

# AUDIT REPORT



FIRST SOURCE FINANCIAL USA

HENDERSON, NEVADA

2005-LA-1003

May 12, 2005

OFFICE OF AUDIT  
PACIFIC/HAWAII REGION  
LOS ANGELES, CALIFORNIA



Issue Date May 12, 2005
Audit Report Number 2005-LA-1003

TO: Frank L. Davis, General Deputy Assistant Secretary for Housing, H  
Margarita Maisonet, Director, Enforcement Center, CV  
*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Pacific/Hawaii  
Region, Los Angeles, 9DGA

SUBJECT: The Federal Housing Administration Loan Origination Process at First  
Source Financial USA, Henderson, NV, Did Not Fully Comply with  
HUD Requirements

## HIGHLIGHTS

### What We Audited and Why

We audited First Source Financial USA (First Source) in Henderson, Nevada. We selected First Source because it had a large number of defaults and claims. We examined the loan origination process on 20 loans, of which 18 had a reported default.

Our audit objectives were to determine whether the mortgagee:

- Complied with U. S. Department of Housing and Urban Development (HUD)/Federal Housing Administration requirements in the origination of Federal Housing Administration-insured loans, and

- Implemented a quality control plan that complied with HUD requirements.

## What We Found

We determined that First Source disregarded HUD requirements and allowed the following to originate and process Federal Housing Administration-insured loans:

- Independent contractors (nonemployees).
- Prohibited net branch arrangements as well as non-HUD approved branches.
- Third party mortgagees.

In addition, we found loans were insured based on falsified information. We also determined that First Source had implemented a quality control plan, but it was not always effective, nor was it in total compliance with HUD requirements. We will not present our findings and discuss recommended corrective actions on quality controls in this report, because First Source surrendered its approval to originate Federal Housing Administration loans effective December 15, 2004.

## What We Recommend

Because First Source surrendered its Federal Housing Administration approval authority, we will not recommend indemnification of all First Source loans in active and claim status. Rather, we recommend the General Deputy Assistant Secretary for Housing impose civil money penalties, and any other administrative sanctions deemed appropriate, in accordance with the recommendations following each finding. In addition, we recommend the Director of the Departmental Enforcement Center proceed with recommended debarments.

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

## Auditee's Response

We provided First Source Financial a draft report on March 28, 2005, and held an exit conference on April 8, 2005. First Source Financial provided

written comments on April 27, 2005. They generally agreed but took issue with some of our report findings.

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

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### Background

First Source Financial USA (First Source) in Henderson, NV, was incorporated in February 1998 and received U. S. Department of Housing and Urban Development (HUD) approval to originate Federal Housing Administration loans as a non-supervised loan correspondent on January 10, 2001. According to HUD's Neighborhood Watch System, First Source has a total of ten active branches and eight that have been terminated. There were four approved locations (the home office and three branches) in the Las Vegas/Henderson area. The remaining approved branches were located in nine other states.

On October 13, 2004, the HUD Office of Inspector General Region VIII (Denver) Office of Audit issued an audit report on the Midvale, UT, branch office of First Source. The report detailed ineffective loan origination and quality control processes. This included:

- Invalid employment information,
- Loan origination by independent contract loan officers, and
- Quality control plans not implemented.

On September 13, 2004, First Source requested HUD terminate its authority to originate Federal Housing Administration-insured loans and cited "limited loan amounts in our area as well as additional expenses associated with originating Federal Housing Administration loans." On December 15, 2004, First Source was terminated as a Federal Housing Administration approved lender.

We selected First Source for audit based on its large number of defaults and claims. Based on data from HUD's Neighborhood Watch system, we determined First Source had 231 defaults and 38 claims reported between January 24, 2001, and February 29, 2004. Neighborhood Watch also showed there were 2,017 Federal Housing Administration loans originated, with a total mortgage amount of \$239,189,800. As of November 29, 2004, HUD incurred losses of \$340,400 on 14 out of 20 loans in our audit sample. The mortgage amounts for these loans totaled \$1,747,949.

### Objectives

The audit objectives were to determine whether First Source complied with HUD regulations, procedures, and instructions in the origination and processing of Federal Housing Administration loans. We wanted to determine whether First Source

- Loan officers were employees;

- Paid operating expenses for its net branches, had HUD approval to originate Federal Housing Administration loans from the branches, and allowed third party originations;
- Allowed misrepresentations in the loan process; and/or
- Implemented a quality control plan that complied with HUD requirements.

## RESULTS OF AUDIT

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### **Finding 1: First Source Allowed NonEmployees and Unapproved Branches To Originate and Process Federal Housing Administration-Insured Loans**

First Source used nonemployee loan officers and processors to originate and process Federal Housing Administration-insured loans contrary to HUD requirements. First Source also allowed unapproved branch offices and third party mortgage companies to use its Federal Housing Administration home office lender identification number to obtain Federal Housing Administration insurance endorsements. As a result, First Source could not directly control or effectively supervise the loan origination and processing function, and therefore contributed to an increased risk to the Federal Housing Administration insurance fund. We attribute the noncompliance to First Source's lack of knowledge and/or disregard for HUD/Federal Housing Administration requirements.

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#### **Loans were Originated and Processed by NonEmployees**

##### **Loan Officers and Processors Were Not Always Employees**

First Source originated virtually all of its Federal Housing Administration-insured loans through independent contractors or nonemployees, contrary to Mortgagee Letter 95-36. The Mortgagee Letter prohibits contracting out customary loan origination functions that would materially affect underwriting decisions.

First Source entered into agreements with independent contractors to originate Federal Housing Administration loans instead of employing its own loan officers. First Source used standard contract language that stated the agreements were between First Source, as "broker" and the independent contractor, as the "mortgage originator." The agreements further stated that the "MORTGAGE ORIGINATOR hereby acknowledges and agrees he is an INDEPENDENT CONTRACTOR and not a servant, employee, joint venture, or partner of the BROKER." We corroborated the contract arrangements during interviews/discussions with First Source management officials, former employees and independent contract loan officers. During these discussions, we also determined loan officers could not participate in any company benefits and rented office space if they worked in the home office.



Most Federal Housing Administration loans at First Source were originated through these independent contractor agreements. HUD's Neighborhood Watch system showed 2,017 Federal Housing Administration-insured loans were originated under First Source's lender number during our audit period. First Source had no records for 36 of the loans. We analyzed the remaining Federal Housing Administration loans and identified over 240 independent contract loan officers. These loan officers originated \$239,189,808 in Federal Housing Administration mortgages for First Source. One independent contract loan officer originated 115 Federal Housing Administration loans totaling over \$12,900,000. Based on First Source accounting records, this loan officer received over \$463,000 in all loan commissions during 2002 alone.

In addition to independent contract loan officers, we determined at least two loan processors were neither First Source employees nor commercial providers. First Source did not maintain personnel files for the loan processors hired by the independent contract loan officers. Although Mortgagee Letter 95-36 allows some loan functions normally performed by a loan processor to be contracted out, the functions must be contracted out to a commercial provider. Most First Source processors had a working arrangement with the independent contractors.

HUD Handbook 4060.1, REV-1, requires mortgagees to maintain control and responsible management supervision over employees. By contracting out almost all loan origination and some loan processing functions, First Source could not exercise adequate control and proper supervision of its contractors. Consequently, the deficient quality of some loans increased Federal Housing Administration insurance fund risks and, as our audit tests of the loan files showed, also increased borrower costs (see Finding 3).

### **Loans were Originated by Unapproved Net Branches and Third Party Loan Originators**

#### **Unapproved Branches and Third Party Originators Were Allowed**

Our review found that First Source was originating Federal Housing Administration loans from at least 17 unapproved branches. According to HUD Handbook 4060.1, REV-1, lenders must be approved by HUD to originate, purchase, hold or sell HUD/Federal Housing Administration insured mortgages. Lenders are also required to submit applications to HUD for each branch office originating loans for insurance.

First Source circumvented Federal Housing Administration approval requirements by allowing the unapproved branches to use its home office

Federal Housing Administration lender identification number. This practice is known as ‘net branching.’ Although these were supposedly First Source branches, they were in actuality individual companies. The branch managers and loan officers had often incorporated and their respective commissions were paid in the name of their independent corporations. According to interviews with First Source management and former net branch managers, the managers paid all expenses of the branch, including rent, furniture, telephone, etc. First Source did not reimburse these expenses. This is a violation of HUD Handbook 4060.1 REV-1, which states in paragraph 2-17 that a HUD/Federal Housing Administration approved lender is required to pay all of its operating expenses for the main and branch offices.

Paragraph 1-2 of HUD Handbook 4060.1, REV-1, specifies that HUD/Federal Housing Administration-insured loans may only be originated by lenders that have been approved by HUD. Approved lenders are permitted to conduct these activities from branch offices; however, separate entities may not operate as branches of a HUD/Federal Housing Administration lender. HUD considers this type of branch arrangement, whereby the branch lacks HUD approval as a third party origination, a violation of Departmental requirements.

Mortgagee Letter 00-15 states ...“The Department has learned that some HUD/FHA approved mortgagees are engaged in the practice of accepting an existing, separate mortgage company or broker as a branch and allowing that separate entity to originate insured mortgages under the approved HUD Mortgagee Number. Some mortgagees refer to this arrangement as a ‘net branch.’ This, however, constitutes a prohibited net branch arrangement...”

First Source was also involved in “co-brokering” Federal Housing Administration-insured loans for at least one mortgage company. There were at least three independent contractor loan officers who originated loans for a mortgage company called Southern Fidelity Mortgage LLC. We identified six loans where Southern Fidelity received disbursements between \$495 and \$1,055. As previously stated, third party loan originations are a violation of HUD requirements.

## **Conclusion**

Due to their disregard of HUD requirements, First Source allowed nonemployees and unapproved branches to originate and process Federal Housing Administration-insured loans. As a result, there was increased risk to the Federal Housing Administration insurance fund. Mortgagee Letter 00-15 concludes with the following:

“The Department believes the origination of insured mortgages by lenders that have not received HUD/Federal Housing Administration approval increases the risk to the Federal Housing Administration insurance fund and to the public. Accordingly, mortgagees found to be in violation may be subject to the full range of HUD sanctions.”

In addition, we believe First Source Financial surrendered its authority to originate Federal Housing Administration-insured loans due to the results of this audit and the recent audit performed on their Midvale, UT branch office. We further believe that HUD will benefit from the removal of First Source and the prevention of additional future losses from claims to the FHA insurance fund. Using First Source’s current claim rate, we have quantified the future savings from preventing future losses, and the amount is shown below in recommendation 1A.

## Recommendations

We recommend that the General Deputy Assistant Secretary for Housing require First Source to:

1A. Pay civil money penalties for the following violations of HUD requirements that occurred between January 2001 and April 2004 :

- Loans processed by independent contract loan officers and processors who were not First Source employees or commercial providers.
- Unapproved and prohibited net branch arrangements, and
- Third party loan originations for Southern Fidelity Mortgage LLC.

Due to First Source’s election to surrender its authority to originate Federal Housing Administration-insured loans, we have determined HUD’s future savings from loss prevention will amount to \$389,000.

We recommend the Director, Departmental Enforcement Center:

1B. Debar the First Source principals for their disregard for HUD/Federal Housing Administration rules and regulations.

## **Finding 2: Federal Housing Administration Loans Were Originated and Processed With False Information and Known Misrepresentations**

Federal Housing Administration-insured loans included false information and known misrepresentations. This was due to failure to use due care, poor quality control procedures, and disregard for HUD requirements. At least 7 of the 20 loans (35 percent) reviewed contained falsified information to obtain Federal Housing Administration insurance endorsement. As a result, HUD and the Federal Housing Administration insurance fund assumed an unnecessary risk, and HUD has incurred losses totaling over \$159,600 on six of these loans (see Appendix C).

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### **Loans were Originated and Processed with False Information**

Seven Loan Files Contained  
Falsified Information

During our review, we confirmed that 7 of the 20 loans we reviewed were approved based on false information. The misrepresented information included, but was not limited to, inadequate employment and credit verifications, a false Social Security number; and the addition of a coborrower to qualify for the loan. Additionally, a First Source loan officer obtained a property with a Federal Housing Administration insured loan using deceptive practices. In every instance, we confirmed the loan officer or processor should have known about the false information based on the available documentation.

HUD Handbook 4155.1, REV-4, requires that mortgagees "...verify borrower's employment for the most recent two years." HUD relies on mortgagees to obtain factual data from the borrower and to verify and analyze the information obtained. Based on our review, First Source did not comply with this requirement. HUD Handbook 4155.1, REV-4, also precludes a borrower from having more than one Federal Housing Administration loan except under very specific extenuating circumstances.

HUD Handbook 4060.1, REV-1, and Mortgagee Letter 96-18 both prohibit individuals from working for more than one company engaged in the real estate finance business at the same time. This also includes working as a real estate agent or broker as well as originating or underwriting loans for more than one lending institution.

Loan No. 332-3867084

First Source independent contract loan officers and/or loan processors were aware of borrowers' false information, and, on occasion encouraged nonqualified borrowers to find others to apply with them as coborrowers for loans. This allowed the nonqualified borrowers to obtain loans for which they would not otherwise be qualified. For example, we interviewed a borrower who stated his loan officer had advised him to find another individual as a coborrower on the loan. The loan officer stated the borrower could remove the coborrower from the title after one year; however, additional income was needed to qualify for the loan. The loan officer also advised the borrower to obtain a cashier's check in the coborrower's name even though the borrower had already purchased a cashier's check. We documented that the borrower's cashier check was cashed to purchase a cashier's check in the coborrower's name. The borrower also stated the loan officer was aware that his Social Security number was false and that the borrower had purchased the Social Security card in Los Angeles. This loan was a five-payment default and HUD ultimately lost \$5,072.

Loan No. 332-3807515

One First Source independent contract loan officer allowed a borrower to obtain two Federal Housing Administration loans within one month. One loan was for the purchase of a new home and closed December 10, 2001, and the other was a cash-out refinance of his existing home. That loan closed on December 20, 2001. The same First Source independent contract loan officer originated the loans.

Based on our review, this occurred because the loan officer wanted to purchase the new home and had the borrower agree to co-sign the loan. The loan was never a co-sign in that the title never showed the loan officer's name. According to county records, the property was transferred through a Grant, Bargain, and Sale of Deed to the loan officer's corporation on January 1, 2002. This was 11 days after the closing. However, the loan officer did not record the sale with the Clark County Recorder's office for more than two years until January 22, 2004. Based on documentation we obtained through interviewing a neighbor and from the servicing mortgage company, we confirmed the loan officer lived in the property more than two years and made the mortgage payments with his personal checks. The loan officer concealed his ownership of the property from HUD by not recording the transfer of ownership with the county and keeping the loan in the name of the borrower for more than two years until the loan officer sold the property.

Loan No. 332-3682470

We determined that at least two loan officers were working for a real estate company at the same time they were originating Federal Housing Administration loans at First Source. For example, we observed while reviewing escrow documents the loan officer on one of the loans was also shown as the real estate agent. We confirmed that he had received a commission from the sale of the property as well as for originating the loan. We also noted the Chief Executive Officer of First Source had signed the Uniform Residential Loan Application as the interviewer. When we spoke to him, he could not recall why he would have done this; however, he speculated the loan officer may have known he was not allowed to act as both loan officer and real estate agent.

The Santa Ana Homeownership Center Quality Assurance Division performed a mortgagee monitoring review of the First Source home office in 2002. In its report dated November 29, 2002, finding 4 dealt with the issue of individuals working at other companies in a related industry. The report identified one particular loan officer as both a real estate agent and a loan officer. In the First Source response dated January 31, 2003, the company stated the "...circumstances of this transaction will not be repeated at First Source USA as we will ensure that the internal procedures described above are closely followed. We also have terminated our relationship with the sponsoring lender in this transaction and no longer do any business with [the named individual]...". However, we determined the same individual originated a Federal Housing Administration loan in June of 2003.

In the same response to finding 3, First Source stated it was taking steps to bring its operation into full compliance with HUD requirements. One step First Source reported instituting was that "...loan originators execute an exclusive affiliation agreement in which they commit that they will not perform any real estate sales or related financial services for any other person or entity during the period of their employment with First Source USA." However, when we requested a copy of this agreement from the First Source Chief Executive Officer and President of Operations, they could not provide one. They stated the agreement had not been implemented until sometime in 2004.

## Conclusion

Due to lack of due professional care, poor quality controls, and disregard for HUD requirements, First Source allowed loans with false information and known misrepresentations to be processed. As a result, we determined HUD experienced losses totaling over \$159,600 on 6 of the 20 loans we reviewed.

In addition, First Source reported to HUD that it had terminated at least one loan officer/real estate agent relationship and instituted steps to preclude any further issues with employees not working exclusively for First Source. However, neither of these purported actions occurred.

## **Recommendations**

We recommend that the General Deputy Assistant Secretary for Housing require First Source to:

- 2A. Repay \$159,663 in losses HUD incurred on six loans. (See Appendix C)
- 2B. Pay civil money penalties for allowing loan officers to also work for a real estate company.

We recommend the Director, Departmental Enforcement Center:

- 2C. Debar the independent contract loan officer who obtained a Federal Housing Administration-insured loan through false pretenses and then deliberately concealed his ownership of the property. (Case Number 332-3807515)

### **Finding3: First Source Allowed Questionable Lending Practices by Collecting Unearned Fees**

First Source allowed yield spread premiums, for which the borrowers received little or no value or service. This was caused by the lack of oversight on the part of First Source. Consequently, borrowers had unnecessarily high mortgage payments resulting in subsequent defaults and foreclosures. Additionally, First Source loan officers received compensation that exceeded the value of the loan origination services provided. This is a violation of the Real Estate Settlement Procedures Act (RESPA).

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#### **Yield Spread Premiums did not Offset Borrower Settlement Costs**

We determined that 19 of 20 loans we reviewed contained yield spread premiums. Eleven of the 19 (58 percent) showed loan officers received yield spread premiums and the borrowers received no value or service for the resulting higher interest rates. Yield spread premiums permit homebuyers to pay some or all of the upfront settlement costs over the life of the mortgage through a higher interest rate. Since the mortgage has a higher interest rate than the market or par rate, the lender is able to sell it to an investor at a higher price. Therefore, the lender compensates the broker for the price difference. According to the RESPA Statement of Policy 2001-1, a yield spread premium is considered an indirect fee and "... simply delivering a loan with a higher interest rate is not a compensable service." It further states that if a payment or a portion thereof bears no reasonable relationship to the market value of the services provided, the excess over the market rate may be used as evidence of an unearned fee, in violation of Section 8(a) or 8(b) of RESPA.

If used properly, the yield spread premium can be used as an effective and legitimate tool to assist the borrower. At First Source, however, loan officers received the yield spread premiums as a major part of their compensation. In turn, the loan officer paid an agreed upon flat rate fee to First Source for each loan originated. Our review showed the yield spread premium was used in a manner that took advantage of the borrowers with the complexity of the settlement transaction. The only benefit derived in the 11 loans cited above was additional income to the loan officers. In all 11 cases, the borrowers' upfront cash requirements were not reduced.



Loan No. 332-3512984

For example, one loan we reviewed showed a yield spread premium (rebate) of \$4,032, yet the borrower had not received anything towards his upfront cash requirements. The entire amount was commission for the loan officer. The loan amount was \$115,192. In this instance, the loan officer also received over \$2,800 for loan origination and various other fees, for a total commission of more than \$6,800. First Source received \$1,500 of the \$6,800. The loan officer also appeared to have been involved in creating the false employment documents and was listed as the contact person for the claimed employer.

Loan No. 332-3810992

In 8 of the 20 loans, we determined borrowers did receive some benefit from the yield spread premiums. For example, one borrower received a credit for about \$1,290; however, the commission sheet showed the loan officer received more than \$4,460 for the yield spread premium alone. This amounted to only approximately 22 percent of the yield spread premium being applied to pay borrower settlement charges and 78 percent going to the loan officer. Total commission for the loan amounted to almost \$7,200. This is clearly not what a yield spread premium was intended for and violates RESPA.

Mortgagee Letter 94-7 discusses the acceptable uses of premium rate pricing (rebates) to cover some or all of a borrower's closing costs and the borrower then incurring a higher interest rate. In addition, the Letter states that if a premium rate will result in excess funds over and above closing costs and prepaids, the overage must be used to reduce the mortgage principal balance.

RESPA is a consumer protection statute, first passed in 1974. The purposes of RESPA are to

- Help consumers become better shoppers for settlement services, and
- Eliminate kickbacks and referral fees that unnecessarily increase the cost of certain settlement services.

Section 8 of RESPA prohibits a person from giving or accepting anything of value for referrals of settlement service business related to a Federal-related mortgage loan. It also prohibits a person from giving or accepting any part of a charge for services that are not performed. However, the above use of yield spread premiums resulted in total compensation in

excess of what would be reasonably related to the total value of the origination services provided by the loan officers.

When we discussed this with the Chief Executive Officer of First Source, he stated he could not control what the loan officers were charging. He indicated he knew there were excessive charges; however, he believed that if he attempted to impose restrictions, the loan officers would merely move to other mortgage companies. This is inconsistent with the customary employer-employee relationship and HUD requirements whereby the lender maintains control and supervision of employee actions. We also believe this demonstrated lack of concern for the borrowers and contributed to the questionable lending practices described in this report.

### Yield Spread Premiums Were Not Always Disclosed

Mortgagee Letter 2001-26 states that "...meaningful disclosure of yield spread premiums, as early as possible in the mortgage origination process, will avoid confusion and enable borrowers to make informed choices." However, two of the loans did not disclose the yield spread premiums on the HUD-1 or the Good Faith Estimates (Case Nos. 332-3938492 and 332-3867084 in Appendix D). Also, 11 other loans did not disclose the yield spread premiums on the Good Faith Estimates (Appendix D).

### Conclusion

First Source allowed loan officers to receive unearned indirect fees in the form of yield spread premiums from their improper use of the intended benefits of premium rate pricing. This was a clear violation of RESPA.

### Recommendations

We recommend that the General Deputy Assistant Secretary for Housing require First Source to:

3A. Pay civil money penalties for the RESPA violations on 19 of the loans in which the borrower received no or very little benefit from the yield spread premium (See Appendix D).

3B. Review and analyze all Federal Housing Administration-insured loans with yield spread premiums in which no interest rate or principal balance

reduction occurred. Report the results to the Mortgagee Review Board. Refunds should be issued in the following order:

1. If the loan is current, a refund must be made to the borrowers.
2. If the loan is delinquent, a refund must be applied to the delinquency.
3. If a claim has been paid, a refund must be paid to HUD and sent to HUD Single Family Claims.

## SCOPE AND METHODOLOGY

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We performed audit work from May through December 2004. The audit period covered January 2001 through April 2004.

The primary audit methodologies included:

- Evaluation of First Source's management and quality control structure and risk assessment;
- Interviews with current and prior First Source employees, independent contract loan officers and processors, and sponsor underwriters;
- Interviews with borrowers; title company employees; neighbors; Clark County employees; insurance company employees; and individuals shown as employers, creditors, and landlords on loan documents;
- Review of First Source and Federal Housing Administration loan files and selected First Source personnel documents and title company files; and
- Review of public records and databases.

When we began the review, we obtained information from HUD's Neighborhood Watch system that showed there were 231 defaults reported during the audit period. Of those 231, there were 38 loans in claim status.

We initially selected 18 loans for review. We added two loans increasing the number to 20, with mortgages totaling over \$2,518,000. We performed our review in accordance with generally accepted government auditing standards.



## INTERNAL CONTROLS

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Internal Controls are 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.

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### Relevant Internal Controls

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

- Validity and Reliability of Data – Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and used during the mortgage loan origination process.
- Compliance with Laws and Regulations – Policies and procedures that management has implemented to reasonable ensure that is loan origination process is carried out in accordance with applicable laws and regulations
- Quality Control Process – Policies and procedures established by management to ensure the quality control plan has been implemented and related reviews are performed.

We assessed the relevant controls identified above.

### Significant Weaknesses

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.

Based on our review, we believe all three areas are significant weaknesses and contributed to the deficiencies reported in this report. First Source provided inadequate supervision and did not ensure Federal Housing Administration loans were processed in accordance with HUD requirements. In addition, the quality

control plan did not meet all HUD requirements. However, because First Source is no longer originating Federal Housing Administration loans, we will not have a finding on this issue.

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## APPENDIXES

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### Appendix A

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

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Recommendation Number	Ineligible 1/	Unsupported 2/	Unreasonable or Unnecessary 3/	Funds To Be Put to Better Use 4/
1A				\$389,000
2A	159,663			

- 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 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 OIG recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.




## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

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#### Ref to OIG Evaluation

#### Auditee Comments



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*Friday, April 22, 2005*

Office of Inspector General  
Joan S. Hobbs  
Regional Inspector General for Audit  
611 West 6th Street - Suite 1160  
Los Angeles, CA 90017-3101

*Re: First Source Financial USA Inc. – Audit Report*

Dear Ms. Hobbs:

On behalf of First Source Financial USA Inc., (“First Source”) I wish to thank you, Helen Sparks, Pamela Martin and the Office of the Inspector General (“OIG”) for meeting with me and John Loveless at First Source’s main office in Las Vegas, Nevada on April 9, 2005 to review your draft audit report. We appreciated your professionalism and courtesies as well as your explanations and comments. The following is our response to your audit report.

**Finding 1: First Source Allowed Nonemployees and Unapproved Branches to Originate and Process Federal Housing Administration-Insured Loans.**

Response

The OIG contends that First Source used nonemployee loans officers and processors to originate and process FHA-insured loans; that it allowed unapproved branch offices and third party mortgage companies to use its FHA home office lender identification number to obtain FHA insurance endorsements; that these practices were contrary to HUD “requirements” because First Source could not directly control or effectively supervise the loan origination and processing functions; and that as a result, the risk to the FHA insurance fund increased. This finding combines three separate concerns: (1) use of nonemployee loan officers; (2) use of nonemployee loan processors; and (3) use of net branch offices to originate FHA-insured loans. Each is discussed separately below.

1. NONEMPLOYEE LOAN OFFICERS. In determining whether the relationship between a loan officer and a mortgagee permits the mortgagee to exercise that degree of control and supervision sufficient to minimize risk to the FHA insurance fund, the OIG cannot focus on a single document, whether it be the loan officer’s employment contract or a 1099, but rather must look at the entirety of the loan officer’s relationship with the mortgagee, including applicable statutes and regulations.

CORPORATE OFFICE  
7020 N. Green Valley Drive • Bldg 2 Suite 212 • Henderson NV 89004

Comment 1

Nowhere in HUD Handbook 4060.1, REV-1 ("HUD 4060.1") or Mortgagee Letter 95-36 ("ML 95-36") is there any requirement that a loan officer be an employee of the mortgagee. HUD 4060.1 provides in Section 2-13 that mortgagees are required to exercise control and responsible management supervision over their employees including, at a minimum, regular and ongoing reviews of employee performance and of work performed. Section 2-14 provides that all employees of the mortgagee except receptionists, whether full time or part-time, must be employed exclusively by the mortgagee at all times. ML 95-36 provides customary loan officer functions may not be contracted out and that mortgagees will be held responsible for the quality of loans and compliance with HUD program requirements. In both HUD 4060.1 and ML 95-36 the focus is on supervision and control of the loan origination function, not on the economic relationship between the loan officer and the mortgagee. Determining whether a loan officer receives a W-2 or a 1099 does not speak to supervision and control of the loan origination function.

In Nevada, where First Source has its headquarters and where the bulk of the FHA-insured loans were originated, a loan officer must be licensed as a "mortgage agent" but the mortgage agent may be either an employee or independent contractor of a mortgage broker. See, NRS 645B.0125. Whether a mortgage agent is an employee or an independent contractor, the mortgage agent:

- may not be associated with or employed by more than one mortgage broker at the same time (NRS 645B.450);
- must be a natural person (NRS 645B.0125); and
- must be licensed by the Division of Mortgage Lending as a mortgage agent (NRS 645B.400).

A mortgage broker has a statutory duty to supervise and control those mortgage agents who are licensed under the mortgage broker. Those duties are set forth generally in NRS 645B.460:

**Supervision by mortgage broker; requirements; regulations.**

1. A mortgage broker shall exercise reasonable supervision over the activities of his mortgage agents. Such reasonable supervision must include, as appropriate:

(a) The establishment of written or oral policies and procedures for his mortgage agents; and

(b) The establishment of a system to review, oversee and inspect the activities of his mortgage agents, including, without limitation:

(1) Transactions handled by his mortgage agents pursuant to this chapter;

(2) Communications between his mortgage agents and a party to such a transaction;

(3) Documents prepared by his mortgage agents that may have a material effect upon the rights or obligations of a party to such a transaction; and

(4) The handling by his mortgage agents of any fee, deposit or money paid to the mortgage broker or his mortgage agents or held in trust by the mortgage broker or his mortgage agents pursuant to this chapter.

2. The Commissioner shall allow a mortgage broker to take into consideration the total number of mortgage agents associated with or employed by the mortgage broker when the mortgage broker determines the form and extent of the policies and procedures for those mortgage agents and the system to review, oversee and inspect the activities of those mortgage agents.

3. The Commissioner may adopt regulations prescribing standards for determining whether a mortgage broker has exercised reasonable supervision over the activities of a mortgage agent pursuant to this section.

Pursuant to this statute, the Division of Mortgage Lending adopted regulations in September 2000 which amplify the concept of "adequate supervision" by the mortgage broker over the mortgage agent:

**NAC 645B.310 Determination by Commissioner of adequate supervision of mortgage agent by mortgage broker.** (NRS 645B.060, 645B.460) In determining whether a mortgage broker has maintained adequate supervision of a mortgage agent, the Commissioner will consider whether:

1. The mortgage broker has made a reasonable effort to investigate the background and experience of a prospective mortgage agent and hire only a mortgage agent whose background and experience indicate that the person is trustworthy and competent to conduct the business of a mortgage agent;

2. The mortgage broker has adopted and followed any policies and procedures, written or oral, relating to the supervision and training of mortgage agents;

3. The mortgage agent has followed the policies and procedures of the mortgage broker, written or oral, governing his activities;

4. The mortgage broker has established and followed a system of review for compliance with his written or oral policies and procedures;

5. The policies and procedures of the mortgage broker require regular review of the work of a mortgage agent;

6. The mortgage broker reviewed the work of the mortgage agent in the case under examination by the Commissioner;

7. The policies and procedures of the mortgage broker include training in the requirements of this chapter and chapter 645B of NRS;

8. The mortgage broker makes copies of this chapter and chapter 645B of NRS available to mortgage agents;

9. The policies and procedures of the mortgage broker include a provision for continuing education for mortgage agents;

10. The mortgage broker spends a sufficient amount of time in the office where the mortgage agent is working;

11. The mortgage broker has received or acted on previous reports of alleged misconduct by the mortgage agent; and

12. Review of the previous work of the mortgage agent would have disclosed a problem with the conduct or issue being examined by the Commissioner.

First Source's supervisory and control duties under Nevada law are more stringent and detailed than the HUD requirements. Those statutory and regulatory duties moreover cannot be overridden by an employment contract. When those statutory and regulatory duties of supervision and control are considered, it is clear that First Source exercises sufficient control and supervision over its loan officers.<sup>1</sup>

Our reading of your audit report does not indicate that the OIG investigated or was concerned with the extent to which First Source *actually* supervises and controls its loan officers. If that is a concern on the part of the OIG, we would be pleased to document our compliance with NRS 645B.460 and NAC 645B.310.

## Comment 2

2. USE OF NONEMPLOYEE LOAN PROCESSORS. First Source has always required its loan officers to use loan processors employed by First Source. First Source loan officers have never been permitted to use loan processors who are not employed by First Source. Although this was not made explicit in loan officer contracts prior to 2002, following the Mortgagee Review conducted by HUD's Quality Assurance Division ("QAD Review") in 2002, First Source added the following provision in boldface type to its Loan Officer Compensation Agreement: "ALL loans must be processed by a First Source Financial USA Processor".

Your audit report does not identify the two nonemployee loan processors. The QAD Review, which reviewed loan files from the same period of time, identified three non-employee loan processors: [REDACTED] and [REDACTED]. Both [REDACTED] and [REDACTED] were determined to have been employed by First Source as receptionists and their names were simply omitted from the list of employees supplied to HUD agents who prepared the QAD Review. First Source was unable to locate records indicating that [REDACTED] was ever employed by First Source. First Source accordingly signed an indemnification agreement with respect to files processed by [REDACTED].

## Comment 3

3. USE OF UNAPPROVED NET BRANCHES AND THIRD PARTY LOAN ORIGINATORS. First Source's net branches were established largely during the tenure of [REDACTED], First Source's President of Operations. During the period of time between January 2001, when First Source became licensed as a FHA loan correspondent and [REDACTED] abrupt departure in September 2002, [REDACTED] was actively involved in setting up his own mortgage company in Las Vegas to compete with First Source. We believe that during this period of time, [REDACTED] took actions that were not in the company's best interests, including his failure to require that net branches originating insured mortgages comply with Mortgagee Letter 00-15. Following [REDACTED] departure from the company in September 2002, First Source hired [REDACTED] to fill the position of Director of Net Branching. [REDACTED] undertook the task of bringing the net branches into compliance with HUD requirements,

<sup>1</sup> The Mortgage Lending Department now requires that when a loan officer applies for a license as a mortgage agent, he must obtain from his mortgage broker a signed "Acknowledgment of Intent to Employ" in which the mortgage broker declares under penalty of perjury that "If a mortgage agent's license is issued to the Mortgage Agent named within, I will exercise careful supervision over his/her activities while he/she is associated with or employed by me."

either by requiring that the branch be separately licensed to originate FHA insured mortgages or that the branch cease originating FHA insured mortgages. Because of the chaos created by [redacted] departure, this corrective action took some time to implement.

It is important to recognize that First Source undertook this corrective action without any prompting from HUD. The QAD Review in 2002 does not address the use of unapproved net branches to originate federally insured home loans, even though evidence of noncompliance, which came from HUD's own records, was certainly available to the Quality Assurance Division in 2002.

**Comment 4**

With respect to six loans that First Source "co-brokered" with Southern Fidelity LLC, First Source discontinued that practice when the actions of the loan officers involved in co-brokering were brought to management's attention.

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**Finding 2: Federal House Administration Loans Were Originated and Processed With False Information and Known Misrepresentations.**

Response

**Comment 5**

Of the seven loans listed on Appendix C alleged to contain false documentation, we were able to review the files for six of those loans. We did not have the file for Loan Number 3810992, but our records show that this was a loan originated by [redacted], a former First Source loan officer, who was promptly terminated when First Source discovered clear evidence of loan fraud. Our records do not indicate whether Loan Number 3810992 was one of the loans that we discovered to have contained loan fraud, but we believe that based on her origination of the loan it is probable that it did contain false documentation. Our internal audit of the other files confirms that Loan Numbers 3619948 and 3804417 contained false documentation, as set forth on Appendix C. With respect to Loan Number 3512984, we were unable to locate any alternative credit, false or otherwise, although it does appear that the pay stubs and wage and tax statements may have been false. With respect to Loan Numbers 3841557 and 3867084 we were unable to identify any obviously false documentation. We could find nothing in either file that would have alerted a loan processor or quality control person that the loan was submitted with false documentation. Your audit remarks concerning Loan Number 3867084 indicate that in order to determine that the loan was based on false documentation including a false social security number, you were obliged to interview the borrower. Based on that interview you discovered that the loan officer actively participated with the borrower in compiling and submitting the false documentation.

No mortgage broker can completely immunize itself from the actions of dishonest loan officers and loan processors. Neither detailed background checks of loan officers and processors nor a HUD-approved quality control program can prevent a dishonest loan officer from conspiring with a dishonest loan processor and/or a dishonest borrower who are determined to obtain a loan based on fraudulent documentation. When First Source learns that a loan officer or a processor has engaged in loan fraud, First Source not only terminates the loan officer or the

processor but also reports it to the Division of Mortgage Lending for the purpose of ensuring that these folks never work in the mortgage industry again.

With respect to those files such as 3804417 and 3619948 where even a cursory review of the loan documents indicates glaring inconsistencies and probable false documentation, we believe that HUD's losses on those files are more accurately attributed to underwriting deficiencies than to deficiencies in First Source's origination policies and procedures.

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**Finding 3: First Source Allowed Questionable Lending Practices by Collecting Unearned Fees.**

Response

**Comment 6**

You contend that under RESPA Statement of Policy 2001-1 ("SP 2001-1"), First Source must in effect rebate to a borrower any yield spread premium that it receives from the lender. We respectfully disagree with your interpretation of SP 2001-1. SP 2001-1 was issued in response to an eleventh circuit court case, *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001) which held that a yield spread premium violated Section 8 of the RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread premiums to the brokers based solely on the brokers' delivery of above par interest rate loans. In so holding, the Court based its reasoning on Statement of Policy 1999-1 ("SP 1999-1"). SP 2001-1 was issued to overrule *Culpepper*. SP2001-1 restated HUD's position that yield spread premiums are not per se illegal. In order to determine the legality of a yield spread premium two tests must be applied. The first is whether the total compensation to a mortgage broker of which a yield spread premium may be a component or the entire amount of the compensation was for goods or services provided or services performed. In determining whether this test has been met it is necessary to "look at each transaction individually, including examining all of the goods and facilities provided or services performed by the broker in the transaction, whether the goods, facilities, or services are paid for by the borrower, the lender, or partly by both."

The second test to be applied is whether the total compensation paid to the mortgage broker is reasonably related to the total set of goods or facilities actually furnished or services performed. SP 2001-1 reconfirmed SP 1999-1 by noting that "the level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders". It is therefore First Source's position that the OIG cannot conclude that First Source violated Section 8 of the RESPA by failing to apply all of the yield spread premium to closing costs, but must rather (1) look at all of the goods and facilities provided or services performed by the broker in the transaction; (2) look at the total compensation paid to the broker; and (3) assess the reasonableness of the total compensation by reference to the degree of effort

required for processing the loan and the level of service which First Source is required to perform under its arrangements with wholesale lenders. Since the key is the reasonableness of the total compensation to the broker in exchange for the goods and services provided, it is irrelevant how that total compensation is divided up between the mortgage broker and the mortgage agent. Your analysis, which holds simply that a yield spread premium is per se illegal, was rejected by HUD in SP 2001-1.

Conclusion

On September 9, 2002, HUD's Quality Assurance Division, Santa Ana Homeownership Center, conducted a review of eighteen HUD insured mortgage loans and issued a report dated November 29, 2002. Loans were generated during the same time period that the loans which your office audited in 2004 were generated. First Source has thus been audited twice on loans generated during the same time period. It is probable that a third audit covering loans generated during this same time period would result in similar findings.

Following the QAD Review in September 2002, First Source took immediate steps to implement all necessary corrective action. To the extent that your audit identified other deficiencies such as the use of unapproved net branches to originate federally insured home loans, First Source also took corrective action on its own. With respect to First Source's use of nonemployee loan officers we believe that you must take into consideration applicable statutes and regulations that impose supervisory and control duties on First Source and that when those statutes and regulations are considered, we are in compliance with HUD's requirements. Similarly, with respect to the yield spread premiums we respectfully disagree with your interpretation of SP 2001-1 and believe that the total compensation paid on each of the loans listed on Appendix D was given for goods and services rendered and that the total compensation in each case was reasonable when the degree of effort for processing the loan and the level of services required for the wholesale lender are considered.

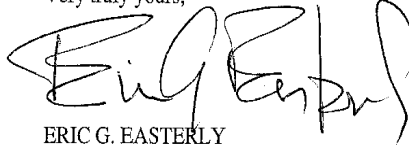
With respect to the seven loans which you have identified as containing false loan documentation, we believe that the appropriate course of action is not to penalize First Source for isolated acts of dishonesty on the part of rogue loan officers and processors working in collusion with borrowers but rather, to take action directly against those loan officers, processors and borrowers. To expect a mortgagee to protect HUD completely against loan fraud is simply unrealistic. Imposing sanctions on the mortgagee for its failure to detect loan fraud discourages mortgagees from participating in federally insured mortgage programs. Without direct action against those engaged in the actual fraud, they will simply move on to a new company. When First Source does uncover evidence that a loan officer or processor has engaged in loan fraud, it promptly reports that finding to the Division of Mortgage Lending. It is difficult to know what else First Source could do under the circumstances.

You refer to the October 13, 2004 audit report of First Source's Midvale, Utah branch and our subsequent decision to terminate our authority to originate FHA insured loans. If you review the files that were audited in that case, you will find that every single one of those loans resulted from the efforts of a single woman, [REDACTED], who over a four month period in 2002, in collaboration with her sister and the borrowers on each of the loans, engaged in rampant

loan fraud. First Source discovered the loan fraud in May 2002, years before the OIG audit and promptly terminated [REDACTED] and reported her to the appropriate regulatory authorities in Utah.<sup>2</sup> She thereafter was unable to find work in the mortgage industry and as a result, sued First Source for breach of contract and defamation. [REDACTED] claims were dismissed by the court last fall on First Source's motion for summary judgment, but [REDACTED] is now appealing that judgment. Discovery during the case served only to establish evidence of loan fraud on the part of [REDACTED] and her co-conspirators. When in September 2004 we determined that as a result of the Midvale audit First Source was going to be held vicariously liable for the acts of a criminal conspiracy, we made the decision to terminate our involvement in the federally insured mortgage program. It is distressing to us that to date no criminal charges have been filed by any law enforcement agency against [REDACTED] or her co-conspirators nor has HUD taken any action to debar her from the industry even though evidence of her criminal fraud is overwhelming. Such agency inaction stands in disappointing contrast to the OIG's appetite for disbarring First Source's principals who have always taken prompt action against loan officers and processors who have engaged in loan fraud.

For all of these reasons we respectfully suggest that no sanctions be imposed on First Source or its principals.

Very truly yours,



ERIC G. EASTERLY  
General Counsel

EGE:nl

Cc: Joseph N. Giuliano

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<sup>2</sup> Since the only loans that the OIG chose to audit at First Source's Midvale branch were loans in which [REDACTED] was involved, we conclude that First Source's actions in reporting the fraud triggered the audit. Such punitive enforcement actions do not seem calculated to encourage mortgagees to report loan fraud.





## OIG Evaluation of Auditee Comments

### Finding 1: First Source Allowed Nonemployees and Unapproved Branches to Originate and Process Federal Housing Administration-Insured Loans

- Comment 1** We disagree with First Source Financial USA's response to this finding. Mortgagee Letter 95-36 states that mortgagees may not contract out customary loan officer functions. Based on the Independent Contract Agreement signed by loan officers and First Source management, loan officers were not employees. This situation was repeatedly emphasized by Human Resources and Administrative First Source staff. Therefore, we determined First Source had contracted out loan officer functions with independent contractors. Whether or not Nevada state law allows this arrangement is not pertinent because HUD is clear that this is not allowed.
- Comment 2** Although First Source states it has always required loan officers to use loan processors employees by First Source, we determined that at least two individuals were never employed by the mortgagee. The Director of Human Resources could not provide a personnel file for either of the two loan processors we identified during our review although one of them appeared on several telephone listings as the loan processor at one of the net branches. We believe this speaks to the issue of whether First Source provided adequate supervision of its loan officers.
- Comment 3** First Source contends that its net branches were largely established during a former employee's tenure and, that employee took actions that were not in the company's best interests. Although we do not necessarily agree with this explanation, we believe this further substantiates that First Source did not actually supervise and control its employees.
- Comment 4** In addition, First Source states it discontinued the practice of co-brokering FHA loans with another mortgage company. When we spoke to the First Source President/CEO regarding this practice, he was surprised this was a prohibited arrangement.



Finding 2: Federal Housing Administration Loans were Originated and Processed with False Information and Known Misrepresentations

**Comment 5** First Source contends that no mortgage broker can completely preclude dishonest loan officers and processors. OIG agrees with this statement; however, the mortgagee bears the responsibility for the loans it originates. Based on our extensive review, all seven loans were originated based on false **and known** misrepresentations. We did not report other loans where we found false documentation but could not determine whether a First Source contractor and/or employee had knowledge of the fictitious information.

Finding 3: First Source Allowed Questionable Lending Practices by Collecting Unearned Fees

**Comment 6** We disagree that OIG implies a yield spread premium is per se illegal. Based on our review, we do not believe either of the two tests described in RESPA Statement of Policy 2001-1 were met when First Source loan officers received unearned compensation for work not performed. Again, based on our audit of loan documentation, we believe borrowers were neither apprised of the yield spread premiums nor received any benefit. We rarely saw any indication that higher rate mortgages provided any benefit except to increase the loan officer/mortgagee compensation.

## Appendix C

### False Documentation and Related Claim Amounts

# 332	Loan Amount	False/Invalid Borrower	False Paystubs & Wage & Tax Statements	False Alternative Credit	False Employment Verification	False Rent Verification	False Social Security Number	Status	HUD Loss
3841557	\$89,725		X	X	X			Claim	\$32,782.54
3867084	\$130,985					X	X	Claim	\$5,072.07
3512984	\$115,192		X	X				Claim	\$1,105.02
3810992	\$148,494		X		X	X		Claim	\$21,918.60
3804417	\$106,052		X		X	X		Claim	\$69,607.97
3807515	\$141,927	X						Terminated	
3619948	\$136,923		X	X	X			Claim	\$29,176.69
Totals	\$869,298	1	5	3	4	3	1		\$159,662.89

Appendix D

Yield Spread Premiums

Federal Housing Administration # 332-	Mortgage Amount	YSP	YSP Credited	% of YSP Applied to Closing Costs	Disclosed on the Good Faith Estimate
3807515	141,927	928	0	0%	N/AV
3841557	89,725	1,206	0	0%	N
3804417	106,052	1,259	0	0%	N/AV
3571585	136,852	2,022	0	0%	N/AV
3938492	118,146	2,363 Not on HUD-1	0	0%	N
3870293	126,022	3,466	0	0%	N
3512984	115,192	4,032	0	0%	N
3682470	137,837	4,652	0	0%	N
3688870	140,790	5,104	0	0%	N
3624006	113,781	3,982	0 <sup>1</sup>	0%	N/AV
3785064	81,200	1,015	0	0%	N/AV
3737414	140,022	3,626	86	2.4%	N
3948999	154,082	4,622	286	6.2%	N
4124230	118,817	3,565	356	10.0%	N
3690901	132,421	5,793	605	10.4%	N
3810992	148,494	5,754	1,290 <sup>2</sup>	22.4%	N/AV
3619948	136,923	1,027	382	37.2%	N
3688893	136,261	5,791	2,971	51.3%	N
3867084	130,985	Not on HUD-1	511 <sup>3</sup>	Undetermined	N
<b>Total</b>	<b>\$ 2,405,529</b>	<b>\$60,207</b>	<b>\$ 6,487</b>		<b>N = 13</b>

N/A = Not applicable

N/AV = Not available in loan file

N = No

<sup>1</sup> The HUD-1 Settlement Statement shows a broker credit of \$3,839 but it was taken back from what the borrower paid through an unearned discount fee of \$3,878.

<sup>2</sup> The HUD-1 Settlement Statement shows a broker credit of \$1,290 and also shows the seller paid a \$1,485 loan discount fee on behalf of the buyer; however, the lender did not provide a loan discount to the buyer. The loan officer pocketed these funds intended for the buyer's benefit.

<sup>3</sup> The HUD-1 Settlement Statement shows a \$511 broker credit but also shows the seller paid a \$2,264 loan discount fee on behalf of the buyer; however, the lender did not provide a loan discount to the buyer. The loan officer pocketed these funds intended for the buyer's benefit.