U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388
(404) 331-3369

September 25, 2001 2001-AT-1807

MEMORANDUM FOR: Charles E. Gardner
Director, Atlanta Homeownership Center, 4AHH

N. H. Cooper

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Family Home Providers, Inc.
Cumming, Georgia
Nonprofit Participation in FHA Single Family Insurance Program

As part of a nationwide audit of the Federal Housing Administration's (FHA) Single Family Insurance Program, we audited Family Home Providers (FHP) purchase of Real Estate Owned (REO) properties. Our objectives were to determine whether FHP was legitimate and independent (not under the influence, control, or direction of other parties) and passed on the benefits of discounts received on the purchase of Department of Housing and Urban Development (HUD) homes to low and moderate-income homebuyers.

FHP did not comply with requirements of HUD's single-family property disposition program. For the 5 properties we reviewed, FHP passed along only $27,822 of the $64,860 in discounts it received from HUD thus depriving the low and moderate-income homebuyers of the program's intended benefits. We also identified at least $147,023 in sales commissions FHP's President paid to his own realty firm from September 1997 through November 2000 on 20 properties FHP purchased from HUD, and $20,061 in profits he paid to a business in which he and his wife were once officers. These transactions violated conflict of interest prohibitions. We observed poor quality workmanship on four houses FHP sold. In addition to its failure to meet HUD's objectives of the program, we question FHP's charitable intent. From 1998 - 2000, FHP's President obtained personal benefit (aside from salary and realty commissions) from the non-profit's operations. Those acts violated HUD's eligibility criteria for participation in its programs.

We recommended HUD require FHP to pay $42,503 in excess profits to reduce the mortgage of three homebuyers and correct or pay for rehabilitation deficiencies identified by our audit.

Exit

We sent a draft of this audit memorandum to FHP on September 10, 2001. FHP provided oral comments on September 17, 2001, and written comments on September 21, 2001. Overall, FHP believed most of the deficiencies were due to improper advice and counsel from its prior outside legal counsel and accountant. FHP representatives stated they had taken a number of steps to improve its operations and way of doing business as a result of our audit.

Within 60 days of this memorandum, please provide us a status report for each recommendation on: (1) corrective action taken; (2) proposed corrective action and date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directive issued because of this review.

If you have any questions, please contact James D. McKay, Assistant District Inspector General for Audit, at (404) 331-3369.

Background

Family Home Providers, Inc. is a nonprofit organization under section 501 (c)(3) of the Internal Revenue Code and was incorporated under Georgia State law on November 1, 1995. According to its By-Laws, FHP's activities are exclusively charitable within the meaning of section 501(c)(3) of the Internal Revenue Code. The exempt purposes set forth in 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals. The Internal Revenue Service (IRS) granted FHP a tax exemption status provided it met these requirements

FHP's Articles of Incorporation stipulated that the organization would accomplish its charitable mission by providing housing to low-median income families through programs sponsored by HUD. The Articles provided that, except for reasonable compensation for services, no part of the property or net earnings of the corporation shall go to the benefit of or be distributed to its directors, officers or other private persons. According to the Articles, the governing body of the Corporation shall be the Board of Directors who "… shall have supervision, control, and direction of the management, affairs and property of the corporation, shall determine its policies or changes therein; and shall actively prosecute its purposes and objectives and supervise the disbursement of its funds." The president was responsible for supervising the affairs of the corporation and for keeping the Board informed. This included authority to hire and fix the compensation of all employees and agents of the Corporation other than officers. The staff included the President and two full time employees.

FHP's non-profit status allowed it to participate in the purchase of HUD owned properties. HUD's discount sales program allows non-profit organizations to purchase HUD owned properties at a discount up to 30 percent in revitalization areas and up to 15 percent in non-revitalization areas. HUD intended that the discounted sales would allow non-profit agencies to rehabilitate the properties if necessary and then resell them to low and moderate-income homebuyers at a reduced, affordable price.

For the period covered by the audit, FHP operated under HUD approvals granted on August 15, 1997, and August 1, 2000. Each of the approvals allowed FHP to participate in the purchase of REO properties at a discount for 2-year increments. During the period of January 1, 1998, through November 10, 2000, FHP purchased 33 properties from HUD for $2,385,510 with discounts that totaled $308,714.

On February 14, 2000, HUD notified FHP of concerns regarding their operations, required the submission of additional information for review, and limited FHP activity to one property at a time. On May 4, 2000, HUD issued a letter of warning that listed several findings and required corrective action.

On May 23, 2001, FHP wrote HUD and asked to be removed from HUD's list of approved nonprofit organizations. FHP made the request after we conducted our on-site review of its operations and noted violations of program requirements.

FHP also operated a down payment assistance program. FHP's president said it was a larger program than its activity in the discount sales program.

Audit objective, scope, and methodology

Our audit objectives were to determine whether FHP was legitimate and independent (not under the influence, control, or direction of other parties) and passed on the benefits of discounts received on the purchase of HUD homes to low and moderate-income homebuyers.

To accomplish our objective, we conducted interviews with HUD officials, FHP's president, one of FHP's rehabilitation contractors, and five individuals who purchased homes from FHP. We also conducted public record searches and on-site reviews of the properties. Further, we reviewed HUD files on FHP, REO case files, property files maintained by FHP, records obtained from a rehabilitation contractor, closing files, and FHP's financial data.

We selected five properties for review from HUD's Single Family Asset Management System (SAMS) report. We selected three 30 percent discounted properties and two 10 percent discounted properties. The audit included properties purchased by FHP during the audit period January 1, 1998, through November 30, 2000. We examined some activity that occurred prior to and after the audit period to develop complete information on certain issues reported in the finding. We performed fieldwork from January 2001 through May 2001.

Exit

FHP Mismanaged its HUD Single Family Property Disposition Program and its Organizers Derived Improper Personal Benefit From Program Operations

FHP did not comply with requirements of HUD's single-family property disposition program. For the 5 properties we reviewed, FHP passed along only $27,822 of the $64,860 in discounts it received from HUD thus depriving the low and moderate-income homebuyers of the program's intended benefits. We also identified at least $147,023 in sales commissions FHP's President paid to his own realty firm from September 1997 through November 2000 on 20 properties FHP purchased from HUD, and $20,061 in profits he paid to a business in which he and his wife were once officers. These transactions violated conflict of interest prohibitions. We observed poor quality workmanship on four houses FHP sold. In addition to its failure to meet HUD's objectives of the program, we question FHP's charitable intent. From 1998-2000, FHP's President obtained personal benefit (aside from salary and realty commissions) from the non-profit's operations. Those acts violated HUD's eligibility criteria for participation in its programs.

Discounts not passed on

Although FHP received discounts of $64,860 from HUD, it sold the 5 properties at or near their appraised fair market value, passing along little, if any, discount.

Property Address	Discount to FHP	Resale Appraised Value	FHP's Resale Price*	Discount to Homeowner
2369 Polar Rock Avenue	$ 10,350	$65,000	$62,150	$2,850
1888 Meadow Lane	8,060	65,000	48,950	16,050
3706 Tulip Drive	18,600	83,000	78,875	4,125
3631 Frey Lake Road	18,750	170,000	169,900	100
930 River Rock Drive	9,100	121,000	116,303	4,697
Total	$64,860			$27,822

* Resale price less FHP's gift to homeowner.

Mortgagee Letter 97-5 clearly limits the resale price for properties purchased with a 30 percent discount to 110 percent of net development cost. If the sale price exceeds 110 percent of net development cost, the excess profit must be used to pay down the existing mortgage. Nevertheless, FHP resold each of the three 30 percent discount properties in our sample for more than HUD's maximum allowed price. The markup totaled $42,503 as shown below.

Property Address	110 Percent of Net Development Cost	Resale Price	Excessive Resale Price
2369 Polar Rock Avenue	$45,882	$64,900	$19,018
1888 Meadow Lane	36,253	51,000	14,747
3706 Tulip Drive	73,762	82,500	8,738
Total	$155,897	$198,400	$42,503

When calculating the net development cost, we excluded amounts not permitted by HUD requirements. Therefore, we excluded the profit earned by an identity of interest contractor FHP used to renovate three properties. We excluded closing costs customarily paid by purchasers. Specifically, we omitted costs associated with the purchaser's loan origination and processing, credit report, appraisal fees, title insurance, and closing fees.

For further illustration, we compared the resale prices to HUD's *as-repaired values.* The table below shows the resale prices of the five test properties ranged from 108 to 125 percent of HUD's *as repaired values.* The results show the non-profits did not pass any savings on to the intended beneficiaries.

Property Address	HUD Discount Percent	HUD's As-Repaired Value	Resale Price	Resale Price as a Percentage of HUD's Value
2369 Polar Rock Avenue	30	$52,000	$64,900	125
1888 Meadow Lane	30	42,000	51,000	121
3706 Tulip Drive	30	75,000	82,500	110
3631 Frey Lake Road	10	158,000	169,900	108
930 River Rock Drive	10	104,000	119,900	115

As shown by these analyses, the discounts to FHP were not used to reduce the price of properties for the benefit of low and moderate-income homebuyers. The resales resulted in higher mortgages to the homebuyers and higher monthly payments, defeating the objectives of the program.

Conflict of Interest

The sales transactions were marred by conflicts of interest when the President of FHP steered business through his own for-profit real estate firm and to a former business partner.

Title 24 of the Code of Federal Regulations (CFR) 291.435(b) states that no person who is an employee, agent, consultant, officer, or an elected or appointed official of the lessee or purchaser of property under this subpart, or who is in a position to participate in a decision making process or gain inside information with regard to the lease or purchase of the property, may obtain a personal or financial interest or benefit from the lease or purchase of the property, or have an interest in any contract, subcontract, or agreement with respect thereto, or the proceeds there under, either for himself or herself or for those with whom he or she has family or business ties, during his or her tenure or for one year thereafter. Internal Revenue Service instructions for completing Form 990, Schedule A, Part III - requires nonprofit organizations to disclose and explain financial transactions with organizations and individuals in a position to influence their operations.

Exit

FHP engaged in the following inappropriate transactions:

<u>$147,023 for commissions.</u> Between September 1997 and November 2000, FHP's president paid $147,023 in realty commissions to a realty firm he owned. The payments were on 20 properties that FHP purchased from HUD and resold. The president stated the realty fees were based on industry standards and the fees should have been counted as part of his salary. This contradicted FHP's affordable housing plan, which implied it would need no agents to locate buyers. Furthermore, the president was paid a salary from FHP for his work, so the commission was duplication of pay.

FHP did not properly disclose the fees either to HUD or to the IRS. For 9 of the 20 properties, the HUD-1 settlement statements did not disclose $75,737 of commissions the president paid to his realty firm by checks drawn on FHP's accounts. Even charges to be paid outside of settlement shall be included on the HUD-1 marked "P.O.C." for "Paid Outside of Closing" according to instructions. Furthermore, FHP's 1999 tax return failed to disclose $83,540 paid to the affiliate during the tax year. The president answered "*no*" on the tax form when asked if the organization purchased goods or services from its officers, directors, or trustees.

<u>$20,061 in profits to an identity-of-interest contractor.</u> FHP obtained renovation services from Dynamic's, a firm incorporated by a former FHP officer on November 12, 1997. The officer listed FHP's president and wife among the original officers, but later removed them. FHP and Dynamic's were prohibited from doing business with each other for 1 year following the break in their affiliation. We calculated the 1-year period starting from September 3, 1997, (the date of FHP's last payroll check to Dynamic's owner) through September 2, 1998. During the 12-month restriction period, FHP allowed the firm to renovate 5 homes, earning profits of $20,061 on the 3 sample homes. FHP did not disclose the conflict of interest and did not obtain a waiver from HUD to allow the firm to do the work.

Personal Benefits Derived

Title 24 CFR 203.41 defines an eligible non-profit as one in which no part of its net earnings inure to the benefit of any member, founder, contributor or individual. Mortgagee Letter 96-52 prohibited members of the nonprofit's board, employees, and any one with an identity of interest to the nonprofit from benefiting specifically from the nonprofit's affordable housing program. FHP's Articles of Incorporations contained similar restrictions. The IRS designed Form 990 to help ensure that organizations remain true to their charitable purposes and that private individuals do not enrich themselves at the expense of those purposes.

FHP paid or used its assets to guarantee personal loans, and other transactions that benefited FHP's president and family.

<u>Building Acquisition</u> - In July 2000 FHP's president made a $100,000 loan from FHP to himself and his wife to buy an office building for $509,700. They financed the building with a $409,000 note guaranteed by FHP. FHP's Board approved the $100,000 loan but the resolution made no mention of the guaranty. The mortgage note listed the president and his wife as the borrowers. FHP's president stated that he did not know that it was inappropriate for him to make the $100,000 loan from FHP and to use FHP as the guarantor for the $409,000 note. After we

brought this issue to FHP's attention, the president transferred ownership of the building from him and his wife to FHP and rearranged the financing with a mortgage in FHP's name.

Vehicle Loan - In January 2000 FHP's president made a $14,000 loan from FHP's account to his daughter-in-law who was also an FHP employee. The president stated that the loan was to assist her with the purchase of a vehicle. The loan was repaid effective April 12, 2001.

Unexplained Salary - From June 1999 to March 2001 FHP's president disbursed $53,095 from FHP's accounts for questionable salary payments to his wife. The president's wife did not have an office at FHP, and the president could not provide a thorough explanation of the services his wife performed to earn the salary payments. He stated that he primarily made the payments to compensate her for the work she did in the past at no pay. The president provided no support for the claim that his wife was due back pay nor did FHP accounting records reflect an account payable for back pay.

Personal Use of Investment Property - FHP's president derived personal benefit from his use of FHP funds to purchase a lake front lot and construct a boat dock. On April 26, 1999, FHP's president purchased the lot for $83,000 in FHP's name. Immediately after the acquisition (May and June 1999), FHP paid $11,993 to construct a boat dock at the lake site. We inspected the undeveloped lot and the boat dock. We also interviewed a neighbor who said FHP's president had a boat that he used to keep at the dock, when the water level was higher. FHP listed the lot as an investment property on its 1999 tax return filed with the IRS.

Entertainment/ Sporting Events – Between March 1999 and October 2000 FHP's president paid $19,211 from FHP's accounts for sports related expenses and equipment. This included $8,219 for seasonal passes to the Atlanta Thrashers hockey games, $5,500 for a charitable golf tournament, $3,500 to sponsor high schools kids in sporting events, $1,300 for a golf cart, and $692 for tickets to Atlanta Falcons football games. FHP's president stated that the payments were legitimate promotional expenses or charitable donations (e.g., sports sponsorships). To the contrary, FHP's 1999 tax return classified most of these as "travel" expenses, not fundraising or charitable contributions.

Rent and Deposits - The president charged FHP rent that exceeded the monthly debt service on a building purchased by he and his wife. FHP occupied only about a third of the available space. The president charged FHP $4,146 per month for rent or $567 more than the monthly mortgage for the whole complex ($3,579). From August to December 2000 the president personally collected rent and deposits from FHP that netted $11,803 over the debt service paid on the building. The President reimbursed FHP after we questioned the inappropriate use of FHP's assets to acquire the building and for rental payments to the president.

Petty Cash - Between May 1998 and August 2000 FHP's president made $6,400 in petty cash payments to himself. The president did not maintain any records to show and support what he did with the money.

These transactions demonstrate that earnings of the non-profit were inuring to the personal benefit of the President. These acts violated HUD's eligibility criteria for participation in its programs.

Need to Improve Quality of Renovation Work - FHP did not complete some needed repairs and, in some instances, completed repairs with poor quality workmanship. The items are presented in Appendix A. For instance, work not done included tile and vinyl flooring, exterior doors, ceiling repairs, and counter tops. The poor quality work included repairs to roof, plumbing, and drainage areas to correct water leaks. In one instance, the owners had to pay the contractor for work FHP had already paid them to perform. FHP had paid the contractor to install a gas line to the stove and dryer and to install an air conditioner at 3631 Frey Road. The owner showed us documents that they paid the contractor $600 to install the gas line and paid another contractor $35 to add Freon to the air conditioner. HUD granted sufficient discounts for FHP to repair all major problems with the homes and FHP should be required to do so.

****

On May 23, 2001, FHP wrote HUD and requested that its name be removed from HUD's list of approved nonprofits organizations. FHP made its request after we conducted our on-site review of its operations and pointed out violations of program requirements.

FHP Response

FHP officials attributed many of the deficiencies to improper advice and counsel from their prior outside accountant and attorney. They said their mistakes resulted from a lack of documentation, or lack of understanding of a particular guideline or regulation, and were unintentional in nature. They said they have changed their operation and way of doing business and have implemented a number of action steps.

FHP officials believed they were passing along appropriate discounts to buyers. They said any errors in their cost profile sheets were inadvertent and not intentional. They asked that the excess resale prices for the 30 percent discount properties be reduced by any gifts or closing costs paid for the homebuyers.

FHP officials said they stopped charging commissions after HUD informed them the commissions should not be paid. The realty company is now dormant, and FHP will file an amended IRS form 990 to correct the disclosure error.

FHP said the conflict of interest with Dynamic was inadvertent, and that the cofounder resigned from FHP when they became aware of the rule. FHP officials said they had no knowledge that they were also listed as officers in Dynamic. However, the situation has been corrected and they are no longer listed as officers in Dynamic.

FHP officials did not agree that private inurement had resulted from FHP's activities. They explained the building transactions were based on incorrect advice from the bank and prior accountant. They have now corrected the purchase and rent transactions, and the transactions will be reflected in the 2001 income tax returns. They said the employee vehicle loan has been repaid. The unexplained salary was based on past services when the spouse had received no salary. The unimproved lake property is an investment property and future proceeds from the sale will be used to further their mission. The entertainment and sporting events were to further the business through the down payment assistance program.

FHP officials believed they had properly rehabilitated the properties, and that some of the repair deficiencies were the responsibility of the homeowners. However, they agreed to pay or make repairs deemed by HUD to be their responsibility.

OIG Evaluation of FHP's response

We consider FHP's actions responsive to our finding. Correction of the transactions and the other steps should improve the nonprofit's operations.

Recommendations

We recommend the Director of the Atlanta Homeownership Center:

1A. Require FHP to pay down the mortgage for the 30 percent discounted properties it sold for prices that exceeded 110 percent of net development cost. FHP requested the prices be reduced for gifts or closing costs paid on behalf of the homebuyers.

1C Require FHP to correct the rehabilitation deficiencies identified in Appendix A at no cost to the purchaser or current occupant of the homes.

APPENDIX A

SCHEDULE OF REHAB WORK DEFICIENCIES

Property Address	Work Not Performed (A)	Poor Quality Work (B)
3706 Tulip Drive	1, 2	1, 2
1888 Meadow Lane	3, 4, 5	3, 4
2369 Polar Rock	6	5
3631 Frey Lake Road	7, 8	6

A—Work Not Performed

1. The gas hot water heater did not have a shut off valve located at or near heater.
2. Only one smoke detector was installed.
3. There was no evidence of caulking around windows.
4. The attic vent on the right side of the house was not secured to the wall.
5. Tile was not installed at the front door entry.
6. The crawl space door was not replaced.
7. The contractor's invoice included work for several items, which the contractor did not perform. The contractor billed for installation of vinyl flooring in bath; repair to garage ceiling; installation of two exterior doors; and installation of electrical plugs, switches and outlets covers which were not performed based on our observations and discussions with the homeowner.
8. The homeowner paid the contractor $635 for work that was included in the contract and for which FHP paid the contractor to perform. The owner provided documentation that showed he paid the contractor $600 to install gas supply lines for stove and dryer connections and $35 to add freon to the air conditioner unit. These services were a part of the renovation work and should not have resulted in any charges to the homeowner.

B—Poor Quality Work

1. Water damage in the rear den and bedroom. The homeowner had to remove the carpet in the den due to water damage. The walls have mildew caused by the continued infiltration of water into the area when it rains.
2. The electrical panel was replaced but the panel box was not labeled to identify which areas of the house each breaker controlled.
3. The exterior paint showed severe signs of flaking.
4. The sub-flooring showed evidence of decay in several areas caused by water leaks. The floor covering in the bathroom is stained from water that leaked from the commode.
5. There was a water leak at the washer hookup up receptacle in the laundry room.
6. The master bathroom faucet leaked.

AUDITEE COMMENTS

FAMILY HOME PROVIDERS, INC.
"Helping Others to Live Better Lives"

September 21, 2001

Ms. Nancy H. Cooper
District Inspector General
For Audit – Southeast
U.S. Department of Housing and Urban Development
District Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, Georgia 30303-3388

Dear Ms. Cooper:

We have received the draft copy of your audit memorandum addressed to Charles E. Gardner, Director, Atlanta Homeownership Center, 4AHH regarding Family Home Providers, Inc.'s participation in the FHA's Single Family Insurance Real Estate Owned (REO) Program. On September 17, 2001 we met with Mr. James D. McKay, Assistant District Inspector General for Audit, Mr. David P. Ellison, Chief, Field Operations Branch, and Ms. Conni E. Phillips, Housing Program Specialist for the purpose of clarifying the draft memorandum and submitting our initial verbal response. We trust that our initial verbal response will be considered and reflected in your final report.

You have requested that we also provide our initial draft of our written response and comments in electronic format. Accordingly, as an attachment to this letter, we are providing our written comments and response. Given the fact, however, that we have been allowed only four days from the exit conference to respond, our response is subject to future clarification and revision.

We appreciate the professionalism of your staff as they carried out the audit and related follow up conference. We have a better understanding of our requirements and have done everything we know of in order to correct any transaction that should be corrected, and put in policies, procedures, and controls to ensure future compliance with HUD regulations or IRS guidelines. If anyone has any questions or comments regarding our response, please do not hesitate to contact me, or Jack L. McGinnis, CPA, at 404-531-4947 or Reginald L. Carver, Attorney, at 770-664-4087.

Sincerely,

Fred C. Proctor, Jr.

Fred C. Proctor, Jr.
President

Enclosure

(via E-mail w/enclosure): James D. McKay (jmckay@hudoig.gov)
David P. Ellison (david_p._ellison@hud.gov)
Conni E. Phillips (conni_e._phillips@hud.gov)

cc: Rusty Paul, I-Squared Communications
Reginald L. Carver, Bach, Carver, Dewberry & McNaull
Jack L. McGinnis, Brooks, McGinnis & Company, LLC
FHP Board Members

6030 Bethelview Rd. Suite 202 Cumming, Ga. 30040 * 770-887-4578 * Fax 770-887-7503

Exit

AUDIT RESPONSE MEMORANDUM

FOR: Nancy H. Cooper
District Inspector General for Audit Southeast/Caribbean, 4AGA
And
Charles E. Gardner
Director, Atlanta Homeownership Center, 4AHH

FROM: Fred C. Proctor, Jr.
President, Family Home Providers, Inc. (FHP)

SUBJECT: Response To Draft Audit Report Regarding FHP's Participation In FHA's Real Estate Owned Single Family Insurance Program

We have received a draft copy of the Audit Memorandum addressed to Charles E. Gardner from Nancy H. Cooper regarding the audit of FHP's purchase of Real Estate Owned (REO) properties. We understand that FHP was chosen for audit as part of the nationwide audit of FHP's Single Family Insurance Program. We also understand that the purpose of this audit was to determine that FHP is legitimate and independent and that it passed on benefits of discounts received on the purchase of HUD homes to low and moderate income homebuyers.

As a general response to the report, please be advised that as soon as the audit fieldwork commenced, I began to realize that I had not received proper outside counsel and advice from FHP's outside CPA and attorney. Accordingly, FHP immediately hired Mr. Reginald L. Carver of the law firm, Bach, Carver, Dewberry & McNaull as legal counsel and Mr. Jack L. McGinnis, CPA of the accounting firm of Brooks, McGinnis & Company, LLC. We have also contracted with I-Squared Communications, State Senator Rusty Paul, President, a former HUD official, to support us as a government advisor. All of these firms and individuals are well known as experts in 501(c)(3) matters and were willing to help make sure that we operated in compliance with all IRS and HUD Guidelines and Regulations. While we may not agree totally with the audit results and presentation of your report, we did realize that we needed outside assistance in order to be fully in compliance. Accordingly, our mistakes have been unintentional in nature, or from a lack of documentation, or from a lack of understanding of a particular guideline or regulation and have <u>not</u> been made from a perspective of intentionally disregarding any government regulations and guidelines.

We have reacted to the findings in your audit report, even before receiving the written report, by making a very serious attempt to change our operations and way of doing business. The following are action steps that have been implemented during the initial audit fieldwork and through today:

1. Our Board of Directors has been reorganized and now meets quarterly, in addition to ongoing teleconference meetings when necessary. This is a board controlled by independent board members and is providing the documented necessary oversight for us to function as a 501(c)(3) tax exempt organization in both appearance and fact.

2. We have analyzed potential excess benefit transactions in order to make sure we are in compliance with related IRS "Intermediate Sanctions" guidelines. As part of this process, Brooks, McGinnis & Company, LLC has issued a related report to our Board of Directors regarding compensation arrangements. This report addressed their market survey of our salary and compensation arrangements and made several recommendations to ensure future compliance. Also, as part of this process, FHP now has written job descriptions for every employee. The hiring and personnel performance results are monitored closely by our Board of Directors.

3. Under the direction of Board Member, David Savage, and in conjunction with outside counsel, Bach, Carver, Dewberry & McNall, FHP now has a company Personnel and Procedures Manual.

Exit

4. Outside CPA firm, Brooks, McGinnis, & Company, LLC has developed a Program Compliance Manual for the HUD gift program that is now our major program at FHP. This manual will be updated periodically and we will have an ongoing internal assessment of our compliance, with periodic reports to our Board of Directors.

5. For the first time FHP is operating under a budget approved by our Board of Directors. The 2002 budget is being prepared and will be presented for discussion and approval at the next Board Meeting.

In general, our mission and goal at Family Home Providers, Inc. has always been and remains to provide homeownership opportunities for low and moderate income persons, which is the same goal as outlined by HUD in its Mortgage Letter #00-8, dated March 3, 2000. This goal is consistent with our original Form 1023 application as filed and approved by the IRS. It is also consistent with all our actions and intentions as we attempted to provide homeownership opportunities in accordance with HUD and IRS guidelines, as we understood them.

Our specific responses to the findings in your audit memorandum are summarized as follows:

1. Regarding "Discounts Not Passed On" Comments and findings:

   We have attempted to pass appropriate discounts to the buyers of our renovated houses. We do not go by the price of the homes in the area, but by the purchase and renovation cost. It is a simple formula and is always done on a cost profile sheet. This cost profile sheet is done on every house and is made a part of the loan package. The following method is used to reach the price of the house: The cost of the house, the renovation cost, the management and development fees, the 10% allowable profit, the closing cost; from that figure we deduct the down payment gift from Family Home Providers and the remainder is the loan amount plus the MIP. The buyer must pay for their homeowners insurance and the prepaid escrow items. Appraisers always appraise a property for the contract amount, but we know that the true values of the homes are 10% to 25% above the contract price. This gives the family equity in the property the day they move in. This is something that Family Home Providers is extremely proud of. We sold one house for $52,000 because that was all the family could qualify for, and the actual value of the house was $80,000. This is a rare example, but it happened. If our cost profile sheets are not in accordance with HUD guidelines, this was inadvertent and not intentional. We truly believed we were passing along the correct discounts and helping these buyers achieve homeownership. If HUD believes it to be appropriate to reduce certain mortgages, please inform us and we will comply with any reasonable request. Based on our exit interview it is our understanding that the calculations, which derived the $42,503 excess markup on the three thirty percent discounted properties, were to be reconsidered. Please advise so that we can reduce the mortgages by the appropriate amounts.

2. Response regarding "Conflict of Interest" Comments and findings:

   We understand that the appearance of a conflict of interest is present with these findings. Again, this was unfortunate and inadvertent. Mr. Proctor, through Affordable Realty, provided real estate services in connection with the sale of homes as outlined on the worksheet titled "Real Estate Commissions to Affordable". It is now realized by Mr. Proctor that such services should have been structured within Family Home Providers, Inc. and any such fees should have been reflected in his salary from Family Home Providers, Inc. during this time. It should be clearly noted that these real estate services were provided and the commission paid was 7%, which is industry standard. These services were necessary and were paid for value received. The bottom line result is that the same amounts have been paid as would otherwise have been paid, and these homes were provided to low and moderate income persons. Both the mission of Family Home Providers, Inc. and the goal of HUD have been achieved. It is unfortunate that the fee on certain of the homes was not properly reflected on the HUD-1 statements as POC.

Exit

It should also be noted that Mr. Proctor's salary was increasing during this time because his duties and responsibilities were increasing tremendously by the addition of and continued expansion of Family Home Providers, Inc.'s Down Payment Assistance Program. This new program is a totally separate program from our purchase, renovation and sale of real estate to moderate and low income persons program. The goals of the Down Payment Assistance Program remain consistent with Family Home Providers, Inc. and HUD's goal of providing homeownership to low and moderate income persons. In addition, Mr. Proctor had received little or no salary from Family Home Providers, Inc. for several years. In order for Mr. Proctor to be fairly compensated for services rendered and within the fair market value for services rendered concepts of nonprofit entities in general, the Board had increased Mr. Proctor's compensation package to be commensurate with duties performed.

In conclusion to this response, no monies have been paid to anyone that were not earned. Accordingly, there has been no "private inurement", and the mission of Family Home Providers, Inc. and the goal of HUD of providing homeownership to low and moderate persons has been achieved.

Regarding reporting to the IRS, this was an oversight by our prior external CPA firm. We will immediately file amended IRS forms 990 in order to correct this disclosure error. It should be noted that all commissions paid were properly reflected to the IRS in Affordable Realty's income tax return. Furthermore, as soon as FHP was informed at a HUD meeting that these commissions should not be paid, they were no longer paid. In addition, in order to avoid any future mix-ups like this, Affordable Realty is now a dormant corporation.

Regarding Mr. and Mrs. Proctor being listed as officers in Dynamic, they had no knowledge that this had happened. Mr. Gary Scarborough (Dynamic) was one of Family Home Providers, Inc.'s co-founders, along with Mr. Fred Proctor. Unfortunately, when they began Family Home Providers, Inc. to participate in HUD's REO Program, they were not aware of certain of the HUD or IRS rules regarding 501(c)(3) organizations. Otherwise, they would have operated differently. After they became of aware of this HUD rule, Mr. Scarborough resigned in order that there not be a conflict of interest in fact or appearance. Even so, no "extra" monies have been spent; any services paid for by Family Home Providers, Inc. to Mr. Scarborough through contracts with Dynamic were at or below the fair market value of such services. Also, such services accomplished Family Home Providers, Inc.'s stated mission of providing homeownership opportunities to low and moderate income persons. This, of course, also accomplished HUD's similar goal and was paid at or less than the fair market value of such services.

3. Response related to "Personal Benefits Derived" Comments and findings:

A. Regarding "Building Acquisition and Rents and Deposits Paid" Comments and findings:

We disagree totally with the presentation of this section of the report. As soon as Mr. Proctor realized from Mr. Stamps that owning and renting the office building was a potential problem, he immediately sought outside legal and CPA counsel. When Family Home Providers, Inc. expanded from only the REO program to also start the Down Payment Assistance Program, it was determined that more space would be needed and additional employees would need to be hired. He found the current space and initially planned for FHP to purchase the three unit office condo building. FHP would use one unit and rent the other two. As FHP expanded, we would have this additional space to use. When he approached Regions Bank regarding financing the purchase by the Company, he was informed that he would have to personally guarantee the $409,000 mortgage. When told this by Regions, he sought counsel from FHP's former external CPA firm. Unfortunately, Mr. Proctor was advised to borrow the down payment from the company, purchase the building personally and lease the space to FHP. The rents paid were only for the space used, and at fair market value or less, based upon a market survey. Upon advice of present legal counsel and CPA, this transaction has been completely reversed, FHP has purchased the building from Mr. Proctor for exactly what the original cost was in August 2000, and all related costs, expenses, rents, etc. have been reimbursed to each party so that the transaction is now the same as if FHP purchased the building as originally planned.

Exit

It should be noted that this transaction will be reflected on FHP and Mr. Proctor's 2001 income tax returns. Accordingly, the presentation that Mr. Proctor somehow has received a $509,000 and $11,803 personal benefit from these transactions is not correct. Furthermore, even if the transaction had not been reversed, the related mortgage, the down payment note and other ownership liabilities would reduce this benefit to or below "zero".

B. Regarding "Vehicle Loan" Comments and findings:

This employee loan has been repaid, with fair market interest.

C. Regarding "Unexplained Salary" Comments and findings:

For FHP's President's wife, it should be noted that Mrs. Proctor has provided services to FHP since its inception. She has answered phones, assisted with shows, arranged and distributed marketing materials, typed correspondence and other reports, and handled other administrative duties, such as record keeping and filing. Even as her duties became more on a part time basis with the move into the new office space, she was compensated for past services for prior years when she received no salary. In order to avoid the appearance of any impropriety, she has since resigned from FHP and has been thanked by the Board for her many years of service.

D. Regarding "Personal Use of Investment Property" Comments and findings:

This is an investment property, (unimproved lot) and when sold all proceeds will be used to further our mission.

E. Regarding "Entertainment/Sporting Events" and "Petty Cash" Comments and findings:

All monies spent by FHP in these categories were to further the business of FHP and its mission of providing homeownership opportunities through its Down Payment Assistance Program. However, the Thrasher tickets are no longer purchased by the company and new documentation guidelines have been instituted for all petty cash and expense reimbursements. All expenses incurred by Mr. Proctor in his capacity as President and CEO of Family Home Providers, Inc. were for the business of FHP, in pursuit of its mission to provide homeownership opportunities for low and moderate income families.

F. Response related to "Medical Expenses" Comments and findings:

These medical expense reimbursements were made pursuant to FHP's medical reimbursement policy for uninsured medical costs to all of its employees as allowed by the IRS under Section 105 of the tax code. FHP's plan included payment of heath insurance premiums, as well as the deductible portion of the medical expenses not covered by insurance reimbursements. Under a Section 105 plan, these payments are not reportable on the W2 as implied by your report.

4. Response regarding "Need to Improve Quality of Renovation Work" Comments and findings:

We believe that all homes we renovated and sold were at the highest quality when we closed. We also provided a one-year home warranty guarantee at closing. We believe that your findings in Appendix A should be the responsibility of the homeowner. However, in an effort to show good faith and to correct any perceived mistakes on our part, we would be willing to deposit a reasonable amount in an escrow account in order to reimburse these homeowners for the repairs deemed by HUD to be our responsibility, or pay for or make the repairs as limited to Appendix A of your memorandum.

SUMMARY AND CONCLUSIONS

Family Home Providers, Inc., its management team and its Board of Directors take very seriously any and all comments and findings presented in your report. Accordingly, as previously stated, outside counsel, external CPA and government advisor have all been engaged by FHP to help correct any and all deficiencies, and to design new and better operating policies and guidelines. This is an ongoing, ever changing process and is being closely monitored by our Board of Directors. Each Board Member takes a strong proactive oversight role, as you would expect in a well-managed 501(c) (3) organization. As you have indicated in your report, we have decided to terminate our participation at this time in your REO program. If new guidelines are issued in this area, and if these revised guidelines are such that we believe we can understand and, therefore be able to follow, we may reconsider this decision and re-apply. In the meantime, we have fully evaluated the requirements of the HUD Gift (i.e. "down payment assistance") Program and we strongly believe we are in total compliance with all HUD and IRS guidelines and regulations. We also strongly disagree that we should not be allowed to continue with this program as implied by recommendation 1A of your report. Your audit findings related to our REO Program and not to our Down Payment Assistance Program. In 2000, our down payment assistance program helped 1,245 families achieve homeownership. We also reached over 1,000 people by providing 28 four-hour home purchase education classes. This year we are reaching many more families. To terminate our participation in this program would unfairly impact thousands of other low and moderate income families we will reach and help.

Regarding recommendations 1B and 1C, as previously stated in this response memorandum, we will pay down the mortgages and provide reasonable repair assistance after we get the final agreed upon amounts.

Exit

DISTRIBUTION

President, Family Home Providers, Inc., Cumming, Georgia
Secretary, S
Deputy Secretary, SD (Room 10100)
Chief of Staff, S (Room 10000)
Assistant Secretary for Administration, S (Room 10110)
Acting Assistant Secretary for Congressional and Intergovernmental Relations, J (Room 10120)
Deputy Assistant Secretary, Office of Public Affairs, S, (Room 10132)
Deputy Assistant Secretary for Administrative Services, Office of the Executive Secretariat, AX (Room 10139)
Deputy Assistant Secretary for Intergovernmental Relations,
Acting Deputy Chief of Staff, S (Room 10226)
Deputy Chief of Staff for Policy, S (Room 10226)
Deputy Chief of Staff for Programs, S (Room 10226)
Special Counsel to the Secretary, S (Room 10234)
Senior Advisor to the Secretary, S
Special Assistant for Inter-Faith Community Outreach, S (Room 10222)
Executive Officer for Administrative Operations and Management, S (Room 10220)
General Counsel, C (Room 10214)
Assistant Secretary for Housing/Federal Housing Commissioner, H (Room 9100)
Assistant Secretary for Policy Development and Research, R (Room 8100)
Assistant Secretary for Community Planning and Development, D (Room 7100)
Assistant Deputy Secretary for Field Policy and Management, SDF (Room 7108)
Office of Government National Mortgage Association, T (Room 6100)
Assistant Secretary for Fair Housing and Equal Opportunity, E (Room 5100)
Director, Office of Departmental Equal Employment Opportunity, U
Chief Procurement Officer, N (Room 5184)
Assistant Secretary for Public and Indian Housing, P (Room 4100)
Director, Office of Departmental Operations and Coordination, I (Room 2124)
Office of the Chief Financial Officer, F (Room 2202)
Chief Information Officer, Q (Room 3152)
Acting Director, HUD Enforcement Center, V, 1250 Maryland Avenue, SW, Suite 200
Acting Director, Real Estate Assessment Center, X, 1280 Maryland Avenue, SW, Suite 800
Director, Office of Multifamily Assistance Restructuring, Y, 1280 Maryland Avenue, SW, Suite 4000
Inspector General, G (Room 8256)

Secretary's Representative, 4AS
Director, Homeownership Center, 4AHH
Audit Liaison Officer, 3AFI
Audit Liaison Officer, Office of Housing, HF (Room 9116)
Departmental Audit Liaison Officer, FM (Room 2206)
Acquisitions Librarian, Library, AS (Room 8141)
Counsel to the IG, GC (Room 8260)
HUD OIG Webmanager-Electronic Format Via Notes Mail (Cliff Jones@hud.gov)
Public Affairs Officer, G (Room 8256)
Stanley Czerwinski, Associate Director, Resources, Community, and Economic Development Division, U.S. GAO, 441 G Street N.W., Room 2T23, Washington DC 20548
The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs, United States Senate, Washington DC 20510-6250
The Honorable Joseph Lieberman, Ranking Member, Committee on Governmental Affairs, United States Senate, Washington DC 20510-6250
The Honorable Dan Burton, Chairman, Committee on Government Reform, United States House of Representatives, Washington DC 20515-6143
The Honorable Henry A. Waxman, Ranking Member, Committee on Government Reform, United States House of Representatives, Washington, DC 20515-4305
Ms. Cindy Fogleman, Subcommittee on Oversight and Investigations, Room 212, O'Neil House Office Building, Washington, DC 20515-6143
Steve Redburn, Chief, Housing Branch, Office of Management and Budget, 725 17th Street, NW, Room 9226, New Executive Office Bldg., Washington, DC 20503
Sharon Pinkerton, Deputy Staff Director, Counsel, Subcommittee on Criminal Justice, Drug Policy and Human Resources, B373 Rayburn House Office Bldg., Washington, DC 20515
Armando Falcon, Director, Office of Federal Housing Enterprise Oversight, O, 1700 G Street, NW, Room 4011, Washington, DC 20552
Andrew R. Cochran, Senior Counsel, Committee on Financial Services, 2129 Rayburn House Office Building, Washington, DC 20510