this time frame."

HUD HANDBOOK 4155.1 REV-5, Chapter 2, Section 2, ¶ 2-11, at 2-32.

The borrower's credit report in the Veal loan indicated a loan from the University of Mobile in the amount of $5,971.00. (Gov't Ex. 51; Resp't Ex. 90.) The credit report also stated that the loan was deferred until October 1, 2008, which was within 12 months of the August 30, 2007 closing date. (Gov't Ex. 51; Resp't Ex. 90.) Pursuant to the HUD Handbook, Respondent was required to consider the student loan as a monthly obligation. Respondent states, by her own admission, that it was an error to overlook the student loan and admitted that "this too was an oversight." (Resp't Post Hr'g Br. 20.) While Respondent may have "expected that the borrower would continue to receive deferments," the basis for her expectation of continued deferral was unsubstantiated. The credit report indicated that the period of deferment would only extend until October 2008, without any further indication that such deferment would extend beyond the date provided. (Tr. 68:1-17.)

The HUD Handbook further requires that underwriters consider all recurring obligations, including "all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations." HUD HANDBOOK 4155.1 REV-5, Ch. 2, Section 2, ¶ 2-11, at 2-31. Consequently, Respondent was obligated to consider the $52.00 monthly payment to Tropical Federal Credit. Again, Respondent, by her own admission, states that this payment was "inadvertently missed." (Tr. 701:19-22; Tr. 702:1-5.)

Respondent adds that even in consideration of the omitted $52.00 liability, she still would have underwritten the loan because the debt-to-income ratio would have only been changed "one percent, two percent, or something like that." (Tr. 702.) The Government counters Respondent's position by arguing that "even without the $52.00 liability, the borrowers' debt-to-income ratio would have been 48.785%," and thus "exceeding the 43% limit." (Tr. 70, 759; Gov't Ex. 49; Mortgagee Letter 05-16.) According to the Government, "factoring in the $52.00 liability would raise the debt-to-income ratio to almost 51%." (T. 71.)

The HUD Handbook requires underwriters to include in the case binder "explanatory statements or additional documentation necessary to make a sound underwriting decision." HUD HANDBOOK 4155.1 REV-5, Ch. 3, ¶ 3-1, at 3-1. The HUD Handbook additionally requires that "[w]hen standard documentation does not provide enough information to support [a] decision, the lender must provide additional explanatory statements, consistent with other information in the application, to clarify or to supplement the documentation submitted by the borrower." Id. at 57.

In this case, Respondent failed to properly document her underwriting analysis in the Windham loan. The borrower's Verification of Deposit (VOD) indicated that the borrower had two outstanding loans that were omitted from the underwriting analysis. (Gov't Ex. 55.) Respondent states, in response, that the "VOD shows that the listed accounts belonged to Holly Gentry Windham—not Stephen Windham, who was the borrower for this loan." (Tr. 708:21-22; Tr. 709:1-5.) The statements from Founders Federal Credit Union showed the same loans and

corresponding account numbers as listed on the VOD, but instead tied them to Holly Gentry Windham. (Tr. 710:17-22; 711:1-4; Resp't Exs. 92, 93, 94.)

Respondent therefore concluded that the loans did not belong to the borrower, but did not provide an explanation for how she reached this conclusion. In fact, Respondent stated:

> FHA doesn't require writing a narrative on each loan explaining every single step. FHA requires writing compensating factors as to why you approved the loan, but any underwriter with experience and knowledge that grabs the file, by looking at it could see everything is not—every comment is there. . . . [I]t's not necessary to have additional documentation . . . ."

(Tr. 711:8-14; 712:1-2.)

Despite Respondent's confidence that no additional documentation was required, HUD regulations plainly state that explanatory statements are required to clarify or supplement the borrower's documentation. (See HUD Handbook 4155.1 Rev-5, Ch.3 Sec. 1, ¶3-1.) Since the VOD indicated that the borrower had two outstanding loans, Respondent should have exercised due diligence in providing an explanation that described how she reached her conclusion that the true owner of the loans was the borrower's wife. Consequently, Respondent's failure to exercise due diligence in acquiring adequate documentation and additional explanations in order to make a sound underwriting decision regarding the borrower's documentation is cause for debarment.

F. **Approved loan that was in excess of HUD requirements**

In the Asson Loan, HUD alleges that "[Respondent] approved the loan with a maximum insurable mortgage in excess of HUD requirements." (Notice of Proposed Debarment 5.)

Respondent states that the loan was originally a cash-out refinance, but she ultimately approved it "as a greater term, paying off the first and second mortgage." (Tr. 473:18-22.) She further states that she did not exceed the loan-to-value rate for a no-cash refinance rate. (Tr. 474:8-11.) Despite Respondent's assertions that she underwrote the loan as a no-cash refinance, Government's Exhibit 31 states that the purpose the refinance was a "cash-out debt consolidation." (Gov't Ex. 31; Tr. 183:1-7.) Respondent offers no evidence, aside from her own assertions, to prove that the loan was later underwritten as a no-cash refinance. (Tr. 450:10-21.)

As a cash-out refinance, the maximum loan-to-value ratio is 95 percent of the appraised value. Mortgagee Letter 05-43 (Oct. 31, 2005). The MCAW for the Asson Loan shows that the loan-to-value ratio was 94.963%. (Gov't Ex. 29; Mortgagee Letter 05-43.) However, Mortgagee Letter 05-43 states that in order to qualify for a cash-out refinance, "the borrower must have made all of his/her mortgage payments within the month due for the previous 12 months, i.e., no payment may have been more than 30 days late and is current for the month due."

The Asson Loan closed on April 26, 2007. (Tr. 183:18.) The borrower's credit report indicates late payments on the second mortgage in both May and June of 2006. (Gov't Ex. 30; Tr. 176:5-7.) Therefore, the borrower did not fulfill the requirement set forth in Mortgagee

Letter 05-43 in which it states that borrower's in cash-out refinances must make all mortgage payments within the 12 months preceding their loan application. Respondent is correct that the pay-off statement does not list late fees for the mortgage, but the credit report certainly does. (Tr. 451:20-22; 452:1-2.) In any event, if Respondent believed the pay-off statement proved that borrower was current on the mortgage, she should have reconciled the pay-off statement with the credit report by providing an explanatory statement. See HUD HANDBOOK 4155.1 REV-5, Ch. 3, ¶ 3-1, at 59.

Even if the assumption is made that this loan was not a cash out refinance, Respondent still was in error in approving this loan. Mortgagee Letter 05-43 states that for no cash out refinances, "[t]he mortgage being refinanced must be current for the month due." Respondent states that the mortgage was current, stating that the payoff statement "include[s] the per diem, $971. . . . til May 10th." (Tr. 453:11-17.) The Government alleges that the borrower was not current on his mortgage obligation because the total unpaid interest in the amount of $971.85 is at least two months' worth of interest. (Tr. 178:15-18; Gov't Ex. 30). Based on the borrower's credit report, the borrower paid $444.00 per month. (Gov't Ex. 30.)

Had the borrower been current on his mortgage, the payoff statement would not have reflected such a high amount of interest. The payoff statement reflected the month of April and part of the month of May, which typically would result in an interest amount of $444.00 for the month of April plus ten days worth of interest for the month of May. The total amount of interest could not be $917.85 if the borrower had been current on his mortgage. Rather the result would be that the borrower was still behind in his mortgage payments.

As a result such loan should not have been approved by Respondent since the approved loan was in excess of HUD HANDBOOK Requirements. Such violation as well is cause for debarment.

RESPONDENT'S MITIGATING FACTORS

Debarment is a sanction to be imposed in the public interest and the best interest of HUD. *In the Matter of Stephen J. Ferry, Beth An Ferry, and Ferry Financial, Inc.*, HUDBCA No. 90-5228-D17 (October 31, 1990). Establishment of a cause for debarment does not, per se, mandate imposition of the sanction and all relevant mitigating factors are to be considered. *Id.* Even where a debarment is found to be warranted, and even where the deterrent effect of a debarment is fully appreciated, the length of the sanction proposed by the debarring official could still be excessive. *Id.* In determining whether debarment is an appropriate sanction, "[t]he debarring official bases the decision on all information contained in the official record. The record includes...[a]ny further information and argument presented in support of, *or in opposition to, the proposed debarment*...." 2 C.F.R. 180.845 (2005). A United States District Court has interpreted this standard as imposing an affirmative duty on the hearing official to consider mitigating factors contained in the official record. *See Feinerman v. Bernardi*, 558 F. Supp. 2d 36, 50 (D.D.C. 2008) (holding that "the Debarring Official acted in an arbitrary and capricious manner by failing to explain why he did not find the mitigating evidence presented by the plaintiffs persuasive.") However, the Respondent has the burden of proof for establishing mitigating circumstances. 24 C.F.R. § 24.313(b)(4).

TIMING OF ISSUING THE NOTICE OF SUSPENSION WAS INTENDED TO PUNISH RESPONDENT

Respondent first contends that HUD waiting for eight months to complete its review before issuing the Notice of Suspension and Proposed Debarment on the same day as the filing of the civil suit was intended to be punitive. (Tr. 403:15-22; Tr. 404:1-13.) This Court has viewed a substantial passage of time following misconduct leading to the imposition of an administrative sanction as being a potentially mitigating factor, however, the passage of time, ipso facto, does not establish present responsibility. *Howard L. Perlow*, HUDBCA No. 92-713 1-D5 (Dec. 3, 1992); *Carl W. Seitz and Academy Abstract Co.,* HUDBCA No. 91-5930-D66 (Apr. 13, 1992); cf, Fed. R. Civ. P. 609 (evidence of conviction involving dishonesty or false statement may be admissible even if more than ten years has elapsed since the date of conviction where a court determines that probative value outweighs prejudicial effect). The appropriate test for present responsibility does not focus merely on the passage of time since Respondent's misconduct occurred, but rather on current indicia of Respondent's professionalism and business practice which the Government must consider before it again assumes the risk of conducting business with Respondent. *In Matter of Kantrow*, 95-A-109-D7, August 2, 1995 (citing *Carl W. Seitz and Academy Abstract Co.*, HUDBCA No. 91–5930–D66 (Apr. 13, 1992).

Although HUD's timing in this case is questionable, Respondent failed to show that her suspension and proposed debarment under the circumstances of this case "does not reflect the Government's desire to protect the public interest pursuant to 24 C.F.R. §24.115(a) or that its imposition reflects an abuse of agency discretion." *William Johnson and Linear Non-Profit Housing Corporation*, 06-1 BCA P 33132, HUDBCA No. 03-D-104-D5, 2004 WL 3560946 (2004).

RESPONDENT HAS NEVER WILLFULLY DISREGARDED THE HUD GUIDELINES

Respondent next contends that she neither has willfully disregarded the HUD guidelines nor had a history of failing to perform in accordance with the HUD Guidelines. (Tr. 444:15-20.) By her own admission, Respondent underwrote "between 400, 500 loans" in 2007, "700 to 800 loans" in 2008, and in 2009 underwrote "at least 800" loans. (Tr. 428:16-22; Tr. 424:9-11; Tr. 425:17-19.) Respondent was very familiar with underwriting HUD transactions, having performed as an underwriter approved to do FHA loans through the government since 1992. (Tr. 414:20-22; Tr. 415:1-12.) Respondent's level of experience is hardly indicative of an underwriter who was unfamiliar with the HUD Handbook requirements for underwriting to not willfully disregard the guidelines. But, because of the level of experience Respondent possesses she should be held more accountable for failing to regard the HUD guidelines in a manner consistent with the standards of the industry. In this case, Respondent has not persuaded this Court that her history of having never fully disregarded the HUD guidelines can, alone, excuse Respondent's performance in relation to the 13 loans involved in this case.

RESPONDENT IS WILLING TO TAKE A REFRESHER

Respondent further states that she is willing to take a refresher course on FHA underwriting guidelines. (Tr. 445:22; Tr. 446:1-2.) While the Respondent's willingness to complete a refresher course is commendable, the Court is not fully persuaded that taking a refresher course in the future serves as proof that Respondent is presently responsible and thus should not be subject to debarment in this case.

DEFICIENCIES INVOLVED WERE LEVEL 1 OR 2 DEFICIENCIES, THAT IS, THE APPROVAL OF THE LOANS DID NOT PRODUCE ANY HARM OR ADDED ANY RISK TO HUD

Respondent next states that she did not think that the alleged violations were serious or compelling enough to alter the risk associated with the 13 loans. (Tr. 445:2-7.) Respondent identified the alleged violations as Level "1 or 2" deficiencies. (Tr. 446:9-18.) But again, Respondent did not meet her burden of proof that the violations alleged did not produce any added risk to HUD. Respondent's declaration alone is not sufficient to meet that burden and is unpersuasive to this Court to find this to be a mitigating factor.

FINANCIAL AND EMOTIONAL HARDSHIP

Respondent finally raises as a mitigating factor the impact of the financial and emotional hardship on her as a result of the suspension and likely of the debarment if imposed. However, beyond Respondent's declaration that she's currently unemployable and late on her mortgage and car payments, the record contains no evidence to support Respondent's position. Therefore, it must fail.

CONCLUSION AND DETERMINATION

Having concluded that cause for debarment exists, I now turn to consideration of the appropriate period of debarment. In determining the appropriate period of debarment, the sanction should be viewed in the context of its intended purpose.

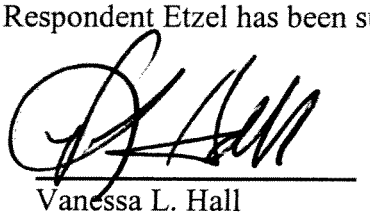
The purpose of debarments imposed by agencies of the federal government is to protect the public interest by precluding persons who are not "responsible" from conducting business with the federal government. 24 C.F.R. § 24.115(a). *See also Agan v. Pierce*, 576 F. Supp. 257, 261 (N.D. Ga. 1983); *Stanko Packing Co., Inc. v. Bergland*, 489 F. Supp. 947, 948-49 (D.D.C. 1980). The debarment process is not intended to punish; rather, it is designed to protect governmental interests not safeguarded by other laws. *Joseph Constr. Co. v. Veterans Admin.*, 595 F. Supp. 448, 452 (N.D. Ill. 1984). In other words, the purpose of debarment is remedial, not punitive. 24 C.F.R. § 24.115(b).

HUD's regulations require that the period of debarment be "commensurate with the seriousness of the cause(s)." 24 C.F.R. § 24.320 (a). Generally, the period of debarment should not exceed three years; however, where circumstances warrant, a longer period of debarment may be imposed. Id. If a suspension precedes a debarment, the regulations require that the

suspension period be considered in determining the debarment period. Id.

Pursuant to the regulations, the period of debarment shall be based upon the seriousness of the causes for debarment. 2 C.F.R. §180.865(a) (2005). Based upon the evidence presented in this case, I cannot conclude that Respondent's present conduct demonstrates so serious a business risk to HUD as to justify a debarment for a period of five years as the Government has proposed.

However, upon consideration of the public interest and the entire record in this matter, I find in this case that a debarment period of three years is warranted to debar Respondent Erika Etzel from further participation in primary covered transactions and lower tier covered transactions as either a participant or principal at HUD and throughout the Executive Branch of the federal Government, and from participating in procurement and nonprocurement transactions. Respondent Etzel's debarment period will be for a period of three years from October 20, 2009, credit being given for the time Respondent Etzel has been suspended.



Vanessa L. Hall
Administrative Judge

January 6, 2012