



U.S. Department of Housing and Urban Development  
Office of the Inspector General for Audit, Region 4  
Richard B. Russell Federal Building  
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MEMORANDUM NO.

June 30, 2005

2005-AT-1801

MEMORANDUM FOR: Brian D. Montgomery, Assistant Secretary for Housing - Federal  
Housing Commissioner, H

*James D. McKay*

FROM:

James D. McKay  
Regional Inspector General for Audit, 4AGA

SUBJECT:

Residential Lending Corporation  
Direct Endorsement Mortgagee  
Duluth, Georgia

INTRODUCTION

We performed an audit survey of Residential Lending Corporation (Residential), operating from its home office in Duluth, Georgia. Residential was a nonsupervised direct endorsement lender approved by the U.S. Department of Housing and Urban Development (HUD) to originate and approve Federal Housing Administration-insured single family mortgages. We selected Residential due to its high default and claim rates.

Our survey objective was to assess Residential's operations to determine whether an audit is warranted.

METHODOLOGY AND SCOPE

To accomplish our objectives, we reviewed applicable HUD program requirements. We also interviewed appropriate HUD and Residential management staff and reviewed various records maintained by HUD and Residential, including audited financial statements, and HUD correspondence.

Our survey generally covered the period March 1, 2003, through February 28, 2005. However, we extended the period as necessary. We considered Residential's single-family housing loans (excluding Title I) for properties located in Georgia that closed from March 1, 2003, through February 28, 2005. We conducted our survey during April and May 2005.

## BACKGROUND

Residential was a HUD-approved nonsupervised lender with authority to originate and underwrite loans in Georgia, Tennessee, Alabama, South Carolina, and Florida. In July 2003, One World Mortgage purchased Residential's stock and took control of Residential.

In November 2002, HUD's Quality Assurance Division conducted a review of Residential's (formerly known as Westminster Mortgage) operations and identified a number of origination deficiencies. As a result, Residential executed 18 indemnification agreements with HUD for mortgages that totaled \$2.3 million. In March 2005, HUD notified Residential that it was planning to terminate approval of the Duluth branch office due to the branch's excessive default and claim rates. The Duluth branch originated/underwrote 87 percent of the 344 Georgia loans Residential closed during the survey period. Residential decided not to contest HUD's action. However, Residential's home office and one remaining branch office were not affected by HUD's action, and Residential retained its HUD approval to operate as a nonsupervised lender.

## RESULTS OF REVIEW

Residential did not comply with HUD requirements to obtain an independent audit for the fiscal year ending December 31, 2004, and had not notified HUD of its plans to liquidate company assets. However, during our survey at Residential's request, HUD withdrew Residential's approval as a nonsupervised lender.

### **Residential Did Not Comply with Requirements Needed to Retain HUD Approval**

Residential did not obtain the required independent audit and planned to liquidate company assets without notifying HUD. Thus, Residential could not support that it had the \$250,000 net worth needed to maintain its HUD approval.

Residential did not comply with the following requirements:

- Annual audit - Residential did not obtain the required independent audit for the fiscal year ending December 31, 2004. HUD Handbook 4060.1 REV 1, "Mortgagee Approval Handbook," paragraph 5-4, requires lenders to obtain annual audits, among other requirements, to support that they have the required \$250,000 net worth needed to maintain their HUD approval.
- Planned liquidation of company assets - Residential had not notified HUD of its plans to liquidate company assets as required by HUD Handbook 4060.1 REV-1, paragraph 2-21.

Residential's president stated that the company did not comply with the above requirements because it no longer plans for the company to originate and underwrite HUD-Federal Housing Administration loans.

Residential wrote HUD on May 9, 2005, and requested that HUD withdraw Residential's approval as a nonsupervised lender. We verified that HUD received the request and withdrew Residential's approval.

### RECOMMENDATION

Since HUD has withdrawn Residential's approval as a nonsupervised lender, no recommendations are considered necessary. Also, since the company is no longer involved in originating Federal Housing Administration-insured loans, we are terminating our review of Residential.

If you have any questions, please contact me or Narcell Stamps, assistant regional inspector general for audit, at (404) 331-3369.