

APPENDIX 7.0 – FHA DEFECT TAXONOMY

Effective for Loan Reviews as of 01/01/20

I. PURPOSE

The Defect Taxonomy is FHA’s method of identifying defects **at the loan level**.

A) The Defect Taxonomy provides:

- useful data and feedback through structured categorization of defects and their sources, causes and severities.
- balance between FHA’s risk management and quality assurance business processes.

B) The Defect Taxonomy **does not**:

- Establish a universal statement on all monitoring or enforcement efforts by FHA.
- Address FHA’s response to patterns of loan-level defects, regardless of severity.
- Limit FHA’s actions with regard to fraud or misrepresentation.
- Establish standards for administrative or civil enforcement action, which are currently set forth in law.
- Preclude FHA from referring any violation of any severity to HUD’s Mortgagee Review Board, Departmental Enforcement Center, Office of Fair Housing and Equal Opportunity, or other HUD offices for findings that, in FHA’s judgment, warrant such referral.
- Affect or override FHA’s normal process for referral of fraud, waste, or abuse to the Office of the Inspector General.

II. CORE CONCEPTS

A) Defect Areas

Underwriting loan reviews are categorized into nine defect areas that represent fundamental characteristics of a loan’s eligibility for FHA insurance. Defect areas are organized following a consistent pattern of sources, causes, severity tier descriptions and potential remedies.

- Applicable HUD policies are provided for reference; they are subject to change and may not be all-inclusive.

B) Sources and Causes

Sources and causes describe Findings in greater detail based on HUD policy requirements. An individual Finding is identified in the Loan Review System (LRS) by its specific defect area, source, and cause.

C) Severity Tiers

There are four potential severity tiers, one of which is assigned to each Finding based on the size and nature of the deviation from FHA requirements. Severity tiers indicate whether a lender response is required in LRS.

- **Tier 1 and 2** Findings are unacceptable, requiring a lender response.
 - Lenders may rebut any unacceptable Finding by responding in LRS with supporting documentation.
- **Tier 3 and 4** Findings are deficient and do not impact a loan’s eligibility for FHA insurance.
 - These Findings do not require a lender response, but optional responses can be submitted in LRS.

III. REMEDIES

Potential remedies described below are applicable for Findings identified in the Loan Review System (LRS).

- Life-of-Loan Indemnification is the only remedy available for tier 1 Findings.
- Alternatives to Indemnification may be available for tier 2 Findings; they are shown in each defect area as a waterfall based on degree of impact.

A) Mitigating Documentation

Findings in any defect area may be mitigated with the lender’s submission of additional documentation which adequately addresses the source and cause of the Finding.

B) Financial Remediation

Certain Findings may be remedied by a financial adjustment in the amount of the violation and the lender’s submission of documentation showing completion of the corrective action.

- A **refund** must be made to the party affected by the violation.
- A **principal reduction** must be applied to the existing principal loan balance; or for Delinquent or Defaulted loans, may be applied to the Mortgagee’s suspense account.
 - When FHA insurance is terminated, and FHA has paid a termination claim, the required amount of financial remediation must be made to FHA via Claims Remittance.
 - When financial remediation cannot be completed due to foreclosure status, or when an FHA claim has not yet been filed, the Finding may be mitigated with the lender’s acknowledgement and agreement to make financial adjustments before or upon submission of an FHA claim.

C) Indemnification

In the absence of any alternative remedy, or when such alternatives have been exhausted, lenders must resolve unacceptable Findings by indemnifying HUD against the risk of financial losses by signing a 5 Year or Life-of-Loan Indemnification agreement as specified.

- Indemnification agreements must be signed electronically in the Loan Review System by lender users with the “Indemnification Submission” role in FHA Connection.

IV. FRAUD OR MISREPRESENTATION

All Findings of fraud or materially misrepresented information are referred to the Office of the Inspector General (OIG), regardless of LRS severity tier or remedy provided by the lender.

A) Findings of fraud or materially misrepresented information can fall into one of two severity tiers:

- **Tier 1:** the lender knew or should have known.
- **Tier 4:** the lender did not know and could not have known.

B) FHA determines if the lender knew or should have known based on whether:

- an employee of the lender was involved *and/or*
- red flags in the loan file should have been questioned by the underwriting lender.

C) FHA’s loan review determinations regarding Findings of fraud or misrepresentation do not affect or override any separate determinations of the Office of the Inspector General through any audit or investigative process.

V. UNDERWRITING LOAN REVIEW

Defect Area 1

Borrower Income (BI)

Source, documentation, and verification requirements for employment and non-employment sources of income used to qualify.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.4.a. Underwriting with an Automated Underwriting System	Mortgagee Letter 2016-10 [Attachment]
II.A.4.e. Final Underwriting Decision (TOTAL)	HECM Financial Assessment and Property Charge Guide - <i>Chapter 2</i> Credit History and Property Charge Payment History Analysis
II.A.4.c. Income Requirements (TOTAL)	- <i>Chapter 4</i> Extenuating Circumstances and Compensating Factors
II.A.5.b. Income Requirements (Manual)	
II.A.5.d. Final Underwriting Decision (Manual)	
<p>Sources</p> <ol style="list-style-type: none"> 1. Salary or Hourly Wages from Primary Employment 2. Part-Time (Secondary) or Seasonal Employment 3. Overtime and Bonus 4. Self-Employment 5. Retirement- Pension IRA/401(k), or SSI 6. Rental Income from Subject Property 7. Disability from SSA, VA, or Public/Private Source 8. Commission 9. Rental Income from Other Real Estate 10. Other Income Source <p>Causes</p> <ol style="list-style-type: none"> A. Qualifying income amount not supported or not calculated according to policy B. History, stability, and/or continuance not supported C. Unacceptable source of income D. Required documentation or verifications missing, illegible, or incomplete F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 1 (continued)

Borrower Income (BI)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>FHA is unable to substantiate the income necessary to support loan approval due to missing documentation; or borrower income was not supported based on documentation.</p> <p>Effective Income not supported or miscalculated and when corrected:</p> <ul style="list-style-type: none"> - Loan underwritten with TOTAL Scorecard results in a “Refer” risk assessment and approval cannot be substantiated based on the requirements for manually underwritten loans. - Loan underwritten manually (referred or downgraded) approval is not substantiated with increase due to insufficient compensating factors or ratio(s) in excess of maximum established by FHA. <p>HECM Financial Assessment or residual income issue, compensating factors not documented, and/or Minimum Life Expectancy Set-Aside was not applied as required or HECM approval is not supported based on documentation.</p>	<p>Mitigating Documentation</p> <p>OR</p> <p>Indemnification <i>Forward</i> - 5 Year <i>HECM</i> - Life-of-Loan</p>
Deficient		
3	<p>Required income documentation is out of compliance in some way, however, sufficient information exists to substantiate income necessary to approve the loan.</p> <p>Effective Income not supported or miscalculated and when corrected:</p> <ul style="list-style-type: none"> - Loan underwritten with TOTAL Scorecard results in a “Refer” risk assessment, but approval is substantiated based on the requirements for manually underwritten loans. - Loan underwritten manually (referred or downgraded) approval is substantiated by sufficient compensating factors and ratio(s) do not exceed maximum qualifying ratio(s) established by FHA. <p>HECM Financial Assessment or residual income issue, compensating factors not documented but Minimum Life Expectancy Set-Aside was applied and HECM approval is supported based on documentation.</p>	
4	<p>Minor data errors or inconsistencies between TOTAL Scorecard, loan documentation and/or FHA systems that are inconsequential to the borrower’s income/ability to repay, and when corrected, TOTAL risk assessment remains an “Accept”.</p> <p>Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.</p>	

Defect Area 2

Borrower Credit (BC)

Requirements for documenting and evaluating credit reports, credit history, liabilities, and debts.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.b.ii.(A) General Borrower Eligibility Requirements	Mortgagee Letter 2016-10 [Attachment]
II.A.4.a. Underwriting with an Automated Underwriting System	HECM Financial Assessment and Property Charge Guide - <i>Chapter 2</i> Credit History and Property Charge Payment History Analysis
II.A.4.e. Final Underwriting Decision (TOTAL)	- <i>Chapter 4</i> Extenuating Circumstances and Compensating Factors
II.A.5.d. Final Underwriting Decision (Manual)	
II.A.4.b. Credit Requirements (TOTAL)	
II.A.5.a. Credit Requirements (Manual)	
Sources	
<ol style="list-style-type: none"> 1. Credit Report and/or Non-Traditional Credit Verification (Refer to BC1A) 2. Minimum Decision Credit Score 3. Monthly Obligations 4. Housing and/or Mortgage Payment History 5. Non-Borrowing Spouse SSN, Credit Report, and/or Liabilities in Community Property State 6. Bankruptcy, Foreclosure, Deed-in-Lieu, Short Sale, and/or Credit Counseling/Payment Plan 7. Delinquent Federal Debt 8. Collections, Charge-Offs, Judgements, and/or Disputed Derogatory Accounts 9. Maximum Debt Ratios and Compensating Factors 10. Other Credit or Liability Issue 	
Causes	
<ol style="list-style-type: none"> A. Required documentation missing, illegible, insufficient, and/or contains unresolved inaccuracies or issues B. FHA standards not met – credit approval not supported/ borrower ineligible C. Amount of qualifying debt not supported, omitted, undisclosed, or not calculated according to policy D. Other Policy Violation F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 2 (continued)
Borrower Credit (BC)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>FHA is unable to determine acceptability, eligibility, underwriting compliance, or cannot calculate monthly debts or obligations based on loan documentation.</p> <p>FHA is able to conclude that the borrower was ineligible and/or aspects of credit were unacceptable to the degree that approval cannot be supported.</p> <p>Amount of qualifying debt not supported, omitted, or miscalculated and when corrected:</p> <ul style="list-style-type: none"> - Loan underwritten with TOTAL Scorecard results in a "Refer" risk assessment and approval cannot be substantiated based on the requirements for manually underwritten loans. - Loan underwritten manually (referred or downgraded) approval is not substantiated with increase due to insufficient compensating factors or ratio in excess of maximum established by FHA. <p>HECM Financial Assessment or credit/property charge payment history does not adhere to FHA standards, extenuating circumstances were not documented, and/or Minimum Life Expectancy Set-Aside was not applied as required or HECM approval is not supported based on documentation.</p>	<p>Mitigating Documentation</p> <p>OR</p> <p>Indemnification Forward - 5 Year HECM - Life-of-Loan</p>
Deficient		
3	<p>Required credit documentation is out of compliance in some way, but documentation/information sufficient to substantiate loan approval.</p> <p>Amount of qualifying debt not supported, omitted, or miscalculated and when corrected:</p> <ul style="list-style-type: none"> - Loan underwritten with TOTAL Scorecard results in a "Refer" risk assessment, but approval is substantiated based on the requirements for manually underwritten loans. - Loan underwritten manually (referred or downgraded) approval is substantiated by sufficient compensating factors and ratio(s) do not exceed maximum qualifying ratio(s) established by FHA. <p>HECM Financial Assessment errors or issues with credit and property charge data or extenuating circumstances, but Minimum Life Expectancy Set-Aside was applied and HECM approval is supported based on documentation.</p>	
4	<p>Minor data errors or inconsistencies between TOTAL Scorecard, loan documentation and/or FHA systems that are inconsequential to the borrower's credit/ability to repay, and when corrected, TOTAL risk assessment remains an "Accept".</p> <p>Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.</p>	

Defect Area 3

Loan to Value and Maximum Mortgage Amount (LM)

Allowable Mortgage Parameters for Purchase and Refinance transactions, including program and product-specific requirements that impact the maximum insurable loan amount.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.b.ii.(A) Maximum Mortgage Amounts	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15
II.A.4.a. Loan-to-Value Limits	Mortgagee Letter 2009-11: HECM for Purchase Program
II.A.4.e. Required Investment	Mortgagee Letter 2015-02: Principal Limit - Eligible and Ineligible Non-Borrowing HECM Spouses
II.A.5.d. Interested Party Contributions (TOTAL)	Mortgagee Letter 2014-21: Disbursement Limits
II.A.4.b. Interested Party Contributions (Manual)	Mortgagee Letter 2016-10 [Attachment] HECM Financial Assessment and Property Charge Guide - <i>Chapters 1 and 5</i>
II.A.5.a. Inducements to Purchase (TOTAL)	
II.A.5.b. Inducements to Purchase (Manual)	
II.A.8. Programs and Products	
Sources	
<ol style="list-style-type: none"> 1. Purchase 2. Rate/Term or Simple Refinance 3. Streamline Refinance 4. Cash-Out Refinance 5. HECM 6. 203(k) 7. New Construction – Proposed, Under Construction, or Existing <1 Year 8. Build-on-Own Land or Construction to Permanent 9. HUD REO 10. Other 	
Causes	
<ol style="list-style-type: none"> A. Required documentation missing, illegible, or insufficient B. Violation of maximum mortgage amount or LTV/CLTV limitation C. Minimum Required Investment (MRI) not met D. Principal Limit or Maximum Claim Amount, or Life Expectancy Set-Aside violation F. Evidence of Fraud or Misrepresentation 	

Defect Area 3 (continued)

Loan to Value and Maximum Mortgage Amount (LM)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known .	Indemnification - Life-of-Loan
2	<p>FHA is able to conclude that the maximum mortgage amount and/or LTV exceeds allowable limits and/or was not calculated according to applicable FHA policies resulting in over-insurance.</p> <p>The borrower did not make the full Minimum Required Investment (MRI) at closing in compliance with statutory requirements.</p> <p>HECM FHA is unable to determine compliance with applicable policies for HECM Principal Limit or Maximum Claim Amount based on available information and loan file documentation.</p> <p>Principal Limit, Maximum Claim Amount, Disbursement Limit exceeds allowable limits and/or</p> <ul style="list-style-type: none"> - Life Expectancy Set-Aside amount is insufficient and/or - HECM loan is over-insured as a result of violation. 	<p>Mitigating Documentation</p> <p style="text-align: center;">OR</p> <p>Principal Reduction Allowed for all Tier 2 Findings EXCEPT</p> <ul style="list-style-type: none"> - Statutory National Loan Limit violations - HECM violations - Minimum Required Investment (MRI) not met on a purchase and shortage exceeds 10% of MRI <p style="text-align: center;">OR</p> <p>Indemnification - Life-of-Loan</p>
Deficient		
3	<p>Violations exist, but the mortgage amount and/or LTV do not exceed allowable limits and loan is not over-insured.</p> <p>Error in the maximum mortgage amount or LTV identified by lender post-endorsement and an appropriate principal reduction was made prior to loan review.</p> <p>HECM Error or miscalculation related to Principal Limit, Maximum Claim Amount, Disbursement Limit, but allowable limits not exceeded and</p> <ul style="list-style-type: none"> - Life Expectancy Set-Aside amount is sufficient; and - HECM loan is not over-insured as a result of violation. 	
4	Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known .	

Defect Area 4

Borrower Assets (BA)

Guidelines and source requirements for the borrower’s Minimum Required Investment (MRI) and verification of other funds at underwriting.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.4.a Underwriting with an Automated Underwriting System	Mortgagee Letter 2009-11: HECM for Purchase Program
II.A.4.e Final Underwriting Decision (TOTAL)	Mortgagee Letter 2016-10 [Attachment]
II.A.4.d Asset Requirements (TOTAL)	HECM Financial Assessment and Property Charge Guide - <i>Chapter 3</i> Cash Flow/Residual Income Analysis
II.A.5.c Asset Requirements (Manual)	
II.A.5.d Final Underwriting Decision (Manual)	
<p>Sources</p> <ol style="list-style-type: none"> 1. Checking/Savings Accounts 2. Gifts 3. Secondary Financing 4. Earnest Money or Other Deposits on Purchase 5. Large Deposits 6. Collateralized Loans or Unsecured Borrowed Funds 7. Retirement Accounts 8. Sale of Personal Property 9. Sale of Real Estate 10. Other Asset Type <p>Causes</p> <ol style="list-style-type: none"> A. Asset not sourced, input improperly, or required documentation missing, illegible, or insufficient B. Minimum Required Investment (MRI) not verified by underwriter or unacceptable source of funds C. HECM monetary investment not verified or from unacceptable source D. Other funds required to close and/or assets used to support approval not verified or supported F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 4 (continued)

Borrower Assets (BA)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>The amount of the borrower’s full MRI, Cash to Close (non-MRI), or HECM monetary investment, not fully verified by the underwriter; and/or</p> <p>Funds to pay off debts, reserves required for 3-4 unit properties and Manually Underwritten loans, funds supporting the amount entered to TOTAL, or other assets required on a HECM were not verified by the underwriter; and</p> <ul style="list-style-type: none"> - Based on loan documentation, FHA determines that the borrower was unlikely to have accumulated sufficient funds by the closing date, there is a strong indication the funds were from an unacceptable source, and/or the borrower would not have otherwise qualified. 	<p>Mitigating Documentation</p> <p>OR</p> <p>Indemnification <i>Forward</i> - 5 Year <i>HECM</i> - Life-of-Loan</p>
Deficient		
3	<p>Part of the borrower’s full MRI, Cash to Close (non-MRI), or HECM monetary investment, not fully verified by the underwriter; and/or</p> <p>Funds to payoff debts, reserves required for 3-4 unit properties and Manually Underwritten loans, funds supporting the amount entered to TOTAL, or other assets required on a HECM, were not verified by the underwriter; but</p> <ul style="list-style-type: none"> - Based on loan documentation, FHA determines that the borrower was likely to have accumulated sufficient funds from an acceptable source by the closing date and would have otherwise qualified. 	
4	<p>Minor data errors or inconsistencies between TOTAL Scorecard, loan documentation and/or FHA systems related to borrower assets, and when corrected, TOTAL risk assessment remains an “Accept” and borrower eligibility is otherwise supported.</p> <p>Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.</p>	

Defect Area 5

Property Eligibility (PE)

Minimum property acceptability and eligibility standards for FHA insurance, including program and product-specific variations.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.b.iv. Property Eligibility and Acceptability Criteria	Handbook 4000.1 Section II.D. Appraiser and Property Requirements
II.A.3.a. Property Acceptability Criteria	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15 - <i>Chapter 3</i> Property Analysis
II.A.1.b.v. Legal Restrictions on Conveyance (Free Assumability)	Mortgagee Letter 2009-11: HECM for Purchase Program
II.D. Appraiser and Property Requirements	Mortgagee Letter 2007-06: Existing Property Eligibility Requirements
II.A.6.a. Mortgage Closing Requirements	24CFR206.47(e) Property Standards – Repair Work
II.A.7.c. Inspection and Repair Escrow Requirements for Mortgages Pending Closing or Endorsement in Presidentially-Declared Major Disaster Areas	
II.A.8. Programs and Products	
Sources	
<ol style="list-style-type: none"> 1. Property Acceptability and/or Eligibility 2. Minimum Property Requirements / Minimum Property Standards 3. Flood Certification and/or Special Flood Hazard Area Requirements 4. Manufactured Housing 5. Legal Restrictions on Conveyance (Free Assumability) 6. Property Ownership and/or Transfer History 7. Condo – Project Approval or Loan Level Certifications 8. Program & Product Specific Property Eligibility Requirements 9. Presidentially Declared Major Disaster Area Requirements 10. Other Property Eligibility Issues 	
Causes	
<ol style="list-style-type: none"> A. Missing, illegible, or incomplete documentation to support acceptability or eligibility B. Unallowable Property Type, Use, and/or Zoning C. Repairs or Rehabilitation not complete and/or inspections not properly documented D. Restrictions on Resales/Flipping and/or owner of record requirements not met F. Evidence of Fraud or Misrepresentation 	

Defect Area 5 (continued)
Property Eligibility (PE)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	FHA is unable to determine acceptability, eligibility, or compliance with applicable policies for Property Eligibility due to absence of required documentation. FHA is able to conclude that the property did not meet Property Eligibility requirements based on documentation in the loan file.	Mitigating Documentation OR Principal Reduction Allowed for all Tier 2 Findings where - repairs or rehabilitation not completed as required - unused escrow funds exist NOTE: In any case where documentation does not evidence completion/status of repairs or rehabilitation per FHA guidelines, Minimum Property Requirements, or Minimum Property Standards are not met, principal reduction must be made before and in addition to life-of-loan indemnification. OR Indemnification - Life-of-Loan
Deficient		
3	Compliance errors, inconsistencies, or missing information identified within the Property Eligibility documentation, but FHA is able to conclude that the property is eligible.	
4	Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.	

Defect Area 6

Property Appraisal (PA)

Appraiser requirements, acceptable reporting forms, valuation and reporting protocols, and property type-specific requirements that impact collateral.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.D. Appraiser and Property Requirements	Handbook 4000.1 Section II.D. Appraiser and Property Requirements
II.A.8. Programs and Products	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15 - <i>Chapter 3</i> Property Analysis Mortgagee Letter 2009-11: HECM for Purchase Program Mortgagee Letter 2007-06: Existing Property Eligibility Requirements 24CFR206.47(e) Property Standards – Repair Work
Sources	
<ol style="list-style-type: none"> 1. Appraiser 2. Appraisal Report- including all required forms/exhibits/addendums 3. Comparable Sales 4. New Construction Documentation 5. Second Appraisal 6. Appraisal Update 7. Other Appraisal, Collateral, or Valuation issue 	
Causes	
<ol style="list-style-type: none"> A. Form(s) missing, expired, invalid, illegible, contains errors, or incorrect form used B. Valuation & Reporting Protocols not met (Appraiser Responsibilities) C. Appraised Value is not supported D. Other Policy Violation F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 6 (continued)
Property Appraisal (PA)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>FHA is unable to determine appraiser and/or underwriter compliance with applicable policies for the appraisal, collateral valuation, or property acceptability due to absence of valid documentation.</p> <p>FHA is able to conclude that the property was not appraised and/or underwritten in compliance with applicable policies and the appraised value is not supported or the property is not acceptable as a result.</p> <p>Documentation required for specific property types, programs/products, or by construction status was not obtained to support FHA max insurable loan amount.</p>	<p>Mitigating Documentation</p> <p style="text-align: center;">OR</p> <p>Indemnification - Life-of-Loan</p>
Deficient		
3	Compliance errors, inconsistencies, or missing information identified within the Property Appraisal documentation, but FHA can conclude that there is no impact on the valuation or property acceptability.	
4	Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.	

Defect Area 7

Borrower Eligibility (BE)

General eligibility criteria for borrowers, including program and product-specific variations.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.b.ii(A) General Borrower Insurance Eligibility	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15 - <i>Chapter 1</i> General Information - <i>Chapter 2</i> Borrower Counseling - <i>Chapter 4</i> Borrower Age
II.A.1.b.iii. Occupancy Types	
II.A.8. Programs and Products	
Sources	
<ol style="list-style-type: none"> 1. Borrower SSN and/or Identity 2. Borrower citizenship, lawful residency status, or Employment Authorization Document (EAD) 3. Borrower Age Restrictions 4. Borrower has another property already under HECM rule 5. Program/Product Specific Borrower Eligibility Requirement 6. Borrower on Exclusionary List(s) 7. Multiple FHA Loans/Exceptions 8. Non-owner Occupant Co-borrower or Co-Signer 9. General Borrower Eligibility 	
Causes	
<ol style="list-style-type: none"> A. Documentation of eligibility missing, illegible, improperly documented, or not validated B. Ownership and/or Occupancy Requirements not met C. Borrower is ineligible for FHA insurance D. Other Policy Violation F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 7 (continued)
Borrower Eligibility (BE)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>FHA is unable to determine acceptability, eligibility, or compliance with applicable eligibility policies due to absence of required documentation, authorizations, and/or validations.</p> <p>FHA is able to conclude that borrower(s) was ineligible based on loan file documentation or other available information.</p> <p>Borrower ownership and/or occupancy requirements, including program and policy specific policies, were not met.</p>	Mitigating Documentation OR Indemnification - Life-of-Loan
Deficient		
3	Compliance errors, inconsistencies, or missing information identified in loan documents, but FHA can conclude that the borrower was eligible based on other documentation or validating information.	
4	Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.	

Defect Area 8

Mortgage Eligibility (ME)

Compliance standards for valid and enforceable FHA-insured Mortgages, including program and product-specific variations.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.b. General Mortgage Insurance Eligibility	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15 - <i>Chapter 1</i> General Information - <i>Chapter 6</i> Closing and Endorsement
II.A.1.b.ii(A)(13) Valid First Liens	
II.A.2.d. Maximum Mortgage Term	Mortgagee Letter 2009-11: HECM for Purchase Program
II.A.2.e. Mortgage Insurance Premiums	Mortgagee Letter 2007-06: Existing Property Eligibility Requirements
II.A.6. Closing Requirements	Mortgagee Letter 2015-02: Principal Limit - Eligible and Ineligible Non-Borrowing HECM Spouses
II.A.7.iii. Post-Closing & Endorsement and Pre-endorsement Requirements	
II.A.8. Programs and Products	
II.A.9. 203(k) Consultant Requirements	
Sources	
<ol style="list-style-type: none"> 1. Mortgage Term 2. Mortgage Insurance Premiums 3. Program & Product Specific Requirements 4. Title and/or FHA Lien Position 5. Non-Profit, Government Agency, Living Trust, or Power of Attorney 6. Mortgage, Note, Riders, and Allonges 7. Sales Contract, Addendums, Amendments, and Related Certifications 	
Causes	
<ol style="list-style-type: none"> A. Acceptable documentation of eligibility missing, illegible, improperly completed/incomplete, or incorrect form used B. Improper Application of FHA Policy C. Other Mortgage Eligibility Issue F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 8 (continued)

Mortgage Eligibility (ME)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known.	Indemnification - Life-of-Loan
2	<p>FHA is unable to determine mortgage acceptability or compliance with applicable eligibility policies due to absence of required documentation.</p> <p>FHA is able to conclude that mortgage is not in compliance with applicable policies based on loan file documentation or other available information.</p> <p>Mortgage does not comply with the program/product specific requirements for which it was approved and would not have been eligible under any other FHA program/product.</p>	Mitigating Documentation OR Indemnification <i>Forward</i> - 5 Year <i>HECM</i> - Life-of-Loan
Deficient		
3	<p>Compliance errors, inconsistencies, or missing information identified in loan documentation, but FHA can conclude that the mortgage was eligible based on other documents or validating information.</p> <p>Mortgage does not comply with the program/product specific requirements for which it was approved but it would have been eligible under another FHA program/product.</p>	
4	Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.	

Defect Area 9

Lender Operations (LO)

Standard loan-level requirements for lender origination, processing, underwriting, closing, and pre/post endorsement, including data integrity.

HUD Policy References	
Single Family Housing Handbook 4000.1	HECM
II.A.1.a Applications and Disclosures	Handbook 4235.1 REV-1, as modified by Mortgagee Letter 1996-15 - <i>Chapter 1</i> General Information - <i>Chapter 6</i> Closing and Endorsement - <i>Chapter 7</i> Payment of Mortgage Insurance Premiums Mortgagee Letter 2016-10: HECM Financial Assessment and Property Charge Guide Mortgagee Letter 2013-02: Amended Late Requests for Endorsement Procedures Mortgagee Letter 2010-39: Settlement Statement/Closing Certification
II.A.3. Underwriting the Property	
II.D. Appraiser and Property Requirements	
II.A.4.a Underwriting with an Automated Underwriting System	
II.A.4.e Final Underwriting Decision (TOTAL)	
II.A.5.d Final Underwriting Decision (Manual)	
II.A.6. Closing Requirements	
II.A.7. Post-Closing and Endorsement	
Sources	
<ol style="list-style-type: none"> 1. NMLS Registration Issues 2. Loan Estimate(s), Closing Disclosure, and/or Certifications 3. Escrow accounts not properly established 4. Late Endorsement or Pre-Endorsement Delinquency 5. Unresolved Data Integrity Issues 6. Application & Underwriting Forms – URLA/1003, 92900a, 92800.5b, 92900LT 7. HECM Loan Agreement or Financial Assessment 8. FHA Program Participation/ Exclusionary List(s) 9. TOTAL Scorecard/AUS Feedback Certificate 10. Loan Review Case Binder Submission 11. Other 	
Causes	
<ol style="list-style-type: none"> A. Required documentation missing, illegible, improperly completed, or incorrect form used B. Unallowable, undisclosed, or excess Closing Costs and/or Fees C. Loan closed or endorsed out of compliance with underwriting approval D. Other Policy Violation F. Evidence of Fraud or Misrepresentation 	

Appendix 7.0 – FHA Defect Taxonomy

Defect Area 9 (continued)

Lender Operations (LO)

Severity Tiers		Remedies
Unacceptable		
1	Evidence of fraudulent or materially misrepresented information about which the lender knew or should have known .	Indemnification - Life-of-Loan
2	<p>FHA is unable to determine loan-level compliance with operational policies and procedures due to absence of required information/documentation.</p> <p>FHA is able to conclude that the loan is uninsurable due to non-compliance with operational policies and procedures based on documentation in the loan file.</p>	<p>Mitigating Documentation</p> <p style="text-align: center;">OR</p> <p>Refund Allowed to remedy related violations unless</p> <ul style="list-style-type: none"> - FHA policy specifically prohibits post-endorsement refunds <p style="text-align: center;">OR</p> <p>Indemnification <i>Forward</i></p> <ul style="list-style-type: none"> - 5 Year <i>HECM</i> - Life-of-Loan
Deficient		
3	Compliance errors, inconsistencies, or missing information related to operational policies and procedures, but sufficient documentation/information exists to substantiate approval.	
4	<p>Minor data integrity errors or inconsistencies between TOTAL Scorecard, loan documentation and/or FHA but when corrected, TOTAL risk assessment remains "Accept" and approval is otherwise validated.</p> <p>Evidence of fraudulent or materially misrepresented information about which the lender did not know and could not have known.</p>	