Audit Report

District Inspector General for Audit
Rocky Mountain District

Brothers Redevelopment, Inc.

Denver, Colorado

Review of Housing Activities In FHA Single Family Insurance Programs

2001-DE-1002
September 28, 2001

Department of Housing and Urban Development
District Office of Inspector General For Audit
633 17th Street, 14th Floor
Denver, CO 80202-3607

Audit Report

District Inspector General for Audit
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Report: 2001-DE-1002   Issued: September 28, 2001

TO: Ronald C. Bailey, Director, Denver Homeownership Center, 8AHH

Robert C. Gwin

FROM: Robert C. Gwin, District Inspector General for Audit, 8AGA

SUBJECT: Review of Housing Activities in FHA Single Family Insurance Programs
Brothers Redevelopment, Inc.
Denver, Colorado

We have completed a review of Brothers Redevelopment, Inc. (Brothers Redevelopment), Denver, Colorado, of their housing activities in the Federal Housing Administration (FHA) Single Family Insurance Programs. This review was done as part of a nationwide audit of nonprofit organizations' participation in the FHA Single Family Insurance Programs. The objective of our review was to determine whether Brothers Redevelopment is legitimate and independent (not under the influence, control or direction) of other parties and is passing on the benefits of discounts received on the purchase of HUD homes to low- and moderate-income homebuyers.

This audit report contains one audit finding dealing with Brothers Redevelopment not carrying out its housing activities in conformity with its Affordable Housing Program and HUD requirements.

At the start of our site work, your staff also initiated a monitoring visit to review the FHA Single Family Insurance Program activities at Brothers Redevelopment. Their review results parallel ours.

Within 60 days please furnish to this office, for each recommendation contained in the finding in this report, a status report on: (1) the corrective action, (2) the proposed corrective action and the corrective date to be completed, or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate the courtesies and assistance extended by the management and staff of Brothers Redevelopment and their related contract parties and the Denver Homeownership Center.

Should you have any questions, please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452.

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Executive Summary

We have completed a review of Brothers Redevelopment, Inc. (Brothers Redevelopment), Denver, Colorado, of their housing activities in the Federal Housing Administration (FHA) Single Family Insurance Programs. This review was done as part of a nationwide audit of nonprofit organizations' participation in the FHA Single Family Insurance Programs.

Brothers Redevelopment is a nonprofit organization that has been approved by HUD to participate in the FHA Single Family Insurance Programs. Brothers Redevelopment was authorized by HUD to carryout the program in conformity with its Affordable Housing Program. Under this program, Brothers Redevelopment purchased HUD properties at a discount, rehabilitated the structures as needed and resold the houses at market value to qualifying homebuyers. Brothers Redevelopment did not pass on any benefits realized from the discounted property purchases from HUD to the low- and moderate-income homebuyer as intended by HUD.

We found that Brothers Redevelopment was not carrying out its Affordable Housing Program in conformity with HUD requirements. Brothers Redevelopment allowed an outside independent Contract Developer to administer all phases of its Affordable Housing Program. The Contract Developer operated the program to realize the maximum profit possible. The realized profits were shared by Brothers Redevelopment, the Contract Developer and a conflict of interest program lender. As a result, no discounts were passed on to the ultimate homebuyer as intended by the program. Basically, Brothers Redevelopment served as a strawbuyer for a fee for the purchase of HUD properties while the Contract Developer functioned as an investor.

Members of the Denver Homeownership Center initiated a site review of Brothers Redevelopment's program activities at the same time we began our site audit. The results of our review parallel the findings of the Denver Homeownership Center.

Nonprofit entities can participate in FHA's Single Family Insurance Programs

Nonprofit organizations can participate in the FHA's Single Family Insurance Programs. HUD approves the nonprofit organizations and authorizes them to carry out their Affordable Housing Program. Under HUD's program, the nonprofits are allowed to purchase HUD properties at a discount ranging primarily from 10 to 30 percent.

The nonprofits rehabilitate the discounted properties and then are to sell the properties to low- and moderate-income homebuyers. The primary intent of the HUD program is to pass on the discounts from the purchase of HUD discounted properties to the purchasing homebuyer. HUD has issued various HUD mortgagee letters and notices setting out the parameters for implementing the HUD programs by the nonprofit organizations.

Audit objectives

The objectives of our audit were to determine whether Brothers Redevelopment is:

- Legitimate and independent (not under the influence, control or direction) of other parties; and

- Passing on the benefits of discounts received on the purchase of HUD homes to low- and moderate-income homebuyers.

Affordable Housing Program not carried out in accordance with HUD requirements

Brothers Redevelopment did not administer or carryout its Affordable Housing Program as approved by HUD or in conformity with HUD requirements. Furthermore, intended savings realized from the discount purchase of properties from HUD were not passed on to the low- and moderate-income homebuyer.

Specifically, Brothers Redevelopment allowed an independent Contract Developer to administer and control all aspects of its Affordable Housing Program with very limited participation by Brothers Redevelopment. In addition, the Contract Developer maintained a conflict of interest relationship with the primary lender for the Affordable Housing Program. The program was administered by the Contract Developer to realize the maximum possible profit that was distributed to the Contract Developer, a conflict of interest lender and Brothers Redevelopment. The discounted properties acquired from HUD were resold at market value to a qualifying homebuyer. As such, any benefits realized from the discounted acquired properties were not passed on to the homebuyer as required by HUD.

Brothers Redevelopment implemented its affordable housing program by allowing an outside independent contract developer to administer the program. The Contract Developer operated the program under a verbal agreement with Brothers Redevelopment and controlled all aspects of the program. The Contract Developer had a vested interest in the program in that the Contract Developer received 40 percent of the profits realized from the sale of the properties. In addition, the Contract Developer secured financing for the acquisition and rehabilitation of the properties from an identity of interest lender who also realized 20 percent of the profits from the property sales. Furthermore, Brothers Redevelopment received 40 percent of the net profits from the resale of the properties. In actual practice, the Contract Developer used Brothers Redevelopment as a strawbuyer for a fee and functioned as an investor of HUD acquired properties.

In our opinion, deficiencies associated with Brothers Redevelopment's affordable housing program stem from Brothers Redevelopment:

1) Not having a clear understanding of the intent of HUD requirements to participate in FHA's Single Family

Insurance Programs, to create homeownership opportunities for **low- and moderate-income persons**; and

2) Not wanting to take part in the risk associated with the purchase, rehabilitation, and resale of the properties.

As a result, Brothers Redevelopment did not administer their affordable housing program to target low- and moderate-income homebuyers and allowed excessive profits from the market sale of the properties to be ultimately funded by the homebuyers. This violated the intent of the program whereby benefits from the discounted acquired properties from HUD were to be passed on to the homebuyer rather than being absorbed by the nonprofit and its contract developer and lender.

Auditee Comments

The results of the audit were discussed with officials of Brothers Redevelopment during the course of the audit. The draft audit finding was submitted to Brothers Redevelopment on August 10, 2001 for their review and comments. On August 30, 2001, Brothers Redevelopment provided us with their written response to the draft finding. At that time, officials discussed the draft finding and their written response. The officials disagreed with our audit finding. At the meeting the draft audit report was provided to Brothers Redevelopment who elected to not provide any additional written comments. We have incorporated their comments into the report as applicable and their complete written response is included in Appendix 1.

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Abbreviations:

FHA	Federal Housing Administration
HUD	Department of Housing and Urban Development

Introduction

Brothers Redevelopment was established on May 10, 1971, as a Colorado nonprofit corporation. A Board of Directors made up of volunteers who represent a cross section of professions and ethnic groups governs Brothers Redevelopment. One of Brothers Redevelopment's primary objectives is:

- To build, repair, remodel and refurbish houses and other dwelling units, and to finance construction, reconstruction, remodeling and refurbishment of houses and other dwellings units through various financial institutions for moderate and low income, elderly, handicapped and minority people to help them improve their standard of living. The welfare of the elderly and handicapped are high priority for these services.

The Purchase Repair Resale program at Brothers Redevelopment began in early 1995. Brothers Redevelopment entered into a verbal agreement with an outside independent Contract Developer, AmReal Companies, with the purpose to purchase and rehabilitate HUD homes for resale. AmReal Companies was responsible for the selection, inspection, and submission of bids to HUD, obtaining financing for purchase and rehabilitation, accomplishing the rehabilitation work, marketing the properties for resale, and providing information to the title company, while Brothers Redevelopment limited its involvement to providing HUD program approval to purchase homes from HUD at a discount.

From March 1995 to March 2001, Brothers Redevelopment obtained financing for the purchase and rehabilitation of acquired properties from various lenders in the form of recourse and nonrecourse[1] loans. Brothers Redevelopment's primary lender during the above mentioned time period was US Capital, Inc. and business entities associated with the principal staff of US Capital, Inc. The Board of Directors for US Capital, Inc. consists of three members: the President, Vice-President and Brothers Redevelopment's Contract Developer. Financing provided by US Capital, Inc. is in the form of a nonrecourse loan at an interest rate of 19.5 percent.

Brothers Redevelopment entered into a verbal agreement with the outside independent Contract Developer and its primary lender whereby proceeds from the subsequent resale of properties is divided as follows:

- 40 percent to Brothers Redevelopment
- 40 percent to AmReal Companies
- 20 percent to US Capital, Inc.

On March 3, 2000, HUD issued Mortgagee Letter 00-8 requiring current and prospective nonprofit entities to submit a recertification package to their local HUD Homeownership Center to gain approval to participate in FHA Single Family Insurance Programs. Brothers

[1] Nonrecourse financing is a type of debt whereby the borrower is not personally liable. If the borrower defaults on the nonrecourse loan, the lender recovers the amount owed through foreclosure on the property, which secures the loan.

Redevelopment requested and was approved by the Denver Homeownership Center on May 30, 2000, to participate in the following activities:

- Participate as a mortgagor to obtain FHA-insured financing at the same attractive terms as owner occupants.

- Purchase HUD foreclosed properties, in certain cases, at a discounted price.

- Provide down payment, closing cost or rehabilitation assistance with a secondary lien.

During the period from January 1, 1998 through January 31, 2001, Brothers Redevelopment had purchased 92 discounted properties from HUD at a total cost of $8,055,378. The total discount awarded to Brothers Redevelopment for these 92 properties was $1,123,405. Brothers Redevelopment has used these properties in their Purchase Repair Resale program.

On May 1, 2001, members of the Denver Homeownership Center initiated a site review on Brothers Redevelopment's compliance with HUD requirements under HUD's FHA Single Family Insurance Programs. On June 5, 2001, the Homeownership Center temporarily suspended Brothers Redevelopment's authority to purchase HUD homes at a discount due to irregularities in their affordable housing program. This suspension is to continue until the Homeownership Center receives our final audit report.

Audit Objectives and Methodology

The objectives of the audit were to determine whether Brothers Redevelopment is:

- Legitimate and independent (not under the influence, control or direction) of other parties; and

- Passing on the benefits of discounts received on the purchase of HUD homes to low- and moderate-income homebuyers.

Our audit approach was to identify and evaluate the management controls in place over the key areas of operations of Brothers Redevelopment's affordable housing program and within HUD's FHA Single Family Insurance Programs requirements. During the review, we examined program records and related documents of Brothers Redevelopment and other parties of their program including their Contract Developer, primary lender, and loan closing agent. We also reviewed applicable HUD records relating to Brothers Redevelopment's program. We conducted interviews with officials and employees of these organizations. Furthermore we conducted inspections of selected program properties and interviewed the individual homebuyers.

Scope

Our audit generally covered the period of January 1, 1998 through January 31, 2001. However, this period was expanded to include the most current data available while performing our site review. Therefore, where applicable, the audit period was expanded to include current data through June 30, 2001. We conducted our field work from March through June 2001.

Generally Accepted Government Auditing Standards

Our review was performed in accordance with generally accepted government auditing standards.

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Finding

Affordable Housing Program Not Carried Out in Conformity with HUD Requirements

Brothers Redevelopment did not administer or carryout its Affordable Housing Program as approved by HUD or in conformity with HUD requirements. Furthermore, intended savings realized from the discount purchase of properties from HUD were not passed on to the low- and moderate-income homebuyer.

Specifically, Brothers Redevelopment allowed an outside independent Contract Developer to administer and control all aspects of its Affordable Housing Program with very limited participation by Brothers Redevelopment. In addition, the Contract Developer maintained a conflict of interest relationship with the primary lender for the Affordable Housing Program. The program was administered by the Contract Developer to realize the maximum possible profit that was distributed to the Contract Developer, conflict of interest lender and Brothers Redevelopment. Because Brothers Redevelopment resold its HUD acquired discounted properties at market value to realize the maximum profit for themselves, the Contract Developer and the program financing lender, any realized benefits from the discounted purchases were not passed on to the low- and moderate-income homebuyer as intended by HUD.

Brothers Redevelopment's implementation of HUD's FHA Single Family Insurance Programs was designed to pass on all risks under the program to the Contract Developer and the program lender. By doing so, the Contract Developer used Brothers Redevelopment as a strawbuyer for a fee and functioned as an investor of HUD acquired properties.

In our opinion, deficiencies associated with Brothers Redevelopment's affordable housing program stem from Brothers Redevelopment:

1) Not having a clear understanding of HUD requirements to participate in FHA's Single Family Insurance Programs, to create homeownership opportunities for low- and moderate-income persons; and

2) Not wanting to take part in the risk associated with the purchase, rehabilitation, and resale of the properties.

As a result, Brothers Redevelopment allowed an outside independent contract developer to administer their affordable housing program and resold their HUD discounted acquired properties at market value without any realized benefit from the discount purchase being passed on to the homebuyer as specified and intended by HUD.

HUD requirements

Under HUD's FHA Single Family Insurance Programs, nonprofits are eligible if certain qualifications are met to acquire HUD owned properties at a discount, rehabilitate them and then to sell them to low- to moderate-income buyers who are to receive any benefit realized by the nonprofit acquisition of discounted properties. The program is governed by various HUD Regulations, Handbooks, Notices and Mortgagee Letters.

HUD Regulation Section 291.110 of Title 24 of the Code of Federal Regulations authorizes HUD to sell "as-is" valued HUD properties to approved nonprofit organizations at a discount of no less than 10 percent. HUD Handbook 4310.5 REV-2, Section 10-20 supplements the HUD Regulations and specifies the nature and extent of discounts that can be granted to nonprofit property purchases. In HUD approved revitalization areas, the discount to nonprofits and government entities is 30 percent off the list price. In non-revitalization areas, the discounts to nonprofits and government entities is 10 percent off of the list price. An additional 5 percent discount may be added to the 10 percent discount if five or more properties are purchased simultaneously by the nonprofit or government entity.

HUD in accordance with Mortgagee Letter 00-8, dated March 3, 2000, required each nonprofit organization to resubmit its application and related Affordable Housing Program to HUD for review and approval. HUD approval letters to the nonprofits identified previously issued HUD issuances that related to HUD's FHA Single Family Insurance Programs. The listing included some issuances that had previously expired expiration dates.

Housing Notice 94-74 and Mortgagee Letter 97-5 established resale restrictions on properties sold to nonprofit agencies at a 30 percent discount. Mortgagee Letter 96-52 established program requirements concerning acceptable affordable housing programs, in addition to other programmatic changes. In addition, Mortgagee Letter 00-8 required current and prospective nonprofit agencies to submit a recertification package to HUD for approval to participate in FHA Single Family Insurance Program activities.

Housing Notice 94-74 and Mortgagee Letter 97-5

Housing Notice 94-74 and Mortgagee Letter 97-5 established resale restrictions on properties sold to non-profit agencies at a 30 percent discount. HUD Housing Notice 94-74 provides that properties purchased at a 30 percent discount are to be sold to individuals who intend to occupy the property as their principal address and whose income is at or below 115 percent of the median income in the area when adjusted for family size.

Mortgagee Letter 97-5, further delineates requirements of nonprofits that are participating in HUD's FHA Single Family Insurance Programs, which is referred to as HUD's Real Estate

Owned Discount Sales Program. Specifically, the Mortgagee Letter states:

> *"Under HUD's REO* [Real Estate Owned] *Discount Sales Program, it is possible under certain circumstances for a non-profit or government entity to receive up to a 30 percent discount on the sales price of a property. HUD's intent is for those buyers receiving a discount off the sales price in excess of 15 percent to perform necessary repairs and resell the property to individuals/families who intend to occupy and whose income does not exceed 115 percent of the median income for the area, when adjusted for family size. The resale price of the property cannot exceed 110 percent of the net development cost."*

> *"The net development cost is defined as the total cost of the project, including items such as acquisition cost, architectural fees, permits and survey expenses, insurance, rehabilitation, and taxes (for a 203(k) loan, use lines A-1 and B-14 of the 203(k) Maximum Mortgage Worksheet, form HUD 92700). Total costs incurred by the purchaser, including those for acquisition financing, management fees and selling expenses related to the project can also be included, but are expected to be reasonable and customary for the area in which the property is located. The purchaser can also include up to three months' mortgage payments (principal and interest only), less all rents received. The net development cost cannot include gifts to the eventual purchaser for the down payment, financing or closing costs, nor any other related expenses associated with that buyer's purchase of the property."*

Mortgagee Letter 96-52

Mortgagee Letter 96-52 established program requirements concerning acceptable affordable housing programs, in addition to other programmatic changes. The affordable housing program must be viable, well-run operation that successfully serves the housing needs of low- and moderate-income individuals and families. The affordable housing program is approved for a two-year period. An acceptable affordable housing program is defined as one in which the ultimate goal is the attainment of affordable housing. **Nonprofits are expected to fulfill their commitment to low- and moderate-income families.**

Also, there are certain elements in an affordable housing program that make it successful. One element is remaining affordable. The principal, interest, tax and insurance for properties "*should remain in the affordable range for* *homebuyers/assumptors, i.e., the end product will be within the financial reach of those families it was designed to serve".* This would mean low- and moderate-income families.

This mortgagee letter relates to the Affordable Housing Programs of nonprofits in connection with their implementation of HUD's FHA Single Family Insurance Programs. The requirements would be applicable to all HUD acquired properties of the nonprofit. Accordingly, this would include 10, 15 and 30 percent discounted HUD properties.

In addition, the nonprofit agency is to demonstrate in its affordable housing program that it is acting on its own behalf and is not under the influence, control or direction of any outside party seeking to derive profit or gain from the proposed project, such as a landowner, real estate broker, contractor, builder, lender, or consultant. Beneficiaries of the affordable housing program itself may not be members of its board, employees or others with an identity of interest to the nonprofit.

Mortgagee Letter 00-8

HUD issued Mortgagee Letter 00-8 in March 2000 detailing provisions for nonprofit agencies participation in HUD's FHA Single Family activities. This letter stated that all nonprofit agencies must follow the uniform standards for participation and recertification in HUD activities. Further, this would ensure nonprofits work to fulfill HUD's goal of creating homeownership opportunities for low- and moderate-income persons.

Under the recertification process of Mortgagee Letter 00-8, nonprofit agencies applied for participation in the following three activities:

- The HUD Homes Program which allows nonprofit agencies to purchase HUD homes at a discount.
- Nonprofit Agencies as Mortgagors which allows nonprofit agencies to obtain FHA financing as an owner occupant.
- Secondary Financing which allows nonprofit agencies to provide secondary financing in the form of second mortgages, forgivable second mortgages or "soft" second mortgages.

Mortgagee Letter 00-8 also reiterated HUD's stance regarding conflicts of interest. Specifically:

> *"No person who is an employee, agent, consultant, officer, or elected or appointed official of the lessee or purchaser of property or who is in a position to participate in a decision*

making process pursuant to the affordable housing plan or gain inside information with regard to the lease or purchase of the property pursuant to the affordable housing plan, may obtain a personal or financial interest or benefit from the purchase of the property, or have an interest in any contract, subcontract, or agreement with respect thereto, of the proceeds there under, either for himself or herself or for those with whom he or she has family or business ties, during his or her tenure or for one year thereafter."

This Mortgagee Letter established the minimum standards for recertification. This included the ability of the nonprofit to meet HUD's and the nonprofit's goal to expand affordable housing opportunities for low- and moderate-income individuals and to complete the rehabilitation of acquired properties from HUD within set time frames. In addition, the nonprofit must follow HUD's resale requirements and maintain an acceptable accounting system to report on property purchases, rehabilitations, rentals and resales.

In the recertification process, the nonprofits are to detail in their Affordable Housing Program how low- and moderate-income persons benefit from their program. In addition the Affordable Housing Program is to be designed to pass along to low-income persons any savings the nonprofit may receive from the discounted purchase of a HUD-owned property. Since no distinction is made about the amount of the discount, the Affordable Housing Plan is to be designed to pass on benefits from all discount properties to low- and moderate-income persons. This would include 10, 15 and 30 percent discounted HUD property purchases.

Mortgagee Letter 00-8 also established conditions for removing a nonprofit agency from the FHA approval list. These included the following:

- Properties purchased under the HUD Homes Program are not resold to persons who are at or below 115% of median income for their area when adjusted for family size.

- Discounts received by the nonprofit agency in purchasing HUD Homes are not adequately passed on to the homeowner.

- The nonprofit agency does not achieve the majority of the goals as outlined in their affordable housing plan.

- The nonprofit agency acts to further objectives not described in the affordable housing plan, or participates in activities or actions detrimental to the Department, etc.

Brothers Redevelopment approved to participate in FHA Single Family Insurance Program activities

Prior to the implementation of Mortgagee Letter 00-8, Brothers Redevelopment was approved to purchase HUD homes at a discount. On March 3, 2000, HUD issued Mortgagee Letter 00-8 requiring all current and prospective nonprofit agencies to submit a recertification or approval package to their local Homeownership Center. Accordingly, Brothers Redevelopment submitted their recertification package and was approved on May 30, 2000 by the Denver Homeownership Center to participate in these FHA Single Family Insurance Program activities:

- Participate as a mortgagor to obtain FHA-insured financing at the same attractive terms as owner occupants.

- Purchase HUD foreclosed properties, in certain cases, at a discounted price.

- Provide down payment, closing costs or rehabilitation assistance with a secondary lien.

Verbal agreement with Contract Developer, AmReal Companies

In early 1995, Brothers Redevelopment entered into a verbal agreement with an outside independent Contract Developer and at-risk Investor, AmReal Companies, for a multitude of services relating to the purchase, rehabilitation and subsequent resale of HUD homes purchased at a discount. The Contract Developer responsibilities entailed, but were not limited to the following:

- Selection and inspection of available HUD homes for purchase.

- Bid submission for selected HUD properties using Brothers Redevelopments assigned name address identifier.

- Obtain financing for the purchase and rehabilitation of awarded HUD properties.

- Coordination of rehabilitation work.

- Marketing of properties for resale.

- Provider of information on properties to Title Company.

Brothers Redevelopment's basic participation in the HUD FHA Single Family Insurance Programs is limited to the signing of the sales contract submitted for the acquisition of a HUD property and the HUD-1 Settlement Statements for the initial purchase and subsequent resale of a property. The Contract Developer is responsible for the selection, inspection, and submission of bids to HUD, obtaining financing for purchase and rehabilitation, accomplishing the rehabilitation work, marketing the properties for resale, and providing information to the title company. Brothers Redevelopment does not review the rehabilitation work accomplished by the outside independent Contract Developer nor require the Contract Developer to submit a summary report disclosing the type and amount of rehabilitation work performed.

The Contract Developer receives 40 percent of the net proceeds from the subsequent resale of a property. Brothers Redevelopment receives the same amount of proceeds as the Contract Developer. However, in some cases the split of proceeds may deviate from the set agreement, if for example Brothers Redevelopment pays the $500 earnest money deposit to HUD for a property. In this case, the Contract Developer's portion of the proceeds would be reduced by $500 while Brothers Redevelopment's portion would increase by $500. During our audit period, January 1, 1998 through January 31, 2001, Brothers Redevelopment received a total of $379,682 in net proceeds from the subsequent resale of properties. If funds are not used from the rehabilitation of a property, the Contract Developer keeps the monies for use on other properties.

Verbal agreement with primary lender, US Capital, Inc.

Brothers Redevelopment entered into a verbal agreement with its primary lender, US Capital, Inc. Under the agreement, US Capital, Inc. provides funds in the form of nonrecourse loans at an excessive interest rate of 19.5 percent to Brothers Redevelopment, for use in the purchase and rehabilitation of properties. Additionally, as an incentive for providing the loans, the two primary principals of US Capital, Inc. receive directly 20 percent of the net proceeds from the subsequent resale of a property. The Contract Developer, with the acknowledgement of Brothers Redevelopment, negotiated the agreement.

Relinquished control of affordable housing program to for-profit entity

During our review, we found that Brothers Redevelopment's affordable housing program was actually administered by an independent Contract Developer, a for-profit entity, with very limited involvement and participation by Brothers Redevelopment. In its recertification package, Brothers Redevelopment made the following certification:

> *"BRI* [Brothers Redevelopment, Inc.] *is acting on its own behalf, and is not operating under the influence, control, or direction of any outside party seeking to derive a profit or*

gain from the proposed project such as a landowner, real estate broker, contractor, builder, lender or consultant."

Our review disclosed that Brothers Redevelopment was not acting on its own behalf in connection with implementing its affordable housing program, but was under the influence, control, and direction of the outside independent Contract Developer, AmReal Companies, a for-profit entity. The Contract Developer selected, inspected and placed bids for discount properties. In addition to coordination of rehabilitation work, the Contract Developer was responsible for maintaining all financial records concerning rehabilitated properties and payment of subcontractors and laborers. **The Contract Developer did not report or substantiate any of these costs to Brothers Redevelopment.**

The Contract Developer was responsible for determining the marketability of rehabilitated properties. Discounted properties were sold at market value of the properties to homebuyers. The Contract Developer also signed as liable on five loans for properties recently purchased at a discount from HUD. Brothers Redevelopment's involvement was limited to providing their name address identifier for use by the Contract Developer in bidding for properties and execution of the sales contracts for the purchase of HUD properties and the HUD-1 Settlement Statements.

Conflicts of interest

We identified two conflict of interest issues in our review of Brothers Redevelopment's affordable housing program:

- The Contract Developer's financial interest in the purchase, rehabilitation and resale of properties; and

- The Contract Developer's relationship with the primary lender, US Capital, Inc.

Under HUD requirements, the nonprofit agency is to demonstrate in its affordable housing program that it is acting on its own behalf and is not under the influence, control or direction of any outside party seeking to derive profit or gain from the proposed project, such as a landowner, real estate broker, contractor, builder, lender, or consultant. Beneficiaries of the affordable housing program itself may not be members of its board, employees, others with an identity of interest to the nonprofit.

Contract Developer has financial interest

During our review we found that the Contract Developer is in a position to make decisions pursuant to the affordable housing program and has a financial interest in the purchase, rehabilitation and resale of properties purchased at a discount from HUD.

The Contract Developer inspects the properties being sold by HUD at a discount and determines if they should be purchased. If the properties are found to be a good investment based on assessment of rehabilitation costs and marketability, the Contract Developer submits a bid for the HUD property using Brothers Redevelopment's name address identifier. The Contract Developer bids on five properties at a time, as HUD increases the discount given on 10 percent properties to 15 percent if 5 or more properties are sold and closed the same day. The Contract Developer does not coordinate (no prior approval) bids with Brothers Redevelopment.

Upon completion of rehabilitation work, the Contract Developer requests information from realtors concerning the market value of homes in the area. The Contract Developer uses this information to determine the sales price of the property. Brothers Redevelopment has no involvement in this process.

In a response to a draft on-site review report issued by the Denver Homeownership Center, Brothers Redevelopment stated:

> *"The only way* [the Contract Developer] *makes money is to assure the sales close on time and under budget.* [The Contract Developer] *has time and financial investment at risk in order to assure this happens."*

It is evident that the Contract Developer has a vested financial interest in the resale of each property. Furthermore, Brothers Redevelopment had limited participation in HUD's FHA Single Family Insurance Programs and allowed an independent outside contract developer and at-risk investor to operate the HUD program on its behalf. The Contract Developer influenced, controlled and directed Brothers Redevelopment's program for a fee of 40 percent of net market sales proceeds, contrary to HUD's program requirements and Brothers Redevelopment's own certification to HUD in its Affordable Housing Program.

Contract Developer is member of Board of Directors of primary lender

In addition, we found that the Contract Developer maintained a conflict of interest relationship with Brothers Redevelopment's primary lender. Specifically, the Contract Developer sits on the Board of Directors for US Capital, Inc. The Contract Developer introduced Brothers Redevelopment to US Capital, Inc. and participated in the negotiation of the loan terms (e.g., interest rate of 19.5 percent) and the 20 percent of net proceeds received by US Capital, Inc. from the subsequent resale of properties. The 20 percent of net proceeds from the sale of properties is disbursed directly to the two principal staff of US Capital, Inc. as it is more advantageous tax wise to realize the disbursements as personal income.

Since 1997, US Capital, Inc. has provided a total of 126 loans with a total original loan amount of $12,830,605 to Brothers Redevelopment, Inc. In a discussion with US Capital, Inc. officials, they indicated they would consider severing their relationship with Brothers Redevelopment if they no longer received the 20 percent of net proceeds. Even though they charged an interest rate of 19.5 percent to offset their risk. US Capital, Inc. feels they are taking all the risk involved with the loans and they need to be compensated for that risk.

Savings not passed on to the low- and moderate-income homebuyer

Brothers Redevelopment has not passed the savings it received from the purchase of discount properties through the HUD FHA Single Family Insurance Programs to the low- and moderate-income homebuyers. Instead, Brothers Redevelopment distributes the net profit from the sale of the properties to the outside independent contract developer, the primary lender, and itself. This is discussed in the following two main sections dealing with properties purchased from HUD at a 30 percent discount and those purchased at a 10 or 15 percent discount.

Thirty Percent Discounted Acquired Properties

During the audit period, Brothers Redevelopment purchased nine 30 percent discounted properties from HUD at a combined price of $533,793. We reviewed records and files for all of these properties that were subsequently resold.

We conducted a detailed review for three of the nine properties to ascertain whether the costs incurred for the rehabilitation were accounted for and supported. We interviewed the homebuyers and inspected the properties to ensure claimed rehabilitation work had been performed. In addition, we calculated the net development costs for the properties, to determine whether profits made by Brothers Redevelopment were in line with HUD requirements and stipulated savings under the HUD's FHA Single Family Insurance Programs were passed on to a low- and moderate-income buyer.

The results of our review of the sample properties are:

Rehabilitation costs neither accounted for nor supported

We found not all of the rehabilitation costs were accounted for nor supported. For example, rehabilitation costs for one property were erroneously charged to another property. Also, proceeds from the subsequent resale of one property were used to pay down the financing costs of another property.

The following table provides the cost of rehabilitation reported by Brothers Redevelopment and by the outside Contract Developer, AmReal Companies, for the three properties reviewed.

30 Percent Discount Reported Rehabilitation Costs				
Properties	**A**	**B**	**C**	**Totals**
Brothers Redevelopment	$16,000	$9,800	$19,300	$45,100
AmReal Companies	10,744	3,156	18,641	32,541
Difference	$5,256	$6,644	$659	$12,559

The amount reported by Brothers Redevelopment represents the amount of the loan allocated to rehabilitation and the amount reported to HUD. The amount reported by AmReal Companies represents the amount of actual rehabilitation costs. The difference of $12,559 in reported rehabilitation costs is the amount of loan funds kept by AmReal Companies to be used towards the rehabilitation of other acquired properties.

The following table provides our calculation of rehabilitation cost and unsupported rehabilitation costs based on our review of supporting documentation maintained by the Contract Developer. We adjusted the cost reported by the Contract Developer for costs not associated with the rehabilitation of the property. The adjustments included such items as rehabilitation expenditures that were improperly charged to the wrong properties.

30 Percent Discount Rehabilitation Costs – Adjusted				
Properties	**A**	**B**	**C**	**Totals**
Rehabilitation Cost	$11,781	$2,119	$18,591	$32,491
Supported	8,286	1,756	18,109	28,151
Unsupported	$3,495	$363	$482	$4,340

For the three properties, the Contract Developer was unable to support $4,340 in claimed rehabilitation costs.

Homebuyer interviews and property inspections

Interviews of the homebuyers and inspections of the three properties indicated that the rehabilitation work claimed by the Contract Developer had been accomplished. However, during a property inspection on June 21, 2001, a homebuyer informed us that the brand new furnace did not work. The homebuyer had moved into the property in November 2000 and went without heat through the winter months. A repairman hired by the homebuyer was unable to repair the furnace. We inquired as to whether the homebuyer had been provided with a warranty for the furnace. The homebuyer had been provided with a warranty, but did not understand how a warranty worked.

In their affordable housing program, Brothers Redevelopment claimed to provide homeownership counseling. However, in our review of a sample of 14 properties purchased and rehabilitated by Brothers Redevelopment, only one of the homebuyers received a certificate that they had received homeownership counseling from Brothers Redevelopment. It is evident the homebuyer, whose furnace did not work, did not receive any homeownership counseling from Brothers Redevelopment.

Profits in excess of 110 percent of net development cost

For the three properties purchased at a 30 percent discount, we found that Brothers Redevelopment received profits in excess of 110 percent of the net development cost, contrary to HUD program requirements. This was due in part to the excessive interest rate charged by US Capital, Inc. of 19.5 percent, the split of proceeds from the subsequent resale of the properties, and the use of unallowable costs in the net development cost calculation, as defined by Housing Notice 94-74, Mortgagee Letter 97-5 and the land use restriction addendum.

The following table provides Brothers Redevelopment's calculation of profit on the subsequent resale of the three properties reviewed.

	30 Percent Discount			
Properties	**A**	**B**	**C**	**Totals**
Sales Price	$119,900	$93,000	$119,900	$332,800
Net Development Cost	113,538	87,829	110,259	311,626
Profit	$6,362	$5,171	$9,641	$21,174

The following table depicts our calculation of net development cost and the excess profits made. Amounts were rounded to the nearest dollar.

	30 Percent Discount			
Properties	**A**	**B**	**C**	**Totals**
Sales Price	$119,900	$93,000	$119,900	$332,800
Net Development Cost	93,231	72,069	81,648	246,948
110% of Net Development Cost	102,555	79,275	89,813	271,643
Excess Profit	$17,345	$13,725	$30,087	$61,157

For these three 30 percent discounted properties, Brothers should have sold the properties to the buyer at the 110 percent of the net development costs value as required by HUD. Instead, Brothers Redevelopment sold the properties at market value. For example, the buyer for property C shown above should have purchased the home from Brothers Redevelopment for $89,813. However, Brothers Redevelopment sold the property at market value of $119,900. This means the buyer had to incur an additional indebtedness of $30,087 for the house. In other words, the buyer had to pay 33.5 percent more for the property than the buyer should have.

The net profit realized by Brothers Redevelopment on the sale of the 30 percent discounted properties exceeded the amount stipulated by HUD. Under Mortgagee Letter 97-5 the resale of a 30 percent discounted property cannot exceed 110 percent of the net development cost. Net development cost is defined as the total cost of the project, including items such as acquisition cost, architectural fees, permits and survey expenses, insurance rehabilitation and taxes as well as selling expenses.
This same requirement was specifically stated in HUD's May 30, 2000 approval letter of Brothers Redevelopment's recertification package. Even with these requirements, Brothers Redevelopment has developed their Affordable Housing Program to sell all of their 30 percent discounted properties at the market value of the properties in order to maximize their profits.

In selling properties at a 30 percent discount to nonprofit organizations, HUD has intended to include in the sales documents a land use restriction addendum that placed restrictions on the resale of 30 percent discounted properties by the nonprofit. For example, the 30 percent discounted property B discussed above contained this addendum to the sales documents.

The addendum sets out certain conditions for the resale of the property. One condition was that the property is to be sold to a buyer whose income is not to be more than 115 percent of the median income in the area. This would be to low- and moderate-income persons. A second condition was that the nonprofit was not to sell the property for more than 110 percent of the net development costs. Net development cost is defined in the addendum as the total cost of the project including items as acquisition costs, architectural fees, permits and survey expenses, insurance, rehabilitation and selling expenses.

Brothers Redevelopment has not complied with the sales restriction placed on the property by the land use restriction addendum to sell the property at no more than 110 percent of the net development cost. Instead, Brothers Redevelopment elected to sell the 30 percent discounted property at market value. The buyer of the property was an individual who could afford to purchase the home. By doing so, Brothers Redevelopment was not providing an opportunity for the purchase of the property at the 110 percent above the net development cost value to a low- and moderate-income person.

<u>Ten and Fifteen Percent Discounted Acquired Properties</u>

During the audit period, Brothers Redevelopment acquired 83 properties at 10 or 15 percent discount from HUD at a combined price of $7,521,586. We reviewed records and files for nine of these properties. For selected property acquisitions, we verified whether the costs incurred for the rehabilitation were accounted for and supported. In addition, we evaluated whether benefits realized from the discount acquisition of the properties were passed on to the low- and moderate-income homebuyer as intended by HUD requirements.

From our review, we found that Brothers Redevelopment process for acquiring, rehabilitating, and selling its 10 and 15 percent discounted properties followed the same procedures as for its 30 percent discounted properties. We noted that not all of the rehabilitation costs for its 10 and 15 percent discounted properties were accounted for nor supported. Proceeds from the subsequent resale on one property were used to pay down the financing costs of another property. The sale of 10 and 15 percent discounted properties at market value prevents Brothers Redevelopment from passing on any realized savings to low- and moderate-income buyers as intended by HUD requirements.

To illustrate, Brothers Redevelopment acquired a 15 percent discounted property from HUD at a cost of $74,550 performed the needed rehabilitation repairs, which was funded at $12,700, and resold the property at the market value of $114,900 to a qualifying buyer.

The sale of this property at market value did not fulfill Brothers Redevelopment obligation to pass on any savings from the discounted purchase to the ultimate homebuyer. Allowing a 10 percent amount for overhead and profit, Brothers Redevelopment could have sold the house at a price of $95,975, thereby granting the homebuyer the benefit of the HUD discounted property sales program. The composition of the $95,975 selling price is:

Purchase price of home from HUD	$ 74,550
Needed rehabilitation costs	12,700
Combined cost	$ 87,250
Overhead and profit at 10 percent of cost	8,725
Sales Price	$ 95,975

By selling the home at $114,900, an additional profit on the sale in the amount of $18,925 was realized. This amount was used to fund costs for another property, with the remaining amount distributed to the Contract Developer at 40 percent, US Capital, Inc. at 20 percent, and Brothers Redevelopment at 40 percent. The true impact is that the additional profit realized by Brothers Redevelopment and the two other contract entities is absorbed in the market value price paid by the property buyer.

We identified two other 15 percent discounted properties that were bought and sold by Brothers Redevelopment on the same day. The properties were purchased at a discount from HUD and then sold at market value. The only rehabilitation costs we saw were $290 for appliances for one property and $300 for heating for the other property. The profit realized from the two property acquisitions and sales was distributed equally between Brothers Redevelopment and the Contract Developer. As a result, no benefit from the discounted purchase from HUD was granted to the homebuyers, contrary to HUD requirements.

Details of these two purchases and sales are shown in the following chart:

	15 Percent Discount		
Properties	**A**	**B**	**Totals**
Sales Price	$168,000	$80,000	$248,000
Acquisition Cost from HUD	140,372	62,899	203,271
Realized Gain	$27,628	$17,101	$44,729

This table shows that Brothers Redevelopment was able to use HUD's discount sales program to buy and immediately sell the properties with a realized gain of $44,729. By selling the properties at market value, no opportunity was granted to providing any savings from the HUD program to low- and moderate-income homebuyers.

Allowing a 10 percent amount for overhead and profit, Brothers Redevelopment could have sold the two houses at a price of $154,409 and $69,189 instead of $168,000 and $80,000 respectively as shown in the following chart. This would have enabled the savings from the discounted HUD properties to be passed on to the homebuyer.

	15 Percent Discount		
Properties	**A**	**B**	**Totals**
Sales Price	$168,000	$80,000	$248,000
Acquisition Cost from HUD	140,372	62,899	203,271
Overhead and Profit at 10% of Cost	14,037	6,290	20,327
Discounted Sales Price	$154,409	$69,189	$223,598

Overall impact of deficient affordable housing program

As shown by these discussions above, Brothers Redevelopment has designed the implementation of its affordable housing program by marketing its acquired discounted HUD properties to be sold at the market value of the property in order to maximize the revenue from the HUD program. According to Brothers Redevelopment, profits from their affordable housing program made up for losses incurred in their other programs and to help finance other activities being carried out by them.

Brothers Redevelopment officials expressed that they have received an average of $5,000 profit per property sold under the HUD program. Brothers Redevelopment in their July 12, 2001 response to HUD's draft report of HUD review of Brothers Redevelopment program implementation stated the following:

> *"BRI* [Brothers Redevelopment, Inc.] *has used the proceeds created from this program to leverage the purchase of additional properties from HUD in order to house still more modest income families and to support ongoing overhead and administrative expenses for the organization."*
>
> *"Nevertheless BRI* [Brothers Redevelopment, Inc.] *earned a grand total of $163,184 for its efforts in this program last year. However, in Housing Counseling (also funded in part by HUD) we had a short fall of $3,962 and for the Paint-A-Thon project (targeted toward maintaining low income seniors in their homes) we experienced a short fall of $16,063. These losses were made up in part from sales proceeds earned from the Purchase Repair Resale Program."*

Clearly, Brothers Redevelopment's participation in HUD's FHA Single Family Insurance Programs has been primarily designed and implemented to generate revenues to help finance its other non-HUD related activities. This implementation process is contrary to the requirements and intent of the HUD program. The HUD program is designed to provide discounted properties to be purchased from HUD, be rehabilitated, and then sold with savings from the program being passed on to the low- and moderate-income homebuyer. The HUD program was not intended to generate revenue to finance activities of the nonprofit entity and at the expense of the homebuyer.

Reporting to HUD not accurate

During our audit period, we found that Brothers Redevelopment submitted reports to the Denver Homeownership Center that were not accurate. For example, rehabilitation costs reported by Brothers Redevelopment in its activity reports were not correct. Brothers Redevelopment incorrectly reported the amount of the loan allocated to rehabilitation as rehabilitation cost, as opposed to the actual rehabilitation costs incurred by its Contract Developer. Brothers Redevelopment did not require its Contract Developer to provide a summation or report on the actual cost to rehabilitate a property.

Brothers Redevelopment suspended from purchasing additional HUD properties

At the time we started our site review, the Denver Homeownership Center also performed an on-site review of Brothers Redevelopment's participation in the FHA Single Family Insurance Program activities. Based on the deficiencies they identified during the on-site review, Brothers Redevelopment was placed on temporary suspension until program changes were made and put in place. The draft on-site review report, dated June 28, 2001, contained the following five findings.

- Brothers Redevelopment lack of control over the HUD Home discount purchase program.
- Brothers Redevelopment exceeds the 110% net development allowed on discounted sales.
- Inconsistencies in marketing to low- to moderate-income purchasers (115% and below median income).
- Record keeping.
- Conflict of interest.

These findings parallel the deficiencies we identified in Brothers Redevelopment's operation of its HUD program.

Deficiencies in carrying out Affordable Housing Program stem from two causes

In our opinion, the deficiencies addressed above in Brothers Redevelopment carrying out their Affordable Housing Program stem from two primary causes. Brothers Redevelopment did not:

1) Have a clear understanding of HUD requirements to participate in FHA's Single Family Insurance Programs, to create homeownership opportunities for low- and moderate-income persons, nor

2) Want to take part in the risk associated with the purchase, rehabilitation, and resale of the properties.

Lack of understanding of HUD program

First, Brothers Redevelopment has demonstrated that they did not fully understand the requirements of the program. Brothers Redevelopment made the following statement in their affordable housing program:

> *"There is no requirement for us to pass along to low income persons any savings we receive from the discounted purchase of a HUD owned property. We price our properties at the lower end of the market range for properties in a particular market area and if we can bring the property up to a level of livability within the range of our available budget, we have a workable project. The buyers qualify for their loans independently, and they know how much home they can afford. Most of the people we help buy homes through our housing counseling efforts do not buy homes from BRI* [Brothers Redevelopment, Inc.]*."*

This statement is in direct conflict with HUD's stated objectives of the program to provide housing opportunities and to pass on the savings from the purchase of discount properties to low- to moderate-income homebuyers.

In addition, Brothers Redevelopment lacked a proficiency of HUD Requirements and was negligent in the application of them. An interview with a staff member of Brothers Redevelopment suggested that Brothers Redevelopment had been basing their Affordable Housing Program on a HUD handbook that had since been revised with the issuance of various Mortgagee Letters and HUD Directives. The staff member indicated that Brothers Redevelopment was not aware of other program requirements, even though attached to their HUD approval letter to participate in FHA's Single Family Insurance Programs was a detailed listing of applicable HUD requirements and guidelines.

Brothers Redevelopment did not want any risk stemming from the HUD program

Secondly, Brothers Redevelopment did not want to take part in the risk associated with the purchase, rehabilitation and resale of properties purchased at a discount. Brothers Redevelopment indicated this in the following statement they made in their response to the draft on-site review report issued by the Denver Homeownership Center on June 28, 2001:

> *"In terms of oversight by BRI* [Brothers Redevelopment, Inc.], *we have drawn the program to rely upon the motivations and risk of others for their involvement in this program."*

Brothers Redevelopment relied solely on an outside independent Contract Developer, AmReal Companies, to make such decisions as to which properties to purchase, amount of rehabilitation work to be performed, and the marketability of rehabilitated properties. In addition, they obtained nonrecourse loans with a high interest rate of 19.5 percent from US Capital, Inc. shifting all risk to the lender.

The use of nonrecourse loans at the high interest rate of 19.5 percent from US Capital, Inc. has increased the cost to each of the discounted properties. A Brothers Redevelopment official provided us with an analysis that they had conducted comparing the cost of using a nonrecourse loan from US Capital, Inc. at a 19.5 percent interest rate and a recourse loan by a separate mortgage company at a 10 percent interest rate. This analysis showed the projected premium for using the nonrecourse loan was $4,345. This increased cost is included in the total net development cost for each property.

Brothers Redevelopment has used some recourse loans under its HUD program with considerable savings in connection with interest rates on property loans. During the earlier part of the HUD FHA Single Family Insurance Programs participation by Brothers Redevelopment, Brothers Redevelopment obtained recourse loans on properties with interest rates ranging from 9.75 to 10 percent.

In the first part of their program, Brothers Redevelopment even obtained a lower interest rate for nonrecourse loans. A 12 percent interest rate loan was obtained from WK Investments. After this loan, Brothers Redevelopment started using US Capital, Inc. to obtain its nonrecourse loan financing with rates at 19.5 percent. The two main principals for WK Investments are the two main principals of US Capital, Inc.

The 19.5 interest rates from US Capital, Inc. were negotiated with the Contract Developer, who sits on the board of US Capital, Inc. In addition, the negotiated arrangement allowed US Capital, Inc. to also receive 20 percent of the profit realized from the resale of the HUD discounted properties. Interestingly, county records show that US Capital Inc. has provided loans to the Contract Developer, AmReal Companies, for non Brothers Redevelopment related properties with interest rates ranging from 4.5 to 5.75 percent.

Brothers Redevelopment has designed the implementation of its HUD program whereby the risks associated with it are passed on to the outside independent Contract Developer and US Capital, Inc. By doing so, the Contract Developer and lender were investors taking the risk, while Brothers Redevelopment functioned basically as a strawbuyer whose approval status was used for a fee, 40 percent of net proceeds from the subsequent resale of each property.

Participation in HUD's Programs needs to be discontinued

Brothers Redevelopment has not operated its Affordable Housing Program to meet HUD's basic requirements under the FHA Single Family Insurance Programs. Brothers Redevelopment:

- Has not controlled its' program to ensure the minimum program requirements were being met;

- Exceeded the 110 percent development allowed on discounted sales for 30 percent discounted acquired properties; and

- Did not pass on the benefits of the purchase of HUD discounted properties to the ultimate homebuyer.

Instead, Brothers Redevelopment's primary focus in participating in the HUD programs has been to obtain the maximum profit possible under the HUD programs to help finance its' other unrelated nonprofit activities and not to grant any benefits realized under its' program to the purchasing low- and moderate-income homebuyer. Furthermore, Brothers Redevelopment designed its program to allow it to be implemented by others who would administer all phases of the program and assume all risks.

Under this arrangement, Brothers Redevelopment did not implement any major oversight or control over its Contract Developer. The Contract Developer, with the knowledge and acceptance of Brothers Redevelopment, was granted full authority and responsibility under the program and to operate it to maximize profits, not only for itself but also for an identity of interest lender, and for the nonprofit. Brothers Redevelopment marketed its properties at the market value for its properties in order to gain the maximum profit for itself, the at-risk Contract Developer, and the primary lender. and by doing so, did not pass on any benefits under the program to the homebuyer as specified by HUD.

For the 30 percent discounted properties acquired from HUD, Brothers Redevelopment was required to sell these properties at no more than 110 percent of the net development costs to low- and moderate-income persons. This requirement was set out in HUD requirements, HUD's authorization letter for participation in the HUD program, and on certain land use restriction addendum to the 30 percent acquired properties from HUD. HUD requirements specify that if the nonprofit does not comply with the HUD provisions for the 30 percent acquired properties, the nonprofit could be removed from the program.

Brothers Redevelopment did not carryout out its program for the 30 percent discount properties acquired from HUD but sold the properties at market value to realize the maximum profit and did not pass on any benefit from the program to the homebuyer. Furthermore, the nonprofit allowed the Contract Developer to function primarily as an investor under the program for a percent of the net profit of the property sales and did not ensure that the minimal requirements of the HUD program were met.

Since Brothers Redevelopment has shown through various verbal and written correspondences that they do not intend to change the administration of their affordable housing program to conform to HUD's FHA Single Family Insurance Program requirements, further participation in the HUD program should be discontinued.

With regards to excess profits made by Brothers Redevelopment, the outside independent Contract Developer, and the primary lender, the Denver Homeownership Center needs to make a decision as to how the homebuyers will be compensated for the excess profits that were passed on to the homebuyer in the form of an increased purchase price.

Auditee Comments

Brothers Redevelopment does not agree with the finding. The written response is contained in Appendix 1. Brothers Redevelopment states that the report ignored certain HUD directives and the findings were slanted to support a predetermined outcome. The response discusses several HUD handbooks and directives and often details various sections to support that the nonprofit is complying with the provisions relating to the purchase, rehabilitation and resale of 30 percent discounted properties from HUD. Furthermore, Brothers Redevelopment discusses at length the differences under the program for 30 percent discounted properties and less than 30 percent discounted properties.

Brothers Redevelopment acknowledged that it did rely too much upon the incentives of the Contract Developer. In addition, Brothers Redevelopment states that it was acting on its own behalf and not under the influence, control, or direction of AmReal Corp. and was contracting for their broad experience for a percentage of the net gain which was comparable to paying someone a real estate commission.

The response to the audit finding discussed that AmReal Companies brought to the attention of Brothers Redevelopment the funding source from US Capital, Inc. Even though, the rates were higher than previously experienced, it provided Brothers Redevelopment with an increase of funding with which to acquire more HUD discounted properties. This was needed according to Brothers Redevelopment if they were to continue in the program. Furthermore, the experience encountered by Brothers Redevelopment in the 1980s whereby they found themselves in financial difficulty made the financing from US Capital, Inc. beneficial. Also, the availability of nonrecourse loans was not readily available except from US Capital, Inc.

In addition, the reply to the finding points out that the schedules presented in the finding are confusing and indicate that the requirements for 30 percent discounted properties are the same as for less than 30 percent discounted properties. The requirements for the 30 percent discounted properties are to be at 110 percent of the net development costs but Brothers Redevelopment states that the requirement is from a HUD document that refers only to the Section 203(k) program for which Brothers Redevelopment is not doing. Therefore, the 110 percent requirement does not apply to Brothers Redevelopment's program. Accordingly, the position taken in the audit finding is incorrect.

Evaluation of Auditee Comments

Brothers Redevelopment response to the draft finding stated that the auditors ignored written program directives and slanted the finding to support a predetermined outcome and intended to manipulate the program for the future. Brothers Redevelopment assertion is totally false. Brothers Redevelopment was selected for review since they are one of the larger nonprofits participating in HUD's FHA Single Family Insurance Programs. Our review focused on how Brothers Redevelopment was implementing its HUD programs and whether it was within the HUD requirements. In fact, the implementation of the HUD property discount program by Brothers Redevelopment as presented in the finding is clearly acknowledged in Brothers Redevelopment's written response to the finding.

Since the response indicates that the finding omitted certain HUD handbook and directives and misapplied others, we have incorporated into the finding all of the HUD documents specifically discussed by Brothers Redevelopment. These additional references further detail and/or restate other program requirements already cited in the finding.

The response indicates that Brothers Redevelopment was not acting under any outside influence, control or direction of its Contract Developer. The point presented in the finding is that the Brothers Redevelopment allowed the Contract Development to influence, control and direct the HUD discounted acquisition program, not to influence, control and direct Brothers Redevelopment.

Brothers Redevelopment's reply to the finding states that they used the nonrecourse loans from US Capital, Inc. to finance their property purchases from HUD so that Brothers Redevelopment would not be in a position to encounter property losses as they experienced in the 1980's. The point being presented in the finding by Brothers Redevelopment allowed the HUD discounted acquisition program to be administered by the outside independent Contract Developer with program financing coming from an identity of interest relationship with the Contract Developer and the program lender. Brothers Redevelopment allowed this arrangement in order to pass all risk under the program to the Contract Developer and the program financing lender for a fee of the net proceeds from the property sales.

In order to clarify the confusion on the definition of the net development cost not being applicable to the program being administered by Brothers Redevelopment, we have clarified in the finding some of the criteria applicable to the definition and use of net development cost. We point out in the finding that Mortgagee Letter 94-74 discusses that under HUD's Real Estate Owned Discount sales program, which is the one Brothers Redevelopment is participating in, that nonprofits that purchase 30 percent discounted properties from HUD are to be resold at no more than 110 percent of the net development cost for the property. This same requirement is specifically stated by HUD in their approved letter of Brothers Redevelopment recertification package. In addition, the finding is modified to show that some of the 30 percent discount sales documents from HUD contained land use restriction addendums that specifically specified the properties were to be resold at no more than 110 percent of the net development cost. The net development cost was clearly defined in the land use restriction addendums.

Even so, Brothers Redevelopment has elected to sell their 30 percent discounted properties at the market value of the property that has been above the amount limited by HUD. In addition, the sale of all of its properties have been to the buyers at the market value without any benefit from the discounted property purchase from HUD being passed on to the homebuyer as also required and intended by HUD.

RECOMMENDATIONS

We recommend that the Denver Homeownership Center:

1A. Disapprove Brothers Redevelopment from further participation in HUD's FHA Single Family Insurance Programs.

1B. Determine what the actual net development cost is for each 30 percent property purchased and rehabilitated by Brothers Redevelopment. Based on the actual net development cost, calculate the excess profits. Decide how the homebuyers are to be compensated for the excess profits that were passed on to them in the form of an increased property purchase price.

Management Controls

In planning and performing our audit, we obtained an understanding of the management controls that were relevant to our audit. Management is responsible for establishing effective management controls. Management controls, in the broadest sense, include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include systems for measuring, reporting, and monitoring program performance.

Management controls assessed

We determined the following Brothers Redevelopment management controls were relevant to our audit objectives:

- Governing policies and procedures as established by Brothers Redevelopment relating to its HUD approved Affordable Housing Program;
- Procedures for implementing its Affordable Housing Program granting independence from other parties; and
- Procedures granting discounts from the purchase of HUD discounted properties were passed on to low- and moderate-income homebuyers.

Assessment procedures

The following audit procedures were used to evaluate the management controls:

- Review of established procedures formulated by Brothers Redevelopment in implementing its Affordable Housing Program;
- Interviews with officials and employees of Brothers Redevelopment and other related parties and entities;
- Review of Brothers Redevelopment's Affordable Housing Program records and related files;
- Review of program records and files maintained by independent parties associated with Brothers Redevelopment's Affordable Housing Program;
- Review of records and files maintained by the Denver Homeownership Center in connection with the approval and oversight of the HUD FHA Single Family Insurance Program activities by the approved nonprofit Brothers Redevelopment, Inc.; and

- Interview with applicable officials and employees of the Denver Homeownership Center relating to activities associated with Brothers Redevelopment.

Significant Weaknesses

A significant weakness exists if management controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained and maintained, and fairly disclosed in reports. Based on our audit, we identified the following significant weaknesses:

- Brothers Redevelopment did not administer or carryout its Affordable Housing Program as approved by HUD or in conformity with HUD requirements, (Finding) and

- Benefits realized from the acquisition of discounted HUD properties were not passed on to the low- and moderate-income homebuyer as required (Finding).

Follow-up on Prior Audits

This is the first HUD Office of Inspector General for Audit review of activities of Brothers Redevelopment, Inc.

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Appendices

Appendix 1 - Auditee Comments

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BRI

August 30, 2001

Mr. Robert C. Gwin
District Inspector General for Audit
U.S. Dpt. Housing and Urban Development
Rocky Mountain Region
633 17th Street, 14th Floor
Denver, Co. 80202-3607

Re: Response to BRI Audit Report
(Dated 08/09/01)

Dear Mr. Gwin:

This letter is in response to the referenced draft audit report relative to the purchase and subsequent resale of HUD owned real estate in conjunction with BRI's Purchase Repair Resale Program.

The report is well written and would have an uninformed reader believe that BRI totally ignored its responsibility with respect to the administration of HUD's requirements for the properties purchased. Unfortunately, the OIG have elected to ignore written program directives and slant their findings to support a predetermined outcome. The report is not objective and the findings have been manipulated to support the imposition of self defined corrective measures representing the OIG's intent to manipulate the program for the future.

Specifically, the OIG has misrepresented reporting of the governing directives for this program by slanting the relevance of each, the omission of certain others and by misconstruing the content for the uninformed reader. This is apparent from reviewing the following written directives relevant to this program:

The governing statute for this program is referenced at 12 U.S.C. 1701 and HUD regulations are reported at 24 CFR 291.90.

24 CFR 291.90

This regulation describes the manner in which HUD is to dispose of individual Real Estate Owned (REO) properties it has acquired as a consequence of its single family mortgage insurance programs. Among other matters at 24 CFR 291.210 (a) it stipulates:

HELPING PEOPLE HOUSE EACH OTHER

> "...qualified private nonprofit organizations that have been preapproved to participate by HUD, according to standards determined by the Secretary, may purchase properties directly from HUD at a discount off the list price determined by the Secretary to be appropriate, but not less than 10 percent, for use in HUD and local housing or homeless programs."

This provision mandates that sales of properties to approved non-profit organizations must be made at no less than at 10 percent discount off the list price, further defined at 24 CFR 291.100(a) as HUD's asking price, based upon an appraisal conducted by an independent Real Estate Appraiser. This regulatory mandate was completely omitted from the OIG audit as several exceptions were found in a cursory review of the audited files from their investigation. This is an example of the OIG's willful intent to ignore written program directives in order to focus on a nonobjective predetermined outcome.

HUD Handbook 4310.5 (Issued 05/17/94):

The above regulations are reflected in HUD Handbook 4310.5 Revision 2 (dated 5/17/94). This is the official HUD interpretation of the implementing regulations and provides direction to HUD staff on how to administer the program. The OIG failed to mention this hand book at all and totally ignored the written directives to staff contained therein. As a point of note, this is the sole document conveyed to BRI when HUD representatives encouraged BRI's initial participation.

HUD Notice 94-74 (Issued 09/29/94):

On 09/29/94 HUD issued Notice 94-74 amending certain portions of HUD Handbook 4310.5 Rev-2. The OIG fails to mention this Notice was self canceling and expired on 09/30/95. Further they mislead the reader by inferring this document defines Net Development Cost common with supplemental instructions issued to HUD Approved Mortgagees in Mortgagee Letter (ML 97-5) for the purposes of the 203 (k) mortgage insurance program. HUD Notice 94-74 does not define net development cost, and supplemental instructions to mortgagees under the 203 (k) program are inapplicable as BRI does not utilize the 203 (k) insured loan mechanism for financing the purchase and sale of its properties. This is an example of the OIG intentionally misconstruing directives to the reader in order to support a predetermined outcome.

Mortgagee Letter 96-52 (Issued 09/19/96)

This Mortgagee Letter was issued to all approved mortgagees to use as a credit evaluation guide for lending to non-profit organizations and contains information about acceptable affordable housing programs. In the Affordable Housing Programs provision it states:

> "AFFORDABLE HOUSING PROGRAMS. Affordable housing programs administered by nonprofits must be approved by the local FHA office. Each affordable housing program must be a viable, well-run operation that successfully serves the housing needs of low- and moderate-income individuals and families.

> Home ownership. Our [HUD's] target is home ownership. As such, we strongly encourage nonprofit agencies to make successful attainment of homeownership as the ultimate goal of their affordable housing programs. We recommend that nonprofits devise innovative approaches to providing additional avenues for first-time and underserved borrowers."

The OIG indicated this letter established program requirements concerning acceptable affordable housing programs. It doesn't, it merely indicates FHA (HUD) approves affordable housing programs and provides mortgagees with insight about what they are and how HUD approves them. Note the context in which the terms "strongly encourage" and "recommend" are used.

Mortgagee Letter 97-5 (Issued 03/03/97):

This directive was issued to HUD approved lenders relative to mortgages originated under the 203 (k) mortgage insurance program. It advises such mortgagees that [HUD] "has revised the Section 203 (k) Escrow Commitment Procedure". The directive goes on to say:

> "Under HUD's REO Discount Sales Program, it is possible under certain circumstances for a non-profit or government entity to receive up to a 30 percent discount on the sales price of a property. HUD's intent is for those buyers receiving a discount off the sales price in excess of 15 percent to perform necessary repairs and resell the property to individuals/families who intend to occupy and whose income does not exceed 115 percent of the median income for the area, when adjusted for family size. The resale price of the property cannot exceed 110 percent of the net development cost."

The OIG chooses to ignore HUD's distinction of properties acquired by BRI in excess of 15% discount and those below 15%. They would have a reader believe the entire inventory of homes purchased by BRI from HUD is subject resale to families at or below the 115% area median income limitation. This is clearly not the intent of the above citation.

Mortgagee Letter 00-8 (Issued 03/03/00)

This directive was issued to all approved mortgagees and non-profit agencies. It contains instructions on obtaining approval from FHA to be approved as a participating agency for the purposes of purchasing HUD's Real Estate owned Properties (HUD Homes) at a discount and outlines reporting and recertification requirements for the non profit agency to remain a participant. The directive announces other program changes and goes on to say:

> "Nonprofit agencies that purchase HUD Homes at the 30 percent discount level must submit an annual report to ...[HUD]... who will review these accomplishments and supporting documentation to determine, among other things, that substantial benefits are passed on to the homeowner as a result of the nonprofit agency receiving a 30 percent discount on the property. Failure to pass on adequate savings to the ultimate home owner may result in removal from the

> approved list of nonprofit agencies. For additional information about this requirement, nonprofit agencies should review Mortgagee Letter 97-5. Although nonprofit agencies that purchase properties at the 10 percent discount level are not required to submit a report, the Department reserves the right to monitor the agency's activities relating to these transactions."
>
> ML-97-5 says in this regard "...The lender is responsible for analyzing the closing documents to assure the non-profit or government entity is not making in excess of a 10 percent profit and that the borrower's income does not exceed 115 percent of median income. If the sales price exceeds 110 percent of the net development cost (which this mortgagee letter defines elsewhere in detail), then the excess profit must be used to pay down the existing mortgage."

These citations taken together clearly indicate that for properties discounted by HUD in excess of 15% the non-profit developer is obligated to sell the property to families at and below 115% of the area median income, adjusted for family size, and to not make in excess of 10% profit [net gain] over the net development cost of the project. Further, it is implied there is no such limitation or requirement for properties purchased by non-profits at discounts below 30%.

The OIG auditor additionally, neglects to mention that our application to HUD was properly approved by HUD outlining the program which we are currently following. Specifically, in HUD's approval letter they correctly stipulated:

"As a reminder, all nonprofit organizations are subject to the following limitations:

- Unless an exception is granted in writing by the Department, the nonprofit purchaser of a property at a 30% discount shall not resell the property for an amount in excess of 110% of the net development costs.
- All FHA properties purchased with a 30% discount and re-sold by a nonprofit agency must be sold to homebuyers who intend to occupy the property as their principal residence and whose income is at or below 115 percent [of] medium income in the area when adjusted for family size..."

This reminder from HUD recognized the difference between 30% deep discount properties and all other properties acquired from HUD. We are following the HUD directive in this regard. The OIG audit would have you believe that all properties purchased from HUD needed to be sold to families at or below the 115% of median income guideline. This is not supported by ML 00-8 or our 05/30/00 recertification letter from HUD.

Control issues:

The audit makes much of relinquishing control of our affordable housing program to our contract developer. The OIG describes BRI as a "Strawbuyer" to our Contract Developer who is paid on a shared net gain basis. Upon reflection, we are receptive to the notion that we have relied too much upon the incentives of our Development Contractor for the operation of the program and will make corrections in that regard. However, it is worthy of note that paying a contractor on an incentive basis is very common to public/private partnership endeavors and does not violate program directives. This incentive compliments our overall strategy. The OIG fails to mention we meet all program requirements relative to whom we sell our homes, and HUD's limitation on net gain to which we are allowed in accordance with the Hand Book.

Conflicts of Interest:

There are several conflict of interest statements reported in the above directives. However, on 05/08/00, as part of BRI's Recertification/Application package the President of BRI signed the following certification:

- BRI certifies that the members of its Board of Directors serve in a voluntary capacity and receive no compensation, other than reimbursement for expenses, for their services. BRI operates in a manner to assure that no part of its net earnings are passed on to any individual, corporation, or other entity. This is reflected in Bylaws to the Articles of Incorporation for the organization (Article IV Paragraph 4.05).

- BRI is acting on its own behalf, and it is not operating under the influence, control, or direction of any outside party seeking to derive a profit or gain from the proposed project, such as a landowner, real estate broker, contractor, builder, lender or consultant.

- I Certify that the information submitted in response to this Application and Recertification Package is Accurate and correct to the best of my knowledge.

At the time this certification was required, BRI examined closely the above language with respect to our agreement with our Contract Developer, AmReal Corporation. We concluded that albeit a fine line distinction, BRI was acting on its own behalf and not under the influence, control, or direction of AmReal Corp. In our minds, we felt that we were contracting for his very broad and extensive experience and that payment for his services based on a percentage of net gain was just as appropriate and common in the marketplace as it is, for example, a listing agreement to pay a commission to a Realtor based on the negotiated sales price.

Another conflict of interest issue was raised by the OIG in their draft audit report. This issue dealt with the principal of AmReal Corp. being a board member of U.S. Capital. Enclosed is a letter from AmReal Corp. discussing that relationship. In essence it says that access to U.S. Capital's resources were made available because of that relationship.

The OIG fails to acknowledge that in all public/private partnerships the private sector's motivation is to make a profit. Our Contract Developer is no different in that regard. Lastly, the certification language provided by HUD, taken in the broadest sense, would eliminate practically all contracting for services from the program.

Financing:

BRI has financed the purchase and renovation of properties from HUD in a variety of ways. We initially utilized the Purchase Money Mortgage (PMM) program with HUD in order to finance the purchase, and private money to finance the renovation. As this source of funding was unreliable, we had to develop another source of interim financing in order to take out HUD's position and to provide construction funding, as well.

This resulted in several loans placed with Key Bank which entailed their providing the necessary funding for construction and subsequent end loan financing for the buyer subject to a 2 year balloon payment, after which, the bank agreed to provide a conventional market rate mortgage to the buyer. BRI, in these instances, would take back a second mortgage note and deed of trust and defer its distribution until refinancing occurred. This was cumbersome, but effective, in terms of putting modest income families into home ownership. The Key Bank personnel changed and we again found ourselves in need of an interim lending source. At the same time, market factors were becoming increasingly apparent, in that, the prices of properties from HUD were escalating and that discounted properties made available to non-profits under the direct sales method were becoming less available.

We understood, at that point, that if we were to continue the program, we would need to increase our volume of properties in order to take advantage of the bulk discount and rely almost exclusively on competitive open listing properties available from HUD.

AmReal suggested we could use the resources of U.S. Capital, a company with which he had previous funding relationships. The rates were higher than we had experienced, but the volume made possible through this mechanism made the program viable. The principal of U.S. Capital initially agreed to finance the purchase and renovation of five homes at a time. The relationship grew and the line of credit expanded. At a point, we had outstanding over 2.5 million dollars worth of real estate with U.S. Capital resources.

All of this was overshadowed by the BRI Board of Directors reluctance to put the organization at risk due to problems encountered in the late 1980's when the market changed and BRI like so many other developers found themselves with greater financial liability on their properties than the market would support (BRI at one time had 28 such properties in its inventory).

The above discussion is included to give perspective to the evolution of the program from BRI's point of view. The program had to evolve due to market factors reflected in HUD sales prices. The OIG fails to acknowledge these changes and wants to audit the program against puritanical standards that HUD written directives do not support.

The OIG believe we are paying excessive amounts for non-recourse loans from U.S. Capital. Since the audit began, we have been searching for more financing resources. Enclosed are copies of letters from lenders who we have approached about this matter. You will note, without exception, that non recourse loans are not readily available and that if they were, the rates we are paying are certainly within the range of expectation.

Erroneous Data:

In the draft audit several tables are presented which claim to show that BRI did not accurately record pertinent information to HUD and that it had made an excessive profit on certain 30% deep discounted properties acquired from HUD. For reasons unknown, these properties were not identified by property address so the data is difficult to dispute. However, in one of the tables the OIG auditor indicates sales price. We have researched our records and find the addresses for these properties are 20 Wolff St. purchased in 1998, 338 Grove St. purchased in 1998, and 2147 East 47th purchased in 2000. The OIG auditor would have you believe these properties were all sold in excess of the 10% net gain limitation. Not only is the data reported incorrect, the allegation that BRI somehow violated a HUD rule relative to the amount of net gain is erroneous.

Specifically, the auditor reported that:

> "BRI received profits in excess of 110 percent of the net development cost. This was due in part to [1] the excessive interest rate charged by US Capital, Inc. of 19.5% [2] the split of proceeds from the subsequent resale of the properties, and [3] the use of unallowable cost in the net development cost calculation..."

Evidently, the OIG has reasoned that construction loan cost in excess of what they feel is reasonable should be disallowed from the cost of the project and added to the profits BRI should have otherwise reported. Similarly, the OIG auditor has evidently reasoned that proceeds paid to the development contractor as well as to the interim lender and any other cost they deem "unallowable" per the strained reasoning previously discussed relative to the provisions ML 97-5 pertinent to the 203 (k) program, all should be declared excess profits to BRI even though it never received these proceeds. This does not follow sound audit logic, particularly, in that, the cost of financing is not limited by HUD written directive. Furthermore, as reported above, the cost of non-recourse construction loans is expensive and the rates paid were the rates available in the marketplace, for which, BRI had no alternative at the time.

Ramifications of the audit:

The OIG has recommended to the Denver Homeownership Center that BRI be suspended and remain suspended from the program, and if we are to be reinstated after major revisions to our affordable housing program have been agreed to, that the number of properties we are allowed to purchase and rehabilitate at a given time be limited to 2 to 5 properties. These recommendations have all been based on erroneous information and strained reasoning from the OIG's supposition about how the program should be revised.

To the best of my knowledge the OIG's responsibility ends with reporting the facts and making recommendations based upon their evaluation of program performance. This audit does not follow that standard. It is at best a misguided report and at worst an intentional fabrication of the facts with the intent to deceive.

In the meantime BRI's Purchase Repair Resale program has been terminated since 06/05/01, and our mission to help others and to create earned income for our programs has been disrupted. As such, and in recognition the draft audit report is stamped "Use Restricted" and "Not to be reproduced in any form", the BRI Board of Directors have directed that I am to wait 10 days and to then forward copies of the relevant information to our congressional liaison. BRI feels that it is being unduly abused by the HUD OIG and Staff in this matter.

Lastly, it has been our intent from the beginning to design a program that would reflect well upon HUD, BRI, and the private sector while working together to deliver homes to modest income families. This audit, if used properly, can underscore that objective. I should think our collective efforts would be better served by engaging in a meaningful dialogue to find middle ground on the many issues discussed, so that we can resume this worthwhile endeavor in a manner acceptable to all parties concerned.

Please contact Keith Sutton for any additional information or clarification necessary for your purposes.

Sincerely

Joe Giron
President

encl.

cc: Chairman of the Board for BRI

amreal companies

Real Estate Development and Investment

4695 South Franklin Street
Englewood, Colorado 80110
Phone (303) 905-6200
Facsimile (303) 781-9699

August 27, 2001

Mr Keith Sutton
Brothers Redevelopment Inc
2250 Eaton Street
Denver, Colorado 80214

Dear Keith:

This letter is being written, upon your request, to identify my relationship with US Capital Corp. Let me first point out that Lee Wienstien and I have been friends doing business together for the past 15 years.

When he formed US Capital he asked if I would serve on the board. My role is consulting, commercial property and land evaluation as well as being a periodic sounding board. I have never been paid nor have I ever been reimbursed for expenses. The infrequent services I provide are at no cost because we are friends and because I've committed to serving on his board. He would not hesitate in doing the same for me, if needed.

I have never received money or compensation of any kind, either directly or indirectly, from US Capital or their stockholders. I do not now nor have I ever owned stock in the company. All loan transactions are completely arms length and fully disclosed on loan documents and settlement sheets. Anyone who suggests duplicity is suggesting without merit.

The government, through their actions and implications, are suspicious of our business relationship because they don't understand the significance of what we are accomplishing through the loan structure we created. Because of their lack of comprehension they wrongly assume there are improprieties; nothing is further from the truth.

Us Capital is providing BRI the following:

1) **A $3,000,000 line of credit**
2) **100% financing on all properties**
3) **100% financing on all rehab cost**

4) * Non-Recourse financing.
5) No appraisal inspection requirements
6) No property inspection requirements
7) Only 4 hours notice for closing

The significant issues are the 100% financing and the * Non-Recourse financing. This type of lending goes deeper than many people understand. Foreclosure laws in many states limit the lender to foreclose and take only the real estate (security) as complete satisfaction of the debt. The borrower has no further liability than to give up his security.

Not so in Colorado. Colorado foreclosure law allows the lender a few more options that are beneficial to the lender.

The first option the lender has, in the event of foreclosure, is to take the property (security) and additionally bid in a deficiency judgment against the borrower for additional monies owed.

The second option under Colorado foreclosure law permits the lender to completely ignore the property (security), permitting the lender to sue the borrower for the total amount of the loan plus accrued default interest, penalties, and all other cost including court costs, legal fees etc.

Non-Recourse financing prevents the Colorado lender from either of the options mentioned and places the borrower in a much more favorable position. The lender can only look to the property for complete satisfaction of the indebtedness and has no further recourse to the borrower. This makes Non-Recourse lending, especially on marginal properties such as HUD repos., a much higher risk. A main reason lenders in Colorado do not offer such financing.

For the past 24 years I have been brokering, developing and syndicating commercial shopping centers, apartment complexes, undeveloped acreage, and now, single family to 6 unit properties. My primary responsibilities have always included working with lenders in obtaining new loans, refinancing and establishing lines of credit.

During the RTC debacle in the mid 80's, I partnered with lenders such as American Federal Savings and Loan in Colorado Springs. I also consulted for various commercial borrowers and negotiated large loan portfolios that were written off as bad debt by lenders such as City Wide Bank, Cherry Creek National Bank, Commercial Federal Savings and Loan and Western Federal Savings and Loan.

I challenge anyone, anywhere to find a lender that would even consider lending on the same criteria that US Capital makes loans to BRI. In my opinion, anyone who suggests that the rate is too high is ill informed. There is no rate sufficient to cause most lenders to make Non-Recourse loans.

The obvious question is, "If no one else would make such a loan, why then would US Capital make such loans to BRI? The answer is less obvious and US Capital will confirm. They make these loans to BRI only because of my involvement in the transactions and experience with a 15-year relationship based on friendship, trust and integrity. Ingredients our "government" seems to have trouble understanding. This is the same type of relationship you and I have developed over the past 6 years. Another reason for making these loans, in spite of what the government thinks is their desire to help and make a contribution to the community. Finally, of course, they are in business to make money.

The loans US Capital provides to BRI were specifically designed and structured to meet the then requirements of BRI. That is, no capital requirement and absolutely no risk. For this type of lending, any reasonable and savvy person would certainly understand the loans would come with a price.

You have asked that I step down as a board member of US Capital. US Capital has asked that I stay on. Currently, I see no reason to give them my resignation. Their loyalty should not be rewarded with abandonment because someone cannot comprehend our relationship or the significance of their contribution without assuming money is wrongly changing hands.

My respect and loyalty to BRI remains undisturbed. I will always be there for you and will continue to assist wherever you feel I am needed. I have watched you work and know your impeccable reputation. I am extremely proud to be affiliated with you.

It's unfortunate you're having the difficulties you are having with HUD in getting the program back on track. It's obvious you've been singled out and it's obvious they aren't remotely aware of the good you do for the community you've served for 30 years. Others with poor judgment and negative outlooks have wrongly accused you.

To make it easier for you, Sheryl and I have decided to discontinue working on additional HUD properties as your partner. We will be happy to take on a much lesser role in the capacity of consultants only or perhaps even construction managers. We wish to simplify our life and simplify yours by making things less complicated. Continuing to work through or with a government operating in bad faith is not a path we wish to take. I will notify you in a few days to discuss the matter further.

Sincerely,

Philip Mazouri
President

KeyBank
2776 N. Speer Blvd.
Denver, CO 80211

Tel: 303 455-2233

August 20, 2001

Joe Giron
President
Brothers Redevelopment Inc.
2250 Eaton St.
Denver, CO 80214

Dear Joe,

Re: Home Ownership Program

After reviewing the terms and conditions of the program you currently have with U.S. Capital Mortgage, KeyBank would find it difficult at this time to meet or beat your current terms.

In order to make a loan to Brothers that is at 100% LTV and non-recourse, we would have to charge a rate that would be comparable to your current one. In most cases, KeyBank would not make a loan under those conditions because of the risk involved. Brothers is very fortunate to have found a funder that is willing to work within these terms.

We do have a product at KeyBank that might be useful to the buyers of these homes after Brothers has completed the rehab. Its is our "HomeAssist" product, and you may contact Diana Olivas at 303-561-4344 for more information.

Sincerely

Randy McCall
Assistant Vice President
Community Development Banking

WELLS FARGO

Denver
1740 Broadway
Denver, CO 80274
303 861-8811

July 27, 2001

Mr. Joe Giron
President
Brother Redevelopment, Inc.
2250 Eaton St.-- Garden Level, Suite B
Denver, CO 80214

Subject: U.S. Capital Mortgage Co. – Home Ownership Program

Dear Joe:

I have reviewed the terms of U.S. Capital Mortgage Co.'s loan commitment to Brothers Redevelopment ("BRI"). Currently, Wells Fargo Bank would not be able to duplicate these terms even considering the possible Community Reinvestment Act ("CRA") benefits which might accrue to the Bank. Typically, our loan criteria would limit maximum loan-to-value to 75% of the completed or "stabilized" value of the asset. In addition, we would require full-recourse on the loan, and may also require additional outside guarantors if the financial capacity of BRI were insufficient to carry the loan(s). We also require a completed appraisal prior to commencement of construction or acquisition which would also need to be reviewed and approved by the Bank's review appraiser. Our Real Estate Technical Services Group would inspect each project on a monthly basis prior to approve monthly draw requests. The primary benefit of working with our Bank would be that, if all of these prior conditions could be met, BRI would have a much lower interest rate which would be based on a percentage spread over Wells Fargo's Prime Rate. In any case, it would be considerably lower than the 19.5% being currently charged.

U.S. Capital's yield requirements, however, are not atypical considering the level of risk involved in the 100%, nonrecourse financing they are providing. There are many other mezzanine lenders such as Weyerhauser Capital, SV Capital, PC Financial that are requiring minimum yields of 20% or more. Based upon your needs and your board's requirements, U.S. Capital's program appears to be a very attractive alternative and offers numerous benefits which we would be unable to duplicate at this time.

I applaud BRI's and your efforts to bring affordable housing to our community and look forward to participating in this year's Paint-a-Thon. Keep up the good work!

Sincerely,

Daniel V. Sheehan

Daniel V. Sheehan
Vice President

Prudential

Prudential Huntoon Paige
Highland Place II, Suite 175
9110 East Nichols Avenue
Englewood, Colorado 80112
Tel 303 925-1700 Fax 303 925-1636

July 6, 2001

Mr. Joe Giron
President
Brothers Redevelopment, Incorporated
2250 Eaton Street, Garden Level, Suite B
Denver, Colorado 80214

Re: Line of Credit for Acquisition and Rehabilitation of HUD-Held Homes

Dear Mr. Giron:

Thank you very much for your recent inquiry into the possibility of Prudential Huntooon Paige providing Brothers Redevelopment with a construction line for the above purpose.

I regret to inform you that the size of your request is below the minimum threshold for loans of this type. In response to your inquiry regarding rate and term for a non-recourse structure with limited fees and no appraisal or due diligence, the risk inherent in such a transaction would necessitate an interest rate in excess of 20%, if we were to even consider offering such a loan.

Should you have any questions or need further information, please don't hesitate to call me at 720-244-3429.

Sincerely,

Peter Wessel

Peter Wessel
Director

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Appendix 2

Distribution

Secretary's Representative, 8AS (2)
Director, Denver Homeownership Center, 8AHH (2)
Deputy Assistant Secretary for Single Family Housing, HU, Room 9282
Special Assistant for Single Family Housing, HU, Room 9278
Deputy Secretary, SD, Room 10100
Chief of Staff, S, Room 10000
Assistant Secretary for Administration, A, Room 10100
Deputy Chief of Staff, S, Room 10226
Deputy Chief of Staff for Operations, S, Room 10226
Deputy Chief of Staff for Programs and Policy, S, Room 10226
Assistant Secretary for Congressional and Intergovernmental Relations, J, Room 10120
Senior Advisor to the Secretary, Office of Public Affairs, S, Room 10132
Deputy Assistant Secretary for Public Affairs, W, Room 10222
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General Counsel, C, Room 10214
Deputy General Counsel, CB, Room 10220
Office of Policy Development and Research, R, Room 8100
Assistant Deputy Secretary for Field Policy and Management, SDF, Room 7106
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Deputy Chief Financial Officer for Operations, FF, Room 10166
Director, Office of Budget, FO, Room 3270
Director, Enforcement Center, V, 200 Portals Building
Director, Real Estate Assessment Center, X, 1280 Maryland Ave., SW, Suite 800
Departmental Audit Liaison Officer, FM, Room 2206
Headquarters Audit Liaison Officer, Public and Indian Housing, PF, Room P8202
Field Audit Liaison Officer, 6AF, (2)
Director of Scheduling and Advance, AL, Room 10158
Assistant Deputy Secretary for Field Policy and Management, SDF, Room 7108 (2)
Special Assistant to the Deputy Secretary for Program Management, SD, Room 10100
Acquisitions Librarian, Library, AS, Room 8141
Inspector General, G, Room 8256
The Honorable Joseph Lieberman, Chairman, Committee on Governmental Affairs, 340 Dirksen Senate Office Building, United States Senate, Washington, DC 20510
The Honorable Fred Thompson, Ranking Member, Committee on Governmental Affairs, 706 Hart Senate Office Building, United States Senate, Washington, DC 20510
The Honorable Dan Burton, Chairman, Committee on Governmental Reform, 2185 Rayburn Bldg., House of Representatives, Washington, DC 20515
Henry A. Waxman, Ranking Member, Committee on Governmental Reform, 2204 Rayburn Bldg., House of Representatives, Washington, DC 20515
Ms. Cindy Fogleman, Subcommittee on Oversight and Investigations, Room 212, O'Neil House Office Building, Washington, DC 20515

Director, Housing and Community Development Issue Area, United States General Accounting Office, 441 G Street, NW, Room 2474, Washington, DC 20548 (Attention: Stan Czerwinski)

Deputy Staff Director, Counsel, Subcommittee on Criminal Justice, Drug Policy and Urban Resources, B373 Rayburn House Office Building, Washington, DC 20515

Steve Redburn, Chief, Housing Branch, Office of Management and Budget, 725 17th Street, NW, Room 9226, New Executive Office Building, Washington, DC 20503

Andy Cochran, House Committee on Financial Services, 2129 Rayburn H. O. B., Washington, DC 20515