AUDIT REPORT

HOMEWIDE LENDING CORPORATION

NON-SUPERVISED MORTGAGEE

2004-LA-1003

MAY 19, 2004

OFFICE OF AUDIT
PACIFIC/HAWAII REGION
LOS ANGELES, CALIFORNIA

audit report

Issue Date	May 19, 2004
Audit Case Number	2004-LA-1003

TO: John C. Weicher, Assistant Secretary for Housing-Federal Housing Commissioner, Chairman, Mortgagee Review Board, H

Joan S. Hobbs

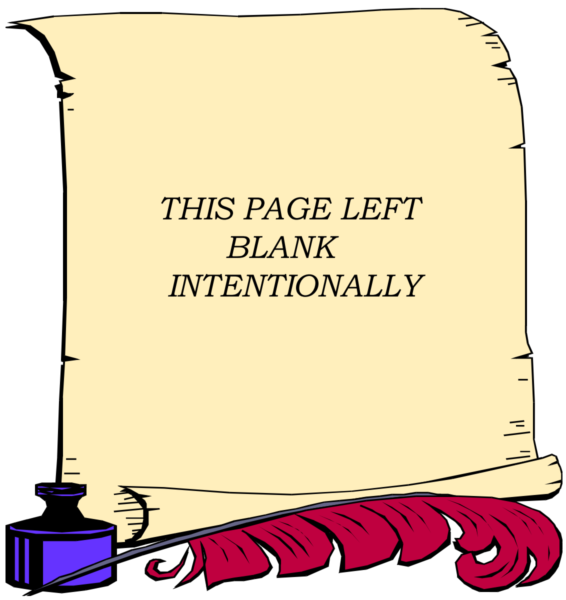
FROM: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

SUBJECT: Homewide Lending Corporation
Non-Supervised Mortgagee
City of Industry, California

We completed an audit of Homewide Lending Corporation (Homewide), a non-supervised mortgagee, based in City of Industry, California. We selected Homewide for audit based on the existence of identified risk factors. The audit objectives were to determine whether Homewide originated Federal Housing Administration (FHA) insured mortgages in accordance with prudent lending practices and HUD requirements, and implemented its Quality Control Plan as required.

Our report contains two findings with recommendations requiring action by your office. In accordance with HUD Handbook 2000.06, REV-3, within 60 days please provide us for each recommendation without a management decision, a status report on (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why corrective action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for each recommendation without a management decision. Also, please furnish us with copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me or Tanya Voigt, Assistant Regional Inspector General for Audit, at (213) 894-8016.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Executive Summary

We completed an audit of Homewide Lending Corporation (Homewide), a non-supervised mortgagee based in City of Industry, California. Homewide was approved as a Loan Correspondent in February 2000, but at the time of our audit had conditional approval as a non-supervised mortgagee and was completing the required test cases to obtain unconditional approval. The audit objectives were to determine whether Homewide originated Federal Housing Administration (FHA) insured mortgages in accordance with prudent lending practices and HUD requirements, and implemented its Quality Control Plan as required.

21 of 30 Loan Files Reviewed Contained False Documents

Homewide used false employment and income documentation to originate FHA loans. Specifically, 21 of 30 loans we reviewed, totaling $3.5 million, contained false documents and information, including: (1) false or altered Internal Revenue Service (IRS) W-2 forms, pay stubs, and verification of employment forms; (2) false down payment and gift fund documentation; and (3) false statement of occupancy on the loan applications. Our review also identified other loan origination deficiencies with the 21 loans including: (1) overstated income; (2) inaccurate or excessive qualifying ratios; (3) unsupported down payment and/or gift funds; and (4) understated liabilities.

The problem occurred because of Homewide's complicity in the document falsification and a serious lack of due care by mortgagee personnel involved in the loan origination process. Additionally, as detailed in Finding 2, Homewide's failure to fully implement its Quality Control Plan allowed the use of false documents to go undetected and uncorrected. As a result, loans were approved based on false information and caused unnecessary risk to the FHA insurance fund.

Homewide Did Not Conduct Required Quality Control Plan Reviews

Homewide did not fully implement its Quality Control Plan as required. Our review disclosed that while Homewide had established a written Quality Control Plan that met HUD requirements, it failed to conduct the required quality control reviews, and to ensure that immediate corrective action was taken on deficiencies identified in the reviews. Since HUD had previously instructed Homewide to implement and maintain a Quality Control Plan, we attribute the deficiency to Homewide management's disregard of its responsibilities to assure the reviews were conducted and that any identified deficiencies were corrected. As a result, as discussed above, the use of false documentation in the origination of FHA loans was allowed to go undetected and continue unnecessarily.

Recommendations

We are recommending that HUD: (1) Remove Homewide from participation in HUD's Single Family Mortgage Insurance Programs; (2) Require Homewide to indemnify HUD/FHA for any losses already incurred, and against future losses, on the 21 loans identified in Appendix B that were originated using false documents; (3) Consider taking civil monetary penalties against Homewide for each loan identified in Appendix B that was originated using false documents; and (4) Require Homewide to take the needed action to ensure the required Quality Control Plan reviews are conducted, and that corrective action is taken, and documented, for all reported deficiencies.

Audit Results Discussed With Auditee

We discussed the findings with Homewide officials during the audit and at an exit conference held on March 25, 2004. We also provided Homewide and HUD with a copy of the draft audit report for comments on March 16, 2004. We received Homewide's response on April 30, 2004. Homewide's response and our evaluation is discussed in the findings, and the full text of their response is included as Appendix C.

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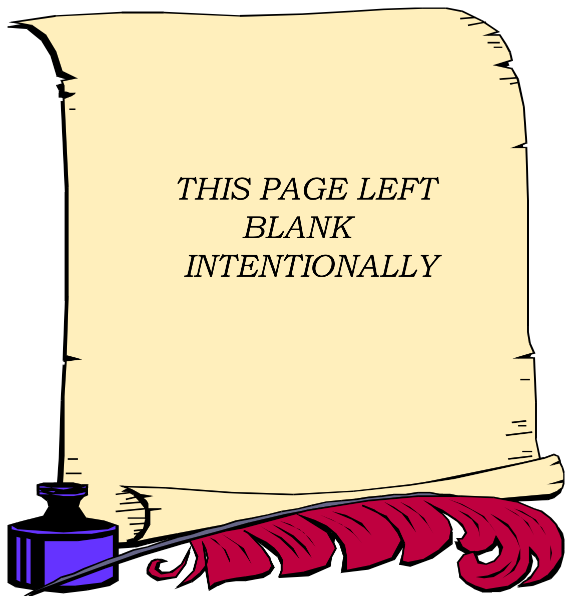
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Introduction

The National Housing Act, as amended, established the Federal Housing Administration (FHA), an organizational unit within the Department of Housing and Urban Development (HUD). FHA provides insurance to private mortgagees against loss on mortgages financing homes. The basic home mortgage insurance program is authorized under Title II, Section 203(b) of the National Housing Act and governed by regulations in Title 24 Code of Federal Regulations (CFR), Section 203.

Homewide Lending Corporation (Homewide) was approved as a loan correspondent mortgagee in February 2000. Subsequently, at the time of our audit, Homewide was granted conditional approval as a non-supervised mortgagee and was in the process of completing the test cases required for unconditional approval. As a loan correspondent, and also while it has only conditional approval as a non-supervised mortgagee, Homewide may originate loans, but they must be sent to a HUD-approved sponsor for underwriting approval prior to loan closing, and submission to HUD for insurance endorsement. The loan origination process includes taking the initial loan application, obtaining the credit report, obtaining the appraisal report, and conducting the verifications of employment and deposits. Based on the information gathered by Homewide, the sponsor underwrites the loan and determines whether the borrower represents an acceptable credit risk for HUD/FHA. The sponsor bases its underwriting decision and approval, largely on the information gathered by Homewide. As such, it is critical that Homewide exercises due care and follows prudent lending practices when originating the loans.

Homewide's home office was located in North Hollywood, California, at the time of our audit, but then relocated to City of Industry, California prior to the issuance of this report. Homewide retained the North Hollywood office open as a branch office. Homewide had two other branch offices, but closed them in 2003. Homewide originates and underwrites FHA-insured loans and conventional loans. Between April 1, 2001, and March 31, 2003, Homewide originated 148 FHA-insured loans totaling $24,633,814.

Audit Objectives and Scope and Methodology

The objectives of our audit were to determine whether Homewide (1) originated FHA loans in accordance with prudent lending practices and HUD requirements, and (2) implemented its Quality Control Plan as required.

To accomplish our objectives, we performed the following:

- ✓ Reviewed pertinent HUD/FHA regulations, requirements, and Mortgagee Letters.

- ✓ Reviewed Homewide's loan origination procedures and interviewed appropriate Homewide officials to obtain an understanding of the loan origination process, including its controls for ensuring loans are in compliance with HUD/FHA requirements.

- ✓ Reviewed Homewide's financial records to determine if Homewide met HUD's net worth and liquidity requirements, and to identify any improper mortgagee expenditures.

- ✓ Contacted appropriate HUD Quality Assurance Division officials and reviewed monitoring results and information.

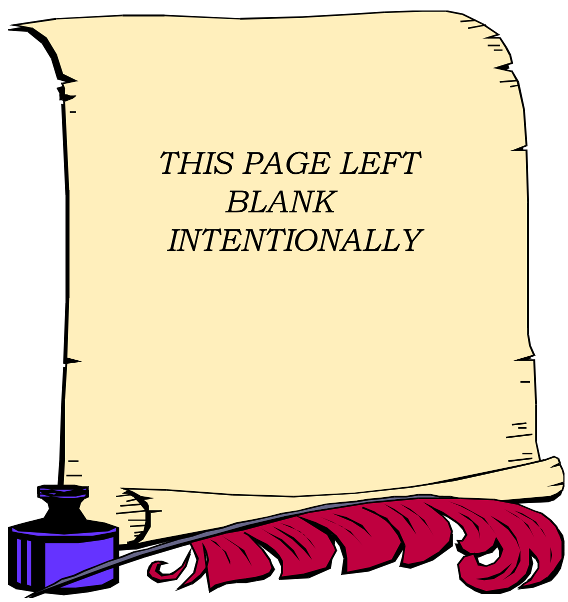
- ✓ Examined records and reports maintained on HUD's Single Family Data Warehouse, Single Family Insurance System, and Neighborhood Watch Early Warning System.

- ✓ Queried Internet systems such as Lexis Nexis and Real Quest to validate loan information and locate borrowers and purported employers.

- ✓ Selected and reviewed a non-representative sample of 30 loans to determine whether Homewide originated the loans in accordance with prudent lending practices and HUD/FHA requirements. We selected these loans because they reported a default within the first two years of the mortgage (22 loans), they received a poor rating in the post-endorsement technical review (4 loans), or they showed indications of possible property flipping (4 loans).

- ✓ Conducted site visits and/or contacted the borrowers and employers as needed to validate the purported employment and income information contained in the loan files to qualify the borrowers for the mortgage loans. We also obtained State of California wage reports for the borrowers in the 30 loans to validate the employment and income information in the loan files.

Our audit generally covered the period from April 2001 through March 2003. Where appropriate, we extended our review to cover other periods. We substantially performed our audit fieldwork between May and December 2003. We conducted our review in accordance with generally accepted government auditing standards.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Homewide Used False Documents To Originate FHA-Insured Loans

Homewide used false employment and income documentation to originate FHA loans. Specifically, 21 of 30 loans we reviewed, totaling $3.5 million, contained false documents and information including: (1) false or altered Internal Revenue Service (IRS) W-2 forms, pay stubs, and verification of employment forms; (2) false down payment and gift fund documentation; and (3) false statement of occupancy on the loan applications. Our review also identified other loan origination deficiencies with the 21 loans including: (1) overstated income; (2) inaccurate or excessive qualifying ratios; (3) unsupported down payment and/or gift funds; and (4) understated liabilities.

The problem occurred because of Homewide's complicity in the document falsification and an apparent serious lack of due care by mortgagee personnel involved in the loan origination process. Additionally, as detailed in Finding 2, Homewide management's failure to fully implement its Quality Control Plan allowed the use of false documents and other deficiencies to go undetected and uncorrected. As a result, loans were approved based on false and inaccurate information, which caused unnecessary risk to the FHA insurance fund.

Loan Origination Requirements

Mortgagees must follow the statutory and regulatory requirements of the National Housing Act and HUD requirements, instructions, guidelines, and regulations when originating FHA-insured loans. HUD Handbook 4000.4 REV-1, *Single Family Direct Endorsement Program*, Section 2-1, states that a Direct Endorsement mortgagee must conduct its business operations in accordance with accepted sound mortgage lending practices, ethics, and standards. Further, Section 2-5 of the same Handbook provides that mortgagees are to obtain and verify information with at least the same care that would be exercised if originating a mortgage when the mortgagee would be entirely dependent on the property as security to protect its investment.

HUD Handbook 4060.1 REV-1, *Mortgagee Approval Handbook*, Section 6-1, states that as a condition of HUD/FHA approval, mortgagees must have and maintain a Quality Control Plan for the origination and servicing of insured mortgages. The Quality Control Plan must be a prescribed function of the mortgagee's operations and assure that the mortgagee maintains compliance with HUD/FHA requirements and its own policies and procedures. It must be sufficient in scope to enable the mortgagee to evaluate the accuracy, validity and completeness of its loan origination and servicing operations.

Homewide Loan Processing Procedures

Homewide's Quality Control Plan included a chapter on loan processing policies and procedures. This chapter provided that Verifications of Employment, Deposit, Mortgage Loan Account(s) or Other Source of Funds must be sent out unless the loan will be processed using alternative documentation or limited documentation. All verifications must be sent to the verifier by U.S. mail with a prepaid return envelope. If the verification is hand-carried by a messenger service, this information must be included in the loan application package. No verification may be hand-carried by a loan officer or other representative of the company who is directly involved in the origination of the loan. All verifications should be sent to street addresses, not to a post office address, if possible. The returned verification must be date stamped "received" and compared with the information provided on the application and shown on the credit report. Any discrepancies must be explained in writing by the applicant(s).

Summary of Findings

We reviewed 30 of 148 FHA-insured loans originated between April 1, 2001 and March 31, 2003 and found that Homewide did not comply with HUD/FHA requirements and prudent lending practices in 21 of 30 loans, totaling $3.5 million. We found the 21 loans were originated based on false documents and information, which included:

- False or altered Internal Revenue Service (IRS) W-2 forms, pay stubs, and VOE forms (19 of 30 loans);

- False down payment and gift funds documentation (11 of 30 loans); and

- False statement of occupancy on the loan application (5 of 30 loans).

Our review also identified other loan origination deficiencies with the 21 loans including:

- Overstated income (15 of 30 loans);
- Inaccurate/excessive qualifying ratios (14 of 30 loans)
- Unsupported down payment and/or gift funds (12 of 30 loans); and
- Understated liabilities (2 of 30 loans).

Details are discussed separately below.

21 Loans Totaling $3.5 Million Contained False Documents

We reviewed a sample of 30 of 148 FHA-insured loans that were originated by Homewide between April 1, 2001 and March 31, 2003 to determine whether Homewide complied with HUD/FHA requirements and prudent lending practices. Our review disclosed that in 21 of 30 loans reviewed (70 percent) we found that false documents were used in the origination of the loans. More specifically, 19 of the 30 loan files contained false IRS W-2 forms, pay stubs, and VOE forms, and false down payment or gift funds. We found that in some cases the borrowers' W-2s or pay stubs had been altered to overstate the borrower's income, or length of employment. In other cases, the documents were fabricated, and the borrowers never worked for the purported employers, and instead were either unemployed, or worked elsewhere at a lower income. The remaining two loans had valid employment documentation, but had false down payment or gift funds documentation.

False Down Payment and Gift Funds

We found, through our interviews with selected borrowers, that in at least 11 of 30 loans (37 percent), the documentation in the loan file used to support the source of the down payments and/or gift funds had been fabricated. For example, one loan file showed the borrower purportedly received a gift of $3,900 from an uncle. However, when we interviewed the borrower, the borrower informed us that he did not know anyone by that name, and it was not his uncle. In fact, the borrower did not receive any gift funds from anyone. In another example, the loan settlement statement showed that a total of $9,100 had been deposited to escrow by the borrowers. When we interviewed the borrowers they informed us that they had only deposited between $4,000 and $5,000, and they thought the seller had deposited the difference. Thus, it appears that the down payment and gift funds documents were falsified to hide the fact that the borrower either did not have the required down payment, or that the true source of funds was some other interested third party involved in the transaction.

False Statements of Occupancy

Our review also disclosed that in at least 5 of 30 loans (17 percent), the borrowers either made a statement of false occupancy in the loan application, or the loan contained one or more strawbuyers. More specifically, in one case, the borrower's landlord used the borrower's personal information to purchase the property without the borrower's knowledge or permission. The borrower recalled signing documents from his landlord but thought they were related to his rental unit. In two other cases, there was a false statement of occupancy because the borrower was purchasing the property to aid close relatives. For example, one borrower purchased the property from her daughter so it would not be foreclosed, and then later executed a quit claim deed to transfer it back to the daughter. In a second case, we interviewed the borrower, who informed us that she never had any intention of residing at the property, and planned to rent out all the units of the multiple unit property. The borrower said that she did not qualify for the loan, so the real estate agent arranged to add two co-borrowers to the loan so that she would qualify. The two co-borrowers did not contribute any funds towards the down payment or the mortgage loan, and their identity and credit was used solely for purposes of getting the loan approved.

Collectively, the falsified documents were apparently intended to enhance the appearance of the borrowers' employment history and creditworthiness, and make it appear more favorable in order to influence the loan underwriter to approve the loan. The loans involving the use of false documents are detailed in Appendix B of this report.

Other Loan Origination Deficiencies Also Existed

In addition to the false documents, our review identified other loan origination deficiencies with the 21 loans, which included: overstated income; understated liabilities; inaccurate/excessive qualifying ratios; and unsupported down payment and/or gift funds. The deficiencies were due to the inclusion of false employment income or mathematical errors in loan processing. For example, in one loan, the loan processor inappropriately included rental income although there were no supporting rental agreements for the multiple units. In another case, the loan processor failed to adequately consider the downward earnings trend of the borrower. More specifically, the VOE form showed the borrower's income was decreasing dramatically each year, from an annual income of about $66,000 in the first year, down to about $22,000 the next year. The underwriter did not adjust for the downward trend and used a monthly gross income of $3,833 for the calculations. We used the corrected, adjusted monthly income of $1,640 and calculated that the mortgage payment-to-income ratio exceeded HUD guidelines by 40 percent, and the total fixed payment-to-income ratio exceeded HUD guidelines by 27.6 percent. Thus, the loan should not have been approved without sufficient compensating factors. Details of the loan origination deficiencies for all 21 loans are also shown in Appendix B of this report.

Homewide Failed to Exercise Due Care

The problem occurred because of Homewide's complicity in the document falsification and a serious lack of due care by mortgagee personnel involved in the loan origination process. Based on our interviews with the borrowers and employers we determined that employment documents and VOE forms were improperly handled and/or processed by interested third parties, such as the real estate agent and loan processor or loan officer. To illustrate, we identified a pattern with six loans that involved the same seller, real estate agent, and loan officer. All of these loans were approved using false employment documentation. When we interviewed the borrowers they confirmed the falsity of the employment information, but did not have any knowledge of the source of the false documents. The borrowers also stated that the real estate agent or loan officer provided them with all the loan documents for signature. Thus, the false documents must have been obtained by one of the parties involved in the loan transactions, not the borrower.

To further illustrate the breach of controls that occurred at Homewide, we identified that in at least 19 of the 30 loans, the VOE forms were either false and/or improperly handled by an interested third party. For example, we identified two borrowers, on two different loans, that worked for the same employer. When we visited the employer to confirm the borrowers' employment, the office manager admitted she signed the handcarried VOE forms, in exchange for some cash, even though she knew the borrowers never worked there and the information was false. Had these VOE forms been processed through the mail as required, the employment would not have been validated, and the loan would not have been approved. In other cases, we attempted to visit the purported employers to validate the borrowers' employment and income, but were unable to locate the employer because it had never existed at the reported location. Thus, it is highly unlikely that the VOE forms were processed through the mail to an employer that we found to be non-existent. Collectively, these examples illustrate mortgagee complicity in the falsification and an apparent lack of due care by mortgagee personnel.

In addition, as detailed in Finding 2, Homewide management's failure to fully implement its Quality Control Plan allowed the use of false documents to go undetected. As a result, loans were approved based on false information and caused unnecessary risk to the FHA insurance fund.

Auditee Comments

Homewide disagreed with the finding and recommendations. Homewide essentially stated that it:

- ✓ Was not involved in any deceitful practices or misconduct in gathering these documents;
- ✓ Performed due diligence and quality control to the best of their ability, including the verbal and written verifications of employment;
- ✓ Relied on the HUD-approved lenders to underwrite the loans and they should have done their due diligence on these loans, and notified Homewide if there were errors or questionable documentation; and
- ✓ Cannot afford to indemnify the loans, and offered to stop originating FHA loans until it can restructure its quality control procedures and retrain the staff.

OIG Evaluation of Auditee Comments

We disagree with Homewide. Our audit work, including site visits and contacts with the borrowers and employers disclosed that Homewide circumvented its procedures and policies for gathering and validating the loan information, and instead used false employment and income information. Had the loans been processed as required by its procedures, then Homewide would have detected the false information before it was forwarded to the HUD-approved lender for underwriting. In our opinion, the recommendations are appropriate based on the severity of the problems found.

Recommendations

We recommend that you:

1A. Remove Homewide from participation in HUD's Single Family Mortgage Insurance Programs.

1B. Require Homewide to indemnify HUD/FHA for the $318,872 in losses already incurred, and against future losses, valued at $3,163,750, on the 21 loans identified in Appendix B that were originated using false documents.

1C. Consider seeking civil monetary penalties against Homewide for each loan identified in Appendix B that was originated using false documents.

Homewide Did Not Fully Implement Its Quality Control Plan As Required

Contrary to HUD requirements, Homewide did not fully implement its Quality Control Plan as required. Our review disclosed that while Homewide had established a written Quality Control Plan that met HUD requirements, it failed to conduct the required quality control reviews, and to ensure that immediate corrective action was taken on deficiencies identified in the reviews. We attribute the deficiencies to Homewide management's disregard of its responsibilities to assure the reviews were conducted and that deficiencies were corrected. As a result, as discussed in Finding 1, this unnecessarily increased the risk to the FHA insurance fund by approving loans that did not comply with HUD/FHA requirements.

Quality Control Plan Requirements

HUD Handbook 4060.1, REV-1, *Mortgagee Approval Handbook*, Chapter 6, provides that as a condition of HUD-FHA approval, mortgagees must have and maintain a Quality Control Plan for the origination and servicing of insured mortgages. The Quality Control Plan must be a prescribed function of the mortgagees operations and assure that the mortgagee maintains compliance with HUD/FHA requirements and its own policies and procedures. It must be sufficient in scope to enable the mortgagee to evaluate the accuracy, validity and completeness of its loan origination and servicing. It must provide for independent evaluation of the significant information gathered for use in the mortgage credit decision making and loan servicing process for all loans originated or serviced by the mortgagee. The quality control plan must enable the mortgagee to initiate immediate corrective action where discrepancies are found.

Quality Control Plan Reviews Not Conducted

In November 2001 HUD, conducted a review of Homewide and found that Homewide failed to maintain and implement a Quality Control Plan in compliance with HUD requirements, and instructed Homewide to revise and implement procedures to correct the deficiencies. Homewide revised its Quality Control Plan as needed, and outsourced the quality control review function to an independent contractor. We found, however, that the contractor only conducted two reviews in April and June 2002. No quality control reviews had been conducted since June 2002, up to the time of our audit. Homewide's procedures provided that it would have quality control reviews conducted on 10 percent of its loans closed. During 2002, Homewide closed 70 loans, and therefore, should have had reviews conducted on at least 7 loans. We found, however that only one FHA loan was reviewed.

We also reviewed the results of the two reviews conducted by the contractor and found that although the reviews identified numerous deficiencies, no corrective action was taken by management to remedy the problems, or prevent future occurrences. For example, the April 2002 review identified 10 deficiencies with the one FHA loan reviewed. Some of the deficiencies identified included: (1) unable to locate evidence that the donor's funds were withdrawn from the corresponding bank account; (2) the good faith estimate in the file did not list all fees and costs associated with the transaction; (3) and unable to locate the escrow amendment or addendum to the purchase contract to delete an individual. The June 2002 review did not include any FHA loans.

Homewide Management Disregarded Its Responsibilities

We attribute the deficiencies to Homewide management's disregard of its responsibilities to assure the reviews were conducted and that deficiencies were corrected. Since HUD had previously instructed Homewide of its responsibilities to maintain and implement a quality control plan, Homewide management was knowledgeable of the requirements. Yet, Homewide management failed to assure it fulfilled its responsibilities. Homewide's FHA Underwriter explained that there was insufficient staff to perform the work. In our opinion, this was not an acceptable explanation for not performing an integral component of its FHA loan program responsibilities. The work required by Homewide was minimal since it had outsourced the actual review function to a contractor.

Homewide Increased The Risk To The FHA Insurance Fund

As a result, as discussed in Finding 1, Homewide unnecessarily increased the risk to the FHA insurance fund by approving loans that did not comply with HUD/FHA requirements.

Auditee Comments

Homewide agreed the quality control plan reviews were not conducted, and has hired a quality control consultant to put together revised policies and procedures and to restructure Homewide. Homewide also reviewed the provisions of the HUD Handbook on the requirements of an acceptable quality control plan, and has now adopted a plan that meets those requirements. Additionally, Homewide has contracted with another company to perform post closing quality control reviews. The planned corrective actions taken will help Homewide better combat deceptive business practices in the future.

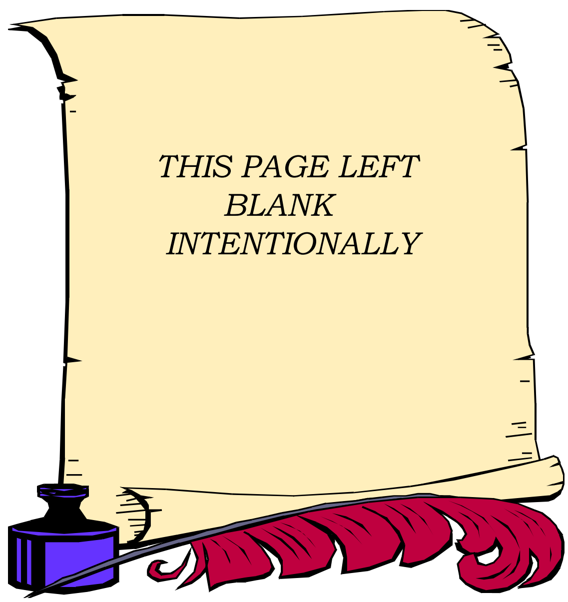
OIG Evaluation of Auditee Comments

Since Homewide agreed with the finding, we have no further comment.

Recommendations

We recommend that you:

2A. Require Homewide to take the needed action to ensure the required Quality Control Plan reviews are conducted, and that corrective action is taken, and documented, for all reported deficiencies.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Management Controls

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

Relevant Management Controls

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

- ✓ Validity and Reliability of Data – Policies and procedures that management has implemented to reasonably assure that valid and reliable data are obtained, maintained, and used during the loan origination process.

- ✓ Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonably ensure its loan origination process is carried out in accordance with applicable laws and regulations.

The following audit procedures were used to assess the relevant controls identified above:

- ✓ Reviewed and obtained an understanding of Homewide's policies, procedures and practices for originating FHA-insured loans;

- ✓ Interviewed appropriate Homewide management and staff; and

- ✓ Reviewed 30 of 148 FHA-insured loans originated between April 1, 2001 and March 31, 2003.

Significant Weaknesses

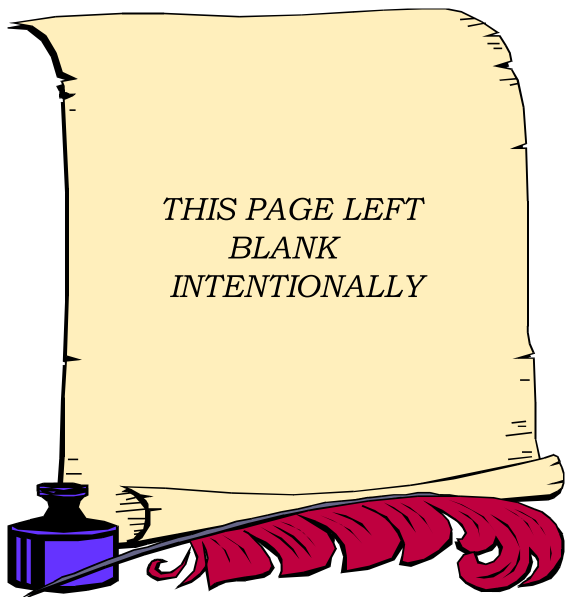
A significant weakness exists if management controls do not give reasonable assurance that control objectives are met. Based on the results of our review, we conclude the following were significant weaknesses:

- ✓ Homewide's policies and procedures, as implemented were inadequate to ensure valid and reliable data was obtained during the loan origination process (Finding 1).

- ✓ Homewide management's policies and procedures were inadequate to ensure compliance with HUD requirements and prudent lending practices (Findings 1 and 2).

Follow Up On Prior Audits

This is the Office of Inspector General's (OIG) first audit of Homewide Lending Corporation.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Schedule of Questioned Costs and Funds Put to Better Use

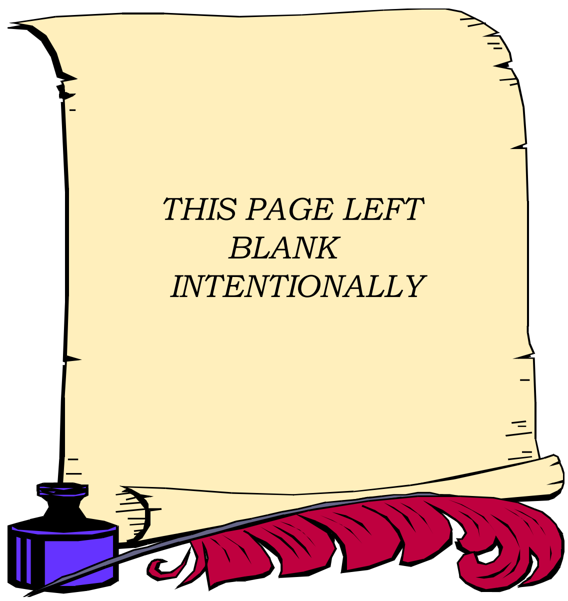
Recommendation Number	Type of Questioned Costs Ineligible 1/	Unsupported 2/	Funds Put to Better Use 3/
1A	$318,872	0	$3,163,750[1]

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/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Funds put to better use relates to costs that will not be expended in the future if our recommendations are implemented; for example, costs not incurred, de-obligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made and other savings.

[1] This represents the total mortgage amounts for 19 of the 21 loans originated using false documents, but that had not yet gone into claim status ($3,163,750), plus the actual claim amounts (as of our audit) for the other two loans ($318,872). Appendix B shows the individual amounts for each of the 21 loans.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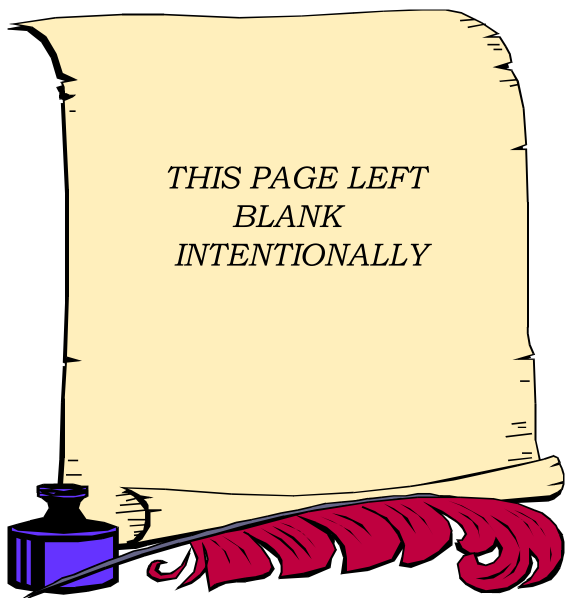
Schedule of FHA Loans Originated Using False Documents

				Source of Funds Problems				Income Problems					Debt/Credit Problems		Occupancy	Invalid Buyer	
FHA Case No.	Mortgage Amount	Claim Amount	Settlement Date	Unsupported Down Payment	False Down Payment	Unsupported Gift Funds	False Gift Funds	Overstated Income	Wage Documents Inconsistent	VOE Inconsistent with Pay Documents	False and/or Mishandled VOE	False Employment Data	Inaccurate / Excessive Qualifying Ratios	Understated Liabilities	Statement of False Occupancy	Strawbuyer	Total Deficiencies
197-2413259	$ 104,760		10/24/01			x	x	x	x		x	x	x	x			8
197-2648158	$ 127,991		04/03/02	x	x	x	x	x			x	x	x		x	x	8
048-2879490	$ 145,221		06/12/01			x	x	x	x		x	x	x			x	7
197-2392086	$ 231,369		08/30/01					x	x	x	x	x	x	x			7
197-2559557	$ 177,219		12/20/01	x	x			x	x		x	x	x				7
197-2643780	$ 167,373		01/09/02			x	x	x	x		x	x	x		x	x	7
048-2791353	$ 139,806		07/06/01			x	x	x	x		x	x	x				7
197-2377559	$ 196,910		04/05/02			x		x	x		x	x	x				6
197-2819719	$ 245,152		07/23/02		x			x	x		x	x	x				6
048-2791376	$ 140,790		06/12/01					x	x		x	x	x				5
197-2293407	$ 273,704		10/12/01		x	x	x		x		x	x			x	x	6
048-2729566	$ 137,837		03/30/01					x	x		x	x	x				5
048-3471323	$ 79,748		08/02/02	x		x	x				x	x					5
197-2069117	$ 118,146		10/25/01					x	x		x	x	x				5
197-2731550	$ 182,141		05/02/02			x	x	x					x		x		4
197-2669499	$ 191,987		02/22/02	x		x		x			x	x					5
197-2634086	$ 275,674		04/19/02	x							x	x					3
048-3143552	$ 87,624		12/28/01						x		x	x					3
048-3282586	$ 140,298		03/13/02				x	x					x				3
	$3,163,750																
LOANS WITH CLAIM STATUS																	
048-2912122	$ 118,146	$ 132,250	11/26/01						x		x	x					3
197-2893549	$ 175,249	$ 186,622	09/17/02								x	x			x		2
	$ 293,395	$318,872															
Total	$3,457,145																
TOTAL DEFICIENCIES PER COLUMN				5	4	10	9	15	14	1	19	19	14	2	5	4	
Case Total	21		Percentage	24%	19%	48%	43%	71%	67%	5%	90%	90%	67%	10%	24%	19%	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Auditee Comments

Homewide Lending
A MORTGAGE BANKER

April 29, 2004

Ms. Joan S. Hobbs
Regional Inspector General for Audit
Pacific/Hawaii IX
U.S. Department of Housing
Office of Inspector General
611 West Sixth Street, Suite 1160
Los Angeles, CA 90017

Re: Response to Audit Report – Homewide Lending Corporation
Mortgagee ID No. 1519600007
2004-LA-xxxx

Dear Ms. Hobbs:

Thank you for the opportunity to respond to your letter dated March 16, 2004. We refer to the draft of the audit report done by your office between May and December 2003 and which covered the period from April 2001 through to March 2003 conducted by Tanya Voigt and her group. We appreciate the information provided to us and offer the following response to the findings.

We apologize for the time that it has taken for us to reply to your letter. Immediately after receiving your letter and report, we hired a quality control consulting firm to assist us to put together a revised policies and procedures plan for the company. With the assistance of this quality control consulting firm, we have put in place policies and procedures that would comply with accepted sound lending practices, ethics while meeting with HUD/FHA requirements. We have enclosed our revised policies and procedures for your reference. The details are as per our answers to your Finding 2.

Finding 1: LOAN FILES CONTAINED FALSE DOCUMENTS

On the report, it stated that Homewide Lending used false employment and income documentation to originate FHA loans. We do not agree to this finding. The documentation for these 21 loans were gathered and compiled by the Independent Contractors (loan agents) with the help of possibly other people outside of our company. In no way was Homewide Lending involved in any deceitful practices or misconduct in gathering these documents. On all of the loans, we did our due diligence and quality control to the best of our abilities. When a loan is submitted to us, we verify employment via telephone. Afterwards, we mail out verification of employment to the borrower's place of work. The honest mistake we have made is that we have not kept the return envelopes for our records.

Homewide Lending would never allow anyone to hand-carry our verification of employment. We would either mail out the verification of employment or call the employer and ask for their fax number so that we could fax our verification of employment directly to them. The employees of Homewide Lending do not deal with borrowers, selling agents, or listing agents directly. When it comes to the issue of funds in escrow and how it was deposited directly to escrow, Homewide Lending has no knowledge of how these funds were gathered. We assumed that the money that is to be deposited directly to escrow is coming from the documentation the Independent Contractor (loan agents) provided to Homewide Lending. All documentation in the file including but not limited to gift letters, proof of donors ability, source of funds, transfer of funds from donor to buyers, or the buyers bank statements were provided to Homewide Lending by the Independent Contractors (loan agents).

After reviewing most of the files, the majority of the loans were from our former loan agent [redacted] Homewide Lending did not have any knowledge on how [redacted] got her clients or how she conducted her business outside of the office. Homewide Lending would have never conducted any business with this person is we knew of her questionable business practices.

I would like to further note that Homewide Lending did not underwrite the 21 loans with questionable documentation. We relied upon our HUD approved lenders to underwrite these loans and they should have done their due diligence on these loans. Furthermore, some of these loans were funded by the HUD approved lenders and not by Homewide Lending.

These 21 loans have been submitted to Accubanc Mortgage and American Capital (Westlend Financing). These established institutions in the mortgage industry are experienced and have funded millions of dollars in FHA loans. In addition, it is safe to assume that these institutions should have their own complete Quality Control system in place and seasoned Quality Control employees to comply fully with all FHA rules and regulations. If errors or questionable documentation were found on the loans, these institutions should have notified Homewide Lending so that we could have taken immediate action in regards to these loans.

We are a small company and must rely heavily upon the HUD approved lender(s) when it comes to the issue of underwriting and sometimes funding of the loan. If these HUD approved lenders have performed their due diligence and quality control properly on all of these 21 loans, then the inaccurate information on the loan should have been discovered before funding of the loan could take place.

Please be assured that Homewide Lending conducted its due diligence and quality control on all of its loans. Although Homewide Lending does its best to do their due diligence on every loan, we cannot control every questionable business practices carried out by the Independent Contractors (loan agents) or brokers that occurs outside our office. If an Independent Contractor (loan agent) want to engage in questionable business practices with the help of other people outside of the company, even the best system to combat this type of misconduct will not be able to stop it completely. In addition, the HUD approved lenders should have done their due diligence and quality control on these loans.

In regards to HUD finding that Homewide Lending failed to identify false employment, we will disagree. In terms of verifying employment, our standard operating procedures include performing pre-processing quality control to determine if the employer listed on the loan application can be verified through 411 Directory Assistance or the Internet White and Yellow pages Directories. Homewide Lending conducts verbal employment verification with the prospective borrower's employer at the pre-processing stage as well. These actions are documented and the verifications are placed in the file. Only if the results of these pre-processing checks are positive and verified does the loan move into formal processing. During the formal processing stage, written verifications of employment, sources of funds and residence history are performed and the file is documented to reflect these results. In addition, as part of our formal processing, we order a Residential Mortgage Credit Report form a credit-reporting agency, which conducts an independent verification of employment and residence history for the borrower and this is documented in the file as well.

Homewide Lending has standards for originating and processing our loans. We take extra care to verify all the information on the loan is correct. Our objective is to ensure that we only make mortgage loans to those persons who are qualified.

Any Independent Contractors (loan agents) or brokers that engages in any questionable business practice will be subject to termination. We reiterate to all the Independent Contractors (loan agents) about our policies and procedures and that deceitful business practice will not be tolerated at Homewide Lending.

Finding 2: HOMEWIDE DID NOT CONDUCT QUALITY CONTROL

As we have stated at the beginning of our reply, we immediately hired a quality control consulting firm to assist us put together revised policies and procedures that will ensure better results for the company. The actions that we are taking should demonstrate to HUD that Homewide Lending does not disregard its responsibilities and is very serious in making sure that risks are managed properly.

We strongly believe that the corrective actions that we have taken with the assistance from our quality control consulting firm will help our company better combat deceptive business practices in the future.

We have reviewed the provisions of HUD Handbook concerning the requirements of an acceptable quality control plan. We have now adopted a plan that meets those requirements.

We have already contracted with LogicEase Solutions Inc. to perform post closing quality control review of our files every month. LogicEase has performed 10% sample base on the past six months' production, from October 2003 to March 2004. We have furthered instructed LogicEase to perform post closing quality control review on 10% of our closed FHA loans, 10% of cancelled, withdrawn and denied files, and all loans that go into default for the past 6 months. With the guidance from the report, we will address the problems identified in our procedures. We will use the report to identify individual and overall staff training needs, and as a performance measure of employees' compliance with company policies/procedures and FHA and other regulatory requirements.

The details of our restructuring plans to be implemented at Homewide Lending are as follows:

(1) Quality Control

LogicEase has completed six months production on our conventional loans, namely October, November, December 2003 and January, February and March 2004. We attached a copy of the Service Agreement and Quality Control Audit Report for March 2004 Production for your reference. (Exhibit "A")

(2) Compliance – Predatory Analyzer

We have signed up with ComplianceEase to run all our files via its platform performing Automated Compliance check. By deploying this audit, all Federal, State and Local Anti-predatory Lending Laws and Regulations, HOEPA, TILA, RESPA, Stage Lending Laws and Regulations are in compliance. We enclose the Services Agreement dated November 23, 2003 and an audit report for your reference. (Exhibit "B")

(3) **FraudGuard – Electronic Loan Review**

We are in the process of negotiating with Sysdome, an Affinity Corporation engaging their service to further protect our loan quality. Sysdome's National Fraud Prevention Database assisting early detection of Broker/Appraiser Fraud, Employment Misrepresentation, Property Flips, HUD Limited Denial List, Freddie Mac Exclusionary list, SSN Verification to further protecting our originations. We have attached a sample Service Agreement and a sample report for your reference. (Exhibit "C")

(4) New Quality Control Plan

We are re-writing our Quality Control Plan and detailed all policies and procedures for Quality Control Staff to follow. This new adopted plan, we believe, meets your requirements. We have enclosed the table of contents for your review. The entire new quality control plan will be submitted in our next correspondence. (Exhibit "D")

(5) Workflow Chart

Detailed workflow charts have been developed. We have illustrated the workflow for both Retail and Wholesale Division. We are educating our employees to adhere to the workflow to ensure originating quality loans. (Exhibit "E")

(6) **Fraud Detection Program**

We have established a Fraud Detection Program. The purpose of this program is to ensure every employee of Homewide has a responsibility and an obligation to bring to the attention of Homewide Lending Senior Management instances where loan fraud is possibly indicated. We also emphasized that the first line of defense in fraud detection is our underwriter and that any suspicious application or documentation should require a re-verification by an employee before the loan is funded. (Exhibit "F")

Recommendations

<u>1A – Indemnify HUD</u>

We cannot afford to indemnify HUD for the amount requested. However, we are willing to negotiate a settlement with HUD. When Homewide Lending sells a loan to the HUD approved lender(s), we are given a rebate and a Service Release Premium (SRP) from them. On all FHA loans, we give **100% Commission** on points and rebates to the Independent Contractors (loan agents) and brokers. The only profit that we keep is the Service Release Premium (SRP). From selling these 21 loans, Homewide Lending profited $55,813.44. The rest of the money collected by the company in regards to points, rebates, etc. were all paid to the loan agents.

We offer to return to HUD the profit of $55,813.44 made by Homewide Lending. We believe that this settlement is fair and just. The parties who have benefited most are the Independent Contractors (loan agents), primarily [redacted] In addition, the lender(s) who underwritten and funded these loans should have profited as well. Another factor that HUD should take into consideration is that Homewide did not underwrite all of these loans so therefore, other lender(s) should burden some of the blame because they should have performed their own due diligence and quality control on these loans.

Most of our assets are either borrowed or pledged, therefore, we cannot touch these assets. Furthermore, we need these assets to maintain warehouse approval and operate daily activities. **The only way we can pay the $55,813.44 to HUD is through a payment plan**. We ask then Homewide not be made to give indemnity to HUD. We hope that the resolutions if agreed upon should be final with no conditions. We assure HUD that we will restructure our organization, implement policies and procedures for prudent lending practices as required by HUD policies. At this time, we are implementing our new policies and procedures with the help our quality control consulting firm. Please refer to Finding 2.

<u>1B – Civil Monetary Penalties</u>

If we can agree on our suggested resolution to Recommendation 1A, we ask that no civil monetary penalties be made against Homewide Lending.

<u>1C – Remove Homewide</u>

Homewide Lending is only willing to settle and pay monetary damages if HUD allows our company to complete our test cases. In addition, if the settlement is finalized between Homewide Lending and HUD, we would like to request HUD for an additional 6 months to complete our test cases. Homewide will try to get the five additional loans to finish our test cases.

Homewide Lending will most likely not engage in anymore FHA business after we complete our test cases. However, we would like to maintain our HUD approval for the following reasons:

1. Homewide Lending want to conduct business out of state and this will not include FHA business.
2. Homewide Lending want to apply for Fannie/Freddie approval in the future

We offer to stop originating FHA loans for the next three to six months in order for us to complete restructuring our company in terms of quality control procedures and for us to re-train our staff properly, especially with the training of the "Fraud Detection Program". If HUD wants to verify the progress of our restructuring program before we re-start originating FHA loans again to complete our test cases, we will gladly accommodate HUD.

We sincerely hope that HUD allows Homewide Lending to be approved as non-supervised mortgagee and give us the necessary time and extension (if necessary) to complete the test cases required for unconditional approval.

2A Action to ensure Quality Control Plan is conducted

We believe that our comments in regards to our QC should be satisfactory

Conclusion

We earnestly ask HUD to consider our requests and suggestions after noting that Homewide itself was a victim of deceptive business practice carried out by certain Independent Contractors (loan agents). Homewide Lending has terminated its business relationship with all of the Independent Contractors (loan agents) who were responsible for these loans. Although Homewide Lending does its best to do their due diligence on every loan, Homewide Lending cannot control every deceptive business practices conducted by Independent Contractors (loan agents) that occurs outside of our office boundaries. Homewide Lending is willing to give back to HUD all of the profits in the amount of $55,813.44 it made on these 21 loans. In return, we would appreciate it if HUD grants Homewide Lending an opportunity to finish the test cases. In addition, we would like to request HUD for an extension of 9 more months since we will be restructuring our organization and won't be originating FHA loans for the next three to six months. **After our test cases are completed and we are granted unconditional approval from HUD, Homewide Lending will most likely not engage in anymore FHA business.**

We are a small minority company trying to help qualified individuals achieve the American Dream of owning their own home. I would not jeopardize my company or the employees at Homewide Lending by conducting in deceptive business practices. The majority of the blame should be placed upon the Independent Contractors (loan agents) originating these loans and the lenders underwriting and funding these loans.

Thank you for the opportunity to submit this response.

Very truly yours,
Homewide Lending Corp.

David W. Chang
President

Corporate Office: 17890 Castleton St., #205 City of Industry, CA 91748 Tel. (626) 839-4552 Fax. (626) 839-4553
Branch Office: 11135 Magnolia Blvd., #110 North Hollywood, CA 91601 Tel. (818) 762-5581 Fax. (818) 762-5734