



Issue Date	October 4, 2004
Audit Case Number	2005-KC-1001

TO: John C. Weicher, Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgage Review Board, H
Margarita Maisonet, Director, Departmental Enforcement Center, CV
/signed/
FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA
SUBJECT: Karim Enterprises, DBA Prime Mortgage, Did Not Follow Federal Housing Administration Requirements

HIGHLIGHTS

What We Audited and Why

We received a complaint alleging that Prime Mortgage, a non-supervised loan correspondent located in Saint Charles, MO, provided funds to a Federal Housing Administration borrower to assist with closing costs.

Our audit objective was to determine whether Prime Mortgage complied with the U.S. Department of Housing and Urban Development's (HUD) source of funds, gift documentation, and quality control plan requirements.

What We Found

The owner of Prime Mortgage inappropriately provided funds to two borrowers just prior to closing their loans. For a third loan, Prime Mortgage did not obtain adequate documentation of the transfer of gift funds. As a result, HUD has insured three loans that would not have met the minimum requirements to qualify

for a Federal Housing Administration loan, placing the HUD insurance fund at risk for loans totaling \$376,102.

Prime Mortgage satisfied one of HUD's quality control requirements by developing a written quality control plan, but failed to perform the required quality control reviews. As a result, HUD lacks assurance that Prime Mortgage is identifying and correcting potential deficiencies in its loan origination process before submitting loans for Federal Housing Administration insurance.

What We Recommend

We recommend that the Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgage Review Board take appropriate administrative action against Prime Mortgage for its improper actions, and against the sponsors of the three loans with origination deficiencies.

We recommend that the Acting Director, Departmental Enforcement Center, take appropriate action against Karim Enterprises, dba Prime Mortgage; such as debarring the business and principals for providing funds to Federal Housing Administration borrowers while making it appear that the funds came from allowable sources, and for providing loans to borrowers to use as funds to close.

If HUD allows Prime Mortgage to maintain its Federal Housing Administration approval status, we recommend that the Assistant Secretary for Housing – Federal Housing Commissioner, and Chairman, Mortgage Review Board require Prime to implement controls that ensure that it follows HUD's quality control review requirements, and verify that Prime has implemented appropriate controls.

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

Auditee's Response

Prime Mortgage disagreed with our conclusions that it loaned closing funds to two borrowers, and that it did not adequately document a gift transfer. However, Prime Mortgage agreed with our conclusion that it did not perform required quality control reviews. We provided a draft report to Prime Mortgage and requested a response by September 24, 2004. Prime Mortgage provided its written comments on September 23, 2004.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

Karim Enterprises is the sole owner of Prime Mortgage, a non-supervised loan correspondent located in Saint Charles, MO. Prime Mortgage began doing business in 1995, and began performing Federal Housing Administration loan originations in 1998. A loan correspondent is a mortgagee that has as its principal activity the origination of Federal Housing Administration-insured loans for sale or transfer to its sponsor(s) for underwriting.

Prime Mortgage originated 69 Federal Housing Administration-insured mortgages from January 1, 2002, through December 31, 2003.

We received an anonymous complaint, stating that the owner of Prime Mortgage had not followed U.S. Department of Housing and Urban Development (HUD) regulations regarding the use of gift funds to assist a borrower in obtaining a Federal Housing Administration-insured loan. HUD regulations state that the gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. During our review, we found evidence to validate the complaint.

Our audit objective was to determine whether Prime Mortgage complied with HUD regulations for Federal Housing Administration loan origination; specifically, HUD's requirements for borrowers' source of funds and gift documentation related to funds to close and HUD's requirements to develop and implement a quality control plan.

RESULTS OF AUDIT

Finding 1: Prime Mortgage Did Not Comply with HUD’s Requirements Regarding Funds to Close

The owner of Prime Mortgage violated HUD’s funds to close requirements by providing funds to two borrowers before their loan closings. As a party to these transactions, Prime Mortgage is not allowed to provide funds to Federal Housing Administration borrowers. Prime Mortgage management chose to ignore HUD regulations regarding funds needed to close loans. As a result, HUD has insured two loans that would not have met the minimum requirements to qualify for a Federal Housing Administration loan, placing the HUD insurance fund at risk for loans totaling \$252,049. In addition, Prime Mortgage did not obtain adequate documentation of the transfer of gift funds for a third loan with an original mortgage amount of \$124,053. As a result, HUD cannot be certain that the borrower used funds from an allowable source to close the loan.

Prime Mortgage Owner Loaned Funds to Borrowers

The owner of Prime Mortgage loaned funds to two borrowers before their loan closings. According to 24 Code of Federal Regulations 202.5, a mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction. HUD Handbook 4155.1, chapter 2, paragraph 2-10, “Funds to Close,” says that gift funds may not be derived in any manner from a party to the sales transaction. Mortgagee Letter 00-28 says that in cases in which gift irregularities occur as a result of a lender not complying with HUD’s requirements, there may be grounds for administrative action, and the lender may be referred to the Mortgagee Review Board for the imposition of administrative sanctions or civil money penalties.

Prime Mortgage originated 69 Federal Housing Administration loans from January 1, 2002, through December 31, 2003. Of those 69 loans, we reviewed 30 loans that required gift funds to close, or that Prime Mortgage had written checks to, or on behalf of, the borrower. We concluded that Prime Mortgage violated HUD regulations when originating 3 of the 30 loans reviewed.

Specifically, Prime Mortgage loaned gift funds to one borrower by supplying the funds to an allowable donor, who deposited the funds into their own bank account, and later forwarded the money to the borrower. The borrower and gift donor told us that Prime Mortgage instructed the borrower to obtain a blank check from the donor, after which Prime Mortgage gave the borrower a \$3,000 check to be deposited in the donor’s bank account. The borrower then negotiated the check provided by the donor for the \$3,000 gift amount, creating the appearance of properly transferred gift funds. The donor provided evidence of the transaction

by supplying a copy of the deposited check written by the owner of Prime Mortgage.

Because Prime Mortgage instructed the borrower to obtain a blank check from the donor, and wrote a check to the donor to then provide the funds to the borrower, it is clear that Prime Mortgage management was aware that HUD rules prohibit a mortgagee from providing funds to a Federal Housing Administration borrower. Therefore, we believe that Prime Mortgage management chose to ignore these regulations. The owner of Prime Mortgage told us that he had loaned the funds to the borrower's relative (the donor) because he had a personal relationship with the relative, and that the relative later repaid the loan. The owner also told us that the relative was trying to help the borrower acquire a home and did not have the funds to donate to the borrower at that time, but would have the funds by the time the loan closed.

Prime Mortgage's owner also directly loaned \$2,456 to a second borrower before the borrower's loan closing, which appears to have been used as funds to close the loan. The Prime Mortgage check, made payable to the borrower within two weeks of closing, showed "loan" on the memo line. The borrower deposited the \$2,456 check from Prime Mortgage on March 22, 2002, and closed the Federal Housing Administration loan on April 4, 2002.

We reviewed case #292-4167405 to determine if the borrower would have had sufficient funds to close the loan despite the funds provided by Prime Mortgage. The borrower provided bank statements for two bank accounts. The bank statements showed that as of March 21, 2002, the day before depositing the Prime Mortgage check, the borrower had \$364 in one account and \$675 in the second account, for a total of \$1,039. The borrower's HUD-1 Settlement Statement showed that the borrower needed \$4,115 to close the loan on April 4, 2002. Therefore, the borrower did not have the funds to close the loan just two weeks prior to closing, which we believe shows that Prime Mortgage provided the funds to assist the borrower with closing costs.

The owner of Prime Mortgage told us that the borrower had the funds to close from the sale of another residence. However, the St. Louis County Government's website showed that the borrower's previous residence sold on May 1, 2002, one month after the borrower closed the Federal Housing Administration loan.

The following table provides details on the two loans described above:

Loan Number	Mortgage Amount	Closing Date	Prime Mortgage Check Date	Check Amount
292-4417214	\$123,068	9/16/03	9/11/03	\$3,000
292-4167405	\$128,981	4/4/02	3/22/02	\$2,456

For a third loan, case #292-4257704, Prime Mortgage did not properly document the transfer of \$7,000 in gift funds from the donor to the borrower. Prime Mortgage received a verification of deposit from the donor's bank that stated that

the donor had a sufficient balance in their account to provide the \$7,000 gift. A deposit slip showed that the donor transferred \$8,000 into the account from which the donor wrote the \$7,000 check to the borrower. However, Prime Mortgage did not obtain documentation that the borrower deposited, or otherwise used, the \$7,000 gift check as funds to close the loan. Therefore, Prime Mortgage did not obtain the proper documentation to ensure that the funds used to close the loan were from an allowable source on the \$124,053 loan.

HUD Handbook 4155.1 requires a lender to document the transfer of gift funds from the donor to the borrower when gift funds are required to qualify a borrower for a Federal Housing Administration-insured loan. HUD requires:

- A gift letter specifying the dollar amount, signed by the donor and the borrower, stating that no repayment is required and showing the donor's name, address, telephone number, and relationship to the borrower; and
- Documentation, such as bank statements of both the borrower and the donor, withdrawals slips, and canceled checks, showing the transfer of the funds from the donor to the borrower, to provide assurance that the funds were not derived from a party to the transaction.

We reviewed the case file to determine if the borrower would have had sufficient funds to close the loan without the gift funds. On the loan application, the borrower disclosed no other assets other than \$1,000 in earnest funds already paid, and the \$7,000 in expected gift funds. The borrower provided bank statements for a two-month period. The bank statements showed that as of September 16, 2002, just two weeks before the loan closed, the borrower had only \$176. The borrower's HUD-1 Settlement Statement showed that the borrower needed \$6,279 to close the loan. Therefore, the borrower did not have the funds to close the loan just two weeks prior to closing. Therefore, HUD can not be assured that the funds used to close the loan were provided by the allowable donor, or were from some other source.

Conclusion

Prime Mortgage did not comply with HUD requirements for funds to close two insured mortgages because the owner loaned funds to the borrowers before closing. Prime Mortgage also did not obtain proper documentation to show the transfer of gift funds from the donor to the borrower on a third loan. As a result, HUD's insurance fund has been placed at risk by insuring loans of borrowers that without the loans from Prime Mortgage, may not have qualified for a Federal Housing Administration loan. Also, without proper documentation showing the transfer of gift funds, HUD lacks assurance that the gift funds were provided by an allowable donor and not by a party to the transaction as an inducement to purchase. HUD's systems showed that as of July 30, 2004, all three of these loans were actively insured.

Recommendations

We recommend that the Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgage Review Board

- 1A. Take appropriate administrative action against Prime Mortgage, such as imposing civil money penalties and withdrawing Prime Mortgage's Federal Housing Administration approval status.
- 1B. Take appropriate administrative action against the Federal Housing Administration sponsor for the three improperly originated loans, such as requiring indemnification from the applicable sponsor(s) for the two loans (totaling \$252,049) with improper sources of funds, and the additional loan (totaling \$124,053) without proper documentation of the transfer of gift funds.

We recommend that the Acting Director, Departmental Enforcement Center

- 1C. Take appropriate action against Karim Enterprises, dba Prime Mortgage, such as debarring the business and principals, for providing funds to Federal Housing Administration borrowers prior to closing.

Finding 2: Prime Mortgage Failed To Perform Required Quality Control Reviews

Prime Mortgage has not performed quality control reviews, as required by HUD, because it mistakenly believed that any requirements of the quality control plan were being met by its certified public accountant. As a result, HUD lacks assurance that Prime Mortgage is identifying and correcting potential deficiencies in its loan origination process before submitting loans for Federal Housing Administration insurance.

Quality Control Plan

A quality control plan is a HUD-required process that all mortgagees, including loan correspondents, must implement to assist in the assurance of the accuracy, validity, and completeness of its loan origination operations. The quality control plan must be a prescribed function of the mortgagee's operations and assure that the mortgagee maintains compliance with HUD/Federal Housing Administration requirements and its own policies and procedures.

To satisfy the basic elements of a quality control plan, the mortgagee must have a written quality control plan and perform the required quality control reviews. The following types of reviews are required:

- A review of 10 percent of all Federal Housing Administration-insured loans,
- A review of all loans defaulting within six months, and
- A review of 10 percent of all rejected loans.

Prime Mortgage's Quality Control Plan

Prime Mortgage is a non-supervised loan correspondent that performs only the origination process for Federal Housing Administration-insured loans. Prime Mortgage's written quality control plan contained all of the HUD requirements for loan origination, but Prime Mortgage had not properly implemented the plan because it had not performed the required quality control reviews. Without a properly implemented quality control plan, the mortgagee cannot ensure that its loan originations comply with HUD/Federal Housing Administration requirements; that it is protecting itself and HUD from unacceptable risk; and that it is guarding against errors, omissions, and fraud.

Prime Mortgage did not have in-house staff to perform the quality control reviews. HUD regulations allow a mortgagee to outsource its quality control

function if adequate staff is not available in house, but Prime Mortgage did not outsource the quality control function. The owner of Prime Mortgage initially told us that the company's certified public accountant performs the required reviews, but the accountant told us that he does not perform these types of reviews. Subsequently, Prime Mortgage's owner told us that he had confirmed that the accountant does not perform the required quality control reviews, and that Prime Mortgage was preparing a quality control process that would meet HUD's requirements.

The owner of Prime Mortgage also told us that he and another staff member review the files and know what actions are being taken on loans. However, a cursory review of a loan file does not show that Prime Mortgage meets HUD's specific requirements for a quality control plan and process.

Conclusion

Prime Mortgage did not meet HUD's quality control requirements because it did not perform the required quality control reviews. As a result, Prime Mortgage did not evaluate the accuracy, validity, and completeness of its loan origination operations. Therefore, HUD lacks assurance that Prime Mortgage is identifying and correcting potential deficiencies in its loan origination process before submitting loans for Federal Housing Administration insurance.

Recommendations

If HUD determines that Prime Mortgage can maintain its Federal Housing Administration approval status, we recommend that the Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgagee Review Board

- 2A. Require Prime Mortgage to implement controls to ensure that it completes quality control reviews according to HUD regulations.
- 2B. Verify that Prime Mortgage has implemented effective controls that prevent Prime from submitting loans for Federal Housing Administration insurance endorsement that do not meet HUD requirements.

SCOPE AND METHODOLOGY

Prime Mortgage originated 69 Federal Housing Administration-insured loans during our audit period of January 1, 2002, through December 31, 2003. To achieve our objectives, we reviewed the Federal Housing Administration case binders for the 13 loans that required gift funds for closing. We reviewed the documents related to the transfer of gift funds, including bank statements of the borrowers and donors, canceled checks, gift letters, and HUD-1 Settlement Statements.

Further, we reviewed Prime Mortgage's bank statements and canceled checks for the same audit period to identify any checks written to, or on behalf of, Federal Housing Administration borrowers or gift donors. We identified an additional 17 loans for review. In addition to Prime Mortgage's bank statements and canceled checks, we reviewed borrowers' checks written to Prime Mortgage for prepaid closing costs, deposit slips showing that Prime Mortgage deposited the borrowers' funds, and HUD-1 Settlement Statements.

We interviewed Prime Mortgage's management and staff to obtain information regarding its policies, procedures, and management controls. We also interviewed borrowers and donors to obtain information regarding their experiences with Prime Mortgage.

We performed audit work from March through June 2004. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Controls over Federal Housing Administration loan originations

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Prime Mortgage has not properly implemented its quality control plan. (see Finding 2).

APPENDIXES

Appendix A

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

Recommendation Number	Ineligible 1/	Unsupported 2/	Unreasonable or Unnecessary 3/	Funds To Be Put to Better Use 4/
1B				\$376,102

- 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 polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a 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/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.
- 4/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. For this review, the funds to be put to better use consist of loans and guarantees not made because of indemnification.

Appendix B

AUDITEE COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation

Auditee Comments

<p>LAW OFFICE</p> <hr/> <p>J O A N N A W. O W E N</p> <hr/> <p>O</p> <p style="text-align: right;">SEP 27 2004</p> <p>September 23, 2004</p> <p>Mr. Ronald J. Hosking Regional Inspector General for Audit, HUD Region 7 Office of Audit Gateway Tower II - 5th Floor 400 State Avenue Kansas City, Kansas 66101-2408</p> <p>Re: Prime Mortgage, Inc. Audit</p> <p>Dear Mr. Hosking:</p> <p>Enclosed please find the Auditee's Response to Draft Audit Report. I understand that this response will be included with the Audit.</p> <p>Sincerely,</p> <p><i>Joanna W. Owen /tlj</i> Joanna W. Owen Attorney at Law</p> <p>JWO/tlj</p> <p>Enclosure</p> <hr/> <p style="text-align: center;"><small>Joanna W. Owen, P.C., Attorney at Law 8866 Ladue Road, Second Floor, St. Louis, MO 63124 / (314) 721-7717 / Fax: (314) 212-5597</small></p>

September 23, 2004

Auditee's, Prime Mortgage, Inc., Response to Draft Audit Report

Malik Karim, President of Prime Mortgage, Inc., has reviewed the Draft Audit Report (the "Audit") from Ronald J. Hosking, Regional Inspector General for Audit, directed to the Assistant Secretary for Housing - Federal Housing Commissioner and the Director of the Departmental Enforcement Center which was delivered with a letter from Mr. Hosking dated September 15, 2004.

The Audit sets forth three basic areas where, according to the Audit, Prime Mortgage failed to comply with the U.S. Department of Housing and Urban Development's (HUD) source of funds, gift documentation, and quality control plan requirements. Prime Mortgage denies that it has failed to comply with those regulations, and further states that any violation that might have occurred was unintentional and inadvertent. Further, Prime Mortgage states that the tone of the Audit is unduly harsh given the realities of the facts as developed below.

I. Prime Mortgage Did Comply with HUD's Requirements Regarding Funds to Close

The Audit states as a categorical fact that the "owner of Prime Mortgage loaned funds to two borrowers before their loan closing." The applicable regulation, 24 C.F.R. section 202.5, states that "a mortgagee may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction...to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgaged property."

Comment 1

In the first transaction cited by the Auditor, it is stated, again categorically, that Prime Mortgage loaned gift funds to one borrower by supplying the funds to an allowable donor, who deposited the funds into their own bank account, and later forwarded the money to the borrower. In fact, what happened is that the father, someone known to the owner of Prime Mortgage, and personally asked for a loan. The owner of Prime Mortgage, sympathetic to the father, gave him a loan. The owner did not instruct the father how to make the check payable, nor did he fill out the check himself since he was unsure as to the exact spelling of his name nor did he inquire as to its purpose other than that the father of one of the borrowers made an unannounced visit to Prime Mortgage's office and told the owner that he needed some money. The issue of the borrower needing the money was not discussed. When the owner of Prime Mortgage attempted to contact the father to get a statement from him regarding this transaction, he learned that the father had recently died. What is stated as categorical fact belies the clear language of the regulations. The owner of Prime Mortgage did not make a loan to the borrower nor did he know that the father was going to give the money to his child.

It simply wasn't discussed.

Comment 2

In the second instance, the owner of Prime Mortgage is accused of having directly loaned \$2,456 to a borrower before the borrower's loan closing. The owner has no memory of this transaction at all, and certainly does not believe that the money was necessary to close the transaction. Circumstantially, the Auditor concludes that since the bank accounts were less than the amount needed to close the day before closing, that therefore, the owner of Prime Mortgage must have provided the loans to close. Of course, this is belied by a number of other possibilities, as for example, that the borrower took out the money before the closing and had the cash on hand, or they had not deposited some payroll checks in order to have cash for closing. There is more than one conclusion that can be drawn from the fact that the borrower did not have the closing funds in their bank account the day before closing.

Comment 3

In the third instance, the Auditor deems that "Prime Mortgage did not properly document the transfer of \$7,000 in gift funds from the donor to the borrower." The Auditor further states that the "deposit slip showed that the donor transferred \$8,000 into the account from which the donor wrote the \$7,000 check to the borrower. However, Prime Mortgage did not obtain documentation that the borrower deposited, or otherwise used, the \$7,000 gift check as funds to close the loan." Again, while the Auditor reaches an absolute conclusion, it does not take into consideration that Prime Mortgage complied in every, single respect with the lender's underwriting requirements. Further, there is a gift letter reflecting the deposit of funds from the mother to the daughter. It is unclear why this letter was not signed by the mother, but Prime Mortgage takes the position that the mother's English language skills were insufficient for such a task. Further the deposit was made two days before the closing. Since the loan was premised on the gift, it is hardly surprising that the Auditor notes that the borrower did not have the funds to close the loan two weeks prior to closing. The borrower would not have the funds to close until receiving the gift from her mother two days prior to closing.

II. Prime Mortgage Believed that it Performed Required Quality Control Reviews

Comment 4

The Auditor does not dispute that Prime Mortgage had a written quality control review, but concluded that it was not properly implemented. After investigation, Prime Mortgage has come to the conclusion that it mistakenly believed that its accountant was reviewing the files in accordance with the written plan. Although the accountant admitted he reviews the files, he does not believe that he performed an audit of the files in conformity with the written plan. This oversight is in the process of correction. Prime Mortgage will ensure that all its files are properly reviewed in accordance with its written plans.

Comment 5

In summary, any error deemed to have been committed by Prime Mortgage is either inadvertent or unintentional. For the foregoing reasons, and because Prime Mortgage has endeavored to correct any perceived deficiencies, the sanctions imposed should be minimal. While Prime Mortgage does not seek to minimize the Auditor's efforts or conclusions, nonetheless none of the facts involve misrepresentation. Indeed they are all compliance-related issues which Prime Mortgage will continue to review and make improvements.

OIG Evaluation of Auditee Comments

Comment 1 We clarified the report to state that the owner of Prime Mortgage told us that he had provided the funds to a relative of the borrower, not directly to the borrower. We also included information that the owner told us that the relative (the donor) was trying to help the borrower acquire a home and did not have the funds to give to the borrower at that time, but would have the funds by the time the loan closed.

Prime Mortgage's position is not consistent with the information provided by the donor and the borrower. Prime Mortgage says that the owner did not provide the funds to the borrower, but to the borrower's father. Our review determined that the donor was actually the borrower's brother, not the father. In addition, the donor and borrower told us that the owner of Prime Mortgage knew that the funds were for the loan closing because the owner had told them both that he could not give funds to the borrower directly, but that he could give the funds to the donor, who could in turn provide the funds to the borrower. Also, the borrower told us that she repaid the owner of Prime Mortgage directly, not through the relative. The owner told us that the relative had repaid the loan.

We maintain that Prime Mortgage indirectly provided closing funds to the borrower, by using a relative in the transfer of funds that the owner provided. This transaction violates HUD's requirements, and HUD should take appropriate action.

Comment 2 We believe, based on the chronology of events and the documents in the loan file, that Prime Mortgage provided closing funds to the borrower. Prime Mortgage's position is that the funds to close could have come from cash on hand, or from a payroll check that had not yet been deposited. HUD requires that a borrower be able to show that the borrower has the wherewithal to close a loan. HUD Handbook 4155.1 requires that all funds for the borrower's investment in the property be verified. Specifically, in order to include cash on hand as funds available to close, the money must be verified, whether deposited in a financial institution or held by the escrow / title company. The borrower must also provide satisfactory evidence of the ability to accumulate such savings. The loan file does not support that the borrower had funds available to close the loan, other than the use of the funds loaned by Prime Mortgage just two weeks prior to closing.

In addition, Prime Mortgage's owner says that he has no memory of the transaction, and does not believe that the funds were needed to close the transaction. This statement is inconsistent with what the owner told us at the conclusion of the audit. The owner had previously told us that he recalled the transaction, and that the borrower would have the funds to close from the sale of another residence. However, as noted in the report, we confirmed that the sale of the borrower's previous residence did not take place until one month after the closing of the Federal Housing Administration loan.

- Comment 3** Prime Mortgage’s position is that it complied, in every respect, with the lender’s underwriting requirements. However, HUD places the same requirements on loan correspondents, such as Prime Mortgage, as it does on lenders / sponsors. As a result, Prime Mortgage was required to properly document the transfer of gift funds from the donor to the borrower, but it did not.
- Comment 4** We commend Prime Mortgage for its efforts to correct the quality control review deficiency. If Prime Mortgage immediately begins to conduct reviews of its files in accordance with its written plan, this should resolve our concerns in this area.
- Comment 5** Given that the owner of Prime Mortgage signed the checks written to the two borrowers that we concluded used the Prime Mortgage funds to close their Federal Housing Administration loans, we maintain that our recommendations are warranted, and that sanctions imposed should reflect the seriousness of the situations.