



Issue Date	January 26, 2006
Audit Report Number	2006-FW-1004

TO: Brian D. Montgomery
Assistant Secretary for Housing – Federal Housing Commissioner, H

FROM: Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: K Hovnanian American Mortgage, LLC, Plano, Texas, Violated Underwriting Requirements and Did Not Meet All Quality Control or Branch Requirements

HIGHLIGHTS

What We Audited and Why

We audited the Plano, Texas, branch office of K Hovnanian American Mortgage Company, LLC (K Hov), part of Hovnanian Enterprises, Inc. We selected K Hov because of its high defaults, specifically defaults involving loans with one underwriter¹ and one appraiser. K Hov is a nonsupervised mortgage company.

Our audit objectives were to determine whether K Hov: (1) followed U.S. Department of Housing and Urban Development (HUD) origination requirements (2) complied with HUD branch requirements in its Plano office; and (3) implemented a quality control plan according to HUD requirements.

What We Found

K Hov violated HUD underwriting, quality control, and branch requirements. As a result, K Hov increased the risk to the insurance fund by more than \$1.3 million

¹ Although this was the case during the survey stage of the audit, we later reviewed loans originated by another underwriter and the automated underwriting system.

and overcharged borrowers \$31,711. This occurred because K Hov ignored or misunderstood HUD regulations including meeting all quality control and branch requirements.

What We Recommend

We recommend that HUD's assistant secretary for housing – federal housing commissioner and chairman of the Mortgage Review Board require K Hov to:

- Indemnify the five loans that had significant underwriting deficiencies.
- Reimburse HUD for the four loans with significant underwriting deficiencies that HUD paid off due to default.
- Reimburse borrowers or HUD, as appropriate, for unallowable closing costs.
- Meet HUD's quality control and branch requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft report to K Hov on October 27, 2005, with an expected written response from K Hov due on November 14, 2005. Due to Hurricane Wilma and its impact on K Hov's West Palm Beach, Florida office, we agreed to an extension and held an exit conference on December 1, 2005. K Hov provided written comments on December 5, 2005. K Hov disagreed with the issues regarding down payment assistance and underwriting deficiencies but agreed to return fees that it improperly charged to borrowers and to address branch deficiencies. Based on K Hov's comments we revised the report to remove discussion of the down payment assistance issue. K Hov's response along with our evaluation is included in Appendix B of this report. We redacted names of borrowers and did not include the attachments due to the volume.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: K Hov Violated HUD Underwriting Requirements and Charged Unallowed Closing Costs	5
Finding 2: K Hov Did Not Meet All Quality Control or Branch Requirements	9
Scope and Methodology	12
Internal Controls	13
Appendixes	
A. Schedule of Questioned Costs and Funds to be Put to Better Use	15
B. Auditee Comments and OIG's Evaluation	16
C. Questioned Closing Costs by Loan	46
D. Underwriting Deficiencies by Loan	47
E. Case Narratives	48

BACKGROUND AND OBJECTIVES

The National Housing Act, as amended, authorizes the U. S. Department of Housing and Urban Development (HUD) to provide mortgage insurance for single family homes. HUD must approve a lender that originates, purchases, holds, or sells Federal Housing Administration-insured loans. Lenders must follow the statutory and regulatory requirements of the National Housing Act and HUD's instructions, guidelines, and regulations when originating insured loans. Lenders that do not follow these requirements are subject to administrative sanctions.

We audited the Plano, Texas, branch office of K Hovnanian American Mortgage Company, LLC (K Hov), part of Hovnanian Enterprises, Inc., located at 5808 West Plano Parkway in Plano, Texas. K Hov is a nonsupervised mortgage company. HUD approved the branch office on March 15, 2001, to originate single family loans under Section 203(b)(1) of the National Housing Act. As a condition of approval, HUD requires K Hov to maintain a quality control plan for the origination and servicing of insured loans. The quality control plan must meet HUD's requirements, as well as be a prescribed function of K Hov's policies, procedures, and operations.

Hovnanian Enterprises, Inc.'s² subsidiaries include K Hov, Goodman Family of Builders (Goodman Homes), and Fair Land Title, the mortgage company, builder, and title company, respectively, for the loans reviewed. Founded in 1959, Hovnanian Enterprises, Inc., designs, constructs, and markets a variety of for-sale houses in 275 residential communities in 13 states. Further, in the markets in which its mortgage subsidiaries originated loans, a majority of the mortgages obtained were from its wholly owned mortgage subsidiary. In turn, those mortgages were sold in the secondary markets.

During our audit scope of January 1, 2003, through December 31, 2004, K Hov originated 197 loans within the Fort Worth and Dallas HUD offices' jurisdiction. Of those 197 loans, the same underwriter originated 63 loans with K Hov. Thirteen of the seventy-one loans defaulted during the audit scope.

As part of our 2005 annual audit plan, we selected K Hov because of its high default rate, specifically defaults involving loans with one underwriter and one appraiser. According to HUD's Neighborhood Watch System, K Hov's default rate was 7.5 percent.

Our audit objectives were to determine whether K Hov: (1) followed HUD origination requirements including underwriting and use of gifts; (2) complied with HUD branch requirements in its Plano office; and (3) implemented a quality control plan according to HUD requirements.

² A Fortune 500 company.

RESULTS OF AUDIT

Finding 1: K Hov Violated HUD Underwriting Requirements and Charged Unallowed Closing Costs

K Hov did not follow underwriting requirements for 17 of 19 loans reviewed and charged the borrowers \$31,711 in 18 of 19 loans reviewed for unallowable closing costs. This occurred because K Hov ignored or misunderstood HUD regulations and because it did not adhere to HUD's quality control and branch requirements as discussed in Finding 2. As a result, K Hov increased the risk to the insurance fund by more than \$1.3 million and overcharged borrowers by \$31,711.

K Hov Loans Contained Underwriting Deficiencies

K Hov loans contained underwriting deficiencies in 17 of the 19 loans reviewed. As a result, K Hov increased the risk to the insurance fund. The loan amounts for the 17 loans totaled \$2,425,300. These underwriting deficiencies occurred because K Hov employees did not follow HUD requirements. K Hov:

- Rolled outstanding debt into the mortgage;
- Did not include compensating factors or debt on the mortgage credit analysis worksheet;
- Did not reduce the sales price by a sales incentive;
- Did not require a written explanation for inquiries regarding a credit report;
- Did not document the gift transfer;
- Allowed interested third parties to fax financial documents; and
- Originated a loan with a bankruptcy and poor borrower financial management.

For three loans, K Hov rolled outstanding debt into the mortgage. HUD regulations state that it is unacceptable underwriting to allow payment of consumer debt.³

For two loans, K Hov did not include the compensating factors when required or all of the outstanding debt on the mortgage credit analysis worksheet. HUD

³ Mortgagee Letter 2002-02.

regulations require that the lender must include supported compensating factors⁴ when liability ratios exceeded HUD benchmark guidelines and counting all debts lasting longer than 10 months toward a borrower's liabilities.⁵

For one loan, the borrower received a 51-inch screen television as a sales incentive. Goodman Homes documented this sales incentive on the real estate purchase agreement, but K Hov did not require Goodman Homes to reduce the sales price by the incentive as required by HUD regulations.⁶

K Hov did not require written explanations for recent inquires regarding the credit report for three loans. HUD regulations require that borrowers must provide sufficient and rational explanation of derogatory credit.⁷

K Hov did not document the transfer for the 16 loans that received gift funds. HUD regulations state that the lender must document the transfer of funds from the donor to the borrower.⁸

For three loans, K Hov received financial documentation faxed from an interested third party. HUD regulations require that lenders may not accept or use documents relating to credit, employment, or income by, from, or through an interested third party.⁹

Lastly, one loan contained a bankruptcy that the borrower did not show was caused by extenuating circumstances beyond their control and the borrower did not exhibit the ability to manage their financial affairs in a responsible manner. HUD regulations¹⁰ allow a borrower to have a bankruptcy on their credit if the borrower can show that the bankruptcy was caused by extenuating circumstances beyond their control and has since exhibited an ability to manage financial affairs. The borrower quit their job without having another job, which is not beyond the borrower's control. Further, two months' worth of bank statements, provided by the borrower, contained numerous overdraft and advance fees, showing that the borrower did not manage their financial affairs in a responsible manner. The loan defaulted within 15 months of closing.

⁴ HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-13.

⁵ HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-11.

⁶ HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties" paragraph 1-7B.

⁷ HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-3B.

⁸ HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-10C.

⁹ HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 3-1.

¹⁰ HUD Handbook 4155.1, REV-4 CHG-1, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-3E.

In our opinion, deficiencies on 9 of the 17 loans were significant enough to warrant indemnification or reimbursement of claims paid (see Appendix D). We recommend indemnification on five loans totaling \$737,850 for significant underwriting deficiencies. Further, K Hov should reimburse HUD \$577,865 for the claims on four loans with significant underwriting deficiencies.¹¹

K Hov Charged Unallowable Fees

K Hov charged borrowers \$5,619 unallowable closing costs in 18 of the 19 loans reviewed.¹² We also reviewed an additional 133 loans for gift processing fees and found \$26,092 in unallowable closing costs. Consequently, borrowers paid \$31,711 in unallowable closing costs because K Hov did not follow HUD requirements and/or guidelines.

The unallowable closing costs included:

- \$28,612 in HUD-prohibited gift-processing fees.¹³
- \$869 in tax service fees on 11 of the 19 loans.¹⁴
- \$370 in inspection fees on 6 of 19 loans when the appraisal showed the property 100 percent complete.¹⁵

K Hov should reimburse the borrowers or HUD, as appropriate,¹⁶ for the \$31,711 for the unallowable closing costs.

K Hov's Participation in Down Payment Assistance Program

Our October 27, 2005 draft report included a discussion of K Hov's activities as participants in a down payment assistance program that involved K Hov, Goodman Homes, and a nonprofit entity. However, during the exit conference and in its response, K Hov cited HUD's response to a recent GAO report¹⁷ and a HUD legal opinion as support for K Hov's position that HUD allowed these

¹¹ See the case narratives in Appendix E for the specific loans to be indemnified or claim reimbursed.

¹² See Appendix C for specifics.

¹³ According to HUD's Quality Assurance Division, any closing costs not specifically addressed in HUD's guidance are considered unallowable.

¹⁴ HUD Homeownership Center Reference Guide, chapter 2, "Mortgage Credit Guide," paragraph 2-15.

¹⁵ *Ibid.*

¹⁶ K Hov should reimburse the borrowers on current loans and HUD on claims paid.

¹⁷ Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance GAO-06-24, November 9, 2005

activities if the timing of the gift funds was appropriate. Based on K Hov's comments, we decided to address the issue with HUD and accordingly removed discussion of this issue from the final report.

Conclusion

Seventeen of the nineteen loans reviewed totaling \$2,425,300 contained several underwriting deficiencies including charging borrowers \$31,711 in unallowable closing costs. We are recommending indemnification on five loans totaling \$737,850 and repayment of \$577,865 on four loans for which HUD paid a claim that contained underwriting deficiencies.

Recommendations

We recommend that HUD's assistant secretary for housing – federal housing commissioner and chairman of the Mortgage Review Board require K Hov to:

- 1A. Indemnify five loans totaling \$737,850 for underwriting deficiencies.
- 1B. Repay \$577,865 to HUD for claims paid on four loans with underwriting deficiencies.
- 1C. Reimburse borrowers or HUD, as appropriate,¹⁸ \$31,711 for unallowable closing costs.
- 1D. Ensure K Hov complies with HUD's underwriting requirements, including charging only allowable closing costs.

¹⁸ K Hov should reimburse the borrowers on current loans and HUD on claims paid.

Finding 2: K Hov Did Not Meet All Quality Control or Branch Requirements

K Hov did not meet all quality control or branch requirements. Specifically, K Hov's quality control plan lacked requirements regarding on-site reviews and review of loans that defaulted within the first six payments. Further, K Hov's part-time Plano branch manager also was a full-time employee of Goodman Homes, which like K Hov is a subsidiary of Hovnanian Enterprises, Inc. Lastly, the space occupied by K Hov's Plano branch office did not distinguish to the public that they entered into a mortgage company. These conditions were contrary to Federal Housing Administration underwriting requirements and were contributing factors to the underwriting problems as discussed in Finding 1. K Hov officials indicated that they were unaware of the requirements. In response to the audit, K Hov has updated its quality control plan and moved to a separate office.

K Hov's Quality Control Plan Did Not Contain All HUD Requirements

K Hov's quality control plan did not contain all HUD requirements regarding on-site reviews and reviews of loans that defaulted within the first six payments. Although HUD requires annual on-site reviews, K Hov did not conduct any on-site reviews that met HUD branch requirements. After we brought this issue to K Hov's quality manager's attention, K Hov revised its quality control plan to include steps for an annual on-site visit to all branches. Before our audit, K Hov performed no annual on-site visits to its branches. HUD requirements¹⁹ required annual visits for offices meeting certain higher risk criteria such as high early default rates, new branches or new key personnel, sudden increases in volume, and past problems.

Although K Hov had a procedure in its quality control plan to review early defaults, it did not. Further, its contractor did not implement this procedure as part of its contractual obligations during K Hov's quality assurance review. HUD requirements²⁰ state that, in addition to the loans selected for routine quality control reviews, lenders must review all loans going into default within the first six payments.

According to K Hov's quality manager, until a review of the North Carolina branch by HUD's Quality Assurance Division, K Hov was not aware of the early

¹⁹ HUD Handbook 4060.1, REV-1, CHG-1, "Mortgagee Approval Handbook," paragraph 6-3G2.

²⁰ HUD Handbook 4060.1, REV-1, CHG-1, "Mortgagee Approval Handbook," paragraph 6-6D.

default review requirement. However, the quality manager stated that since November 2004, the contractor had accomplished the early default step.

Without the loan reviews, K Hov could not ensure it was protecting HUD and itself from unacceptable risk. Also, K Hov could not swiftly identify, address, and correct anomalies or problems that occurred.

K Hov's Branch Manager Was an Employee of Goodman Homes

K Hov's Plano branch manager was a part-time K Hov employee and a full-time employee of Goodman Homes. HUD regulations²¹ require K Hov employees, whether full- or part-time, to be exclusively employed by K Hov. Also, contrary to HUD regulations requiring a branch to have at least three employees, K Hov's Plano office only employed one part-time branch manager.

HUD regulations require that only lender employees conduct the business affairs of the lender. As shown in the following e-mail, the Plano branch manager made business decisions for Goodman Homes on loans originated by K Hov. In the e-mail, the K Hov branch manager tells an identity-of-interest title company (Fair Land Title) employee that adding a gift to the sales price is the only way a house will sell. At this point the branch manager is acting in the interests of the builder, her full-time employer.

April 2003 E-mail from Goodman Family of Builders (GFB)/K Hov employee to Fair Land Title employee

The only way KHOV can make this work for [REDACTED] is increase SP\$ up to \$148,000. There shouldn't be an appraisal issue since this home already had a \$14K community discretionary reduction. This will have GFB paying \$3,903 + \$500 (Realtor Reduction) + \$4,197 Home Gift USA + Title Policy. KHOV will give "low cost promo" credit to Buyer @ close.

They will be very tight in qualifying but it's about the only program that will work...they only have \$2000 in the bank. Please contact Buyer and/or Agent to let them know how we arrived at this figure and get FPA signed as soon as possible.

Thanks!

Entrance to K Hov's Plano Branch Was Not Clearly Identified

K Hov did not clearly identify itself; thus, the borrowers and the public may not have known whether they were in the offices of K Hov or its identity-of-interest

²¹ HUD Handbook 4060.1, REV-1, "Mortgagee Approval Handbook," paragraph 2-14.

company, Goodman Homes. From outside the building, it appeared that Goodman Homes was the only occupant. Additionally,

- K Hov located its office on the second floor within space used by Goodman Homes' administrative personnel.
- K Hov conducted its loan originations out of its home office in West Palm Beach, Florida. The Plano office only took applications for and provided information to Goodman Homes' buyers. K Hov maintained all Plano branch origination files at its home office.
- K Hov believed it met HUD's requirements because it only originated loans for Goodman Homes. Further, it did not believe that it needed to place its name on the door because its offices were located within the Goodman Homes offices.
- HUD regulations require K Hov to clearly identify itself so people would know with whom they were doing business.²²

Recommendation

We recommend that HUD's assistant secretary for housing to:

- 2A. Ensure K Hov initiated corrective actions that comply with HUD's quality control and branch requirements.

²² HUD Handbook 4060.1, REV-1, "Mortgagee Approval Handbook," paragraph 2-16A4.

SCOPE AND METHODOLOGY

To accomplish our objectives, we:

- Reviewed applicable HUD handbooks and mortgagee letters.
- Reviewed 19 insured loans originated by K Hov between January 1, 2003, and December 31, 2004. The 19 loans were part of a universe of 197 loans from the Fort Worth and Dallas HUD offices originated by K Hov during the audit period. The results of the detailed testing apply to the 19 reviewed loans only and cannot be projected to the universe of the other insured loans
- Expanded our audit scope to include 133 insured loans that received gift funds to determine whether the sales price increased by the gift and whether K Hov charged borrowers gift processing fees.
- Examined closing documentation including sales contracts, appraisals, and loan applications.
- Conducted interviews with officials and employees of K Hov, K Hov's quality assurance contractor, Fair Land Title Company, and the HUD Quality Assurance Division.
- Contacted borrowers by mail, telephone, or in-person interviews.
- Performed site visits to several properties.

In addition, we relied in part on data maintained by HUD in its Neighborhood Watch system. We did not perform a detailed analysis of the reliability of this computer database.

The audit covered the period from January 1, 2003, through December 31, 2004. We conducted our fieldwork from March 14 through September 30, 2005. We performed our fieldwork at the offices of Goodman Homes and Fair Land Title, both located in Plano, Texas. We reviewed the loans at our Fort Worth, Texas, office. We performed the audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Branch requirements—Policies and procedures to ensure that K Hov conducts reviews of its branch activities.
- Loan origination process—Policies and procedures that management requires to reasonably ensure that the loan origination process complies with HUD program requirements.
- Quality control plan—Policies and procedures that management requires to reasonably ensure implementation of HUD quality control requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our review, we believe the following item is a significant weakness:

- K Hov did not operate in accordance with HUD requirements as they relate to branch, loan origination, and quality control requirements.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation numbers	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A		\$736,517 ²³
1B	\$576,622 ²⁴	
1C	31,711	
Totals	\$608,333	\$736,517

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.
- 2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

²³ Represents the \$737,850 total loan amount less \$1,333 questioned in recommendation 1C.

²⁴ Represents the \$577,865 total loan amount less \$1,243 questioned in recommendation 1C.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



December 5, 2005

BY FEDERAL EXPRESS

Frank E. Baca
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region VI, Office of Inspector General
819 Taylor Street, Room 13A09
Fort Worth, Texas 76102

Re: October 27, 2005 Draft Audit Report

Dear Mr. Baca:

This letter provides the formal comments of K. Hovnanian American Mortgage Company, LLC ("K Hov" or the "Company") on the October 27, 2005 draft K Hov Audit Report prepared by your office (the "Draft Audit Report"). The Draft Audit Report reviewed the practices of the Company's Plano, Texas branch office in originating HUD-FHA insured mortgages during the period of January 1, 2003, through December 31, 2004.

We appreciate this opportunity to comment on the Draft Audit Report. We also appreciate the time and consideration given by you and your colleagues to the informal comments about the draft Audit Report that we presented to you at your offices in Fort Worth, Texas on December 1, 2005 at the exit conference. As we emphasized at the exit

Comment 1

conference, and as we discuss below, the Company respectfully disagrees with certain key findings and recommendations in the Draft Audit Report.

We address below each of the Findings in the Draft Audit Report.

Finding No. 1: K Hov violated HUD downpayment assistance and underwriting requirements. The Office of Inspector General (“OIG”) indicates that for 16 of 19 loans reviewed, K Hov added gifts from an identity-of-interest company (K Hov’s affiliated homebuilding company) that, in all but two cases, increased the sales price of the home; that the borrowers did not meet their minimum required downpayments; and that the gifts artificially raised the value of the home. The OIG further indicates that a review of 123 additional loans, in which the identity-of-interest company provided the gift funds, the sales price of the home was increased. Further, the OIG indicates that the Company did not follow other underwriting requirements for 18 of the 19 loans reviewed.

K Hov’s Comments

The Company respectfully disagrees with the OIG’s conclusions, particularly with those relating to gift funds provided to borrowers by a nonprofit charitable organization to meet the borrowers’ minimum investment requirement through a downpayment assistance program. The Company respectfully submits that the OIG’s Finding that such gifts represent a violation of HUD-FHA requirements is not supported by the facts. The Company further disagrees with the OIG’s conclusion that HUD-FHA requirements prohibit a builder/seller from increasing the sales price of the home and making a contribution or paying a service fee to a nonprofit organization that provides downpayment assistance gift funds to the borrower.

Minimum Investment Not Made

K Hov respectfully submits that gift funds provided by a nonprofit charitable organization, through its down payment assistance program, clearly is permitted by HUD requirements, as set forth in HUD Handbook 4155.1 Rev-5, Chapter 2, Section 3, Paragraph 2-10c.

Further, the OIG incorrectly characterizes such gift funds as an “inducement to purchase” provided by the builder/seller, which must be subtracted from the sales price of the home.

K Hov respectfully submits that HUD’s requirements set forth in HUD Handbook 4155.1 Rev-5, Chapter 1, Section 2, Paragraph 1-7A, and Section3, paragraph 2-10c, do not include downpayment assistance provided by a nonprofit charitable organization as either a seller concession or contribution. The OIG’s contention that such gift funds are an “inducement to purchase” and must be subtracted from the sales price of the home is simply incorrect.

Further, and importantly, the gift funds in these transactions are not provided by the seller, as incorrectly stated by the OIG, but rather by the nonprofit charitable organization. HUD has expressly approved nonpayment assistance programs administered by nonprofit agencies as an acceptable source for the borrower’s downpayment.

The Company further submits that the OIG is incorrect in its conclusion that HUD Mortgagee Letter 96-18, prohibits the use of a downpayment assistance program if the buyer obtained financing with a specified lender or purchased a home from a particular builder. Nowhere in Mortgagee Letter 96-18 is there language that prohibits this. The

Company respectfully submits that the OIG is attempting to impose a standard that is not stated in HUD-FHA requirements.

Further, the transfer of the gift funds from the nonprofit charitable organization prior to loan closing is properly documented by a wire receipt of the funds from the bank account of the nonprofit organization to the title Company. The wire transfer clearly shows the borrower's name and the amount of the gift funds. **See Attachment C.**

After closing, as permitted by HUD-FHA guidelines regarding downpayment assistance programs, the closing agent disburses the service fee (or contribution) to the nonprofit organization from the builder/seller's proceeds. The Company respectfully submits that the OIG's finding regarding downpayment assistance is not warranted and should be withdrawn by the OIG.

Gifts Were Added To The Sales Price And The Gifts Artificially Raised House Value

The Company respectfully submits that HUD-FHA requirements do not prohibit the builder/seller from increasing the sales price of a home, if supported by the appraisal, where the builder/seller makes a contribution or pays a service fee to a nonprofit organization that provides downpayment assistance to the borrower.

The Company is aware that in September 1999 HUD issued a proposed rule for public comment to establish specific standards regarding the use of gifts by charitable and other organizations as a source of the mortgagor's investment in the property. The proposed rule specifically addressed HUD's concerns with the increase in the sales price. Importantly, HUD withdrew this proposed rule from its rulemaking process in January 2001, due to the overwhelming majority of negative public comments it received opposing the proposed rule.

Since the time that HUD proposed the rule over five years ago, and withdrew it, HUD has not issued any written guideline that prohibits this practice. Accordingly, there is no prohibition by HUD against an increase in the sales price by the seller, if supported by the appraisal, in connection with a downpayment assistance program provided by a nonprofit organization.

The Company further respectfully submits that the OIG in its Finding does not offer an appraisal at variance with the appraisal for the properties cited in this Finding.

Further, the Company's quality control contractor, Tena Companies Incorporated ("Tena"), has performed both desk reviews and field reviews of the appraisals performed by the appraiser cited in this Finding. These reviews covered the periods 2003, 2004, and 2005. These reviews determined that the appraiser's overall errors per appraisal were below the overall average for all of the Company's appraisers. Further, the 18 field review appraisals performed from January 2004 through September 2005 have all been returned with a result of "Value Acceptably Confirmed". The Tena report is enclosed with this response as **Attachment A**.

Accordingly, and respectfully, we also request that this portion of Finding No. 1 also be withdrawn by the OIG.

**HUD Rejects Government Accountability Office (GAO)
Recommendations Regarding Downpayment Assistance Programs**

K Hov respectfully notes that in a report issued by the GAO in November 2005, the GAO "found" and determined that, in its view, the downpayment assistance provided by seller funded (identify-of-interest) entities is, in effect, a seller inducement. For that reason (the same one essentially advanced by the OIG in this Draft Audit Report), the GAO requested that HUD revise FHA requirements to treat assistance from a seller-

funded nonprofit as a seller contribution, and therefore subject to the 6 percent limit on seller contributions that also could not be relied upon to meet the required 3 percent minimum investment.

The October 25, 2005 response of HUD to this GAO "Finding" and GAO recommendation was included in this GAO report. In its response, HUD, speaking through the FHA Commissioner himself and a little over one month ago, flatly and expressly rejected this GAO Finding and this GAO recommendation. In doing so, the FHA Commissioner confirmed that HUD's Office of General Counsel has advised HUD that, under the applicable provisions of the National Housing Act, as revised, the timing of the payments is a key point in whether there is a seller contribution that is an inducement to purchase.

As the FHA Commissioner explained it to the GAO, under HUD's downpayment assistance program, if a gift is made from a nonprofit entity (either directly or through an entity such as the closing agent), from the nonprofit's own funds, prior to the completion of the closing, the gift becomes the homebuyers property so that the buyer can make the 3 percent required downpayment. After completion of the closing, a seller makes a contribution (perhaps through the closing agent as well) from the gross sales proceeds to the nonprofit entity. The donation is commingled with other nonprofit funds that later become a source of donations to buyers other than the buyer who just closed the purchase of the seller's property. Because the buyer has not received funds from the nonprofit that can be traced to the seller's contribution, there has not been an inducement to purchase provided by the seller.

K Hov respectfully submits that HUD's very recent and authoritative response to the GAO report on this same point raised by the OIG in this Draft Audit Report clearly and expressly affirms HUD's approval of downpayment assistance programs provided by a nonprofit agency as an acceptable source of the borrower's downpayment or minimum required investment.

We enclose the FHA Commissioner's October 25, 2005 response to the GAO report as **Attachment B**.

The timing and manner in which HUD requires that such downpayment assistance programs work if they are to comply with HUD's requirements—nonprofit gifts prior to closing; seller contributions after closing—are precisely and exactly the timing and manner in which the K Hov downpayment assistance program worked, as shown by the wire transfer documentation enclosed as **Attachment C**.

We certainly can appreciate that the OIG does not favor the downpayment assistance program enacted by the Congress and administered by HUD in a manner consistent with congressional requirements as interpreted by HUD's General Counsel. Respectfully, however, when, as is the case here, HUD does what the Congress told it to do in terms of a downpayment assistance program, and K Hov in turn does what HUD told it to do in terms of that same program, the Finding to the contrary by the OIG must be withdrawn.

K Hov Loans Contained Underwriting Deficiencies

Our Underwriters are assigned to specific regions and typically do not underwrite in other areas unless volume warrants and they are approved to do so. The loans that were selected in the initial examination were originated during a time period when

volume warranted only one underwriter in and for the Texas region, which explains why the same underwriter appears in the multiple loans selected by the OIG for its underwriting review. In addition, we note that the Underwriter [REDACTED] AS60) was issued her Direct Endorsement (DE) Approval by HUD in September of 2002. This was based on her previous underwriting experience and the training she received prior to her DE Approval. K Hov has always been committed to providing resources and training to its associates, including its underwriters. Certain deficiencies identified in the draft Audit Report, as to which K Hov agrees helpfully identify areas in which additional training would be helpful and is appropriate, have been and will be addressed with the responsible associate and through other Company initiatives.

K Hov also, respectfully, notes its disagreement with many of the OIG's underwriting-related findings and believes that they are not supported by, or reflect a misunderstanding of, the facts. Those areas are addressed immediately below, and in the individual Case Narratives that follow. Respectfully, there are no circumstances under which K Hov should be required to indemnify HUD with respect to any of the loans, and that recommendation by the OIG in the draft Audit Report should be withdrawn.

Comment 2

K Hov Charged Unallowable Fees

K Hov at all times strives diligently to assure that only those fees permitted by HUD-FHA should be charged to the borrower. However, the Company recognizes that there were some shortcomings in our performance in this area in the loans reviewed by the OIG. Importantly, K Hov has implemented corrective action to prevent any future recurrence. For example, we have added a Quality Control Check List that is required to be initialed by our Associates. Requiring our Associates to initial next to the document

Comment 3

indicates responsibility of accuracy and establishes ownership. See Attachment D. In addition, we have updated our LOS system to remove all unallowable fees. We will continually seek out opportunities to improve our processes to help assure strict compliance with HUD requirements.

Gift Processing Fee

The Company respectfully submits that the fee paid by a seller to a nonprofit agency that provides downpayment assistance funds to a borrower as a “gift processing fee” is an administrative (or service fee) that is paid by the seller to the nonprofit agency. As noted above, it clearly is a permissible fee for the seller to pay to the nonprofit.

With respect to the 18 loans cited in the draft Audit Report, this fee was inadvertently charged to the borrowers in only two instances, ██████, FHA Case No. 492-7028013, and ██████s FHA Case No. 492-7247559. For the remaining 16 loans, this fee was paid by the seller, and not charged to the borrower, as a review of the relevant HUD-1 statements confirms.

Further, with respect to the 123 additional loans cited by the OIG in which this fee was paid by the seller to the nonprofit, the Company has reviewed the HUD-1 settlement statements to determine whether in fact the borrowers were charged this fee. The Company’s review disclosed that in 20 of the total 123 loans reviewed the borrower was inadvertently charged the gift processing fee.

Accordingly, there are a total of 22 loans in which the nonprofit gift processing fee inadvertently was charged to the borrower, in the aggregate amount of \$6,571.98. A list of those 20 loans is attached to this letter. K Hov is prepared to refund to the affected borrowers (or to HUD as appropriate) those charges.

Comment 4

Finding No. 2: K Hov Did Not Meet All Quality Control or Branch Requirements. The OIG indicates that K Hov's Quality Control Plan did not contain all HUD requirements regarding on-site reviews and review of loans that defaulted within the first six payments. The OIG indicates further that the Company did not conduct annual on-site visits to all branches.

As the draft OIG report expressly acknowledges, immediately upon being informed by the OIG field examiner that amendments should be made to our plan, and well before the draft OIG report was issued, we changed our Quality Control Plan to include an Annual On-site Branch Review. Further, as the draft OIG report further acknowledged, since November 2004 the company has incorporated the required early default review procedures in its Quality Control Plan. In fact, we are continually reviewing the Neighborhood Watch report to include Early Payment Default in our TENA audit to ensure that we are protecting HUD, swiftly identifying, and correcting, anomalies or problems that occurred.

- **K Hov's Branch Manager Was an Employee of Goodman Homes**

The OIG indicates that K Hov's Plano branch manager was only a part-time K Hov employee and a full-time employee of Goodman Homes.

K Hov respectfully submits that this finding arises out of a misunderstanding by the Company of HUD-FHA requirements. The former branch manager of the Company's branch office in Plano was considered by the Company to be the manager of its office. The Company mistakenly believed that since the builder entity also is part of the K Hov "family" of businesses, it was permissible for the former Company branch manager also to sign documents on behalf of the builder.

Comment 4

The OIG audit process has clarified HUD's requirements in this regard for K Hov, and K Hov appreciates that. K Hov has taken corrective action, and is in full compliance with HUD-FHA requirements.

Specifically, the Company has closed the Plano, Texas office and established a new branch office in Houston, Texas, located at 2030 North Loop, Suite 105. Both the closure of the Plano office and the opening of the Company's Houston office properly have been reported to HUD via the FHA connection. **See Attachment E.**

The Company also has appointed an acting branch manager, ~~XXXXXXXXXX~~ ~~XXXXXXXXXX~~, to run the Houston branch office until such time as a permanent branch Manager is appointed. **See Attachment F.**

- **Entrance to K Hov's Plano Branch Was not Clearly Identified To The Public**

As stated previously, the Company has terminated the Plano, Texas branch office and opened a new branch office in Houston that has or shortly will have proper signage clearly identifying the branch office to the public. **See Attachment G.**

CASE NARRATIVES

492-6943572- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in K Hov's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, although the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, now requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We also have subsequently obtained a copy of the wire transfer. **See Attachment C**.

Comment 2

- Unallowable closing costs charged: \$350.00 commitment fee and \$79.00 tax service fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

Comment 5

- No compensating factors when back-end ratio exceeded HUD guidelines:

The underwriter overlooked noting the comments on the MCAW. The justification for approving the loan with high ratios was based on the borrowers current mortgage payment at \$1,396.00 a month and the new housing payment was increasing \$5.00. All current debt was older than 1 year showing the borrower having the ability to maintain a higher debt ratio.

According to the Neighborhood Watch the borrower defaulted due to "Death of mortgagors family member".

Comment 5

- Financial documents sent through interested third party.

The Company respectfully submits that it occasionally and temporarily relies upon faxed documents solely for the convenience of the Borrower and in the interests of time. As cited by the OIG in this Finding, the documents that were faxed to the Company were from a builder that is a member of the K-Hov "family". Further, the company submits that such faxed documents pose no material risk to HUD-FHA as it is the Company's policy and practice to reverify all financial and employment information provided to it by the borrower and/or to obtain and include in the file the originals of faxed documents. The Company submits further that there is no finding by the OIG that the faxed documents contained incorrect information.

The Company also has re-confirmed its procedures to require that original documents be obtained and placed in the loan file. The Company has corrected the shortcoming cited by the OIG. **See attachment H.**

492-7312005- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party:

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agent's escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

Comment 2

- Unallowable closing costs charged: \$79.00 tax service fee and \$50.00 rush wire fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

Comment 5

In addition, the company is prepared to refund these fees to HUD or the borrower.

- Financial documents sent through interested third party.

Please see the Company's Response to FHA Case No. 492-6943572, [REDACTED], that previously addressed this Finding.

492-7048388- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agent's escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. See **Attachment C**.

Comment 2

- Unallowable closing costs charged: \$79.00 tax service fee

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund this fee to HUD or the borrower.

Comment 5

- Borrower not required to explain derogatory credit:

Borrower resides in a community property state, which requires a credit report on the non-purchasing spouse (4155.1Rev-5 Sec. 2-2D). The spouse's credit report contained derogatory credit including unpaid collections. Our interpretation of the guidelines (4155.1, rev.-5, paragraph 2-2D) did not include requiring a credit explanation from the non-purchasing spouse. The guidelines state: "Although the non-purchasing spouse's credit history is not to be considered a reason of credit

denial, a credit report that complies with the requirements of paragraph 2-4 must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio. The credit report on the non-purchasing spouse does comply with paragraph 2-4. Respectfully, the OIG is incorrect in its Finding with respect to this loan.

492-7272944-██████████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$350.00 gift processing fee

The company respectfully submits that the OIG is incorrect in its Finding. This is a gift processing or administrative services fee paid by the builder/seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. Please also see the additional explanation provided elsewhere in this response.

492-6783078-██████████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

- We have responded to these findings elsewhere in this response.

- Gift transfer not documented in KHAM's files:

Comment 1

Comment 2

Comment 1

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. See **Attachment C**.

- Unallowable closing costs charged: \$79.00 tax service fee

Comment 2

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund this fee to HUD or the borrower.

- Installment loans included in the mortgage:

Comment 6

The borrower had adequate funds in the account to pay debts as long as the gift funds were acceptable which, respectfully, they were.

The compensating factor mentioned for high debt ratio to income is offset by excellent credit with no lates on current housing for 48 months.

The outstanding debt was a medical collection that was over 3 years old and was considered minor, and the borrower paid it in full at closing. Another compensating factor was that the borrower co-signed for spouse's mother on a car loan, which was included in the debt ratio since it was only 5 months old and a 12-month history is required.

Comment 5

- Explanation regarding derogatory credit not required:

Collections were medical-related as stated on the credit report and occurred during a specific period. They were considered minor occurring two or more years in the past, during the same time frame, and also were medical related. Although they are collections, evidence of collections paid at closing and prior to closing was provided. FHA does not require collections to be paid; however, our borrower acknowledged the debt, thereby showing a regard to his/her credit. The company respectfully disagrees with the OIG's Finding with respect to this loan.

According to the Neighborhood Watch, the Borrowers defaulted due to "Marital difficulties".

492-6896014-██████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

Comment 1

- Unallowable closing costs charged: \$79.00 tax service fee, \$350.00 commitment fee \$385.00 gift processing fee

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund the tax service fee and commitment fee to HUD or the borrower.

\$385.00 gift processing fee:

The Company respectfully submits that the OIG is incorrect in its Finding. This is a gift processing or administrative services fee paid by the builder/Seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. See also the explanation provided elsewhere in this response.

Comment 2

- Installment Loans included in Mortgage:

The borrower had adequate funds in the account to pay debts as long as the gift funds were acceptable which, respectfully, there were.

Comment 6

Comment 5

- Defaulted within Six Months but not reviewed in Quality Control Plan:

We have since added the Neighborhood Watch Report to our Quality Control Plan and have conducted audits for loans in default during the first 6 payments.

According to the Neighborhood Watch, the borrower defaulted due to "Curtailment of borrower income".

492-7020820-██████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See exhibit C.**

Comment 2

- Unallowable closing costs charged: \$79.00 tax service fee \$75.00 for final inspection

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch borrower defaulted due to "Excessive obligations".

492-7028013-██████

Underwriting Deficiencies:

- Cost of Gift included in sales price:
- Gifts used to meet minimum downpayment:
- Gift received from an interested third party:

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requesting documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See exhibit C.**

Comment 2

- Unallowable closing costs charged: \$350.00 gift processing fee:

The Company respectfully submits that the OIG is incorrect in its Finding. This is a processing or administrative services fee paid by the builder/Seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. See also the explanation provided elsewhere in this response.

492-7247559- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price:
- Gifts used to meet minimum downpayment:
- Gift received from an interested third party:

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Exhibit C.**

- Unallowable closing costs charged: \$350.00.00 gift processing fee.

Comment 2

The Company respectfully submits that the OIG is incorrect in its Finding. This is a processing or administrative services fee paid by the builder/Seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. See also the explanation provided elsewhere in this response.

Comment 5

- No compensating factors on mortgage credit analysis worksheet:

This was an oversight by the very experienced underwriter, and is an aberration. The borrower has a potential for increased earnings, as indicated by job training or education in the borrowers profession.

Comment 5

- Debt not included on the mortgage credit analysis worksheet:

Borrower provided a print out from her Credit Union on the auto loan in the amount of \$356.00 a month. The statement reflects the balance of \$3,471.46 as of 7/12/04. Based on the new balance the borrower had less than 10 months remaining, which is why it was not included in the debts ratio. See statement.

Comment 5

- Borrower received inducement to purchase without a sales reduction:

This is not typical of the builder and was an aberration. This will be addressed with the responsible associates and will further be utilized for training purposes.

492-6688777-██████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$40.00 overcharge of appraisal; \$385.00 gift processing fee.

Comment 2

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund the overcharge of the appraisal fee to HUD or the borrower.

\$385.00 gift processing fee

The company respectfully submits that the OIG is incorrect in its Finding. This is a processing or administrative services fee paid by the builder/seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. See also the explanation provided elsewhere in this response.

Comment 5

- Credit, employment, and financial documents sent to lender through interested third party:

Please see the Company's response to FHA Case No. 492-6943572, Schlein, that previously addressed this Finding.

491-8226744- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price:
- Gifts used to meet minimum downpayment:
- Gift received from an interested third party:

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$79.00 tax service fee.

Comment 2

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund this fee to HUD or the borrower.

Comment 5

- All debt not included on Mortgage Credit Analysis Worksheet:

The Underwriter conditioned on the Commitment Letter for the RMCR to show all collection/judgments/past due accounts either as current or as paid in full. After further review, it appears that the condition was not satisfied. This is an aberration. This will be addressed with the responsible associates and will further be utilized for training purposes.

Comment 5

- Bankruptcy not beyond control of borrower and overdraft and advance fees reflecting on bank statements:


The Underwriter based her decision on good ratios, low debt, good rental history and good credit re-established after bankruptcy. After further review, it appears that the decision was not fully supported. This also was an aberration. This will be addressed with the responsible associates and will further be utilized for training purposes.

Comment 5

- Recent Credit Inquiry Not Explained:

The Underwriter did not carefully review the explanation the borrower provided; it should have included a detailed explanation for omission of significant debt shown on the credit report and the reason for recent inquiries. This will be addressed with the responsible associates and will further be utilized for training purposes.

According to the Neighborhood Watch, the borrower defaulted due to "Other".

492-6623146-

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a cop of the wire transfer. **See Attachment C.**

Comment 2

- Unallowable closing costs charged: \$75.00 for inspection fee and \$10.00 wire fee

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch, the borrower defaulted due to "Curtailment of borrower income".

492-6679168-██████

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed this finding elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$40.00 overcharged in inspection fee.

Comment 2

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove

these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund this fee to HUD or the borrower.

According to the Neighborhood Watch, the borrower defaulted due to "Other".

492-6724976 [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$200.00 underwriting fee and \$200.00 processing fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch, the borrower defaulted due to "Other".

492-6788329 [REDACTED]

Unallowable Closing Costs

Comment 1

Comment 2

Comment 2

- Unallowable closing costs charged: \$350.00 for a commitment fee \$100.00 for an inspection fee \$79.00 tax service fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch, the borrower defaulted due to "Other".

492-6909226-██████████

Unallowable Closing Costs

- Unallowable closing costs charged: \$350.00 for a commitment fee and \$79.00 tax service fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch borrower defaulted due to "Other".

492-6995236-██████████

Underwriting Deficiencies:

- Cost of Gift included in sales price:
- Gifts used to meet minimum downpayment:
- Gift received from an interested third party:

We have addressed these findings elsewhere in this response.

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the

Comment 1

Comment 2

closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Attachment C.**

- Unallowable closing costs charged: \$79.00 tax service fee and \$40.00 overcharge of inspection fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund these fees to HUD or the borrower.

According to the Neighborhood Watch, the borrower defaulted due to "Other".

492-7071238- [REDACTED]

Underwriting Deficiencies:

- Cost of Gift included in sales price.
- Gifts used to meet minimum downpayment.
- Gift received from an interested third party.

We have addressed these findings elsewhere in this response.

Comment 1

- Gift transfer not documented in KHAM's files:

The gift funds were from a non-profit organization and were wired directly to the closing agents escrow account, the wire transfer receipt was not returned in the closed loan package. See Memorandum sent to all Associates, **Attachment I**, requiring documentation on the gift transfer of funds from donor including but not limited to gift funds from a non-profit organizations. We have subsequently obtained a copy of the wire transfer. **See Exhibit C.**

Comment 2

- Unallowable closing costs charged: \$79.00 tax service fee \$350.00 gift processing fee.

When we were notified that the unallowable fees were being charged to the borrower, we immediately made enhancements to our LOS system to remove these fees to avoid any future unallowable fees charged to the borrower. In addition, we have implemented a Quality Control Check List that must be

completed by appropriate personnel to ensure fees are being reviewed for accuracy including all appraisal invoices. See attached form and instructions.

In addition, the company is prepared to refund the tax service fee to HUD or the borrower.

\$350.00 gift processing fee:

The company respectfully submits that the OIG is incorrect in its Finding. This is a processing or administrative services fee paid by the builder/seller to the nonprofit agency that provides the gift funds for the borrower's downpayment.

Most importantly, this \$350 fee was not charged to the borrower. See also the related explanation provided elsewhere in this response.

According to the Neighborhood Watch, the borrower defaulted due to "Excessive obligations".

We appreciate your time and consideration in conducting your audit in a fully professional and comprehensive manner, and in considering these comments on the Draft Audit Report.

The Company has further strengthened its processes and procedures in areas noted above in which such improvements were appropriate, and the Company appreciates the OIG's assistance in identifying those areas. In others, and particularly with respect to Finding No. 1, the Company respectfully urges the OIG to reconsider and withdraw its Finding. The downpayment assistance program as administered by the Company clearly and unambiguously meets all applicable HUD-FHA requirements.

Very truly yours,



Dan Klinger
President

Enclosures

cc (with enclosures):
James A. Brodsky
Weiner Brodsky Sidman Kider, PC

F:\95074\001\KhovAuditmemo.doc

OIG Evaluation of Auditee Comments

Comment 1

Our October 27, 2005 draft report included discussion of K Hov's activities as participants in a down payment assistance program that involved K Hov, Goodman Homes, and a nonprofit entity. However, during the exit conference and in its response, K Hov cited HUD's response to a recent GAO report²⁵ and a HUD legal opinion as support for K Hov's position that HUD allowed these activities if the timing of the gift funds was appropriate. Based on K Hov's comments, we decided to address the issue with HUD and accordingly removed discussion of this issue from the final report.

With respect to the wire transfers, we only noted K Hov did not have the wire transfer documentation in the files as required. K Hov agreed that the wire transfer documentation should be in their files and added policies to implement. We commend K Hov for taking the actions to comply with requirements.

Comment 2

K Hov agreed that unallowable closing costs were charged on the settlement statements. K Hov promised to take actions to ensure these types of closing costs are not charged to the borrower on future closings. We commend K Hov for addressing the issue.

Comment 3

K Hov agreed that in the 22 instances when it charged gift processing fees to the borrower and listed the fee on the settlement statement that it was wrong and violated HUD requirements. K Hov agreed to repay these funds. However, K Hov did not agree that it was wrong in the other instances cited in the report where K Hov added the gift processing fees to the sales price. We do not accept K Hov's distinction that the fee can be charged to the borrower by raising the sales price, but the same fee could not be shown on the settlement statement as a charge to the borrower. We maintain HUD prohibited K Hov from charging borrowers a gift-processing fee irrespective of how K Hov lists it on the settlement statement.

Comment 4

We commend K Hov for taking action to correct deficiencies cited in the report.

Comment 5

In one instance, we revised our case narrative where K Hov provided additional information. In three instances, K Hov attributed the deficiencies in its underwriting as "aberrations" and will address these with the responsible associate. Further, K Hov believes there are no circumstances

²⁵ Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance GAO-06-24, November 9, 2005.

under which it should be required to indemnify poorly underwritten loans and these instances should only be used for training purposes. OIG disagrees and maintains these loans showed poor underwriting. Thus, we did not change the recommendation requiring indemnifications or repayment of claim amounts.

Comment 6

In two instances, K Hov's response confirmed that it violated Mortgagee Letter 2002-02 by allowing gift funds to pay consumer debt. In the draft, we did not report that the gift funds paid the consumer debt; only that K Hov included the consumer debt in the mortgage. K Hov responded that the borrower had adequate funds to pay the debts if gift funds could be used. However, Mortgagee Letter 2002-02 specifically states that it is unacceptable underwriting to allow payment of consumer debt and that payment of consumer debt should be a dollar-for-dollar reduction in sales price. Therefore, we disagree with K Hov and maintain that the two loans contained underwriting deficiencies and the sales price should be reduced dollar for dollar for the payment of consumer debt. Thus, we did not change the recommendation of indemnifying or repayment to HUD for claim amounts.

Appendix C

QUESTIONED CLOSING COSTS BY LOAN

Loan Number	Inspection Fee	Tax Service Fee	Wire Transfer Fee	Commitment Fee	Gift-Processing Fee *	Underwriter Fee	Processing Fee	Totals
492-6943572		\$79		\$350				\$429
492-7312005		\$79	\$50					\$129
492-7048388		\$79						\$79
492-7272944					\$350			\$350
492-6783078		\$79						\$79
492-6896014		\$79		\$350	\$385			\$814
492-7020820	\$75	\$79						\$154
492-7028013	**	**	**		\$350			\$350
492-7247559					\$350			\$350
492-6688777	\$40				\$385			\$425
491-8226744		\$79			\$350			\$429
492-6623146	\$75		\$10					\$85
492-6679168	\$40							\$40
492-6724976						\$200	\$200	\$400
492-6788329	\$100	\$79		\$350				\$529
492-6909226		\$79		\$350				\$429
492-6995236	\$40	\$79						\$119
492-7071238		\$79			\$350			\$429
Totals	\$370	\$869	\$60	\$1,400	\$2,520	\$200	\$200	\$5,619

* We reviewed 133 additional loans that contained \$26,092 in unallowable gift processing fees, resulting in \$28,612 total questioned gift processing fees and \$31,711 total questioned closing costs.

** HUD questioned these closing costs during a loan review.

Appendix D

UNDERWRITING DEFICIENCIES BY LOAN

Loan Number	Sales Incentive Price Not Reduced	Debt Rolled Into Loan	All Debt Not On MCAW	Bankruptcy Not Beyond Control	No Explanation of Inquiries to Credit Report/Bad Debts	No Compensating Factors	Docs thru Third Party	No Gift Docs in File
<i>492-6943572</i>						X	X	X
492-7312005							X	X
492-7048388					X			X
492-7272944		X						X
<i>492-6783078</i>		X			X			X
<i>492-6896014</i>		X						X
<i>492-7020820</i>								X
<i>492-7028013</i>								X
492-7247559	X		X			X		X
492-6688777							X	X
<i>491-8226744</i>			X	X	X			
<i>492-6623146</i>								X
<i>492-6679168</i>								X
<i>492-6724976</i>								X
<i>492-6788329</i>								X
<i>492-6995236</i>								X
<i>492-7071238</i>								X
Total	1	3	2	1	3	2	3	16

Notes:

Italicized loan number indicates loans that had significant underwriting deficiencies that HUD paid a claim. K Hov should reimburse HUD for these payments.

Bolded loan numbers indicate loans that had significant underwriting deficiencies. K Hov should indemnify.

Unallowable Closing Costs are listed in Appendix C.

Appendix E

CASE NARRATIVES

Case Narrative—Loan Number 492-6943572

Mortgage amount: \$156,750

Date of loan closing: August 8, 2003

Unallowable closing costs: \$429 - \$350 commitment fee and \$79 tax service fee

Underwriting Deficiencies

- Gift transfer not documented by lender,
- Unallowable closing costs charged,
- No compensating factors when back-end ratio exceeded HUD guidelines, and
- Financial documents sent through interested third parties.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements²⁶ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$429 in unallowable closing costs, \$350 for an unallowable commitment fee and \$79 for a tax service fee. According to HUD's Homeownership Center Reference Guide, commitment fees and tax service fees are unallowable.

Required Compensating Factors Not Provided

K Hov did not provide compensating factors for the borrower exceeding the back-end ratio. HUD Handbook 4551.1 requires K Hov to obtain supporting documentation from the borrower and record the compensating factor(s) when borrowers exceed mortgage and debt repayments-to-income ratios to justify mortgage repayment.

Financial Documents Sent through Interested Third Party

Diamond Homes, a subsidiary of Goodman Homes, faxed credit, employment, and financial documentation to K Hov. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1, states lenders may not accept or use documents relating to the credit, employment, or income of borrowers that

²⁶ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse HUD \$429 for allowable closing costs paid.
- Reimburse HUD \$156,376 for the amount of the claim paid on this loan.

Case Narrative—Loan Number 492-7312005

Mortgage amount: \$163,550

Date of loan closing: October 20, 2004

Unallowable closing costs: \$129--\$79 for tax service fee and \$50 for rush wire transfer fee

Underwriting Deficiencies

- Gift transaction not documented by lender,
- Unallowable closing costs charged, and
- Financial documents through interested third party (real estate agent).

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements²⁷ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$129 in unallowable closing costs; it charged \$79 for a tax service fee and \$50 for a wire fee. The borrower paid a \$79 tax service fee outside of closing to K Hov. In addition, K Hov charged the borrower a \$50 rush wire fee. Based on an e-mail, K Hov did not order the gift funds in a timely manner, which resulted in the wire fee. These were unallowable closing costs per HUD guidelines.

Financial Documents Sent through Interested Third Party

The borrower's real estate agent faxed credit, employment, and financial documentation to K Hov. HUD Handbook 4155.1, REV-5, paragraph 3-1, state lenders may not accept or use documents relating to the credit, employment, or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$129 for unallowable closing costs.
- Indemnify HUD for \$163,550 against loss for this loan's underwriting deficiencies.

²⁷ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Case Narrative—Loan Number 492-7048388

Mortgage amount: \$148,800

Date of loan closing: January 28, 2004

Gift amount: \$8,743

Unallowable closing costs: \$79 tax service fee

Underwriting Deficiencies

- Gift transfer transaction not documented by lender,
- Unallowable closing costs charged, and
- Borrower not required to explain derogatory credit.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements²⁸ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$79 in an unallowable tax service fee closing cost. This was an unallowable closing cost according to HUD guidelines.

Derogatory Credit Information Not Explained

The borrowers' did not provide an explanation of a spouse's derogatory credit information. Texas is a community property state. HUD Handbook 4155.1, REV-5, paragraph 2-3 requires the borrower to provide sufficient and rational explanation of the derogatory credit. Also, HUD Handbook 4155.1, REV-5, paragraph states, "Except for the obligations specifically excluded by state law, the debts of the non-purchasing spouse must be included in the borrower's qualifying ratios if the borrower resides in a community property state or the property to be insured is located in a community property state. Although the non-purchasing spouse's credit history is not to be considered a reason for credit denial, a credit report that complies with the requirements of paragraph 2-4 must be obtained for the non-purchasing spouse in order to determine the debt-to-income ratio."

HUD Handbook 4155.1, REV-5, paragraph 2-3C, states that collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness with the lender documenting its reasons for approving a mortgage when the borrower has collection accounts or judgments. The borrower must explain in writing all collections and judgments.

²⁸ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$79 for the unallowable closing costs.
- Indemnify HUD for \$148,800 against loss for this loan's underwriting deficiencies.

Case Narrative—Loan Number 492-7272944

Mortgage amount: \$135,100

Date of loan closing: September 10, 2004

Unallowable closing costs: \$350 gift processing fee

Underwriting Deficiencies

- Gift transfer transaction not documented by lender,
- Unallowable closing costs charged, and
- Installment loan included in the mortgage.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements²⁹ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov did not require Goodman Homes to reduce the sales price of the house by the unallowable fee. Goodman Homes charged the borrower an unallowable \$350 Home Gift USA gift-processing fee in the calculation of the mortgage amount. As discussed above, Goodman Homes added the gift-processing fee to the sales price of the home.

Installment Loan Included in Mortgage

The settlement statement showed that an installment loan to Capitol One in the amount of \$338 was rolled into the purchase price of the property. Total closing costs of \$9,856 were added to the contract sales price of \$136,244. Of the \$9,856, \$338 of debt was rolled into the mortgage. Mortgagee Letter 2002-02 states that it is unacceptable underwriting to allow payment of consumer debt and that payment of consumer debt should be a dollar-for-dollar reduction in price.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$350 for the gift processing fee.
- Indemnify HUD for \$135,100 against loss for this loan's underwriting deficiencies.

²⁹ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Case Narrative—Loan Number 492-6783078

Mortgage amount: \$145,700

Date of loan closing: April 29, 2003

Gift amount: \$4,197

Unallowable closing costs: \$79 tax service fee

Underwriting Deficiencies

- Gift transaction not documented by lender,
- Unallowable closing costs charged,
- Installment loans included in the mortgage, and
- Explanation regarding derogatory credit not required.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁰ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$79 in unallowable tax service fee closing costs. This is an unallowable closing cost according to HUD guidelines.

Installment Loans Included in Mortgage

The settlement statement showed that \$253 outstanding debt was included in the \$3,479 closing costs. The \$3,479 in total closing costs was added to the contract sales price of \$148,000. Mortgagee Letter 2002-02 states that it is unacceptable underwriting to allow payment of consumer debt and that payment of consumer debt should be a dollar-for-dollar reduction in price.

One of the compensating factors included in the file was that the borrower's "High total debt to income ratio is offset by excellent credit with no lates on current housing for 48 months." However, K Hov did not address any outstanding debt issues.

K Hov responded that the "borrower had adequate funds in the account to pay debts as long as the gift funds were acceptable which, respectfully, they were." K Hov did not reduce the price dollar-for-dollar as required by HUD.

³⁰ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Derogatory Credit Information Not Explained

The borrowers did not provide an explanation of derogatory credit information. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3, requires the borrower to provide sufficient and rational explanation of the derogatory credit.

This loan went into default, resulting in HUD paying a \$146,352 claim on the loan.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse HUD \$79 in unallowable closing costs.
- Reimburse HUD \$146,352 for the claim paid.

Case Narrative—Loan Number 492-6896014

Mortgage amount: \$127,550

Date of loan closing: July 15, 2003

Unallowable closing costs: \$814--This amount includes \$79 tax service fee, \$385 gift-processing fee, and \$350 commitment fee paid outside of closing.

Underwriting Deficiencies:

- Gift transaction not documented by lender,
- Unallowable closing costs charged, and
- Three installment loans on settlement statement.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³¹ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$814 in unallowable closing costs. It charged a \$350 commitment fee, \$385 gift-service fee that it included in the sale price, and \$79 for a tax service fee.

HUD's Homeownership Center Reference Guide states that it only allows commitment fees to nonprofits or governmental entities. According to the settlement statement, the borrower paid this commitment fee to K Hov; thus, the \$350 commitment fee was unallowable.

Goodman Homes charged the borrower an unallowable \$385 Nehemiah gift-processing fee in the calculation of the mortgage amount. As discussed above, Goodman Homes added the gift and the processing fee to the sales price of the home.

The borrower paid a \$79 tax service fee outside of closing to K Hov. This is an unallowable closing cost according to HUD guidelines.

Installment Loans Included in Mortgage

The settlement statement showed that three installment loans totaling \$336³² were included in the closing cost and subsequently rolled into the mortgage. Mortgagee Letter 2002-02 states that it is unacceptable underwriting to allow payment of consumer debt and that payment of consumer debt should be a dollar-for-dollar reduction in price.

³¹ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

³² (Nationwide Recovery \$171.78, Credit Management \$103, and Park Dansan \$61).

K Hov provided the following compensating factor for the borrower: “made a diligent effort to clean up all credit issues.” However, K Hov’s closing instructions included payment of these three outstanding installment loans.

In its response, K Hov stated the “borrower had adequate funds in the account to pay debts as long as the gift funds were acceptable which, respectfully, they were.” K Hov did not reduce the price dollar-for-dollar as required by HUD.

Loan Defaulted within Six Months But Not Reviewed in Quality Control Plan

The borrower made three payments, and the loan went into claim in July 2004. K Hov did not review this loan as required by HUD Handbook 4060.1. REV-1. CHG-1, paragraph 6-6D. This regulation states that in addition to the loans selected for routine quality control reviews, lenders must review all loans going into default within the first six payments.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse HUD \$814 for unallowable closing costs.
- Reimburse HUD for \$128,402, the amount of the claim paid, against loss for this loan’s underwriting deficiencies.

Case Narrative—Loan Number 492-7020820

Mortgage amount: \$103,500

Date of loan closing: October 30, 2003

Unallowable closing costs \$154--\$79 in tax service fees paid outside of closing and \$75 for a final inspection when the house was 100 percent complete at appraisal

Underwriting Deficiencies

- Gift transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³³ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$154 in unallowable closing costs. It charged \$79 for a tax service fee and \$75 for an inspection fee when the house was 100 percent complete.

The borrower paid a \$79 tax service fee outside of closing to K Hov. This is an unallowable closing cost according to HUD guidelines.

The borrower paid \$75 for an inspection fee when the house was 100 percent complete at appraisal. HUD Handbook 4145.1, REV-2, CHG-1. Chapter 1, paragraph 6-3A3, states that the appraisal serves as the final inspection on properties “under construction” if the home is 100 percent complete and the appraiser completed the uniform residential appraisal report and all necessary exhibits. In this instance, the appraisal served as the final inspection.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse HUD for \$154 in unallowable closing costs.

³³ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Case Narrative—Loan Number 492-7028013

Mortgage amount: \$156,100

Date of loan closing: November 21, 2003

Unallowable closing costs: \$350

Underwriting Deficiencies

- Gift transfer transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁴ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower a \$350 unallowable gift-processing fee. According HUD's Homeownership Center Reference Guide, processing fees are unallowable.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$350 for the unallowable closing costs.

³⁴ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Case Narrative—Loan Number 492-7247559

Mortgage amount: \$118,800

Date of loan closing: July 29, 2004

Unallowable closing costs: \$350 gift-processing fee

Underwriting Deficiencies

- Gift transfer of funds not documented by lender,
- Unallowable closing costs charged,
- No compensating factors on mortgage credit analysis worksheet when front/back-end ratio exceeded, and
- Borrower received inducement to purchase without a sales reduction.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁵ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$350 in unallowable closing costs for a gift-processing fee. HUD's Homeownership Center Reference Guide lists all the allowable fees, and gift-processing fee is not on that list.

Mortgage Credit Analysis Worksheet Lacked Compensating Factors

K Hov did not provide compensating factors for the borrower exceeding the back-end ratio. HUD Handbook 4155.1 REV-5, paragraphs 2-12 and 2-13 requires K Hov to obtain supporting documentation from the borrower and record the compensating factor(s) when borrowers exceed mortgage and debt repayments-to-income ratios to justify mortgage repayment.

Sales Price Not Reduced by Purchase Inducement

The borrower received a 51-inch Sony television promotion, which was an inducement to purchase and should reduce the sales price, dollar for dollar per HUD Handbook 4155.1, REV-5, paragraph 1-7B. Personal property items such as cars, boats, riding lawn mowers, furniture, televisions, etc., given by the seller to consummate the sale result in a reduction to the mortgage. The value of the item(s) must be deducted from the sales price and the appraised value of the property (if not already done so by the appraiser) before applying the loan to value ratio.

³⁵ HUD Handbook 4155.1, REV-5, paragraph 2-10C.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower the \$350 for the unallowable closing cost.
- Indemnify HUD for \$118,800 against loss for this loan's underwriting deficiencies.

Case Narrative—Loan Number 492-6688777

Mortgage amount: \$171,600

Date of loan closing: March 21, 2003

Unallowable closing costs: \$425 -- \$385 gift-processing fee and \$40 overcharge of appraisal

Underwriting Deficiencies

- Gift transaction not documented by lender,
- Unallowable closing costs charged, and
- Credit, employment, and financial documents sent to lender through interested third party.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁶ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$425 in unallowable closing costs. It charged a \$385 gift-processing fee that it included in the sale price and overcharged \$40 for the final inspection fee.

Goodman Homes charged the borrower an unallowable \$385 Nehemiah gift-processing fee in the calculation of the mortgage amount. As discussed above, Goodman Homes added the gift-processing fee to the sales price of the home.

Exceeding the HUD maximum of \$60 for a final inspection fee, K Hov charged the borrower \$100 for the final inspection fee; thus overcharging the borrower \$40.

Credit, Employment, and Financial Documents Sent through Interested Third Party

Goodman Homes, an identity of interest of K Hov, faxed credit, employment, and financial documentation to K Hov. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 3-1, states, “[I]enders may not accept or use documents relating to the credit, employment or income of borrowers that are handled by or transmitted from or through interested third parties (e.g., real estate agents, builders, sellers) or by using their equipment.”

³⁶ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Recommendations:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrowers \$425 in unallowable closing costs.
- Indemnify HUD for \$171,600 against loss for this loan's underwriting deficiencies.

Case Narrative—Loan Number 491-8226744

Mortgage amount: \$164,400

Date of loan closing: October 17, 2003

Gift amount: \$9,103

Unallowable closing costs: \$79 tax service fee

Underwriting Deficiencies

- Gift transaction not documented by lender,
- Unallowable closing costs charged,
- All debt not included on mortgage credit analysis worksheet,
- Bankruptcy not beyond the control of the borrower, and
- No explanation for inquiries on credit report within the last 90 days.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁷ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged \$79 in unallowable closing costs for a tax service fee. HUD's Homeownership Center Reference Guide states that it does not allow tax service fees.

All Debt Not Included on Mortgage Credit Analysis Worksheet

K Hov did not include all the debt on the mortgage credit analysis worksheet. Two of the borrowers' accounts went into collection in July and September 2003. Neither of these accounts was included in the total installment debt amount on the mortgage credit analysis worksheet. The borrower had additional outstanding debt of \$620. The mortgage credit analysis worksheet only showed \$750. This would have changed the back-end ratio to more than 51 percent. Also, both of the uniform residential loan applications show that the borrowers had negative assets. Even without considering all of the non-reported debt, the borrowers had more than \$33,000 in outstanding debts and obligations on the mortgage credit analysis worksheet.

³⁷ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Bankruptcy Not Beyond Control of Borrower

One of the borrowers had a bankruptcy with more than one and less than two elapsed years. According to HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3E, an elapsed period of less than two years (but not less than 12 months) may be acceptable if the borrower can show that the bankruptcy was caused by extenuating circumstances beyond his or her control and has since exhibited an ability to manage financial affairs and the borrower's current situation is such that the events leading to the bankruptcy are not likely to recur. The borrower needed to show that the bankruptcy was caused by extenuating circumstances beyond her control and she has exhibited the ability to manage her financial affairs in a responsible manner.

The borrower quit her job without having another job, which is not beyond her control; the change in jobs caused the bankruptcy. Also, two months' worth of bank statements that the borrower provided contained numerous overdraft and advance fees, showing that the borrower not managing her financial affairs in a responsible manner. The loan defaulted within 15 months of closing.

Recent Credit Inquiries Not Explained

There were multiple inquiries regarding the borrower's credit report, which K Hov did not require the borrower to explain. HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3B, states that a satisfactory explanation must be provided by the borrower to account for the omission of any significant debt shown on the credit report but not listed on the loan application. The borrower must explain all inquiries shown on the credit report.

The loan went into default, resulting in HUD paying a \$167,116 claim on the loan.

Recommendations:

We recommend that the assistant secretary for housing –federal housing commissioner require K Hov to:

- Reimburse HUD \$79 for the unallowable closing costs.
- Reimburse HUD for the \$167,116 claim paid on this loan.

Case Narrative—Loan Number 492-6623146

Mortgage amount: \$141,450

Date of loan closing: January 9, 2003

Unallowable closing costs: \$85 -- \$75 for an inspection fee when appraisal showed house was 100 percent complete and \$10 wire transfer fee

Underwriting Deficiencies

- Gift transfer transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁸ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged \$85 in unallowable closing costs. It charged \$75 for an inspection fee when the appraisal showed the house was 100 percent complete and \$10 for a wire transfer fee.

K Hov charged unallowable closing costs of \$75 inspection fee when appraisal showed the house was 100 percent complete. HUD Handbook 4145.1, REV-2, CHG-1, chapter 1, paragraph 6-3A3, states that the appraisal serves as the final inspection on properties if the home is 100 percent complete and the appraiser performs the appraisal and completes the uniform residential appraisal report and all necessary exhibits. In this instance, the appraisal serves as the final inspection.

K Hov charged the borrower \$10 for a wire transfer. This is an unallowable closing cost according to HUD guidelines.

This loan went into default, resulting in HUD paying a \$146,631 claim on the loan.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse HUD \$85 in unallowable closing costs.

³⁸ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Case Narrative—Loan Number 492-6679168

Mortgage amount: \$152,450

Date of loan closing: February 14, 2003

Unallowable closing costs: \$40 Overcharged in inspection fee.

Underwriting Deficiencies

- Gift transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements³⁹ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$100 for a final inspection fee when the appraisal showed the house was 100 percent complete; thus, no final inspection was needed. HUD does not allow the lender to charge more than \$60 for an inspection fee if the house was 100 percent complete at the time of appraisal.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$100 for the unallowable closing cost.

³⁹ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Case Narrative—Loan Number 492-6724976

Mortgage amount: \$143,150

Date of loan closing: March 21, 2003

Unallowable closing costs: \$400 -- \$200 underwriting fee and a \$200 processing fee

Underwriting Deficiencies

- Gift transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements⁴⁰ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$400 for unallowed costs, a \$200 underwriting fee, and a \$200 processing fee. According to the HUD Homeownership Reference Guide on Closing Costs and Other Fees, both underwriting fees and processing fees are unallowable.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$400 for unallowable closing costs.

⁴⁰ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Case Narrative—Loan Number 492-6788329

Mortgage amount: \$155,700

Date of loan closing: May 9, 2003

Unallowable closing costs: \$529 -- \$350 for a commitment fee, \$100 for an inspection fee, and \$79 for a tax service fee

Summary:

Unallowable Closing Costs

K Hov charged the borrower \$529 in unallowable closing costs, \$350 for a commitment fee, \$100 for an inspection fee, and \$79 for a tax service fee.

The borrower paid a commitment fee of \$350 to K Hov outside of closing. A commitment fee has to be by a nonprofit or the instrumentality of a government to be allowed. K Hov is not a nonprofit or an instrumentality of a government. Thus, this is an unallowable closing cost.

K Hov charged unallowable closing costs of a \$100 inspection fee when the appraisal showed the house was 100 percent complete. HUD Handbook 4145.1. REV-2, CHG-1, chapter 1, paragraph 6-3A3, states that the final inspection on properties “under construction” serves as the final inspection if the home is 100 percent complete and the appraiser performs the appraisal and completes the uniform residential appraisal report and all necessary exhibits. In this instance, the appraisal served as the final inspection.

The borrower paid a \$79 tax service fee outside of closing to K Hov. This is an unallowable closing cost according to HUD guidelines.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$529 for the unallowable closing fees.

Case Narrative—Loan Number 492-6909226

Mortgage amount: \$125,750

Date of loan closing: July 28, 2003

Unallowable closing costs: \$429 -- \$350 for a commitment fee and \$79 for a tax service fee

Summary:

Unallowable Closing Costs

K Hov charged the borrower \$429 in unallowable closing costs; the borrower paid \$350 for a commitment fee and \$79 for a tax service fee.

The borrower paid a commitment fee of \$350 to K Hov outside of closing. A commitment fee has to be by a nonprofit or the instrumentality of a government to be allowed. K Hov is not a nonprofit or an instrumentality of a government. Thus, this is an unallowable closing cost.

The borrower paid a \$79 tax service fee outside of closing to K Hov. This is an unallowable closing cost according to HUD guidelines.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$429 for the unallowable closing fees.

Case Narrative—Loan Number 492-6995236

Mortgage amount: \$123,000

Date of loan closing: October 8, 2003

Unallowable Closing Costs: \$119 -- \$79 tax service fee and overcharged \$40 for an inspection

Underwriting Deficiencies

- Gift transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements⁴¹ state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$119 for unallowed costs, \$79 for a tax service fee and an overcharge of \$40 for a final inspection. According to the HUD Homeownership Reference Guide on Closing Costs and Other Fees, tax service fees are unallowable. Further, a final inspection fee should not exceed \$60. K Hov charged \$100.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower \$119 for unallowable closing costs.

⁴¹ HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-10C.

Case Narrative—Loan Number 492-7071238

Mortgage amount: \$117,700

Date of loan closing: January 29, 2004

Unallowable closing costs: \$429 (\$350 gift processing fee and \$79 tax service fee)

Underwriting Deficiencies

- Gift transaction not documented by lender and
- Unallowable closing costs charged.

Summary:

No Documentation of Gift Funds Transfer

K Hov did not document the transfer of the gift funds as required by HUD. HUD requirements⁴² state the lender must document the transfer of the funds from the donor to the borrower.

Unallowable Closing Costs

K Hov charged the borrower \$429 in unallowable closing costs. It charged \$350 in gift-processing fees and a \$79 tax service fee. According to the HUD Homeownership Reference Guide on Closing Costs and Other Fees, both processing fees and tax service fees are unallowable.

This loan is currently in default.

Recommendation:

We recommend that the assistant secretary for housing – federal housing commissioner require K Hov to:

- Reimburse the borrower for the \$429 in unallowable fees.

⁴² HUD Handbook 4155.1, REV-5, paragraph 2-10C.