




Issue Date	March 28, 2006
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Audit Report Number	2006-FW-1006
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TO: Brain D. Montgomery
Assistant Secretary for Housing—Federal Housing Commissioner, H

Margarita Maisonet
Director Departmental Enforcement Center, CV

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

SUBJECT: America's Mortgage Resource, Inc., Metairie, Louisiana: Branch Manager
Formed an Identity-of-Interest Entity That Provided Gift Funds; and Did Not
Always Meet HUD Loan Origination and Quality Control Plan Requirements

HIGHLIGHTS

What We Audited and Why

We audited America's Mortgage Resource, Inc. (America's Mortgage), located in Metairie, Louisiana, a nonsupervised lender approved by the U. S. Department of Housing and Urban Development (HUD) to originate Federal Housing Administration-insured single family mortgages. We selected America's Mortgage for review due to its high default rate.

Our audit objectives were to determine whether America's Mortgage (1) followed HUD origination requirements, including the use of gifts and underwriting, and (2) implemented a quality control plan according to HUD requirements.

What We Found

America's Mortgage's LaPlace branch manager¹ formed an identity-of-interest company, Imagine Foundation that provided prohibited quid pro quo gifts to borrowers. Imagine Foundation provided \$404,997 in gift funds to 73 America's Mortgage borrowers. The Internal Revenue Service denied Imagine Foundation nonprofit status because it did not meet nonprofit requirements.² According to the Internal Revenue Service, America's Mortgage's owner served on the board of Imagine Foundation.³ Under the HUD requirements, the gifts should be considered as "inducements to purchase," and HUD regulations require the sales price to be reduced dollar for dollar for gifts in determining the maximum mortgage amount. Therefore, HUD unnecessarily over insured 73 Federal Housing Administration loans totaling more than \$7.6 million.

Additionally, America's Mortgage did not originate and process loans in accordance with HUD's regulations, nor did its quality control plan meet HUD's regulations, further putting Federal Housing Administration-insured loans at risk.

What We Recommend

We recommend that HUD require America's Mortgage to write down the loans for the \$404,997 in inappropriate gifts by Imagine Foundation, indemnify 73 loans totaling \$6,904,509, and reimburse HUD \$303,261 for claims paid on four loans. Further, HUD should take administrative action as appropriate, including debarment and civil monetary penalties, against the president and board of Imagine Foundation. America's Mortgage should develop and implement a quality control plan that complies with HUD's requirements before it is allowed to underwrite additional loans.

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

Auditee's Response

We provided a draft report to America's Mortgage on February 17, 2006, and held an exit conference on March 7, 2006. America's Mortgage provided written

¹ The branch manager also served as an underwriter for America's Mortgage.

² 26 CFR [*Code of Federal Regulations*] 501(c)(3).

³ According to the response, the owner asserts that although he "signed a letter of intent to serve on the board in 2003, [Imagine Foundation's] board of directors was never ratified and I withdrew my intent to serve on the board before ever assuming such a position."

comments on March 10, 2006. America's Mortgage disagreed with the identity-of-interest finding and the underwriting deficiencies. Based on documentation provided by America's Mortgage, we revised the report for two underwriting deficiencies. America's Mortgage response along with our evaluation is included in appendix B of this report. We redacted name of borrowers and did not include attachments due to the volume.

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BACKGROUND AND OBJECTIVES

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

America's Mortgage Resource, Inc. (America's Mortgage), a nonsupervised lender, was incorporated on September 3, 1996. It is located at 3317 North I-10 Service Road, Suite 200, Metairie, Louisiana. On May 16, 1997, HUD approved America's Mortgage as a loan correspondent to originate Federal Housing Administration loans. America's Mortgage operates four branches: Metairie and LaPlace in Louisiana and Biloxi and Ocean Springs in Mississippi.

During the period March 1, 2003, to February 28, 2005, America's Mortgage originated and underwrote 213 Federal Housing Administration loans totaling \$21,804,459. Of the 213 loans, the Metairie branch originated and underwrote 151 loans totaling \$16,154,083. The Metairie branch had 16 defaults, including one claim.

Due to a high default and claim rate at the Metairie branch, HUD terminated its approval to originate Federal Housing Administration-insured single-family mortgages in HUD's New Orleans jurisdiction. The termination became effective on September 10, 2004. We reviewed 11 Metairie branch loans that closed before September 10, 2004. However, according to the LaPlace branch manager, these loans were actually originated at the LaPlace branch. Thus, we expanded our audit to include operations at the LaPlace Branch by selecting five additional loans for review. Due to the identity of interest between America's Mortgage and Imagine Foundation, we performed a limited review of an additional 69 loans America's Mortgage originated during the audit scope that received Imagine Foundation gifts.

The audit objectives were to determine whether America's Mortgage (1) complied with HUD regulations, procedures, and instructions in the origination and underwriting of Federal Housing Administration-insured single-family mortgages and (2) implemented its quality control plan as required.

RESULTS OF AUDIT

Finding 1: A Branch Manager Formed an Identity-of-Interest Entity and Provided Quid Pro Quo Gift Funds

America's Mortgage's LaPlace branch manager⁴ formed an identity-of-interest company, Imagine Foundation, which provided prohibited quid pro quo gifts. These gifts were used for downpayment assistance for America's Mortgage borrowers. According to the Internal Revenue Service, America's Mortgage's owner served on the board of Imagine Foundation.⁵ Although HUD allows charitable organizations to provide downpayment assistance, Imagine Foundation did not obtain the required Internal Revenue Service 501(c) (3) nonprofit status. To the contrary, the Internal Revenue Service denied Imagine Foundation's request on August 10, 2005. Without the gifts from Imagine Foundation, America's Mortgage borrowers did not meet the statutory 3 percent minimum downpayment. Some of the sales prices increased when the borrower received gifts. HUD regulations require the sales price to be reduced dollar for dollar for gifts from an unallowable source. Imagine Foundation inappropriately provided \$404,997 in gift funds to America's Mortgage borrowers. As a result of this identity-of-interest providing gift funds to borrowers, America's Mortgage put at risk 73 HUD-insured loans totaling \$7.6 million.

The Identity-of-Interest Nonprofit Provided More Than \$400,000 in Gift Funds to Borrowers

America's Mortgage's LaPlace branch manager created and served as president of Imagine Foundation. The company provided downpayment gifts solely to America's Mortgage borrowers. Because of the branch manager's employment at America's Mortgage and his interest in the company, Imagine Foundation was a prohibited identity-of-interest entity. From January 2003 to February 2005, Imagine Foundation provided \$404,997 in gift funds without obtaining Internal Revenue Service 501(c) (3) nonprofit status. As a result, America's Mortgage put \$7,612,767 of HUD-insured loans at risk.

According to the branch manager, he founded Imagine Foundation as a means to provide gifts to America's Mortgage borrowers. Imagine Foundation provided no documentation that it ever provided gifts to any borrowers that did not use America's Mortgage. The branch manager used other nonprofit downpayment assistance providers' business plans as a format. Further, Imagine Foundation's proposed board included both the branch manager's spouse and the owner of

⁴ The branch manager also underwrote loans for America's Mortgage.

⁵ According to the response, the owner asserts that although he "signed a letter of intent to serve on the board in 2003, [Imagine Foundation's] board of directors was never ratified and I withdrew my intent to serve on the board before ever assuming such a position."

America's Mortgage. Mortgagee Letter 96-18 affirms HUD's position on the inappropriateness of only approving assistance if the buyer obtained financing with a specified lender.

Loans Were Closed by the Branch Manager/President of the Nonprofit

Of the 73 loans reviewed, the branch manager and president of Imagine Foundation reviewed and underwrote 15 loans (21 percent) that received gift funds from Imagine Foundation. The majority (44 loans or 60 percent) of the other loans were closed by an automated underwriting system. The other 14 loans (19 percent) were underwritten by underwriters who were supervised by either the branch manager or America's Mortgage's president.

Because the president of Imagine Foundation was also the branch manager of America's Mortgage, he had an interest in the sale of the property. Further, the owner of America's Mortgage knew of the interest.

HUD regulations⁶ 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. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. Further, no repayment of the gift may be expected or implied.

Nonprofit Status Was Denied by the Internal Revenue Service

While trying to receive nonprofit status for at least 3 ½ years, the Internal Revenue Service has never recognized Imagine Foundation as a nonprofit. Mortgage's branch manager formed Imagine Foundation on May 29, 2001, and sought nonprofit status from the Internal Revenue Service in December 2001. Between January 2003 and February 2005, Imagine Foundation contributed from \$1,998 to \$8,700 to 73 borrowers. In March 2004, Imagine Foundation informed the Internal Revenue Service that it had suspended operations pending a ruling from the Internal Revenue Service; however, records show Imagine Foundation provided 13 of the 73 gifts after March 2004.

In a letter, dated August 10, 2005, the Internal Revenue Service denied Imagine Foundation nonprofit, tax-exempt status because its gift program

⁶ HUD Handbook 4155.1, REV-4, CHG-1, or REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," section 3, paragraph 2-10C.

- Involved an identity-of-interest entity,
- Did not differentiate among income levels,
- Did not provide a service, and
- Did not meet the definition of a gift.

Regarding the identity-of-interest entity, the ruling stated:

In your brochure, it states that buyers must be pre-qualified by America's Mortgage. A member of Imagine Foundation's governing board owns America's Mortgage. Imagine Foundation's founder and president manages the local America's Mortgage office.

Although Imagine Foundation reported to the Internal Revenue Service that it provided gifts to qualified buyers, purchasing participating homes and using eligible loan programs, the Internal Revenue Service determined that Imagine Foundation provided gifts

- Regardless of income limits,
- Without meeting the prospective buyers or providing any homeowner education courses, and
- To any seller willing to pay the required 1 percent fee.

The ruling further stated the following:

Almost all of your revenue comes from the sellers you serve. That your primary activity is to promote and to further your private business interests is reflected in the financing structure of your downpayment assistance program.

Your grant making procedures indicate that gift funds are only provided if a seller has paid a processing fee and made a contribution to you. In fact, while you call the funds you will receive from the sellers 'contributions,' these transactions are not contributions because they will not 'proceed from detached and disinterested generosity.' Your characterization of these transactions as contributions ignores the business realities surrounding the payments.

These 'contributions' are more appropriately characterized as fees received in exchange for the sale of a service.

HUD regulations state that the source of the funds to close must be from the applicant's own assets or gifts from relatives, an employer, a long-standing friend not involved in the transaction, a government agency, or a charitable organization. Because Imagine Foundation did not meet the requirement of being a charitable organization, it was an inappropriate source of gift funds. HUD considers gifts

from other sources as inducements to purchase and requires a reduction in the sales price.⁷

Borrowers Did Not Meet the Minimum Downpayment Requirement

Of the 16 loans reviewed, the 11 loans that received Imagine Foundation gifts did not meet the statutory 3 percent minimum downpayment required by the National Housing Act. During the audit scope, six borrowers receiving Imagine Foundation gift funds defaulted on loans totaling \$561,384.

Borrower's downpayment versus required downpayments for loans reviewed⁸

Loan number	Total borrower's investment	Minimum investment required	Difference	Gift
221-3521311	\$7,905	\$4,650	\$3,255	
221-3526608	\$3,954	\$1,800	\$2,154	
221-3634657	\$4,386	\$3,900	\$486	
221-3636165	\$2,225	\$2,220	\$5	
221-3697208	\$3,589	\$3,585	\$4	
221-3486754	\$1,530	\$1,845	(\$315)	\$1,845
221-3646287	\$3,590	\$4,200	(\$610)	\$5,825
221-3660809	\$808	\$1,950	(\$1,142)	\$3,500
221-3537459	\$323	\$2,250	(\$1,927)	\$4,000
221-3685960	-	\$3,000	(\$3,000)	\$6,000
221-3681056	(\$123)	\$3,060	(\$3,183)	\$7,000
221-3670149	\$287	\$3,523	(\$3,236)	\$6,475
221-3680202	\$65	\$3,645	(\$3,580)	\$7,105
221-3637539	-	\$3,600	(\$3,600)	\$6,800
221-3549457	-	\$4,275	(\$4,275)	\$7,000
221-3655765	\$275	\$4,690	(\$4,416)	\$8,700

The Sales Price Increased

Contrary to reducing the sales price by the amount of the inappropriate gift, the loan files showed that in 28 of the 73 loans (38 percent), the sales price increased

⁷ HUD Handbook 4155.1, REV-4, CHG-1, or REV 5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," section 3, paragraph 2-10C.

⁸ Loans closed by America's Mortgage as a loan correspondent in italics.

by all or part of the gift amount. As shown in the table below, the sales price increased from \$1,000 to \$13,519.

Sales price increase with gifts

Case number	Original purchase price	Gift amount	HUD sales price	Increase
221-3537459	\$74,000	\$4,000	\$75,000	\$1,000
221-3522693	\$95,500	\$4,500	\$96,500	\$1,000
221-3646468	\$90,000	\$5,460	\$91,000	\$1,000
221-3628668	\$84,800	\$5,240	\$86,000	\$1,200
221-3668319	\$83,740	\$4,200	\$85,000	\$1,260
221-3746945	\$113,300	\$4,200	\$115,000	\$1,700
221-3496440	\$81,000	\$4,430	\$83,000	\$2,000
221-3685960	\$98,000	\$6,000	\$100,000	\$2,000
221-3712363	\$125,400	\$6,000	\$127,400	\$2,000
221-3509067	\$105,000	\$6,050	\$107,000	\$2,000
221-3515838	\$84,500	\$6,135	\$86,500	\$2,000
221-3606735	\$125,000	\$7,000	\$127,000	\$2,000
221-3652043	\$63,900	\$1,998	\$66,570	\$2,670
221-3588496	\$147,000	\$5,876	\$150,000	\$3,000
221-3657165	\$116,900	\$4,900	\$120,000	\$3,100
221-3637539	\$116,390	\$3,610	\$120,000	\$3,610
221-3681056	\$98,239	\$3,761	\$102,000	\$3,761
221-3656334	\$103,500	\$5,500	\$107,500	\$4,000
221-3558016	\$79,900	\$4,500	\$84,400	\$4,500
221-3669662	\$97,000	\$5,000	\$102,000	\$5,000
221-3507349	\$70,000	\$3,735	\$76,500	\$6,500
221-3680202	\$114,000	\$7,105	\$121,500	\$7,500
221-3656386	\$106,900	\$6,700	\$114,900	\$8,000
221-3507933	\$95,000	\$7,050	\$103,000	\$8,000
221-3646287	\$131,800	\$5,825	\$140,000	\$ 8,200
221-3655765	\$147,343	\$8,615	\$156,343	\$9,000
221-3713250	\$140,000	\$6,000	\$152,400	\$12,400
221-3549457	\$128,981	\$7,000	\$142,500	\$13,519

Imagine Foundation received \$14,123 in fees for providing gifts on America's Mortgage loans. Further, America's Mortgage received \$46,062 in origination fees on the loans.

Conclusion

America's Mortgage's branch manager created Imagine Foundation, an identity-of-interest company, with the knowledge of America's Mortgage's owner.

Because Imagine Foundation did not receive Internal Revenue Service nonprofit status, it did not meet HUD's definition of an allowable source of funds. Further, loans receiving a gift from Imagine Foundation did not meet minimum investment requirements, and in some instances, America's Mortgage increased the sales price of the house. As a result, America's Mortgage put 73 loans totaling more than \$7.6 million at risk.

Recommendations

We recommend that HUD's assistant secretary for housing require America's Mortgage to

- 1A. Write down the \$404,997 in ineligible gifts for 73 loans.
- 1B. Indemnify HUD for \$6,904,509⁹ for the 73 loans that received gift funds from Imagine Foundation.

We recommend that HUD's director of the enforcement center

- 1C. Take administrative action as appropriate, up to and including debarment and civil monetary penalties, against the president and board of Imagine Foundation.

⁹ Represents the \$7,612,767 total loan amount for the 73 borrowers, less the \$404,997 questioned in recommendation 1A and \$303,261 in recommendation 2A.

Finding 2: America's Mortgage Did Not Meet HUD Loan Origination or Quality Control Plan Requirements

America's Mortgage's underwriting procedures and its quality control plan did not meet HUD requirements. America's Mortgage did not obtain documentation required by the Loan Prospector underwriting system, did not review loans defaulting within the first six payments, and did not conduct on-site reviews. Also, America's Mortgage's loan files contained other instances of underwriting deficiencies, and its employees input information incorrectly into HUD's computer systems. These deficiencies occurred because America's Mortgage ignored or misunderstood HUD regulations. As a result, HUD paid claims totaling \$303,261.

America's Mortgage Did Not Obtain Required Documentation

For five of ten loans reviewed that were underwritten using an automated underwriting system, America's Mortgage did not obtain the required payroll documentation. The loan files only contained partial payroll information for the borrowers. For these five loans, Loan Prospector¹⁰ required one full month of payroll stubs. Mortgagee Letter 98-14 states that Loan Prospector will determine the level of documentation needed to determine a loan's eligibility for Federal Housing Administration insurance. America's Mortgage did not meet that level of documentation for these loans.

Three of the ten loans¹¹ mentioned above contained other deficiencies,¹² including

- Lacking explanations for gaps in employment,
- Exceeding the 6 percent allowance for seller-paid closing costs, and
- Not obtaining a signature.

¹⁰ Loan Prospector is a Federal Housing Administration-approved automated underwriting system.

¹¹ One of the ten loans reviewed did not contain any underwriting deficiencies.

¹² See appendix D for details.

Underwriting deficiencies by loan

Case number	No explanation of gap in employment	Lack of loan Prospector documentation obtained	Loan defaulted within six months not reviewed	Gift funds exceed 6%	Loan application not submitted
221-3549457		X			
221-3670149	X		X		
221-3634657		X			X
221-3636165			X		
221-3697208			X		
221-3637539		X	X		
221-3681056		X	X	X	
221-3526608		X			

As of November 21, 2005, HUD had paid \$303,261 in claims¹³ on four of the ten loans.

America's Mortgage's Quality Control Plan Did Not Meet HUD Requirements

America's Mortgage did not have a quality control plan that met HUD requirements. The quality control plan implemented did not require a review of loans defaulting within the first six payments or annual site visits for new branches.

America's Mortgage did not review early defaults as required by HUD regulations. America's Mortgage's president stated that America's Mortgage did not service any loans and that it sold all of its loans after closing and before the first payment. The president went on to claim that although America's Mortgage can get information from HUD's Neighborhood Watch system, its contracts prevent it from contacting the borrower after sale of the loan. We reviewed data provided by the president and could not find evidence to support his claim. HUD requirements¹⁴ state that in addition to the loans selected for routine quality control reviews, lenders must review all loans going into default within the first six payments. Without the loan reviews, America's Mortgage did not ensure that it protected HUD and itself from unacceptable risk. Also, it could not identify, address, and correct deficiencies or problems that occurred.

America's Mortgage's quality control plan read like a contract between America's Mortgage and its quality control contractor, the SRS Group. America's

¹³ The loans with claims and underwriting deficiencies are bolded in the above table.

¹⁴ HUD Handbook 4060.1, REV-1, "Mortgage Approval Handbook," paragraph 6-6D.

Mortgage’s president stated that the quality control plan was written as it was because “the SRS Group handles everything as a third party to ensure everything is in accordance with HUD.” However, our review determined that the plan lacked requirements to review loans that default within the first six payments and to review new branches. HUD requirements¹⁵ state that all Federal Housing Administration-approved lenders, including loan correspondents, must implement and continuously have in place a quality control plan for the origination and/or servicing of insured mortgages as a condition of receiving and maintaining HUD approval.

America’s Mortgage did not perform on-site visits of two new branches¹⁶ it opened in Mississippi. Its president did not believe the new branches warranted a review since they had only recently opened. HUD regulations require¹⁷ America’s Mortgage to perform annual site visits for new branches.

America’s Mortgage Lacked Input Controls

America’s Mortgage incorrectly inputted gift data into HUD’s systems in 28 of 80 instances. HUD relies upon information provided by lenders for monitoring activities. As shown in the table below, the majority of the input errors occurred with the automated underwriting system.

Loans incorrectly input

Underwriter identification	Number of loans input incorrectly
Automated underwriting systems	20
Manual underwriters	8
Total	28

Conclusion

Because America’s Mortgage did not originate loans in accordance with HUD regulations, it put HUD’s insurance fund at risk. America’s Mortgage should reimburse HUD \$303,261 for claims it paid on four loans. If America’s Mortgage follows HUD’s loan origination and quality control plan requirements, its loans will be less likely to default.

¹⁵ HUD Handbook 4060.1, REV-1, CHG-1, “Mortgagee Approval Handbook,” paragraph 6-1.

¹⁶ The Biloxi branch opened in April 2004, and the Ocean Springs branch opened in January 2005.

¹⁷ HUD Handbook 4060.1, REV-1, CHG-1, “Mortgagee Approval Handbook,” paragraph 6-3G2.

Recommendations

We recommend that HUD's assistant secretary for housing require America's Mortgage to

- 2A. Repay HUD for \$303,261 in claims paid on four defaulted loans.
- 2B. Require America's Mortgage to comply with HUD's underwriting requirements.
- 2C. Ensure America's Mortgage's quality control plan incorporates all HUD requirements, including reviewing all loans defaulting in the first six months and procedures for annual on-site visits.
- 2D. Require America's Mortgage to input information correctly into HUD's systems to reduce Single Family Data Warehouse data entry errors.

SCOPE AND METHODOLOGY

To accomplish our audit objectives, we

- Reviewed relevant statutory, regulatory, and HUD handbook requirements.
- Reviewed 16 of 151 loan files originated by America's Mortgage between January 2003 and February 2005. Due to the identity-of-interest between America's Mortgage and Imagine Foundation, we performed limited procedures on an additional 69 loans America's Mortgage originated during the audit scope that received Imagine Foundation gifts.
- Reviewed loan files maintained by various title companies in the New Orleans metropolitan area and HUD's Denver Homeownership Center.
- Obtained and reviewed Imagine Foundation gift records.
- Reviewed and analyzed America's Mortgage's quality control plan.
- Interviewed America's Mortgage management and employees.
- Interviewed HUD Quality Assurance Division personnel.
- Interviewed personnel from title companies.
- Conducted site visits.

We relied on data maintained by HUD in the Single Family Data Warehouse and Neighborhood Watch systems. We did not perform a detailed analysis of the reliability of these computer databases, nor do we offer an opinion on these systems. As stated in finding 2, America's Mortgage inputted incorrect gift information into the system.

We performed our audit work between May 19 and November 22, 2005, which included fieldwork at America's Mortgage's Metairie¹⁸ and LaPlace¹⁹ offices and five title companies located around the metropolitan New Orleans area. The audit covered the period from March 1, 2003, through February 28, 2005.

We performed our review in accordance with generally accepted government auditing standards.

¹⁸ Located at 3317 North I-10 Service Road, Suite 200, Metairie, Louisiana 70002.

¹⁹ Located at 568 Belle Terre Boulevard, LaPlace, Louisiana 70068.

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:

- Loan origination process—Policies and procedures that management requires to reasonably ensure that the loan origination process complies with HUD program requirements and
- Quality control plan—Policies and procedures that management requires to reasonably ensure implementation of HUD quality control requirements.

We assessed the relevant controls identified above.

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

Significant Weaknesses

As described in the findings, we believe America's Mortgage did not operate in accordance with HUD requirements related to nonprofit identities of interest, loan originations, and quality control.

APPENDIXES

Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Funds to be put to better use <u>2/</u>
1A	\$404,997	
1B		\$6,904,509 ²⁰
2A	\$303,261	
Totals	\$708,258	\$6,904,509

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

²⁰ Represents the \$7,612,767 total loan amount for the 73 borrowers, less the \$404,997 questioned in recommendation 1A and \$303,261 in recommendation 2A.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

AMERICA'S MORTGAGE RESOURCE

A PROFESSIONAL MORTGAGE FIRM

March 8, 2006

VIA FEDERAL EXPRESS

Mr. Frank E. Baca
Regional Inspector General for Audit
U.S. Department of Housing
and Urban Development
Office of the Inspector General
Fort Worth Regional Office, 6AGA
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**RE: America's Mortgage Resource, Inc.
HUD OIG Draft Audit Report**

Dear Mr. Baca:

America's Mortgage Resource, Inc. ("AMR" or "Company") is in receipt of the Draft Audit Report ("Report"), dated February 17, 2006, from the U.S. Department of Housing and Urban Development ("HUD" or "Department") Office of the Inspector General ("OIG"). The Report is based on a review conducted between May 19, 2005 and November 22, 2005 of certain loans originated by AMR in the Metairie, and LaPlace, Louisiana areas between January 2003 and February 2005.

The Report states that its primary objective was to determine whether AMR followed HUD loan origination requirements, including the use of gifts and underwriting, and implemented a Quality Control Plan according to HUD requirements. The Report contains two findings alleging that a branch manager formed an identity-of-interest entity and provided quid pro quo gift funds, as well as that AMR did not meet HUD loan origination or Quality Control Plan requirements. Based on these findings, the Report recommends that HUD require the Company to: (1) buy down the loans in the amount of the gift funds provided to borrowers; (2) indemnify HUD for any future losses incurred on loans where the borrowers received downpayment assistance funds; (3) reimburse HUD for claims paid on four loans; (4) develop and implement a Quality Control Plan in accordance with HUD requirements; and (5) take administrative action as appropriate.

The OIG provided the Company with an opportunity to submit written comments for inclusion in the final report. This response summarizes AMR's history and operations, including the extensive improvements AMR has implemented since the loans in question were originated, and addresses the individual findings in the Report. We appreciate this opportunity to comment on the OIG's findings and recommendations.

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Mr. Frank E. Baca
March 8, 2006
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I. INTRODUCTION

A. AMERICA'S MORTGAGE RESOURCE, INC.

AMR is a small mortgage lender, with four branches and 33 employees, located in the Louisiana and Mississippi Gulf-coast region. The Company was formed to provide diversified mortgage products, excellent service, and to protect the interests of consumers. AMR opened for business in September 1996 and first received FHA approval as a loan correspondent in 1997. On April 9, 2002, it received HUD approval as a Direct Endorsement underwriter. AMR sells all loans that it originates into the secondary market on a servicing-released basis, and its primary investors include ABN AMRO and Irwin Mortgage Corporation. The Company is an authorized agent for one principal and acts as principal for five authorized agents.

In the past six months, the face of the Company has changed dramatically as a result of Hurricane Katrina and the destruction that targeted the Gulf region. AMR's home office in Metairie, Louisiana and branch office in Biloxi, Mississippi were completely destroyed and were forced to relocate as a result of the storm. In addition, the Company was forced to relocate employees to Baton Rouge and Hammond, in Northern Louisiana, to sustain the operations of the Metairie office. Despite this disruption and the chaos that plagued the Gulf region following the August 29, 2005 storm, AMR made it a priority to retain all Company employees and continues to pay 100% of our employees' salaries and benefits, at a loss of over \$300,000 to the Company. After enduring the effects of the United States' costliest hurricane, never has AMR been more committed to the financial well-being of our employees and the rebuilding of the Gulf region.

Despite the effects of Hurricane Katrina, FHA lending constituted approximately thirty percent (30%) of AMR's loan production in 2005. As FHA-insured loans comprise a substantial portion of its business, the Company takes its relationship with the Department and its responsibilities under the FHA program seriously. We strive to comply with applicable rules and regulations and are committed to educating and training our employees on issues of FHA compliance. AMR imposes a strict zero tolerance fraud policy on all employees and takes significant measures to guard against predatory lending. In addition, AMR is dedicated to working with minority borrowers and members of underserved communities and contributes heavily to local charities supporting the end of homelessness.

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AMR places a premium on FHA compliance. It is careful to ensure compliance with insurer, guarantor, and investor requirements and takes its Quality Control responsibilities seriously. In addition, AMR is dedicated to consumer service. We aim to make the lending process as simple as possible for borrowers and work closely with each individual applicant to ensure that he or she receives the type of financing that best fits his or her needs. Since becoming FHA approved, we have endeavored to provide dependable and professional service and have repeatedly demonstrated our commitment to borrowers and allegiance to the FHA program. At a time when homeownership is a precious commodity in Louisiana and Mississippi, AMR views its responsibilities as an FHA lender, as well as a contributing member of the community, as more important than ever.

B. IMPROVEMENTS IN AMR'S ORIGINATIONS AND QUALITY CONTROL

As discussed above, AMR is dedicated to the FHA program and diligently educates and trains its employees on issues regarding FHA compliance. To this end, AMR has made a number of changes to its underwriting and Quality Control department over the past few years. During its evaluation of AMR, the Report states that the auditors concentrated on loans originated beginning in March of 2003. AMR did not receive final approval as a DE underwriter until November 12, 2003, meaning many of the loans originated prior to November were part of the test cases originated by the Company and individually reviewed by the Department. Moreover, during that time, the industry was in the midst of a refinance boom, interest rates were lower than they had been in decades, and mortgage companies were experiencing considerable growth. Due to growing pains experienced during this early period of direct underwriting and expanded business, AMR made a number of changes to its policies and procedures, including hiring new and experienced underwriting personnel and enhancing its Quality Control and compliance functions.

We believe that these actions resulted in significant improvements in the Company's loan quality and performance since the audit period and, importantly, satisfy the Report's recommendation that AMR implement a Quality Control Plan in compliance with FHA guidelines. Therefore, we briefly outline some of these underwriting and Quality Control changes prior to addressing the Report's specific findings.

1. Improved Underwriting and Quality Control Standards

Prior to the Department's audit in 2005 and after the Company's approval for DE underwriting, AMR, on its own, addressed its underwriting practices and hired a senior underwriter with significant DE underwriting experience. Specifically, the Company transferred all underwriting activity to its home office, and, in April 2004, AMR hired [REDACTED]

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██████ who had over ten years of underwriting experience, to manage the Company's FHA underwriting and to develop and maintain quality assurance standards, train Company employees on underwriting policies and procedures, and evaluate the competency of staff in complying with Company policy and FHA guidelines. In September 2005, AMR transferred this position to ██████ who has over 35 years of experience in the mortgage industry and has proved to be an invaluable addition to AMR.

AMR also has made significant strides in improving the Company's Quality Control. In July of 2003, AMR entered into a contract with The SRS Group ("SRS") to provide independent, third-party audits on a requisite sample of the Company's FHA loans (**Exhibit A**). As a result of SRS's reviews, the Company receives monthly reports, which permit AMR to review specific Quality Control findings and correct any outstanding issues. Moreover, the Company continues to conduct an internal review of 10% of the FHA loans originated by all Company branch locations. Each loan file is re-underwritten and re-verified according to FHA guidelines and all findings are reported directly to AMR management. The Company also reviews each correspondent file on a post-closing basis and requires Company personnel to complete internal checklists to verify compliance with FHA requirements and other obligations of the Company (**Exhibit B**).

In addition to tightening the Company's Quality Control procedures, in response to this review, AMR has amended its Quality Control Plan and instructed its employees to fully implement and follow the policies and procedures outlined in the amended plan (**Exhibit C**). Although the Company's Quality Control policies and procedures have generally followed HUD's requirements since inception, AMR took the necessary steps to ensure each of these policies are strictly enumerated in writing.

Finally, AMR has instituted a strict zero tolerance policy with regard to fraud. Not only does the Company invest considerable time and resources in training all employees to recognize potential fraudulent transactions, but AMR requires all employees to agree to abide by a "Zero Fraud Tolerance Policy" and indicate their acceptance of the policy in writing (**Exhibit D**). AMR employees understand that deviation from this policy could result in substantial risk to the Company, as well as jeopardize their own employment with the Company.

2. Improved Loan Performance

As evidenced by the above discussion, AMR is not the same company that originated the loans cited in the Report. We believe that the significant changes detailed above resulted in considerable improvement in the Company's loan quality and

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performance. AMR's FHA loan portfolio consists of quality originations and the Company does not pose a risk to the FHA Insurance Fund. AMR's default/claim rates evidence the quality of its loan originations. For example, the Company's current FHA Connection/Neighborhood Watch data in HUD's New Orleans jurisdiction reflects a 176% default/claim rate at a time when Hurricane Katrina left many local homeowners with an outstanding mortgage and no home (**Exhibit E**). As this response and supporting documentation demonstrate, any deficiencies that existed in connection with the findings in the Report were inadvertent and largely technical in nature, and the Company has taken steps to ensure that such deficiencies do not recur.

II. RESPONSES TO THE FINDINGS

The Report contains two findings, including several main sub-findings, in which it alleges that: (1) one of AMR's branch managers formed an identity-of-interest downpayment assistance entity; and (2) the Company did not meet HUD loan origination or Quality Control Plan requirements. Upon receipt of the draft Report, AMR conducted a thorough review of the findings and loan files, as well as examined applicable HUD/FHA guidelines and internal Company procedures at the time these loans were originated in an effort to provide pertinent information and documentation with this response. Our review indicated that several of the findings in the Report are at variance with the facts, do not constitute violations of HUD/FHA requirements, or do not affect the underlying loans' insurability. While we recognize that there is always room for improvement, at no time did the Company intentionally disregard HUD guidelines or knowingly misrepresent information to the Department. Where a deficiency existed, we have acknowledged it and strengthened our policies and procedures to assure compliance with HUD's requirements. We believe, and we hope the OIG will agree, that this response and accompanying exhibits demonstrate AMR's general compliance with HUD/FHA requirements and adherence to prudent lending standards. Below we reply to the individual matters raised in the Report and evidence our adherence to FHA requirements in connection with several of the cited sub-findings and loans.

A. FINDING 1 – DOWNPAYMENT ASSISTANCE

In the first finding, the Report alleges that one of AMR's branch managers founded a downpayment assistance company and provided gift funds to Company borrowers. In connection with this entity, the Report asserts that: (1) the entity operated as an identity-of-interest arrangement and provided quid pro quo gifts; (2) AMR's branch manager had an interest in the sale of the properties; (3) the entity did not receive nonprofit status; (4) borrowers did not meet minimum downpayment requirements; and (5) the sales prices increased on the transactions. We address each of the Report's concerns regarding this entity below.

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1. **Downpayment Assistance Company and Gifts Made to AMR Borrowers**

In the first sub-finding, the Report alleges that AMR's LaPlace branch manager formed an identity-of-interest company, Imagine Foundation ("Imagine"), to provide prohibited quid pro quo downpayment assistance gifts to AMR borrowers. Specifically, the Report alleges that because the Company's branch manager was employed by AMR and served as President of the assistance company, Imagine was a prohibited identity-of-interest entity. The Report also claims that AMR's President and the branch manager's spouse served on Imagine's board of directors and that the branch manager formed Imagine as a means to provide gifts exclusively to AMR borrowers. As a result of Imagine's operations, the Report alleges that, between January 2003 and February 2005, Imagine provided \$404,997 in gift funds in 73 FHA loan transactions.

a. **Imagine Foundation Was Not an Identity-of-Interest Entity**

AMR understands and appreciates the Department's requirements regarding downpayment assistance programs as identified in Mortgagee Letter 1996-18. Specifically, the Company understands that HUD "will consider whether there is an identity-of-interest between the donor (e.g., builder, developer, etc.) and recipient of the funds (e.g., nonprofit agency) as well as the amount of discretion afforded the homebuyer in using the assistance provided. . . . If the homebuyer may only use the builder, developer, lender, real estate firm, etc., that contributed the funds, the program will in all likelihood be unacceptable for FHA mortgage insurance." Mortgagee Letter 96-18. Based on this provision, HUD's determination of whether an identity-of-interest arrangement exists rests on an examination of whether there is a relationship between the contributor of funds and the downpayment assistance entity that receives them, rather than a relationship between the downpayment grant provider and the mortgage lender involved in the transaction. Nevertheless, we appreciate that the Department also does not "believe it to be appropriate to approve quid pro quo arrangements whereby assistance is only available if the buyer obtains financing with a particular lender or buys a particular builder's property." Id. Contrary to the Report's allegations, as neither the branch manager nor AMR donated funds to Imagine or required borrowers to obtain financing from the Company as a condition to receiving downpayment assistance, Imagine did not operate as an identity-of-interest entity or provide quid pro quo gifts to borrowers.

We note that Mortgagee Letter 1996-18, upon which the Report relies, was issued to address the Department's concerns with builders and developers establishing their own nonprofit companies and requiring buyers to purchase their properties in order

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to receive downpayment assistance. In this case, the Report makes no allegations regarding the sellers in the 73 transactions, and, to the best of our knowledge, the sellers who made contributions to Imagine had no interest in the downpayment assistance entity and no control over the provision of gifts to borrowers. In fact, according to the gifts letters, the borrowers received gift funds that were in no way made available to the donor from any person or entity with an interest in the property sale, including the seller, real estate agent or broker, builder, or loan officer (**Exhibit F**). Nevertheless, the Report attempts to characterize Imagine's owner's employment with AMR, his wife's service on Imagine's board of directors, and my alleged service, as AMR's President, on the board of directors as an identity-of-interest arrangement. To the contrary, AMR has no ownership interest in Imagine, the Company does not make contributions to the entity, and I have never served on Imagine's board of directors. In fact, although I signed a letter of intent to serve on the board in 2003, Imagine's board of directors was never ratified and I withdrew my intent to serve on the board before ever assuming such a position. AMR, therefore, has no interest or connection to Imagine. The Company never exercised control over whether borrowers qualified for downpayment assistance, whether borrowers received gift funds from Imagine, or how borrowers used any of the funds obtained from Imagine. We maintain that no identity-of-interest arrangement existed between these two entities.

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Moreover, we are unaware of any FHA rule or regulation that would prohibit an officer of a mortgagee from also serving as an officer for a charitable organization that furnishes downpayment assistance funds to the mortgagee's customers. In fact, FHA guidelines expressly permit dual affiliation. See HUD Handbook 4060.1 REV-1, ¶ 2-11(B). In this case, AMR's branch managers are Company Vice Presidents and, according to FHA guidelines, are permitted to serve as officers of other organizations. LaPlace's branch manager, therefore, was not prohibited from serving as President of Imagine, and his dual affiliation does not constitute an identity-of-interest arrangement. HUD regulations also do not govern the service of the branch manager's spouse on Imagine's board of directors, and her service is irrelevant to the Report's identity-of-interest allegations.

In sum, as AMR has no interest in Imagine, never controlled the borrowers' qualification for and receipt of downpayment assistance funds, and the Company's branch manager is not prohibited from serving as an officer of a downpayment assistance entity, no identity-of-interest arrangement existed in this case. The allegations and recommendations associated with this finding, therefore, should be removed from the final report.

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b. Imagine Foundation Did Not Provide Quid Pro Quo Gifts

With regard to the Report's allegation of quid pro quo gifts, as discussed above, FHA guidelines prohibit quid pro quo arrangements where downpayment assistance funds are only available if the buyer obtains a loan from a specific lender or buys a home from a specific seller. See Mortgagee Letter 96-18. To the best of our knowledge, neither AMR nor Imagine ever required borrowers to obtain financing from the Company in order to receive downpayment assistance from Imagine. In fact, contrary to the Report's assertion that Imagine was created to provide gifts exclusively to AMR borrowers, AMR understood that the LaPlace branch manager formed Imagine to assist the borrowers of any local lender who sought downpayment assistance. We also understood, as the Report acknowledges, that Imagine's business plan matched that of other downpayment assistance companies with which the Company conducted business and that it provided gifts to borrowers using a variety of lenders to obtain mortgage financing. It was never Company policy to compel our borrowers to obtain downpayment assistance from Imagine, and, in fact, AMR originated loans in which borrowers obtained gifts from other downpayment assistance entities. In the cases at issue in the Report, AMR would have originated a borrower's FHA loan if a gift were made available from any other downpayment assistance entity.

Moreover, the Report alleges that an Imagine brochure states that buyers must be pre-qualified by AMR. Please note that the Company never created such a brochure. In preparation for this response, we obtained copies of information Imagine's President submitted to the Internal Revenue Service ("IRS") in connection with his application for IRS approval as a nonprofit entity. We understand that Imagine's President designed this brochure and provided it to the IRS as an example of marketing materials to be used by Imagine. To the best of our knowledge, this brochure was never distributed to potential Imagine gift recipients. Furthermore, any borrowers pre-qualified by AMR for FHA financing were not obligated to obtain an FHA loan from the Company. It is our understanding that the pre-qualification language was included on the brochure as a way to ensure that potential gift recipients were, in fact, qualified to receive an FHA loan. Imagine's President has informed us that the brochure and the pre-qualification language were never intended to obligate a borrower to obtain financing from the Company.

In sum, contrary to the Report's allegations, at no time did AMR require its borrowers to obtain downpayment assistance from Imagine as a condition to FHA financing. As a result, the downpayment assistance gifts provided by Imagine did not constitute quid pro quo gifts as defined by the Department and did not put HUD-insured

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loans at risk. We respectfully submit that the identity-of-interest and quid pro quo gift allegations should be removed from the Report.

2. Uninterested Gift Donor

In addition to Finding 1's identity-of-interest allegations, in the second sub-finding, the Report alleges that Imagine's President had an interest in the sale of the properties. Specifically, the Report asserts that, of the 73 loans that received gifts funds from Imagine, the branch manager and Imagine's President reviewed and underwrote 15 loans. Because Imagine, as the downpayment assistance entity, provided the gift funds, and because Imagine's President was also the branch manager for AMR's LaPlace office, the Report claims that this individual had an interest in the sale of the properties secured by these loans, which is prohibited by HUD regulations. The Report also alleges that AMR's owner knew of this interest. As a result, the Report claims that these gifts operated as inducements to purchase and should have been subtracted from the sales price. The Report also states that no repayment of the gift may be expected or implied.

AMR understands and appreciates the Department's requirement 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. See HUD Handbook 4155.1 REV-4, CHG-1 ¶2-10(C); HUD Handbook 4155.1 REV-5, ¶2-10(C). Contrary to the allegations in the Report, the gift donor in each of the 73 cases was Imagine, an uninterested entity, not its President, the sellers in these cases, or AMR. While we acknowledge that it may have been a conflict of interest for Imagine's President to underwrite 15 loans in his capacity as an AMR branch manager, the borrowers in these cases qualified for downpayment assistance and would have received such assistance from any charitable entity. Moreover, any other AMR underwriter would have deemed the borrowers to be eligible for FHA financing. In fact, after the Company received approval for DE underwriting, the Department specifically reviewed the underwriting in approximately 10 to 20 loans as test cases, performed post-endorsement reviews on another 50 to 100 loans, and never rejected these loans for underwriting deficiencies. As the Company's LaPlace branch manager underwrote the loans that were reviewed as DE test cases, we are confident that the loans would have been approved and insured regardless of the underwriter or downpayment assistance provided involved in the transaction. In addition, in connection with the preparation of this response, another AMR underwriter, who was not employed by the Company at the time these loans were made, re-underwrote a sample of the 15 loans and concluded that the borrowers were, in fact, eligible for FHA insurance. Therefore, even if these loans had not been underwritten by an individual with an interest in

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Imagine, we are confident that the Department would have insured these loans. As these borrowers qualified for FHA financing regardless of the source of downpayment assistance, these transactions did not involve an inducement to purchase and AMR was justified in not reducing the sales price.

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We also do not believe that the branch manager's or my supervision of other Company underwriters, or my knowledge of the branch manager's underwriting responsibilities and ownership of Imagine, are in any way related to the Report's allegations that the gifts were provided by an interested party. As discussed above, I have never served on Imagine's board of directors and AMR has no interest in the downpayment assistance company. As President of the Company, I would have supervised the underwriters in these transactions regardless of the source of the gift. Additionally, as Imagine was structured like every other downpayment assistance entity with which AMR conducted business, I never had knowledge or believed the gifts from Imagine to be from an interested source. Furthermore, with regard to Imagine's President, as a branch manager, it was his responsibility to supervise the underwriters in the LaPlace office. This supervision in no way suggests that the branch manager had control over whether Imagine provided the downpayment assistance or whether another underwriter ultimately approved a loan. Thus, based on these allegations, we believe the Report misconstrues HUD's gift regulations involving interested parties, and these statements should be removed from the Report.

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Finally, AMR understands and appreciates the Department's requirement that repayment of gifts provided by any permissible source cannot be expected or implied. See HUD Handbook 4155.1 REV-4, CHG-1 ¶2-10(C); HUD Handbook 4155.1 REV-5 ¶2-10(C). Please note that in none of the cases that received downpayment assistance from Imagine was repayment expected or implied of the borrowers. In fact, as expressly stated on the grant letters, the borrowers acknowledged by their signature that "I also understand that I have no obligation whatsoever to repay any amount of the down payment assistance received from the Imagine Foundation" (**Exhibit F**). Therefore, the Report's suggestion that AMR did not comply with FHA guidelines in this regard is unfounded, and the allegation should be removed from the Report.

3. Non-Profit Status of Imagine Foundation

In a third sub-finding, the Report alleges that Imagine provided \$404,997 in gift funds without obtaining 501(c)(3) nonprofit status from the IRS. Specifically, the Report asserts that AMR's branch manager formed Imagine on May 29, 2001, provided 73 gifts between January 2003 and February 2005, but did not seek nonprofit status from the IRS until December 2003. The Report also claims that in March 2004, Imagine informed the IRS that it had suspended operations pending a formal ruling from the IRS;

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however, records show that Imagine provided gifts after March 2004. Moreover, the Report alleges that the IRS denied Imagine nonprofit, tax-exempt status on August 10, 2005. As a result, the Report asserts that Imagine did not meet the requirement of being a charitable organization and was an inappropriate source of gift funds.

AMR understands and appreciates the Department's requirement that the source of funds to close an FHA loan must be from the applicant's own assets or gifts from relatives, an employer, a long-standing and un-interested friend, a government agency, or a charitable organization. See HUD Handbook 4155.1, REV-4, CHG-1, ¶ 2-10(C); HUD Handbook 4155.1, REV-5, ¶ 2-10(C). In this case, until receiving a telephone call from Imagine's President in August 2005, AMR did not know that Imagine was not approved as a nonprofit entity, and the Company had no reason to believe that Imagine would not be approved. Notably, we understood Imagine to be structured to operate like the numerous other IRS-approved downpayment assistance companies with which AMR conducted business. With a business plan to match other downpayment assistance companies, we believed Imagine's approval as a charitable organization was imminent. Moreover, we are unaware of any FHA rule or regulation that requires AMR to obtain a copy of a downpayment assistance entity's approval letter or other IRS documentation prior to, or after, allowing its borrowers to utilize the entity to obtain downpayment assistance. Thus, AMR never requested or obtained copies of the Imagine documentation submitted to the IRS, and we appropriately relied on Imagine's representation that it was permitted to provide downpayment assistance gifts to local borrowers.

In preparation of this response and to appropriately respond to the Report's allegations, the Company has obtained factual background information from Imagine's President, as well as the documentation and information he submitted to the IRS. Contrary to the Report's allegations, we have been informed that Imagine's President, with the assistance of a local certified public accountant ("CPA"), applied for 501(c)(3) status in the later months of 2001, rather than December 2003, and first responded to the IRS's request for additional information in April 2002 (**Exhibit G-1**). In addition, we understand that Imagine suspended operations in March 2004, as acknowledged in the Report, and provided a few additional gifts after that date only to borrowers seeking downpayment assistance from Nehemiah and who were unable to receive these gifts because of Nehemiah system disruptions. We also understand that Imagine's President was informed both by the CPA and IRS personnel that the date of Imagine's nonprofit approval would be retroactive to the date of Imagine's formation (**Exhibit G-2**). Thus, until Imagine's President received the IRS's August 10, 2005 letter denying nonprofit and tax-exempt status, it is our understanding that he believed that any gifts made by Imagine before its date of approval were validated by the entity's eventual

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retroactive nonprofit status. Prior to August 2005, AMR was never given a reason to doubt the entity's status as a charitable organization.

Furthermore, we understand that the CPA was only retained to prepare and submit Imagine's initial application for approval. Thereafter, after preparing and submitting Imagine's April 2002 response to the IRS, Imagine's President responded to all subsequent requests from the IRS regarding Imagine's structure and business plan. Based on the quotations in the Report from the IRS's denial letter, it is now clear that Imagine's President was not capable of explaining the role of the downpayment assistance company or its operations under the business plan without professional guidance and assistance in preparing the materials submitted to the IRS. Nevertheless, Imagine's structure and operations are no different from the scores of downpayment assistance programs the IRS has approved on numerous occasions. As AMR understood Imagine to operate exactly like the seven other downpayment assistance companies¹ with which the Company had conducted business in the New Orleans area or that sought to market its services to AMR, the Company had no reason to question that Imagine would receive the necessary IRS approval or that the gifts provided to borrowers were permissible.

Having said that, upon learning that Imagine's nonprofit status was denied in August 2005, we acknowledge that the gifts made to Company borrowers did not come from a charitable organization. We, however, respectfully disagree with the Report's assertion that these gifts operated as an inducement to purchase, required a reduction in the sales price, or otherwise put the Department's insurance fund at risk. If the Company had known that Imagine could not provide downpayment assistance to AMR borrowers, AMR would have referred eligible borrowers to any number of other nonprofit entities to receive downpayment assistance. Thus, in each of the 73 cases, the borrowers still would have qualified for FHA financing, the gifts would have been made from an IRS-approved source, and HUD ultimately would have insured these loans.

In fact, on several occasions, AMR underwent Departmental audits, which included several loans in which borrowers received downpayment assistance from Imagine. With each audit, the field auditor requested additional files with Imagine gifts to ensure underwriting quality. After reviewing these files, not once did the Department question the integrity of the underwriting or any other component of the loans, and the auditors, in fact, encouraged the Company to undertake its own DE underwriting. The HUD auditors also received information regarding Imagine's President's employment as

¹ These nonprofit downpayment assistance companies include: (1) Nehemiah; (2) HART; (3) American Family Funds; (4) Genesis; (5) Neighborhood Gold; (6) Partner's in Charity; and (7) Homegrants USA.

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one of AMR's branch managers and the relationships were discussed at length. Not once did the auditors suggest the relationship posed a conflict of interest. We, therefore, are confident that the borrowers who received downpayment assistance from Imagine were eligible for FHA financing and would have qualified and received the same gift from another nonprofit entity. Without any allegations that these borrowers were otherwise ineligible for FHA financing, we respectfully submit that HUD's FHA Insurance Fund was never at risk and the remedies sought in the Report are unwarranted. Asking the Company to both buy down the loans by the gift amount and agree to indemnify the Department for any losses, as well as proposing individual debarments, is a draconian remedy when the Department, in each of the 73 cases, would have insured eligible loans.² Moreover, we understand that the IRS granted Imagine an extension of time, due to Hurricane Katrina, to protest the denial of 501(c)(3) status, and the entity is still pursuing the approval of its nonprofit status under the original application. Thus, if OIG's only issue in this case is whether Imagine should or should not have made the gifts, we respectfully submit that the Department take up this issue with the downpayment assistance company.

Moreover, please be aware that the Report's proposed remedies, if implemented, will force the Company to go out of business. As discussed above, after the devastation of Hurricane Katrina, the Company not only lost certain of its branch locations, but lost over \$300,000 in net worth. AMR remains committed to fully compensating all Company employees as the region rebuilds, and the buy down and indemnification of the loans at issue in this case would force us to close our doors and terminate our employees who are dependent on the Company, now more than ever, for survival. At a time when FHA lenders are valued in the Gulf region of Louisiana and Mississippi, and because the Department would have ultimately insured each of the loans at issue, we believe that the buy down and indemnification of the loans in this case are unwarranted.

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² While we strongly believe that both of the Report's recommendations regarding these loans should be removed, we would like to briefly address the inappropriateness of recommending both indemnification and a principal reduction in connection with the same loan. In the event that a borrower agrees to indemnify HUD for an FHA loan, the lender agrees to be liable for the entire amount of any insurance claim that the Department would satisfy in connection with that loan in the event that the borrower did not fulfill her repayment obligation, as well as any expenses the Department had incurred in connection with the property securing the loan. As a result of a lender's agreement to indemnify HUD, the Department will suffer absolutely no loss in that FHA transaction and will retain the up-front insurance premium. Because a lender's agreement to indemnify is an agreement to cover all of HUD's potential losses, a principal reduction in connection with the same case would impose an additional and unnecessary penalty on the lender. Such action would constitute double jeopardy, as it would punish the Company twice for the concerns addressed by the lender's agreement to indemnify. Moreover, we understand that the Report's recommendation for both indemnification and principal reductions in this instance is contrary to the Department's standard policy of requesting either a principal reduction or indemnification in the event the loan is in default. We invite the OIG to consult the Quality Assurance Divisions in HUD's Homeownership Centers to confirm their practice of imposing only one, but not both, of these penalties in the case of an over-insured loan.

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We, therefore, respectfully ask the OIG to weigh the proposed remedies in light of the harmless error that occurred and remove these allegations from the Report.

4. Required Borrower Minimum Downpayment

In its fourth sub-finding, the Report alleges that without the gifts from Imagine, AMR's borrowers did not meet the statutory 3% minimum downpayment. Specifically, the Report refers to 11 cases where the borrowers' total investment allegedly did not meet the minimum downpayment without the downpayment assistance received from Imagine. Although the borrowers in these cases did not technically receive a gift from a charitable organization, as discussed above, had the Imagine funds not been available, each of these borrowers would have obtained downpayment assistance from another approved entity and otherwise met the minimum downpayment requirements for FHA insurance. We, therefore, believe that any deficiency in this regard is, at worst, harmless error, and the borrowers in these cases were eligible for FHA financing.

Moreover, in light of the zero down payment FHA mortgage proposed by the White House in its 2007 budget and the Department's push for Section 203(h) loans to recent hurricane victims, we believe the Report's focus on minimum downpayment requirements is misplaced and the proposed remedies unwarranted. Specifically, as a way to remove a barrier to homeownership, the current Administration has proposed a "Zero Down Payment" mortgage to allow first-time home buyers with a strong credit record to finance 100% the home purchase price and closing costs. In a summary released by the White House Office of Management and Budget, this proposal is designed to "enable FHA to better meet its objective of serving first-time and low-income home buyers by managing its risks more effectively" (Exhibit H-1).³ Based on this reasoning, if the government envisions a zero downpayment loan as a method to permit HUD to better manage its risks, we believe that requesting the buy down and indemnification of loans involving eligible borrowers overestimates HUD's exposure to risk in the cases at issue. Furthermore, in response to Hurricanes Katrina and Rita, the Department specifically announced that its no downpayment, Section 203(h) loans are available to victims who lost their homes as a result of the storms (Exhibit H-2). If the Department is willing to overlook minimum downpayment requirements for risky borrowers subject to natural disasters, we respectfully submit that the buy down and indemnification of loans where the borrowers were eligible for downpayment assistance and FHA financing are excessive remedies in this case. This sub-finding, therefore, should be removed from the Report.

³ See "Department of Housing and Urban Development," at <http://www.whitehouse.gov/omb/budget/fy2007/hud.html> (last visited Feb. 28, 2006).

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5. Increased Sales Prices

In a fifth sub-finding, the Report alleges that, in 28 loans, instead of reducing the sales price by the amount of the Imagine gift, the sales price increased by all or part of the gift amount. The Report also alleges that Imagine received \$14,123 in fees for providing gifts on AMR loans and that AMR received \$46,062 in origination fees.

As discussed above, the borrowers in these cases were eligible for FHA financing, other tax-exempt downpayment assistance entities would have provided gifts to the borrowers, and the Department would have ultimately insured each of the loans at issue. As a result, without knowledge that Imagine was not an approved nonprofit organization, the Company was not obligated to reduce the sales prices in these cases by the amount of the Imagine gifts. Moreover, while the OIG may dislike the builder/sellers' increase of the property sales price where assistance grants were provided, such action by these entities does not violate HUD guidelines. HUD requirements govern only the practices of FHA-approved lenders and require that they follow guidelines to ensure that borrowers qualify for financing and the value of the underlying property for which financing is obtained is supported. We are not aware of any HUD guideline that dictates what considerations a seller/builder must use to determine property value, nor are we aware of any restriction on the increase of the property value in an amount of downpayment assistance gifts. Provided that the builder/seller makes contributions to the nonprofit entities after closing,⁴ which the Report does not question in this case, HUD guidelines do not govern whether a builder or seller may increase a property's sales price in the amount of that future contribution.

Moreover, AMR cannot control what factors any builder or seller uses to set the price of its properties. With regard to property value, a lender can only satisfy itself that the value of the real property securing the loan is supported and is not less than the sales price agreed upon by the buyer and seller. To do so, HUD guidelines require lenders to obtain an appraisal of the property to establish an estimated value for mortgage insurance purposes. See HUD Handbook 4000.2 REV-3, ¶ 2-3. In addition, HUD requirements expressly state that, rather than any considerations made by the buyers and/or sellers in determining the sales price, "the [appraised] value serves as the basis for determining the maximum insurable mortgage loan." HUD Handbook 4150.1 REV-1, ¶ 1-1. Thus, provided the appraised value supports the sale price, HUD requirements permit lenders to calculate the maximum mortgage amount based on that value, regardless of how the parties to the sales transaction determine the ultimate sale price. In each of the cases cited in this sub-finding, a third-party appraiser conducted

⁴ See Mortgagee Letter 2002-22.

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an independent analysis of the property and determined that the value of each property supported the final sale price. The Report does not take issue with the appraisals in this case; rather it specifically alleges that AMR, in some cases, increased the sales price of the homes. This is not the case. AMR has no control over a builder's decision to increase the sale price based on a downpayment assistance gift. In fact, in many cases, the sellers increased the price by considerably less than the amount of the gift. Thus, such determinations by the builder and the factors used to increase the price were outside of AMR's control and HUD's jurisdiction, and we believe these allegations should be removed from the Report.

With regard to the fees received by both AMR and Imagine, we note that the Company's origination fees were unrelated to the presence of the gift and are expressly permitted by FHA guidelines. See HUD Handbook 4000.2, REV-3, ¶ 5-2(E); HUD Handbook 4000.2, REV-2, ¶ 5-3(D). In addition, the \$14,123 in processing fees paid to Imagine over the course of 73 gifts amounts to less than \$200 per loan. Considering the processing fees authorized and properly charged by other nonprofit downpayment assistance companies typically exceed this amount, we believe the Report unduly focuses on the amounts collected by Imagine. Furthermore, we have been informed that Imagine was structured to minimize its own overhead costs and to provide assistance to local charities committed to fighting homelessness. Thus, we understand that it was Imagine's practice to donate all proceeds collected through processing fees. In fact, the entity has donated more than \$30,000 to New Orleans Artists Against Hunger and Homelessness (**Exhibit I**) since its formation, which is substantially more than Imagine collected in processing fees on the 73 loans at issue in the Report. We, therefore, respectfully submit that the amount of processing fees collected by Imagine is irrelevant to the Report's allegations that the gifts at issue in this case should not have been made, and we ask the Department to remove these statements from the Report. Ultimately, at no time did AMR, any Company employees, or Imagine's President profit from the activities of Imagine.

B. FINDING 2 – QUALITY CONTROL AND LOAN ORIGATION

In the second finding, the Report alleges that the Company's Quality Control Plan and underwriting procedures did not meet HUD requirements. Specifically, the Report asserts that AMR did not obtain documentation required by the Loan Prospector ("LP") underwriting system, did not review loans defaulting within the first six payments, and did not conduct on-site reviews. The Report also alleges that the Company's loan files contained other instances of underwriting deficiencies, and its employees keyed information incorrectly into HUD's computer systems. As discussed above, AMR has made substantial improvements in its Quality Control activities and its Quality Control

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Plan, and the Company is committed to underwriting all loans in accordance with FHA requirements. In no case did AMR ignore the Department's regulations. We address each of the Report's allegations in more detail below.

1. Quality Control Plan, Quality Control Reviews, and On-Site Reviews

In connection with the Company's Quality Control Plan, the Report alleges that AMR's Quality Control Plan did not require a review of loans defaulting within the first six payments or annual site visits for new branches. AMR recognizes that its former Quality Control Plan omitted the above-referenced items. That plan, however, did not reflect all of the Company's policies and procedures, and AMR has strived to adhere to the requirements embedded in the referenced items since its inception. Moreover, AMR has revised its Quality Control Plan to specifically include the review of loans defaulting within the first six months and on-site visits and to ensure that the plan meets applicable HUD/FHA requirements. A copy of the amended plan is enclosed for your review (**Exhibit C**). AMR is implementing the new Quality Control Plan and has notified Company employees of the new plan and instructed them to adhere strictly to it. While the Report asserts that the Company's prior Quality Control Plan read like a contract between AMR and its third-party Quality Control provider, we note that FHA guidelines do not dictate a specific Quality Control Plan format. We, therefore, will continue our long-standing practice of stringent Quality Control and trust that our response to this finding fully addresses the OIG's concerns.

With regard to the Company's Quality Control reviews, AMR understands and appreciates the Department's requirements that a lender must conduct analysis of all loans that go into default within the first six months and that these requirements must be included in the lender's Quality Control Plan. As indicated in the Report, the Company previously operated with the understanding that it was not required to review those loans it sold to its investors before the first mortgage payment was due. Moreover, based on correspondence it received from its investors, the Company further believed that it was prohibited from contacting borrowers who had defaulted on their mortgage obligations to review the circumstances causing the default or to attempt to correct the deficiencies or problems that occurred (**Exhibit J**). The Company, however, never intentionally disregarded the Department's Quality Control requirements. In response to the OIG's review, AMR has implemented a policy, which is set forth in its amended Quality Control Plan, to monitor all loans that have defaulted within the first six months and will expand such a review where a pattern of deficiencies or fraudulent activity is disclosed (**Exhibit C**). The Department should be assured that AMR has incorporated a policy and practice of conducting Quality Control reviews, and going forward, the

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Company will continue to conduct timely Quality Control reviews in accordance with FHA guidelines.

Finally, with respect to on-site branch office reviews, AMR respectfully disagrees with the Report's allegations. AMR understands and appreciates that a lender must complete an on-site branch office review at least once a year, and that this requirement must be included in a lender's Quality Control Plan. See HUD Handbook 4060.1, ¶ 6-1(D)(6). In compliance with FHA requirements, it is AMR's practice to conduct on-site branch office reviews at least once per year. Contrary to the Report's allegations, while the Company did not visit the branches immediately after their opening, AMR performs quarterly on-site branch reviews of its Mississippi branches. Moreover, samples of files from these branch locations are included in the periodic Quality Control reviews conducted by SRS, the Company's third-party audit company. AMR's amended Quality Control Plan sets forth the Company's policy regarding on-site branch office reviews (**Exhibit C**), and the Company, therefore, complied with FHA requirements.

AMR has always engaged in stringent Quality Control. We consistently review and analyze Company practices and procedures, and take responsibility to ensure that FHA requirements are met. As discussed above, we have implemented a written Quality Control Plan that complies with HUD/FHA requirements. Furthermore, it is now our policy and practice to conduct Quality Control reviews of all loans that default within the first six months and of all offices at least once a year. We have made the timely completion of Quality Control reviews a priority. We are confident that any problems that the Company may have experienced in the past with regard to the issues raised in the Report have been resolved, and we respectfully request that these allegations be removed from the Report.

2. Underwriting Documentation

In addition to the second finding's Quality Control allegations, the Report asserts that AMR did not obtain certain LP employment documentation, the Company did not comply with other FHA underwriting requirements, and Company employees keyed inaccurate data into HUD's computer system.

First, in five cases,⁵ the Report asserts that AMR obtained only partial payroll information, rather than the one full month of payroll documentation as directed by the LP

⁵ These five cases include: (1) [REDACTED] - FHA Case No. 221-3549457; (2) [REDACTED] - FHA Case No. 221-3634657; (3) [REDACTED] - FHA Case No. 221-3637539; (4) [REDACTED] - FHA Case No. 221-3681056; and (5) [REDACTED] - FHA Case No. 221-3526608.

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automated underwriting system. Please note that AMR has been unable to locate one of the files cited in the Report – the [REDACTED] loan, **FHA Case No. 221-3634657** – as it was destroyed in the damage caused to our Metairie office by Hurricane Katrina. We, therefore, cannot meaningfully respond to the allegations in this case. With regard to the remaining cases, while we acknowledge that the files in these cases did not contain one month of pay stubs for the borrowers, AMR nevertheless complied with HUD's employment documentation requirements. Specifically, to document a borrower's employment, FHA guidelines require a lender to obtain a Verification of Employment ("VOE") and the borrower's most recent pay stub. See HUD Handbook 4155.1 REV-4, CHG-1, ¶3-1(E); HUD Handbook 4155.1 REV-5, ¶3-1(E). As an alternative to obtaining a VOE, a lender may obtain the borrower's pay stubs covering the most-recent 30 day period and W-2 forms from the previous two years, as well as verify the borrower's current employment by telephone. Id. In each of these cases, the underwriter obtained the borrowers' proper employment documentation to meet these FHA requirements. For example, the loan files contained the following documentation in three cases:

<u>Borrower</u>	<u>FHA Case No.</u>	<u>Employment Documents</u>
[REDACTED]	FHA Case No. 221-3549457	VOE and most recent pay stub (Exhibit K-1)
[REDACTED]	FHA Case No. 221-3637539	VOE and most recent pay stub (Exhibit K-2)
[REDACTED]	FHA Case No. 221-3681056	VOE, most recent pay stubs, and VOEs for prior employment (Exhibit K-3)

The underwriter, therefore, obtained sufficient employment documentation in these cases, and we believe that indemnification is unwarranted. We respectfully request that these allegations be removed from the final report.

Second, in addition to the allegations regarding LP payroll documentation, the Report alleges that certain loans contained other underwriting deficiencies, including not providing compensating factors, lacking explanations for gaps in employment, and not obtaining a borrower's signature, to name a few. We respond to a sample of the Report's allegations in more detail below.

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a. [REDACTED] – FHA Case No. 221-3680202

In the [REDACTED] case, the Report alleges that the borrower's qualifying ratios exceeded HUD's requirements of 29%/41%. Specifically, the Report asserts that the borrower's ratios were 33.9% and 48.9% and AMR did not provide compensating factors as required by HUD regulations. The Report also notes that underwriters must state in the "remarks" section of the Mortgage Credit Analysis Worksheet ("MCAW") the compensating factors used to support loan approval.

AMR understands and appreciates HUD's requirement that certain explicitly enumerated compensating factors may be used to justify approval of a loan where the borrower's qualifying ratios exceed HUD's benchmark guidelines. See HUD Handbook 4155.1 REV-5, ¶2-13. The Company also understands that these compensating factors must be recorded on the "remarks" section of the MCAW and be supported by documentation. Id. Contrary to the allegations in the Report, the underwriter in this case recorded sufficient compensating factors used to justify approval of the loan and obtained documentation to support them.

First, as noted in the "remarks" section of the MCAW (**Exhibit L-1**), the borrower maintained an excellent credit history with minimal recurring obligations and FICO scores of 710 and 644 (**Exhibit L-2**), which the underwriter documented with the borrower's credit report. See id. ¶¶2-13(C), (D). Second, the underwriter noted the borrower's minimum housing increase of \$125, which is reflected on the MCAW (**Exhibit L-1**). FHA guidelines explicitly permit a minimal increase in the borrower's housing expense to justify approval of the loan. See id. ¶2-13(F). Third, the "remarks" section of the MCAW reflects the underwriter's notation that the borrower was pursuing further technical education in connection with his employment as a computer technician (**Exhibit L-1**). The loan file contained a letter from the school documenting the borrower's attendance (**Exhibit L-3**), as well as a VOE reflecting his current employment in the computer field (**Exhibit L-4**), which the Department recognizes as evidence of the borrower's potential for increased earnings and a sufficient compensating factor. See id. ¶2-13(I). Finally, although not recorded on the MCAW, the loan file contained a Verification of Rent ("VOR"), which documented the borrower's timely payment of rent for 18 months (**Exhibit L-5**). As FHA guidelines recognize the borrower's ability to timely satisfy his or her housing obligation over the previous 12 to 24 months as a compensating factor, this documentation is additional support for the underwriter's prudent decision to approve the loan. See id. ¶2-13(A). The underwriter in this case, therefore, complied with HUD requirements and properly recorded and documented sufficient compensating factors to justify approval of the loan.

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Indemnification is not appropriate in the Becnel case, and we respectfully request that the allegations be removed from the Report.

b. [REDACTED] – FHA Case No. 221-3670149

In the [REDACTED] case, the Report alleges that AMR did not obtain an explanation for one borrower's three-month gap in employment from May 9 to August 19, 2002. AMR understands and appreciates the Department's requirement that to document a borrower's stability of income, the borrower must explain any gaps in employment spanning one month or more. See HUD Handbook 4155.1 REV-5, ¶12-6. Contrary to the allegations in this case, the loan file contained documentation of the borrower's uninterrupted employment from December 5, 2001 until the date of closing. Specifically, the loan file contained a Verification of Employment ("VOE") of the borrower's previous employment with Louisiana Machinery from December 5, 2001 until May 9, 2002 (**Exhibit M-1**). The loan file also contained a written explanation and copies of W-2 forms to document the borrower's employment with Wilstaff Worldwide, Inc. in May 2002 and with Latico of Louisiana, Inc. until the borrower began his current employment in August 2002 (**Exhibit M-2**). Finally, the file contained a VOE for the borrower's current job, which began August 19, 2002 (**Exhibit M-3**). As the Company properly documented a full 27 month employment history for the borrower, indemnification is not appropriate in this case and the allegations should be removed from the Report.

c. [REDACTED] – FHA Case No. 221-3681056

In the [REDACTED] case, the Report alleges that the seller paid 7.3% of the buyer's closing costs, when HUD permits sellers to contribute only up to 6% of the property's sales price toward the buyer's actual closing costs. The Report asserts that any amount above 6% should reduce the sales price dollar-for-dollar, or by \$1,405 in this case.

Contrary to the allegations in this case, the closings costs paid by the seller did not exceed 6% of the sales price. AMR understands and appreciates the Department's requirement that a seller's payment of more than 6% of the borrower's closing costs normally requires a dollar-for-dollar reduction to the sales price prior to calculating the maximum mortgage amount. See HUD Handbook 4155.1 REV-4, CHG-1 ¶1-7; HUD Handbook 4155.1 REV-5 ¶1-7. With regard to downpayment assistance and other gift funds, however, HUD guidelines indicate that the Department requires a dollar-for-dollar reduction only when the gift funds do not meet FHA guidelines regarding permissible gifts. *Id.* In this case, Imagine was the gift donor, not the seller, and the Report makes no allegation that the Imagine gift did not comply with FHA guidelines regarding the

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documentation of the transfer of the gift. AMR, therefore, was not required to reduce the sales price by the amount of the gift.

Moreover, while the seller may have made donations to the downpayment assistance entity in the amount of the gift funds received by the borrower, HUD requirements expressly state that such circumstances are permissible under FHA guidelines, provided that the donor receives the contribution from the seller outside of closing of the particular transaction. See Mortgagee Letter 02-22(E). In accordance with FHA guidelines, it is AMR's policy to require downpayment assistance companies to wire all gift funds to the settlement agent at or before closing. Thus, the downpayment assistance gift in this case came from Imagine's funds, not that of the seller. Contrary to the allegations in the Allen case, the Company was not required to characterize the downpayment assistance grant as a seller concession in its calculation of the 6% limitation. We, therefore, respectfully request that the allegations and recommendations associated with this finding be removed from the final report.

d. [REDACTED] – FHA Case No. 221-3549457

In this case, the Report alleges that the borrower did not sign or date the final loan application. Contrary to the allegations in this case, in accordance with HUD's requirement that the borrower sign and date all application forms, the loan file contained both the initial Uniform Residential Loan Application ("URLA") and the final URLA signed and dated by the borrower (**Exhibit N**). See HUD Handbook 4155.1 REV-4, CHG-1, ¶3-2(A).

Finally, in 28 cases, the Report alleges that AMR incorrectly keyed the gift code in to HUD's computer systems. While the Company understands and appreciates that the Department relies upon this information for its monitoring activities, the Report does not allege that these 28 loans were ineligible for FHA financing as a result of the incorrect code information. Nevertheless, it is the Company's policy to ensure that accurate information on all loan transactions is provided to the Department. We have reminded Company employees of the importance of this information and have cautioned them to carefully review the data inputted into HUD's system. In these 28 cases, we are confident the input errors were inadvertent, that the borrowers' were eligible for FHA financing, and that HUD's insurance fund was never at risk. As a result, the input errors made in these cases were, at worst, harmless error, and we believe that any deficiencies with regard to the gift data codes will not recur in the future. The Company has taken appropriate measures to ensure that all data submitted through the Department's electronic systems is reviewed and accurate. This allegation, therefore, should be removed from the Report.

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III. CONCLUSION

AMR takes the matters raised in the draft Report seriously. Because FHA lending comprises a significant portion of AMR's overall business operations, the Company is committed to educating and training its employees on issues regarding FHA compliance and to assuring their adherence to HUD's rules and regulations. As discussed above, AMR generally complied with FHA underwriting requirements and made loans to qualified FHA borrowers. AMR's thorough review of the findings set forth in the Report indicated that many of the findings are at variance with the facts, do not constitute violations of HUD/FHA requirements on the part of AMR, or do not affect the underlying loans' insurability. AMR at no time misrepresented information it submitted to the Department. Moreover, since the loans cited in the Report were originated, the Company has continued to enhance its underwriting practices and Quality Control standards. The Company identified and responded to operational and underwriting concerns, and it has exercised responsible management supervision.

We believe that this response and accompanying exhibits demonstrate that certain of the Report's recommendations in connection with the cited loans are unwarranted. We respectfully request that the OIG revise its recommendations to fit the facts of this case and remove allegations from the Report in those instances in which AMR has demonstrated its compliance with HUD requirements.

If you have any additional questions, or if you need additional information, please do not hesitate to contact our Washington counsel, Phillip L. Schulman, at (202) 778-9027. Thank you for your kind consideration.

Sincerely,



M. Andrew Remson
President

cc: Phillip L. Schulman, Esq.

OIG Evaluation of Auditee Comments

- Comment 1 We appreciate America's Mortgage's efforts to correct deficiencies cited in the finding and agree if corrections are implemented they should improve America's Mortgage Resource's operations and decrease the risk to the Federal Housing Administration's loan portfolio.
- Comment 2 We maintain that an identity of interest existed between America's Mortgage Resource and Imagine Foundation because the same person served as the branch manager (in the response, America's Mortgage identifies this person as a vice president in the company) and as the president of Imagine Foundation. The branch manager underwrote 15 loans cited in the report. As branch manager, he would have been the supervisor of the other loans.
- Comment 3 While HUD Handbook 4060.1 Rev-1 Paragraph 2-11(B) allows officers to represent more than one company, America's Mortgage Resource provided no evidence that it met the HUD requirements allowing it to do so.
- Comment 4 Although America's Mortgage's owner stated that he withdrew his intention to serve on Imagine Foundation's board, he did not provide documentation to that effect, or a date when this occurred. The report did not state that America's Mortgage Resource maintained an ownership position in Imagine Foundation. We clarified the role of America's Mortgage president with Imagine Foundation in the body of the report.
- Comment 5 Although America's Mortgage may have understood that Imagine Foundation would help any borrower from any lender, Imagine Foundation only provided gifts to borrowers who used America's Mortgage.
- Comment 6 America's Mortgage response described Imagine Foundation as an "uninterested entity" that provide gifts. We disagree with this characterization. Imagine Foundation's president was the branch manager/vice president of America's Mortgage and in 15 instances (20.5 percent of the 73 loans cited) underwrote and approved the loans. The branch manager/vice president received compensation from America's Mortgage and controlled Imagine Foundation. America's Mortgage held the mortgage on the loans.²¹ Also, the branch manager provided closing instructions to title companies regarding the loans that received gifts. It is unlikely that either the seller or the borrower in most instances would have been aware of the downpayment assistance program or Imagine Foundation without the involvement of the branch manager.
- Comment 7 America's Mortgage contends that Imagine Foundation acted similarly as other gift providers and the use of Imagine Foundation had no effect on the

²¹ According to America's Mortgage, it sells all the mortgages in the secondary market.

borrower's eligibility for Federal Housing Administration loans. However, the Internal Revenue Service expressly denied Imagine Foundation's nonprofit status. As a result, Imagine Foundation's contributions are considered inducements to purchase and the mortgage must be reduced. Without Imagine Foundation's contributions, the borrowers did not make the required downpayment on the houses.

America's Mortgage repeatedly asserts if borrowers did not receive gifts from Imagine Foundation that borrowers could receive similar gifts from another downpayment assistance provider. Further, the response contends that Imagine Foundation operated similar to these downpayment assistance providers. However, the Internal Revenue Service denied Imagine Foundation's nonprofit status based upon Imagine Foundation accurately describing the transaction. America's Mortgage's response did not indicate how a different provider would nullify the Internal Revenue Service's objections.

Comment 8 America's Mortgage owner did not believe the gifts to be from an interested source. However, the same person underwrote or supervised the underwriter for loans that he as president of Imagine Foundation wrote the checks for the gift. Irrespective of the owner's belief, America's Mortgage benefited and profited from this relationship.

Comment 9 The report accurately reflects the criteria and facts.

Comment 10 Based on documentation provided OIG changed the date to December 2001.

Comment 11 We would not expect America's Mortgage to indemnify HUD for the amount that it reduces the principal. HUD regulations²² require the principal reduction due to the contributions being inducements to purchase. Because of the other violations including not meeting minimum investment, we are recommending the indemnification of the remaining amount of the loan.

Comment 12 We cannot apply proposed changes to HUD requirements to existing transactions. We relied upon requirements in place during the audit time frame.

Comment 13 When the branch manager closed a loan or oversaw the closing of a loan, he had influence over a loan. Further, in at least one instance the branch manager instructed a title company to change the sales price. We reported information obtained through file reviews. America's Mortgage's response did not indicate what information was incorrect.

Comment 14 The finding accurately discloses the fees earned by America's Mortgage and Imagine Foundation.

²² HUD Handbook 4155.1, REV-4, CHG-1, or REV 5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," section 3, paragraph 2-10C.

- Comment 15 OIG commends America's Mortgage for taking steps to correct its quality control plan.
- Comment 16 America's Mortgage did not include any of the quarterly reports.
- Comment 17 America's Mortgage did not comply with Loan Prospector requirements that required one full month's payroll documentation. America's Mortgage may have complied with HUD non-Loan Prospector requirements, but Mortgagee Letter 98-14 states Loan Prospector will determine documentation needed to determine a loan's eligibility.
- Comment 18 Based upon documentation provided, we removed this from the report.
- Comment 19 HUD regulations state an explanation of the gap in employment is required. Although America's Mortgage can explain this gap, the HUD maintained loan file did not contain this information.
- Comment 20 The sales addendum clearly shows that \$7,000, the amount of the gift, was to be used for closing costs. America's Mortgage has a fiduciary responsibility to HUD to ensure that the seller does not pay more than the 6 percent allowed for closing costs

Appendix C

LISTING OF THE 73 AMERICA'S MORTGAGE LOANS THAT RECEIVED IMAGINE FOUNDATION GIFTS

Case number	Loan amount	Case number	Loan amount
221-3452738	\$116,925	221-3600329	\$94,254
221-3507349	\$75,899	221-3591778	\$140,887
221-3507933	\$102,192	221-3606735	\$126,044
221-3501947	\$77,388	221-3628668	\$85,325
221-3509067	\$106,160	221-3608056	\$140,887
221-3496440	\$82,348	221-3637539	\$119,059
221-3504829	\$46,135	221-3602205	\$62,505
221-3501540	\$97,728	221-3646468	\$89,594
221-3508656	\$53,278	221-3647066	\$126,004
221-3522693	\$95,743	221-3652043	\$65,540
221-3524189	\$97,231	221-3642732	\$80,860
221-3523892	\$139,875	221-3655765	\$155,117
221-3527474	\$114,098	221-3656386	\$113,998
221-3528197	\$79,670	221-3656334	\$106,657
221-3515838	\$85,821	221-3646287	\$138,902
221-3521783	\$113,106	221-3660809	\$63,995
221-3534866	\$122,035	221-3668319	\$84,333
221-3538664	\$90,286	221-3657165	\$119,059
221-3542226	\$153,289	221-3670149	\$116,491
221-3537459	\$74,411	221-3634742	\$69,451
221-3540911	\$111,647	221-3660295	\$90,286
221-3541838	\$63,498	221-3668735	\$72,318
221-3558016	\$83,738	221-3674396	\$64,490
221-3549457	\$141,382	221-3669662	\$101,200
221-3559425	\$99,216	221-3681056	\$101,200
221-3560242	\$156,716	221-3688865	\$121,043
221-3553343	\$90,237	221-3683454	\$137,413
221-3561283	\$147,261	221-3677160	\$98,719
221-3558719	\$82,845	221-3685960	\$99,216
221-3557380	\$74,192	221-3712363	\$126,401
221-3571688	\$144,440	221-3713629	\$120,051
221-3575979	\$136,561	221-3713250	\$151,205
221-3578482	\$152,793	221-3706447	\$61,514
221-3593762	\$149,651	221-3733392	\$130,965
221-3588496	\$144,637	221-3746945	\$114,098
221-3592557	\$59,529	221-3757297	\$90,241
221-3597265	\$71,484		

Appendix D

UNDERWRITING DEFICIENCY DETAIL

The Loan File Lacked Employment Verification

For loan number 221-3670149, America's Mortgage did not obtain an explanation for one borrower's gap in employment of three months from May 9 to August 19, 2002. HUD regulations²³ require the borrower to explain any gaps in employment spanning one month or more. The LaPlace branch manager underwrote this loan, and the loan went into default within the first four payments.

The 6 Percent Allowance in Closing Cost Was Exceeded

For loan number 221-3681056, the seller paid 7.3 percent of the buyer's closing cost.²⁴ HUD²⁵ permits sellers to contribute up to 6 percent of the property's sales price toward the buyer's actual closing costs. However, any amount above 6 percent should reduce the sales price dollar for dollar. Thus, the sales price should be reduced by the \$1,405 that the seller paid over the allowed 6 percent.²⁶ The borrower did not make any payments on this property.

America's Mortgage Did Not Submit the Required Loan Application

For loan number 221-3634657, America's Mortgage did not submit both of the required loan applications. HUD regulations²⁷ state that a copy of an initial and final application must be submitted as part of the endorsement package. We found the initial and final loan applications only in America's Mortgage's loan file. The initial loan application was dated October 21, 2003, and the final loan application was dated November 14, 2003. Both HUD's and title company's files contained only the final loan application, dated November 14, 2003.

²³ HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 2-6.

²⁴ The amount includes the \$7,000 in funding through Imagine Foundation.

²⁵ HUD Handbook 4155.1, REV-4, CHG 1, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," section 1.

²⁶ In finding 1, we are recommending that the loan be written down for the \$7,000 gift.

²⁷ HUD Handbook 4155.1, REV-5, "Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties," paragraph 3 2A.