audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
July 9, 1998
Audit Case Number
98-CH-221-1004

TO: Art Agnos, Acting Assistant Secretary for Housing - Federal Housing Commissioner, and Chairman, Mortgagee Review Board

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Legend Mortgage Company
Single Family Mortgage Insurance Program
Lisle, Illinois

We completed an audit of the books and records of Legend Mortgage Company, a loan correspondent. We selected Legend Mortgage Company for audit based on our audit plan and input from the HUD program staff. The audit objective was to determine if Legend Mortgage Company originated HUD-insured 203(k) rehabilitation loans according to HUD's requirements.

We reviewed all four HUD/FHA 203(k) loans originated by Legend Mortgage Corporation that were in default as of April 1997. At the time we started our audit, Legend's 203(k) default rate was 2.21 percent; and it has risen to 5.33 percent as of April 30, 1998. We concluded that Legend did not originate the four 203(k) loans in accordance with HUD's requirements. All four of the loans were originated by the same loan officer, Legend's President. Strawbuyer's were identified in all four loans. Legend Mortgage: (1) added fictitious information into loan files and applications without the knowledge or approval of borrowers; (2) collected the fictitious information from a contractor without the knowledge or approval of borrowers; (3) failed to obtain evidence that 401(k) accounts were redeemed; (4) failed to consider the taxation and early withdrawal penalties when valuing a 401(k) account; (5) failed to verify the source of partnership assets used to qualify borrowers; and (6) failed to verify the receipt of funds by the partnership for the borrowers. The deficiencies occurred because of Legend's poor loan origination practices. The fictitious information added by Legend Mortgage enabled the borrowers to appear to qualify for mortgages by improving their liquid asset and income positions. All four loans involved either a fictitious "partnership agreement" or a fictitious residence lease. All four documents appeared to have the forged signatures of the borrowers. Consequently, applications submitted to HUD contained false information about the borrowers' intention to be actual borrowers, and the true value of their assets and income. HUD relied on Legend's origination process and as a result assumed abnormally high risks when it insured the four loans which together were valued at $310,200.

If you have any questions, please contact me at (312) 353-7832.

Executive Summary

We completed an audit of the books and records of Legend Mortgage Company, a loan correspondent. We selected Legend Mortgage Company for audit based on our audit plan and input from the HUD program staff. The audit objective was to determine if Legend Mortgage Company originated and serviced HUD-insured 203(k) rehabilitation loans according to HUD requirements.

We concluded that Legend Mortgage Company did not originate HUD/FHA 203(k) loans in accordance with HUD's requirements for the four loans we reviewed. Strawbuyers were identified in all four loans.

Legend did not originate loans in accordance with HUD requirements or prudent lending practices

We reviewed all four HUD/FHA 203(k) loans originated by Legend Mortgage Company that were in default as of April 1997. We concluded that Legend did not originate the four 203(k) loans in accordance with HUD's requirements. All four of the loans were originated by the same loan officer, Legend's President. Strawbuyer's were identified in all four loans. Legend Mortgage: (1) added fictitious information into loan files and applications without the knowledge or approval of the borrowers; (2) collected the fictitious information from a contractor without the knowledge or approval of borrowers; (3) failed to obtain evidence that 401(k) accounts used to qualify the borrowers were redeemed; (4) failed to consider the taxation and early withdrawal penalties when valuing a 401(k) account; (5) failed to verify the source of partnership assets used to qualify borrowers; and (6) failed to verify the receipt of funds by the partnership for the borrowers. The deficiencies occurred because of Legend's poor loan origination practices. The fictitious information added by Legend Mortgage enabled the borrowers to appear to qualify for mortgages by improving their liquid assets and income positions. All four loans involved either a fictitious "partnership agreement" or a fictitious residence lease. All four documents appeared to have the forged signatures of the borrowers. Consequently, applications submitted to HUD contained false information about the borrowers' intention to be actual borrowers, and the true value of their assets and income. HUD relied on Legend's origination process and assumed abnormally high risks when it insured the four loans which together were valued at $310,200.

We recommend that: (1) the Mortgagee Review Board take appropriate action based on the information contained in the Finding; and (2) the Assistant Secretary for Housing consider imposing administrative sanctions on Legend's President, who was responsible for all four of the improperly originated loans.

We presented our draft findings and narrative case presentations to Legend Mortgage Company and the Illinois State HUD Office during the audit. We held an exit conference with Legend on May 15, 1998. Legend Mortgage Company provided written comments to our finding and narrative case presentations. We included excerpts from the comments with the finding. Appendix C contains the complete text of the comments.

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Introduction

HUD approved Legend Mortgage Company as a loan correspondent on March 29, 1995. Legend Mortgage Company originates HUD/FHA insured loans. The HUD/FHA insured loans are underwritten by Direct Endorsement sponsors and sold to the Direct Endorsement sponsors for servicing. At the time we started the audit, Legend Mortgage Company had originated 181 Section 203(k) loans and four of those loans defaulted, for a 2.21 percent default rate. As of April 30, 1998, Legend Mortgage Company has originated 244 Section 203(k) loans and 13 of those loans have defaulted, for a 5.33 percent default rate.

Legend Mortgage Company's books and records are located at 906 Lacey Avenue, Suite 206, Lisle, Illinois. The President of Legend Mortgage Company is David Whitacre.

Audit Objectives

Our audit objectives were to determine if Legend Mortgage Company originated and serviced HUD-insured section 203(k) rehabilitation home loans according to HUD's requirements.

Audit Scope and Methodology

Our audit included tests of compliance with HUD's requirements for the origination of HUD/FHA 203(k) loans. The purpose was to evaluate the propriety and accuracy of: (1) the borrower's income; (2) liquid assets; (3) liabilities; and (4) previous use of credit. We performed in-depth reviews on all four loans that were in default as of April 1997.

We interviewed HUD staff, all four borrowers with their attorneys, Underwriting staff, and Legend's President. We reviewed Legend's loan origination methods as they related to these four loans. We reviewed HUD's, Underwriters, and Legend's FHA case files. We received title histories from a title company. The title company also provided information related to both the 203(k) closing and the previous closings related to the strawbuyer's acquisition of the properties before the 203(k) refinancing. We also received information from a finance company that related to the notes/loans that were refinanced with 203(k) monies.

Our audit included a review of all 203(k) loans that were in default as of April 1997. We conducted the audit at Legend Mortgage Company between April 1997 and September 1997.

The audit was conducted in accordance with generally accepted government auditing standards. We provided a copy of this report to Legend Mortgage Company.

Legend Mortgage Company Did Not Originate Loans In Accordance With HUD Requirements Or Prudent Lending Practices

Legend Mortgage Company, a loan correspondent, improperly originated all four of the HUD/FHA-insured loans reviewed. We reviewed all Section 203(k) loans originated by Legend Mortgage Company that were in default as of April 1997. All four loans involved strawbuyers. Legend Mortgage: (1) added fictitious information into loan files and applications without the knowledge or approval of borrowers; (2) collected the fictitious information from a contractor without the knowledge or approval of borrowers; (3) failed to obtain evidence that a 401(k) account used to qualify a borrower was redeemed; (4) failed to consider the taxation and early withdrawal penalties when valuing a 401(k) account; (5) failed to verify the source of partnership assets used to qualify the borrowers; and (6) failed to verify the receipt of funds by the partnership for the borrowers. The deficiencies occurred because of Legend's poor loan origination practices. The fictitious information added by Legend Mortgage enabled the borrowers to qualify for mortgages by improving their liquid asset and income positions. All four loans involved either a fictitious "partnership agreement" or a fictitious residence lease. All four documents appeared to have the forged signatures of the borrowers. Consequently, applications submitted to HUD contained false information about the borrowers' intention to be actual borrowers, and the true value of their assets and income. HUD relied on Legend's origination process and as a result assumed abnormally high risks when it insured the four loans which together were valued at $310,200. HUD has already been indemnified by the underwriter for its losses on three of the loans.

HUD Requirements

HUD Handbook 4060.1, Mortgagee Approval Handbook, page 2-7, paragraph 2-20 requires mortgagees to originate HUD/FHA-insured loans in accordance HUD regulations. In this regard, loan correspondent mortgagees are required to complete Form HUD-92001-E, HUD/FHA Application Commitment for Insurance Under the National Housing Act (Application). The applicants are required to sign this form and by signing the form, they agree to a number of requirements including the requirement to comply with the provisions of the HUD Regulations and other requirements of the Secretary of HUD.

24 CFR Part 25.5 allows the Mortgagee Review Board to impose administrative actions against a mortgagee, which includes the withdrawal of the HUD/FHA approval. Part 25.12 states the Mortgagee Review Board is authorized to impose civil money penalties against any mortgagee or lender.

Loan officers who violate HUD requirements are subject to administrative sanctions contained in 24 CFR Part 24, including debarment, suspension, and limited denial of participation.

The following table summarizes the more significant violations of HUD loan origination requirements for the four cases. These and other deficiencies are summarized and discussed in more detail in the Narrative Case Presentations (Appendices B-1 through B-4):

Deficiency	No. of Loans
Strawbuyer/false intent to invest	4
Mishandled mortgage documents	4
Cash/liquid assets overstated	4
Overstated income	1
401(k) funds not properly verified	1
401(k) funds not properly valued	1
"Partnership" funds not properly verified	3

The Chief of the Single Family Production Branch, Office of Housing, Illinois State HUD Office, said all four loans would have been rejected had Legend submitted accurate information.

Borrowers were recruited by a contractor

All four borrowers were recruited by the same Contractor to be strawbuyers. The Contractor promised the borrowers that it would find properties to rehabilitate, rehabilitate the properties, and sell the properties to third parties after the rehabilitation was completed. The borrowers were told by the Contractor or understood that they would not have to contribute any of their own money.

Borrowers acted as strawbuyers

All four borrowers told the auditors that they did not invest any money toward either the initial purchase or refinance of the properties. All four borrowers were, in fact, strawbuyers. For their participation in the Contractor's plan, the strawbuyers were paid between $500 and $1,500.

With the aid of the Contractor, the strawbuyers purchased properties at prices ranging from $3,500 to $23,000. Three of the four properties were sold by the Government at Real Estate Owned sales. The fourth property was acquired in a private sale. The initial purchases for Borrowers A, C, and D were financed with no down-payment high-interest loans from a finance company. The loans required a six-month balloon payment in full and had net effective rates of between 22 percent and 23 percent. The Contractor supplied the funds for Borrower B's purchase. The finance company loans were taken out in amounts far greater ($34,300 to $44,800) than the funds necessary to purchase the properties ($3,500 to $23,000).

Contractor and an affiliate received inappropriate payments

The Contractor and an affiliated company ("Affiliate") were paid $110,613 from mortgage proceeds/borrowers' funds at the loan closings for the initial purchase of the properties and the Section 203(k) refinancings. These payments were made for mortgages from an affiliated company, rehabilitation work that was not performed, and other unexplained reasons. For Borrower's B and C, the Affiliate filed mortgages with the County Recorder's office. Borrower's B and C said they never took out mortgages with the Affiliate and they never signed the mortgage documents. The improper and unexplained payments are as follows:

Borrower	Transaction	Amount	Description
B	203(k) refinance	$ 40,000	Payment to Affiliate for unexplained mortgage
C	Initial	3,500	Payment to Contractor for rehabilitation work not

	purchase		performed
C	Initial purchase	7,095	Unexplained payment to Contractor
C	Initial purchase	5,000	Unexplained payment to Contractor
C	203(k) purchase	8,000	Payment to Affiliate for unexplained mortgage
A	Initial purchase	10,973	Unexplained payment to Contractor
A	203(k) refinance	7,902	Payment to Contractor for rehabilitation work not performed
D	203(k) refinance	14,095	Payment to Contractor for rehabilitation work not performed
D	Initial purchase	4,048	Unexplained payment to Contractor
D	Initial purchase	10,000	Unexplained payment to Affiliate
		$110,613	

Assets necessary to close were not verified

In all four cases, the total assets necessary to close each transaction were not verified by Legend Mortgage. HUD Handbook 4155.1 REV-4 CHG 1 states that "[a]ll funds for the borrower's investment in the property must be verified." The actual assets necessary to close that were verified by Legend ranged from a low of $1,457 to a high of $7,999 per borrower. The amount actually needed at closing ranged from a low of $12,313 to a high of $17,832 per borrower. The following table shows the amount of assets verified by Legend Mortgage Company and the amount of assets it was required to verify for Borrowers A, B, C, and D in order for the borrowers to qualify for the HUD/FHA insured loans.

Borrower	Amount Verified	Amount Needed
A	$3,466	$12,313
B	7,999	15,837
C	6,093	14,531

D	1,457	17,832

As a result, none of the borrowers qualified for the HUD/FHA insured loans.

In three instances, a fictitious partnership agreement was placed in the borrowers loan file to give the appearance that they qualified.

There was no information in Borrower A or B's file, other than a partnership agreement, to provide any verification that partnership funds needed to close were available. HUD Handbook 4000.2 REV-2, paragraph 3-6 mandates that mortgagees obtain and verify information with great care. Legend's President said the rules regarding verification of partnership agreements were communicated to him by an underwriter that he used to work for before he started Legend Mortgage Company. Legend's President said the underwriter told him that only a partnership agreement was necessary to verify the existence of the entire amount of partnership liquid assets. Legend's President believed the underwriter was authorized to speak on behalf of HUD and that all HUD required was a partnership agreement to evidence partnership liquid assets. Legend's President's belief that he did not have to verify the actual assets of the partnership to satisfy prudent lending practices was mistaken. A loan correspondent's basic duty, on HUD's behalf, is to verify the validity of information that is received. Indeed, as HUD's agent, Legend had a duty to verify the assets of the partnership before placing HUD at risk.

The Chief of HUD's Single Family Loan Production Branch said HUD accepted loan packages with partnership agreements. However, HUD did not approve the loan packages on an as-is basis. Prudent lending practices would have required the broker to verify the assets of the partnership.

For Borrowers A, B, and C, Legend did not verify that the borrowers had the $10,000 required by the partnership agreements. If a verification of the borrowers' funds had been made, Legend's President would have found that the partnerships were fictitious. A verification could also have uncovered that the borrowers did not belong to a partnership and the borrowers did not have the funds necessary to close the transactions. All three borrowers said they did not belong to a partnership and had never seen the partnership agreement.

They said the signatures on the partnership agreements were not their signatures.

During a phone conversation, regarding Borrower C's loan, the underwriter's Vice-President asked the Chief of the Single Family Production Branch about the requirements for verification of funds to close a loan. The underwriter's Vice-President asked whether a bank statement from the Contractor would be a sufficient verification of assets. The Chief said the Contractor's bank statement would be a sufficient verification of assets. However, the Chief assumed that the underwriter was only referring to the $5,000 the Contractor was contributing to the partnership. The Chief reasonably assumed that Borrower C's funds ($10,000) were being verified independently of the Contractor's funds. The Chief had no way of knowing that the partnership was fictitious. To satisfy prudent lending practices, both sources of funds should have been independently verified.

If a verification of Borrower C's funds had been made, Legend's President would have discovered that the borrower did not contribute any funds to the partnership and did not have the funds necessary to close the transaction. A loan correspondent's basic duty, on behalf of HUD, is to verify the validity of information received. If Legend's President had followed prudent lending practices, he would have verified the underlying assets of the partnership.

A 401(k) account was used to document the majority of the funds Borrower D needed to qualify for a 203(k) loan. There was no evidence that Borrower D's 401(k) account was redeemed. HUD Handbook 4155.1 REV-4 CHG 1 states that evidence of redemption is required. Even assuming redemption occurred, Borrower D would not have qualified. The current value on the account was $23,132. HUD Handbook 4155.1 REV-4 CHG 1 states that only the net amount after subtracting federal income tax and withdrawal penalties may be considered as assets to close. Based on the monthly income shown on The Uniform Loan Application for Borrower D, Borrower D would be at a 28 percent tax bracket. After taxes and early withdrawal penalties of ten percent, a $9,000 reduction would be incurred. Additionally, a $10,315 loan had been taken out against its current value leaving an asset of less than $4,000 when $17,832 was needed to close on the property. Thus, Borrower D lacked the necessary funds to close.

Partnership agreements were improperly used

Fictitious partnership agreements were used as evidence that Borrowers A, B, and C had the necessary funds to close and thus qualified for 203(k) mortgages. All three partnership agreements stated that the borrower contributed $10,000 and the Contractor invested $5,000 to the partnership, respectively. The partnership agreements were placed in all three loan files by someone at Legend Mortgage. This occurred even though the borrowers: (1) were never in a partnership with the Contractor; (2) did not tell Legend's President they were in a partnership with the Contractor; (3) did not give Legend's President a copy of the partnership agreements or direct Legend's President to contact the Contractor for a copy; (4) never saw the partnership agreements; and (5) told us that the signatures on the partnership agreements were not their signatures.

Information related to the partnership agreement was placed into an initial loan application after Borrower A signed the application. The following words were placed on her loan application in the liquid assets section by Legend's President without her knowledge or permission: "Gift From Partnership - $15,000." There was no mention made of a partnership agreement in the borrower's final application. Thus, Borrower A never had the opportunity to find out that Legend's President placed information into her loan file without her knowledge.

Borrower A's initial application was signed by her and Legend's President on April 14, 1995. The Partnership Agreement itself was not dated until April 15, 1995. More importantly, the Partnership Agreement was not faxed to Legend's President until May 5, 1995. Legend's President said he had no knowledge of the Partnership Agreement's existence until it was faxed to him by the Contractor on May 5, 1995. Thus, Legend's President placed the information into Borrower A's initial application after she signed it.

Borrower A signed a second and final application on June 26, 1995. Our review of the second signed application in Borrower A’s loan file disclosed that the application did not include information regarding the partnership agreement even though Legend's President received the partnership agreement from the Contractor on May 5, 1995. If this information had been included in the second application, Borrower A would have had the opportunity to inform Legend's President that she was not in a partnership with the Contractor.

Borrower B's initial application was signed by him and Legend's President on March 30, 1995. The Partnership Agreement was dated April 15, 1995. The Partnership Agreement was not faxed to Legend's President until May 5, 1995. Borrower B signed a second and final application on June 2, 1995. Our review of the second signed application in Borrower B's loan file revealed that it did not include information regarding the partnership agreement even though Legend's President received the partnership agreement from the Contractor on May 5, 1995. If this information would have been included in the second application, Borrower B would have had the opportunity to inform Legend's President that he was not in a partnership with the Contractor.

Both Borrower A and Borrower B's partnership agreements were faxed to Legend Mortgage at the same time. The facsimile was sent by the Contractor on May 5, 1995 between approximately 1:25 and 1:34 PM. Individual front and signature pages were faxed for Borrower A and Borrower B. One set of pages two through ten of the partnership agreement were also faxed to Legend Mortgage.

Legend Mortgage photocopied all of the faxed pages of the partnership agreement for Borrowers A and B in order to create two separate documents. The second through tenth pages are completely illegible in various places for both partnership agreements. The agreements appear to have been photocopied many times. We believe Legend Mortgage should have investigated these documents with some suspicion especially when the signatures on the partnership agreements did not resemble the actual signatures of the borrowers on the loan applications. Given the above, known signatures should have been compared with those placed on the partnership agreements.

Borrower C said that information related to the partnership agreement was placed into his application after he signed it. The following words were placed into his loan application in the liquid assets section by someone at Legend Mortgage without Borrower C's knowledge or permission: "Partnership Agreement - $15,000." Thus, Borrower C did not have an opportunity to discover that the partnership agreement was placed in his file and application.

When interviewed, all three borrowers said they never contributed $10,000 to a partnership. One borrower remarked that, in fact, he "never had $10,000 in [his] life!" All three borrowers said their signatures were forged to the agreements.

Legend's President said he told Borrowers A, B, and C that they were short of the funds needed for closing. Legend's President could not produce documentation, such as a letter or memorandum, evidencing his alleged notice to the borrowers. Legend's President said he advised the three borrowers that the HUD acceptable sources of funds were either: (1) a gift from a blood relative; (2) borrowed funds from a collateralized asset; or (3) a partnership agreement. Legend's President said some time after his notice to the borrowers, he received faxed copies of the partnership agreements from the Contractor. Legend's President could not identify who, at the Contractor's office, faxed the agreements to him. Legend's President believed his receipt of the partnership agreements from the Contractor was in response to his alleged notice to the borrowers. He also believed that his actions were performed in accordance with prudent lending practices.

Legend's President's explanations do not agree with the actions he took regarding the partnership agreements. Legend's President accepted the partnership agreements from the Contractor without the borrowers' knowledge or permission. Placing key information into loan applications and files without the knowledge or consent of borrowers is not a prudent lending practice.

Residence lease was used improperly

Legend used a fictitious residence lease to inflate Borrower D's income. The residence lease for a property at 227 West 108th Place stated that Borrower D had a tenant that was paying $1,050 per month in rent. The residence lease was placed in Borrower D's loan file. This occurred even though Borrower D: (1) never had a tenant at 227 W. 108th Place; (2) did not tell Legend's President he had a tenant; (3) did not give Legend's President a copy of the residence lease or direct Legend's President to contact the Contractor for a copy; (4) never saw the residence lease; and (5) told us that the signature on the partnership agreement was not his signature.

We gave Borrower D the opportunity to review his loan application. Borrower D said that when he signed the application on May 5, 1995 there was no information related to the residence lease in it. This information was placed in the loan application without his knowledge or approval. Borrower

D said his signature was forged to the residence lease.

The residence lease itself supports Borrower D's version of events. Borrower D's application was signed by him and Legend's President on May 5, 1995. The residence lease was not faxed to Legend's President until July 7, 1995. Thus, Legend's President placed the information into Borrower D's initial application after Borrower D signed it. Borrower D did not have an opportunity to discover that the residence lease was put into his file and application.

The borrowers described the loan application and approval methods of Legend Mortgage as a rubber-stamp process. Borrower C said he only met with Legend's President on one occasion. This meeting took place at 10:00 on a Friday night in the living room of Legend's President's home. Borrower C said he "signed where [Legend's President] told me to." All four borrowers described similar experiences.

Prior ownership was not confirmed

A chain of title for the previous year was not requested by Legend Mortgage Company for Borrower C. HUD Mortgagee Letter 95-40, page 6, mandated that the "[Direct Endorsement] Lender must obtain evidence of prior ownership when a property was sold in the last year" and "[t]he 203(k) mortgage must be based on the lowest sales price in the last year." Mortgagee Letter 95-40 went into effect on September 13, 1995. The closing did not occur until November 2, 1995. Legend had an adequate amount of time to obtain a chain of title report from a title company. On May 25, 1995, the property sold for $23,000. Borrower C paid $55,000 on November 2, 1995. The maximum mortgage amount was $86,150. It was computed by the underwriter based upon information received from Legend Mortgage Company. The mortgage amount was based on the sum of the $55,000 purchase price, estimated rehabilitation costs, and estimated closing costs. If a chain of title had been performed by Legend Mortgage Company, the maximum mortgage amount would have been computed based upon the $23,000 price instead of the $55,000 price. The maximum mortgage amount would have been $49,380, thus reducing HUD's exposure by $36,770.

Legend Mortgage received fees

Legend Mortgage earned fees totaling $26,944 at the loan closings as follows:

Borrower	Fees Received

A	$ 6,502
B	8,508
C	6,318
D	5,616
Total	$26,944

If Legend Mortgage had submitted accurate information to HUD, the borrowers would not have qualified for the 203(k) loans. Therefore, Legend Mortgage would not have received the loan fees.

Auditee Comments

Excerpts from Legend's President's comments on our draft finding follow. Appendix C contains the complete text of his comments.

Legend Mortgage Company, and all of its employees, in no way, nor at any time originated any loans without complete compliance with HUD requirements. Prudent lending practices were always exercised.

With all due respect to the auditors, who obviously did a fine and thorough job with respect to what they saw and understood, I feel that their findings and conclusions are more a focus on the results of the Contractor's loan fraud scheme then they are an accurate and realistic measurement of the responsibilities, actions, and efforts of myself or Legend Mortgage Company. Specific areas of the audit, represent findings relating to the Contractor's involvement which was unknown to me and my company during the entire period of dealings with the 203(k) loan referrals.

Inclusion of these findings leads to the implication that my company and I had knowledge of, or participated in, his practices. That is ever so far from fact and truth. It is inappropriate for findings that relate to the Contractor's involvement to be formally included in the scope of an audit that are intended to evaluate my company and me, because it is not fair to be judged for another persons actions. The overall constancy of the audit findings have been corrupted by a failure to properly segregate the Contractor's actions, Carl I. Brown and Company's actions, and my company's and my actions.

I did, in fact, rely on what I was being told by the underwriters at Carl I. Brown and Company. The situation had been fully and completely discussed with HUD. All issues had been approved.

OIG Evaluation of Auditee Comments

The audit finding discusses facts relating to the Contractor's overall loan fraud scheme, including improper or unexplained payments to the Contractor. Although Legend Mortgage Company may have had no way of knowing of these payments, Legend's failure to follow prudent lending practices allowed the Contractor to perpetuate the strawbuyer loan arrangement.

We do not believe that Legend's alleged reliance on direction from Carl I. Brown absolves it from responsibility in these matters. We have never been presented with any evidence that HUD communicated, either orally or in writing, with Carl I. Brown about partnership asset verification.

Auditee Comments

The Contractor suggested that the appropriate procedure would include the Contractor or his staff filling out the loan applications with the Borrowers. The Contractor suggested that this was an appropriate format for business dealings because the Borrowers had an established relationship with the Contractor in the area of property rehabilitation that predated the use of FHA 203(k) financing. The Borrowers had already worked in conjunction with the Contractor, and there was a well-established relationship and track record of successful rehab projects. The Borrowers had also provided all types of credit documents to the Contractor so as to enable the Contractor to provide them to the preferred or selected lender. He explained that this was how business was conducted with other lenders, and wanted me to get with the program.

There was no reason at the time for me to suspect that there was fraudulent intention in the heart of the Contractor. I was aware of multiple previous transactions between the Contractor and Carl I. Brown and Company. The general perception was that the Contractor's goal had been to effectively centralize the point of contact and documentation with the Contractor for the benefit of the

Borrower, Contractor, and lender. Indeed, it appeared that the Contractor's system of business was sensible and ethical, especially since so many 203(k) transactions had already been closed with Carl I. Brown and Company. I had always thought that for development to occur efficiently and on a large-impact scale, control was a central component. So some of the Contractor's thinking made a lot of sense to me.

Notwithstanding, I took the position that a face-to-face interview and application would have to occur with each of the Borrowers, because such was a fundamental HUD requirement. I took this position with the full knowledge that the Contractor could easily have elected to simply not do business with Legend, because this type of direct involvement with the Borrower seemed to be at odds with the Contractor's perspective on organization, communication, and control. Clearly, the Borrowers had given the Contractor the complete authority to select lenders on their behalf. The Contractor made this decision, not the Borrower.

To me, face-to-face applications represented not only a compliance issue, but also a control issue to insure success as a businessperson. It was also critical from a disclosure standpoint in terms of payments, cash requirements, feasibility, etc. From the outset, I would not relinquish this HUD requirement. The Contractor threatened to pull this new business and send it to Carl I. Brown and Company, or one of the other lenders that were strongly courting his favor. I basically told him to go ahead and pull it. I was firm and would not move.

OIG Evaluation of Auditee Comments

Only a HUD approved lender can take and sign loan applications. A loan correspondent should not allow others to fill out loan applications and then say that the practice was okay because they participated in a face-to-face interview with the applicant.

The Contractor’s demand that he or his staff fill out the loan applications with the borrowers should have been taken as serious “red flags” to Legend Mortgage. Legend’s President accepted what we now know to be apparently false documents from the very same Contractor that asked him to violate HUD’s requirements. Legend Mortgage then placed the inaccurate information into the borrowers loan applications and credit packages without their knowledge.

Auditee Comments

The Contractor acquiesced to my position on this matter, and proceeded on the basis that the Contractor would provide credit documents to Legend that had been provided to the Contractor by the Borrower. In this manner, the Borrower would not be asked to reproduce documents they had already given. This procedure made sense to me because there did not appear to be any fraudulent intent. Also, the mere fact that the Contractor was in possession of all of these personal, private documents obtained directly from the Borrower seemed to assume permission for the second party to provide them to me, something I could easily confirm with the Borrower directly.

It would not be difficult for me to review these documents and assess their validity. When I visited with the Borrower directly, I could confirm that these documents were valid, which is what I did. There was no reason to suspect fraud, but I was generally aware that these documents were coming from the Contractor. I would have to balance the Contractor's (and Borrower's) desire for central control and communication with the Contractor, with HUD's guidelines and prudent lending practices. I did this even though I was told by the Contractor this was not happening elsewhere.

OIG Evaluation of Auditee Comments

Legend Mortgage did not confirm the validity of documents received from the Contractor with the borrowers. The most important documents in the borrowers’ loan packages, namely three partnership agreements and one residence lease, were not confirmed with the borrower. The borrowers had no knowledge of the existence of the documents.

Auditee Comments

I pointed out to the Contractor that, most likely, additional documents were going to be needed beyond the scope of what was provided initially. The Contractor informed me that he had informed the Borrower that he wanted additional requests of the Borrower to be made through the Contractor, since the Borrower would not like to be assailed with requests. Matters like this would be better handled through the Contractor, whom we had come to believe the Borrower relied on as a central point of contact.

Most likely, I was told, the Borrower had already provided to the Contractor most items I would eventually request.

I felt that additional or further documents should be requested directly from the Borrower, and took the position that I would be able to make such requests with an attitude and style that did not cause unnecessary hardship for the Borrower. Again, I did not believe the Contractor to be ill-intended; rather, I believed that the Contractor was operating from a frame of reference that was ultimately addressing a level of efficiency and control that described a successful developer/rehabber. And thus, there appeared to be a reasonable line of logic to it. On most occasions, the requested documents would ultimately come from the Contractor's office, because it had become obvious that the Borrowers preferred to deal with the Contractor's office. Many Borrowers simply resisted or refused giving me documents directly. They always routed then through the Contractor.

The Contractor also had a habit of contacting me when I had just begun to work on a loan. Frequently, when I was pressed for answers, I might thumb through my file and offer opinions to the Contractor on lacking documentation. Before I was able to generate a request letter to the Borrower, the documents would appear on our fax.

There were requests for documents that were sent off to the Borrowers, documents that subsequently showed up on our fax machine from the Contractor's office. The Borrowers would later confirm in discussions that they had gotten our request and delivered the documents to the Contractor. Evidently, the Contractor was also advising the Borrowers to do the same. In this manner, I heard, the Contractor would be able to keep files updated so that future projects could be pursued without repetitive and unnecessary requests of the Borrower by the (various) lender(s).

I observed that this circumstance was occurring not because of fraudulent intent; rather, it appeared that the Borrower and Contractor did in fact enjoy a solid, trusting relationship. It seemed especially important that I not become duplicative with requests, since it generally produced a negative reaction from the Borrower, who preferred their relationship with the Contractor. Duplicate requests also produced a negative reaction from the

Contractor, who would readily point out that my insistence on direct (lender) involvement was bothersome and unnecessary (both of which I heard on several occasions).

All of the Borrowers involved with the Contractor reflected an attitude towards me that spoke to: "Why are you bothering me with this when I already gave it to the Contractor?" "Can we just get this over with because I already understand what is happening here?" and "I have already discussed all of this with the Contractor, why are you going over this again?"

My intention here is not to blame the Borrower. But I will point out that the audit findings avoid completely the simplest and most fundamental observation. The Borrower and the Contractor had engaged in a relationship with each other that entailed an agreement that resulted in deception to the lender. Both Borrower and Contractor discouraged lender involvement. I had to push to have a measure of involvement as lender, and push carefully because both Borrower and Contractor were discouraging it.

OIG Evaluation of Auditee Comments

Legend's President accepted documents from the Contractor without the borrowers' knowledge. The borrowers never confirmed the partnership agreements or residence lease. In fact, the borrowers' said that they had no knowledge of the existence of the documents and the signatures on the documents were not theirs. These documents were used to qualify the borrowers for the 203(k) loans.

Auditee Comments

203(k) loans were, and are, a very different animal as far as cash requirements are concerned. The loans themselves, and therefore the applications, were moving constantly as they unfolded. During this time, as we first began performing 203(k)'s, we simply recognized that the cash requirements would change, and approached the loan as a changing entity.

The auditors seemed to have difficulty understanding this phenomenon, since they have never originated 203(k) loans themselves. I could tell they felt there was something wrong with things being added to a loan application. They reflected an air of suspicion when items were added to a credit package when those same items were not reflected on the initial application.

In this area, the audit findings cast a menacing shadow over differences between the initial applications and the credit packages. The suggestion, both directly and indirectly, is that Legend purposely and deceitfully added things to the Borrower's applications without their knowledge, and inserted manufactured and forged documents into their credit files.

Simply put, those allegations and suggestions are false. I did not, nor did anyone else at Legend Mortgage Company, ever, at any time, intentionally add information to loan applications without fully believing that the information was true, and without receiving either direct, or what we perceived was indirect, confirmation from the Borrower.

OIG Evaluation of Auditee Comments

We understand that it is appropriate, under many circumstances, to add certain items to credit packages. However, for the four loans in question, the borrowers had no knowledge of key documents that were added to their credit packages, namely, the partnership agreements. In fact, the borrowers had no knowledge of the documents that purported to represent the vast majority of the assets that were needed to close the deals.

Auditee Comments

With all of my years of experience in FHA lending, with all of my knowledge and exposure brought about by overseeing the production of hundreds of millions of dollars of FHA loans on a monthly basis throughout the United States when I operated in the capacity as Senior Vice President of Carl I. Brown and Company, with all of my voracious reading of HUD guidelines, I had never been involved with a loan where a partnership agreement existed.

From the start, I was unfamiliar with the nature and purpose of the agreement. In many ways, I was unclear about exactly what it was, why it was being used, what purpose it was to serve, how it came about, how it should be documented, and what HUD thought of all of it. There was absolutely no mention of it in any of the HUD regulations. There were no clear definitions in any of HUD's literature, mortgagee letters, or any other known HUD source.

No one I knew of in the entire mortgage industry had any background or experience in this area. No associate of mine had ever used one or seen one used. I talked to and telephoned numerous people to determine if any had experience with partnership agreements and came up with nothing.

Like other new animals the 203(k) theater seemed to be populated with, I concluded that the partnership agreement was just another new animal. I was simply unaware of it previously and I, along with others in my business, had not before witnessed this animal. Well, there were a lot of new things with 203(k). Since I couldn't get my arms around the idea, and had no historical guidance from others in the mortgage business, I had to rely on specific guidance from underwriters and HUD.

It is difficult for me to both listen to and digest current opinions about what documentation should have accompanied the agreements in the past as far as bank statements, initial investment verification, etc. There is no written guidance anywhere to support any particular view. It is obvious these opinions are both made with the benefit of hindsight and are easily argued from one particular point of view. Documentation requirements, in hindsight, could be argued from a large range of perspectives, because the partnership agreement exhibits characteristics of so many different loan elements simultaneously.

In hindsight, one could just as easily now take the position that a partnership tax return, an audited financial statement, or bank account statements solely in the name of the specific partnership were required. Conversely, one could argue that if an FHA borrower has ownership in an S-corporation or a partnership, then the lender is not required to reach back in time and verify that the borrower had the funds to initially capitalize the venture. One could point out that if a borrower owns stock, then there is no HUD requirement that the lender reach back in time to verify the source of funds used to purchase the stock. None of these recent approaches are ultimately valid because the partnership agreements fit into no known category comfortably.

No clear written HUD guidelines or HUD standards did exist in terms of spelling out what was needed to document a partnership agreement. Because of this circumstance, and because the partnership agreement has no clear parallel category, the possibilities are endless, and could be argued and debated a whole variety of ways.

OIG Evaluation of Auditee Comments

Legend's President believes no clear written HUD guidelines or standards existed to guide him relating to partnership agreement verification. We disagree because HUD Handbooks state that "all funds needed for the borrower's investment in the property must be verified."

Legend Mortgage should not have accepted the partnership agreements from the Contractor without the borrowers' knowledge or approval. Further, Legend Mortgage accepted the partnership agreements as evidence of borrowers' liquid assets. We believe Legend should have verified the liquidity in the same manner as for any other assets necessary to close the transaction.

Auditee Comments

I made every effort to confirm the acceptability of the partnership agreement itself, as well as the attendant required documentation, from HUD's perspective. Every effort, both verbally and in writing, was made on my part to proceed in accordance with what would be considered normal HUD requirements with regard to partnership agreements. I initially made those efforts through the underwriters, both national and local, at Carl I. Brown and Company. I confirmed with them many times what had been discussed and verified with HUD, and was repeatedly told these topics had been very specifically and carefully examined and explored.

Partnership agreements were included in the Borrower B and Borrower A files submitted to the underwriters at Carl I. Brown and Company. I followed the procedural and documentation requirements exactly as they defined them for me. There were no underwriting conditions made as to verification of initial investment. There were no underwriting conditions made as to any other required documentation like bank statements, partnership tax returns, or partnership financial statements, or any other attendant or supporting records.

It is no coincidence that the initial Borrower A loan application reflects the idea of a gift from a partnership. I used the term gift from partnership on Borrower A's loan because it was a remembrance of the earlier Borrower B loan. I believe the Borrower B loan was the first loan where a partnership agreement was used. Based on specific underwriting requirements that were communicated to me by Carl I. Brown and Company's underwriters, the only documentation required by FHA, I was told at the time, for the partnership agreement to work was the agreement itself. There were absolutely no other documentation requirements, not even bank statements from the Contractor's account. I remember thinking to myself that it reminded me of the old HUD requirements pertaining to gifts. In earlier years, before HUD changed their guidelines, gift letters themselves were the only documentation required in connection with a gift. No source of funds as far as the donor's account was concerned. No documentation of receipt of funds to the recipient. Because the documentation requirements of the partnership agreement reminded me of the old gift rules, I remember that this is the reason I called it a gift from partnership. Again, no other documents were needed. The partnership agreement was self-defining, self-documenting, and self-verifying.

The whole partnership agreement issue was a new and untested area for me. I left it totally to the underwriter to determine what was needed. Underwriters establish guidelines. I responded to the definitions and parameters I was given to the letter. I did exactly what I as told to do. This was, and is, normal and prudent lending practice.

I believe that these circumstances help to clarify another area where the audit fails to segregate findings properly. Findings that should properly relate to Carl I. Brown and Company are being portrayed as findings relating to Legend Mortgage. Instructions, guidance, and input came from Carl I. Brown and Company to its correspondent lender, Legend Mortgage, and should be attributable to Carl I. Brown and Company, not Legend Mortgage.

OIG Evaluation of Auditee Comments

Legend's President states that Carl I. Brown told him that he need not verify any partnership assets. We have not seen any written documentation from Carl I. Brown instructing Legend as to what documentation was required to verify partnership assets. We have not seen any written requests from Legend to either Carl I. Brown or HUD asking for guidance.

Auditee Comments

[A] letter describes that a detailed description of the investment strategy had been provided to HUD by Dollars Express, and that essentially, HUD was clearly defining what would be required on applications taken after September 1, 1995. I was relieved when I read it. HUD had, in writing, reviewed and responded to the entire issue. HUD had looked into everything. HUD would have had the opportunity to question anything that was unclear or suspect. There was no greater evidence I could ever ask for to confirm that all that had been done in the past as far as partnership agreements were concerned had been acceptable. Unambiguous, written definitions were provided for the future.

OIG Evaluation of Auditee Comments

This letter was addressed to the Contractor. HUD did not give any guidance related to partnership asset verification for loan correspondents or mortgagees in this letter. HUD was unaware that Legend Mortgage was accepting partnership agreements from the Contractor and placing them in borrowers' loan applications and credit packages without their knowledge.

Auditee Comments

The Borrower C loan was sent to Malone Mortgage Company. I had a good working relationship with the senior FHA underwriter. The senior FHA underwriter was already well aware of the volume of 203(k) loans at Carl I. Brown and Company with Dollars Express, an awareness that most of the 203(k) lending community in the area had. She was very interested in looking into the loan and the issue. I spoke to senior FHA underwriter about our mutual desire for her to contact the local HUD office, explain the matter thoroughly, and describe exactly what documentation was present so that compliance could be absolutely insured.

The senior FHA underwriter was, as I was, extremely focused on being as precise, as detailed, and as thorough as possible with her discussions with HUD. We both were well aware of the idea that since the partnership was an unusual matter, it was absolutely imperative to approach this issue with 100% certainty. Neither one of us wanted to be dealing with an insuring issue down the road (which is precisely what I am doing now). Accordingly, we discussed several times prior to the senior FHA underwriter making contact with HUD, the absolute importance of being thorough and accurate. We also discussed the absolute need of documenting the discussion, whatever the results were. She reviewed the recent letter from HUD regarding partnership agreements and made the call.

I am absolutely certain that every issue regarding the partnership agreement and required documentation was discussed. The senior FHA underwriter and I discussed in advance the vital importance of going over each and every documentation issue related to partnership agreements. She maintains that to this day that this is what she did. I am confident there was no requirement made by HUD to verify the initial investment made into the partnership by the Borrower. The credit file exhibits, as well as the senior FHA underwriter's later written confirmation, clearly speak to the idea that the down payment was coming from the Contractor's account. Other than what was in the credit package, no other documents were needed. I am confident I did everything within my abilities, and more than most would have done or would have thought to do, to act prudently in insisting on and directing clear communication with HUD on these matters, and responding accordingly.

Like the partnership and lease agreements we received, I along with everyone else, had no reason to suspect they had been forged. You do not throw red flags up when there is no reason to suspect anything is wrong, when there is no inkling or likelihood that a document is not real. In the course of processing any loan, it is common for a Realtor or a builder to fax through documents requested from the borrower. Real estate contracts, letters of explanation, lease agreements, pay stubs, bank statements, and sometimes credit reports, all would be typical examples. Just as we would not be inclined to pick up the phone and ask the borrower, in a situation like this, whether they actually signed the contract, a lease, or a letter, we were not inclined to do so on these loans. There was no reason to even suspect the signatures were forged.

OIG Evaluation of Auditee Comments

We interviewed the senior FHA underwriter from Malone Mortgage. She said that she did know: (1) the borrower was not in a partnership with the contractor; (2) the borrowers signature on the partnership agreement was not his; (3) the borrower did not tell Legend Mortgage he was in a partnership; (4) Legend Mortgage received the partnership agreement from the contractor and not the borrower; and (5) the partnership agreement information was placed in the asset section of the loan application after the borrower signed it. In fact, she said that if she knew the above, her firm would not have underwritten the loan and would have disclosed the situation to the authorities. We asked the senior FHA underwriter if she could think of any situation where information about a borrowers assets did not initially come from the borrower. She stated she could not. We asked her if it was a prudent lending practice to add information to a borrower's loan without their knowledge. She said it was not.

Recommendations

We recommend that: (1) the Mortgagee Review Board take appropriate action based on the information contained in the Finding; and (2) the Assistant Secretary for Housing consider imposing administrative sanctions on Legend's President for all four improperly originated loans.

Management Controls

In planning and performing our audit, we considered the management controls relating to Legend Mortgage Company's HUD/FHA loan origination process in order to determine our auditing procedures and not to provide assurance on management controls. Management controls consist of the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance adopted by management.

Relevant Management Controls

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

- Program Operations - The policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.

- Validity and Reliability of Data - The policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

- Compliance with Laws and Regulations - The policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

- Safeguarding Resources - The policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed all relevant controls identified above.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organizations objectives.

Significant Weaknesses

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

Program Operations - Legend Mortgage did not originate four HUD/FHA loans in accordance with HUD's requirements or prudent lending practices. Consequently, HUD relied on Legend's origination process and assumed abnormally high risks when it insured four loans valued at $310,220 (see Finding).

Follow Up On Prior Audits

This is the first OIG audit of Legend Mortgage Corporation.

Summary of Deficiencies

FHA Case Number	Loan Amount	Strawbuyer	Mishandled Mortgage Documents	Cash/Liquid Assets Overstated	Overstated Income	Narrative Case Presentation Appendix No.
131-7937533	$78,200	X	X	X		B-1
131-7928583	$78,200	X	X	X		B-2
131-7983941	$86,150	X	X	X		B-3
131-7950870	$67,650	X	X	X	X	B-4
Total	$310,200					

Introduction to Narrative Case Presentations

Appendices B-1 through B-4 represent four case-by-case narrative discussions summarizing and detailing the deficiencies in Finding 1.

Appendix B-1

Street Address: 10545 South State Street

FHA Case #: 131:7937533

Insured Amount: $78,200

Underwriting Company & Underwriter Number: Carl I. Brown, N745

Summary: Legend Mortgage Company improperly originated Borrower A's HUD/FHA insured loan. The loan was originated by Legend's President. Legend Mortgage added a fictitious partnership agreement to Borrower A's loan application and file without her knowledge or approval, and collected fictitious information from a Contractor without Borrower A's knowledge or approval. Also, Legend Mortgage failed to verify all of the funds necessary to close the loan. Legend Mortgage failed to verify Borrower A's contribution to the partnership, and failed to verify the receipt of Borrower A's funds by the partnership.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, said HUD would have rejected the loan had Legend submitted accurate information.

Pertinent Details:

Borrower A Acted As A Strawbuyer

Borrower A was recruited by the Contractor to be a strawbuyer. The Contractor promised Borrower A that it would find a property to rehabilitate, rehabilitate the property, and sell the property to a third party after the rehabilitation was completed. Borrower A was told by the Contractor that she would not have to contribute any money to purchase the property.

Borrower A told us that she did not invest any money toward the purchase of 10545 South State Street. Borrower A was paid $1,500 to participate as a strawbuyer.

Assets Necessary To Close Were Not Verified

Legend Mortgage did not verify all of the funds Borrower A was required to invest in the property. HUD Handbook 4155.1 REV-4 CHG 1 states that "[a]ll funds for the borrower's investment in the property must be verified." The actual assets necessary to close that were verified by Legend Mortgage totaled $3,466. Borrower A needed to invest $12,313 in order to close on the loan. As a result, Borrower A did not qualify for the HUD/FHA insured loan.

There was no information in Borrower A's file, other than a partnership agreement, to provide any verification that partnership funds needed to close were available. HUD Handbook 4000.2 REV-2, paragraph 3-6 mandates that mortgagees obtain and verify information with great care. Legend's President said he believed that the HUD rules and guidelines for partnership agreements were made regionally. These rules were communicated to him by the underwriter.

Legend's President said the underwriter told him that only a partnership agreement was necessary to verify the existence of the entire amount of partnership liquid assets. The underwriter was recently sanctioned by the Mortgagee Review Board in this matter. Consequently, the underwriter's parent company agreed to indemnify HUD for any loss on this loan.

Legend's President's was mistaken in his belief that he did not have to verify actual assets of the partnership to satisfy prudent lending practices. A loan correspondent's basic duty, on HUD's behalf, is to verify the validity of information that is received. Indeed, as HUD's agent, Legend had a duty to verify the assets of the partnership before placing HUD at risk.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, said HUD accepted loan packages with partnership agreements. However, HUD did not approve the loan packages on an as-is basis. Prudent lending practices require that the loan correspondent verify the assets of the partnership.

There was no verification that Borrower A had the $10,000 required by the partnership agreement. If a verification of Borrower A's funds had been made, Legend's President would have discovered that the partnership was fictitious. Borrower A said that she did not belong to a partnership and that the signature on the partnership agreement was not her signature. Borrower A also did not have the funds necessary to close the transaction.

<u>Partnership Agreements Were Used Improperly</u>

A fictitious partnership agreement was used as evidence that Borrower A had the necessary funds to close. The partnership agreement stated that Borrower A invested $10,000 and the Contractor invested $5,000 to the partnership, respectively. The partnership agreement was placed in Borrower A's loan file by someone at Legend Mortgage. This occurred even though Borrower A: (1) was never in a partnership with the Contractor; (2) did not tell Legend's President she was in a partnership with the Contractor; (3) did not give Legend's President a copy of the partnership agreement or direct Legend's President to contact the Contractor for a copy; (4) never saw the partnership agreement; and (5) said the signature on the partnership agreement was not her signature.

Information related to the partnership agreement was placed into Borrower A's initial application after she signed the application. The following words were placed into her loan application in the liquid assets section by Legend's President: "Gift From Partnership - $15,000." There was no mention made of a partnership agreement in Borrower A's final typewritten application. Thus, Legend's President did not give Borrower A an opportunity to discover that the partnership agreement was placed into her file and application.

Borrower A's initial application was signed by her and Legend's President on April 14, 1995. The Partnership Agreement itself was not dated until April 15, 1995. More importantly, the Partnership Agreement was not faxed to Legend's President until May 5, 1995. Legend's President said he had no knowledge of the partnership agreement's existence until it was faxed to him by the Contractor on May 5, 1995.

Borrower A signed a second and final application on June 26, 1995. Our review of the second signed application in Borrower A's loan file disclosed that the application did not include information regarding the partnership agreement even though Legend's President received the partnership agreement from the Contractor on May 5, 1995. If this information had been included in the second application, Borrower A would have had the opportunity to inform Legend's President that she was not in a partnership with the Contractor.

Both Borrower A and Borrower B's partnership agreements were faxed to Legend Mortgage at the same time. The facsimile was sent by the Contractor on May 5, 1995 between approximately 1:25 and 1:34 PM. Individual front and signature pages were faxed for Borrower A and Borrower B. One set of pages two through ten of the partnership agreement were also faxed to Legend Mortgage.

Legend Mortgage photocopied all of the faxed pages of the partnership agreement for Borrowers A and B in order to create two separate documents. Also, the second through tenth pages are completely illegible in various places. The agreements appear to have been photocopied many times. We believe Legend Mortgage should have investigated these documents with some suspicion. Finally, none of the signatures on the partnership agreements resemble the actual signatures of the borrowers on the loan applications. Given the above, known signatures should have been compared with those placed on the partnership agreements.

When interviewed, Borrower A said she never contributed $10,000 to a partnership. Borrower A also said her signature was forged to the agreement.

Legend's President said he told Borrower A that she was short the funds needed for closing. Legend's President could not produce documentation, such as a letter or memorandum, evidencing his alleged notice to Borrower A. Legend's President said he advised Borrower A that the HUD acceptable sources of funds were either: (1) a gift from a blood relative; (2) borrowed funds from a collateralized asset; or (3) a partnership agreement.

Legend's President said some time after his notice to Borrower A, he received a faxed copy of the partnership agreement from the Contractor. Legend's President could not identify who at the Contractor's office faxed the agreement to him. Legend's President believed that his receipt of the partnership agreement was in response to his alleged notice to Borrower A. He also believed that his actions were performed in accordance with prudent lending practices.

Legend's President's explanations do not agree with the actions he took regarding the partnership agreements. Legend's President accepted the partnership agreement from the Contractor, without Borrower A's knowledge or permission. We believe that placing key information into a loan application and file without the knowledge or consent of the borrower is not considered to be a prudent lending practice. Borrower A described her dealings with Legend's President as a "rubber-stamp" process rather than a meaningful, substantive exchange of information.

Legend Mortgage was paid $6,502 in loan fees at closing.

Appendix B-2

Street Address: 118 West 113th Place

FHA Case #: 131:7928583

Insured Amount: $78,200

Underwriting Company & Underwriter Number: Carl I. Brown, N745

Summary: Legend Mortgage Company improperly originated Borrower B's HUD/FHA insured loan. The loan was originated by Legend's President. Legend Mortgage added a fictitious partnership agreement into Borrower B's loan application and file without his knowledge or approval, and collected the fictitious information from a Contractor without Borrower B's knowledge or approval. Also, Legend Mortgage failed to verify all of the funds necessary to close the loan. Legend Mortgage failed to verify Borrower B's contribution to the partnership, failed to verify the receipt of Borrower B's funds by the partnership, and failed to properly value or determine if a 401(K) account was redeemed.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, said HUD would have rejected the loan had Legend submitted accurate information.

Pertinent Details:

Borrower B Acted As A Strawbuyer

Borrower B was recruited by the Contractor to be a strawbuyer. The Contractor promised Borrower B that it would find a property to rehabilitate, rehabilitate the property, and sell the property to a third party after the rehabilitation was completed. Borrower B understood that he would not have to contribute any money to purchase the property.

Borrower B told us that he did not invest any money toward the purchase of 118 West 113th Place. Borrower B was paid $1,000 to participate as a strawbuyer.

Assets Necessary To Close Were Not Verified

Legend Mortgage did not verify all of the funds Borrower B was required to invest in the property. HUD Handbook 4155.1 REV-4 CHG 1 states that "[a]ll funds for the borrower's investment in the property must be verified." The actual assets necessary to close that were verified by Legend Mortgage totaled $7,999. Borrower B needed to invest $15,837 in order to close on the loan. As a result, Borrower B did not qualify for the HUD/FHA insured loan.

There was no information in Borrower B's file, other than a partnership agreement, to provide any verification that partnership funds needed to close were available. HUD Handbook 4000.2 REV-2, paragraph 3-6 mandates that mortgagees obtain and verify information with great care. Legend's President said he believed that the HUD rules and guidelines for partnership agreements were made regionally. These rules were communicated to him by the underwriter. Legend's President said the underwriter told him that only a partnership agreement was necessary to verify the existence of the entire amount of the partnerships liquid assets. The underwriter was recently sanctioned by the Mortgagee Review Board in this matter. Consequently, the Underwriter's parent company agreed to indemnify HUD for any loss on this loan.

Legend's President's was mistaken in his belief that he did not have to verify actual assets of the partnership to satisfy prudent lending practices. A loan correspondent's basic duty, on HUD's behalf, is to verify the validity of information that is received. Indeed, as HUD's agent, Legend had a duty to verify the assets of the partnership before placing HUD at risk.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State HUD Office, said HUD accepted loan packages with partnership agreements. However, HUD did not approve the loan packages on an as-is basis. Prudent lending practices would have required that the loan correspondent verify the assets of the partnership.

There was no verification that Borrower B had the $10,000 required by the partnership agreement. If a verification of Borrower B's funds had been made, Legend's President would have discovered that the partnership was fictitious. Borrower B said that he did not belong to a partnership and that someone else signed his signature to the partnership agreement. Borrower B also did not have the funds necessary to close the transaction.

Partnership Agreements Were Used Improperly

A fictitious partnership agreement was used as evidence that Borrower B had the necessary funds to close. The partnership agreement stated that Borrower B invested $10,000 and the Contractor invested $5,000 to the partnership, respectively. The partnership agreement was placed in Borrower B's loan file by someone at Legend Mortgage. This occurred even though Borrower B: (1) was never in a partnership with the Contractor; (2) did not tell Legend's President he was in a partnership with the Contractor; (3) did not give Legend's President a copy of the partnership agreement or direct Legend's President to contact the Contractor for a copy; (4) never saw the partnership agreement; and (5) said the signature on the partnership agreement was not his signature.

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There was no mention made of a partnership agreement in Borrower B's initial or final typewritten application. Thus, Legend's President did not give Borrower B an opportunity to discover that Legend's President placed the partnership agreement into his file without his knowledge.

Borrower B's initial application was signed by him and Legend's President on March 30, 1995. The partnership agreement itself was not dated until April 15, 1995. More importantly, the partnership agreement was not faxed to Legend's President until May 5, 1995. Legend's President said he had no knowledge of the partnership agreement's existence until it was faxed to him by the Contractor on May 5, 1995.

Borrower B signed a second and final application on June 2, 1995. Our review of the second signed application in Borrower B's loan file revealed that it did not include information regarding the partnership agreement even though Legend's President received the partnership agreement from the Contractor on May 5, 1995. If this information would have been included in the second application, Borrower B would have had the opportunity to inform Legend's President that he was not in a partnership with the Contractor.

Both Borrower A and Borrower B's partnership agreements were faxed to Legend Mortgage at the same time. The facsimile was sent by the Contractor on May 5, 1995 between approximately 1:25 and 1:34 PM. Individual front and signature pages were faxed for Borrower A and Borrower B. One set of pages two through ten of the partnership agreement were also faxed to Legend Mortgage.

Legend Mortgage photocopied all of the faxed pages of the partnership agreement for Borrowers A and B in order to create two separate documents. Also, the second through tenth pages are completely illegible in various places. The agreements appear to have been photocopied many times. We believe Legend Mortgage should have investigated these documents with some suspicion. Finally, none of the signatures on the partnership agreements resemble the actual signatures of the borrowers on the loan applications. Given the above, known signatures should have been compared with those placed on the partnership agreements.

When interviewed, Borrower B said he never contributed $10,000 to a partnership. Borrower B said his signature was forged to the agreement.

Legend's President said he told Borrower B that he was short the funds needed for closing. Legend's President could not produce documentation, such as a letter or memorandum, evidencing his alleged notice to Borrower B. Legend's President said he advised Borrower B that the HUD acceptable sources of funds were either: (1) a gift from a blood relative; (2) borrowed funds from a collateralized asset; or (3) a partnership agreement.

Legend's President said some time after his notice to Borrower B, he received a faxed copy of the partnership agreement from the Contractor. Legend's President could not identify who at the Contractor's office faxed the agreement to him. Legend's President believed that his receipt of the partnership agreement was in response to his alleged notice to Borrower B. He also believed that his actions were performed in accordance with prudent lending practices.

Legend's President's explanations do not agree to the actions he took regarding the partnership agreements. Legend's President accepted the partnership agreement from the Contractor, without Borrower B's knowledge or permission. We believe that placing key information into a loan application and file without the knowledge or consent of the borrower is not considered to be a prudent lending practice.

Borrower B described his dealings with Legend's President as a "rubber-stamp" process rather than a meaningful, substantive exchange of information.

Legend Mortgage was paid $8,508 in loan fees at closing.

Appendix B-3

Street Address: 11203 South Hermosa Avenue

FHA Case #: 131:7983941-702

Insured Amount: $86,150

Underwriting Company & Underwriter Number: Malone Mortgage, G701

Summary: Legend Mortgage Company improperly originated Borrower C's HUD/FHA insured loan. The loan was originated by Legend's President. Legend Mortgage added a fictitious partnership agreement into Borrower C's loan application and file without his knowledge or approval and collected the fictitious information from a Contractor without Borrower C's knowledge or approval. Also, Legend Mortgage failed to verify all of the funds necessary to close the loan. Legend Mortgage failed to verify Borrower C's contribution to the partnership, and failed to verify the receipt of Borrower C's funds by the partnership.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, said HUD would have rejected the loan had Legend submitted accurate information.

Pertinent Details:

Borrower C Acted As A Strawbuyer

Borrower C was recruited by the Contractor to be a strawbuyer. The Contractor promised Borrower C that it would find properties to rehabilitate, rehabilitate the properties, and sell the properties to third parties after the rehabilitation was completed. Borrower C understood that he would not have to contribute any money to purchase the property.

Borrower C told us that he did not invest any money toward the purchase of 11203 South Hermosa. Borrower C was paid $500 to participate as a strawbuyer.

Assets Necessary To Close Were Not Verified

Legend Mortgage did not verify all of the funds Borrower C was required to invest in the property. HUD Handbook 4155.1 REV-4 CHG 1 states that "[a]ll funds for the borrower's investment in the property must be verified." The actual assets necessary to close on the loan that were verified by Legend Mortgage totaled $6,093. Borrower C needed $14,531 in order to close on the loan. As a result, Borrower C did not qualify for the HUD/FHA insured loan.

During a phone conversation regarding Borrower C's loan, the underwriter's Vice-President asked the Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, about the requirements for verification of funds to close a loan. The underwriter's Vice-President asked whether a bank statement from the Contractor would be a sufficient verification of assets. The Chief said the Contractor's bank statement would be a sufficient verification of assets. However, the Chief assumed that this underwriter was referring to the $5,000 the Contractor was contributing to the partnership. The Chief reasonably assumed that Borrower C's funds ($10,000) were being verified independently of the Contractor's funds. The Chief had no way of knowing that the partnership was fictitious. To satisfy prudent lending practices, both sources of funds should have been independently verified.

If a verification of Borrower C's funds had been made, Legend's President would have discovered that Borrower C did not contribute any funds to the partnership, or have the funds necessary to close the transaction. A loan correspondent's basic duty, on behalf of HUD, is to verify the validity of information that is received. Indeed, as HUD's agent, Legend had a fiduciary duty to verify the assets of the partnership before putting HUD at risk. If Legend's President had followed prudent lending practices, he would have verified the underlying assets of the partnership.

A Partnership Agreement Was Used Improperly

A fictitious partnership agreement was used as evidence that Borrower C had the necessary funds to close. The partnership agreement stated that Borrower C invested $10,000 and the Contractor invested $5,000 to the partnership, respectively. The partnership agreement was placed in Borrower C's loan file by someone at Legend Mortgage. This occurred even though Borrower C: (1) was never in a partnership with the Contractor; (2) did not tell Legend's President he was in a partnership with the Contractor; (3) did not give Legend's President a copy of the partnership agreement or direct Legend's President to contact the Contractor for a copy; (4) never saw the partnership agreement; and (5) said the signature on the partnership agreement was not his signature.

Borrower C said that information related to the partnership agreement was placed into his loan application after he signed it. The following words were placed into his loan application in the liquid assets section by Legend's President without Borrower C's knowledge or permission: "Partnership Agreement - $15,000." Thus, Borrower C did not have an opportunity to discover that the partnership agreement was put into his file and application.

When interviewed, Borrower C said he never contributed $10,000 to a partnership. Borrower C said, in fact, that he "never had $10,000 in [his] life." Borrower C said his signature was forged to the agreement.

Legend's President said he told Borrower C that he was short the funds needed for closing. Legend's President could not produce documentation, such as a letter or memorandum, evidencing his alleged notice to Borrower C. Legend's President said he advised Borrower C that the HUD acceptable sources of funds were either: (1) a gift from a blood relative; (2) borrowed funds from a collateralized asset; or (3) a partnership agreement. Legend's President said some time after his notice to Borrower C, he received a faxed copy of the partnership agreement from the Contractor. Legend's President could not identify who, at the Contractor's office, faxed the agreement to him. Legend's President believed that his receipt of the partnership agreement was in response to his alleged notice to Borrower C. He also believed that his actions were performed in accordance with prudent lending practices.

Legend's President's explanations do not agree with the actions he took regarding the partnership agreements. Legend's President accepted the partnership agreement from the Contractor, without Borrower C's knowledge or permission. Placing key information into the loan application and file without the knowledge or consent of the borrower is not considered to be a prudent lending practice.

Borrower C described his dealings with Legend's President as perfunctory. Borrower C said he "signed where [Legend's President] told me to." Borrower C only met with Legend's President once. The meeting was held at about 10:00 p.m. on a Friday in the living room of Legend's President's home.

Prior Ownership Not Confirmed

A chain of title for the previous year was not requested by Legend Mortgage for Borrower C even though Borrow C purchased the property within the past year. HUD Mortgagee Letter 95-40, page 6, mandates that the "[Direct Endorsement] Lender must obtain evidence of prior ownership when a property was sold in the last year" and "[t]he 203(k) mortgage must be based on the lowest sales price in the last year." Mortgagee Letter 95-40 went into effect on September 13, 1995. The closing did not occur until November 2, 1995. Legend had an adequate amount of time to obtain a chain of title report from a title company. On May 25, 1995, the property sold for $23,000. Borrower C paid $55,000 on November 2, 1995. The maximum mortgage amount was $86,150. It was computed by the underwriter based upon information received from Legend Mortgage Company. The mortgage was based upon the sum of the $55,000 purchase price, estimated rehabilitation costs, and estimated closing costs. If a chain of title had been performed, the maximum mortgage amount would have been computed based upon the $23,000 price instead of the $55,000 price. The maximum mortgage amount would have been $49,380, thus reducing HUD's exposure by $36,770.

Legend Mortgage was paid $6,318 in loan fees at closing.

Appendix B-4

Street Address: 5241 South Aberdeen Street

FHA Case #: 131:7950870

Insured Amount: $67,650

Underwriting Company & Underwriter Number: Carl I. Brown, N745

Summary: Legend Mortgage Company improperly originated Borrower D's HUD/FHA insured loan. The loan was originated by Legend's President. Legend Mortgage added a fictitious residence lease into Borrower D's loan application and file without his knowledge or approval, and collected the fictitious information from a Contractor without Borrower D's knowledge or approval. Also, Legend Mortgage failed to verify all of the funds necessary to close the loan. Legend Mortgage failed to obtain evidence that a 401(k) account was redeemed, and failed to consider the taxation and early withdrawal penalties when valuing a 401(k) account.

The Chief of HUD's Single Family Production Branch, Office of Housing, Illinois State Office, said HUD would have rejected the loan had Legend submitted accurate information.

Pertinent Details:

Borrower D Acted As A Strawbuyer

Borrower D was recruited by the Contractor to be a strawbuyer. The Contractor promised Borrower D that it would find properties to rehabilitate, rehabilitate the properties, and sell the properties to third parties after the rehabilitation was completed. Borrower D was told by the Contractor that he would not have to contribute any money to purchase the property.

Borrower D told us that he did not invest any money toward the purchase of 5241 South Aberdeen. Borrower D was paid $1,000 to participate as a strawbuyer.

Assets Necessary To Close Were Not Verified

Legend Mortgage did not verify all of the funds Borrower D was required to invest in the property. HUD Handbook 4155.1 REV-4 CHG 1 states that "[a]ll funds for the borrower's investment in the property must be verified." The actual assets necessary to close that were verified by Legend Mortgage totaled $1,457. Borrower D needed $17,832 in order to close on the loan. As a result, Borrower D did not qualify for the HUD/FHA insured loan.

A 401(k) account was used to document the majority of the funds Borrower D needed to qualify for a 203(k) loan. There was no evidence that Borrower D's 401(k) account was redeemed. HUD Handbook 4155.1 REV-4 CHG 1 states that evidence of redemption is required. Even assuming redemption occurred, Borrower D would not have qualified. The current value on the account was $23,132. HUD Handbook 4155.1 REV-4 CHG 1 states that only the net amount after subtracting federal income tax and withdrawal penalties may be considered as assets to close. Based on the monthly income shown on The Uniform Loan Application for Borrower D, Borrower D would be at a 28 percent tax bracket. After taxes and early withdrawal penalties of ten percent, a $9,000 reduction would be incurred. Additionally, a $10,315 loan had been taken out against its current value leaving an asset of less than $4,000 when $17,832 was needed to close on the property. Thus, Borrower D lacked the necessary funds to close.

A loan correspondent's basic duty, on behalf of HUD, is to verify the validity of information that is received. Indeed, as HUD's agent, Legend had a fiduciary duty to verify the assets of the partnership before putting HUD at risk. If Legend's President had followed prudent lending practices, he would have verified the underlying assets of the partnership.

The underwriter was recently sanctioned by the Mortgagee Review Board in this matter. Consequently, the underwriter's parent company agreed to indemnify HUD for any loss on this loan.

Residence Lease Used Improperly

A fictitious residence lease was used to inflate Borrower D's income. The residence lease for a property at 227 West 108th place stated that Borrower D had a tenant that was paying $1,050 per month in rent. The residence lease was placed in Borrower D's loan file. This occurred even though Borrower D: (1) never had a tenant at 227 W. 108th Place; (2) did not tell Legend's President he had a tenant; (3) did not give Legend's President a copy of the residence lease or direct Legend's President to contact the Contractor for a copy; (4) never saw the residence lease; and (5) said the signature on the lease was not his signature.

We gave Borrower D the opportunity to review his loan application. Borrower D said when he signed the application on May 5, 1995 there was no information related to the residence lease in it. This information was placed in the loan application without his knowledge or approval. Borrower D said his signature was forged to the residence lease.

The residence lease itself supports Borrower D's version of events. Borrower D's application was signed by him and Legend's President on May 5, 1995. The residence lease was not faxed to Legend's President until July 7, 1995. Thus, it appears that Legend's President placed the information into Borrower D's application after Borrower D signed it. Borrower D did not have an opportunity to discover that the residence lease was put into his file and application.

Borrower D described his dealings with Legend's President as perfunctory. Borrower D said he merely exchanged the same information with Legend that was used to get the initial loan from a finance company. Legend Mortgage was paid $5,616 in loan fees at closing.

Auditee Comments

Response to Draft Audit Findings of the Inspector General

LEGEND
MORTGAGE COMPANY

Submitted By:
David B. Whitacre

April 24, 1998

Response to Draft Audit Findings Legend Mortgage Company

Mr. Richard Urbanowski
Senior Auditor
Department of Housing and Urban Development
Office of Inspector General
77 West Jackson Blvd., Suite 2646
Chicago, Illinois 60604-3507

April 24, 1998

Mr. Urbanowski-

Introduction

I am in receipt of your audit findings dated April 1, 1998. Thank you for the opportunity to respond to the finding of the Inspector General's review. I will cooperate with your office fully and to the best of my ability.

Let me make myself perfectly clear from the onset. I will show, I, David Whitacre, President of Legend Mortgage Company, and all of its employees, in no way, nor at any time originated any loans without complete compliance with HUD requirements. Prudent lending practices were always exercised.

While it is foreign to me to have suspicion and doubt cast upon me, my business practice, and my motives for the community, I will try to contain my shock and disbelief and present to you accurate and helpful information. I cannot stand up to wrongdoing in this or any situation if I am not aware of it. It is clearly recorded that when I sensed the slightest hint of wrongdoing, I took immediate and clear action to stop it.

The facts show that the Dollars Express scam put Borrower and Contractor in partnership to defraud HUD. It is my responsibility to communicate here things that were not apparent to the auditors. I will present to you more proper and realistic conclusions that will confirm I was not a party to any deception and should reinforce my honorable reputation. To the best of my ability, I have assembled the following material, which will show that this is true. The information pertains to the Dollars Express scam, the Borrowers, partnerships, my association with Carl I. Brown and Company, Legend Mortgage Company practices, and the draft audit findings.

Although I admire the auditor's concern for safeguarding the integrity of the FHA insurance fund, I cannot help but totally disagree with their conclusions. I believe their conclusions were based on incomplete data and flawed insight. While attention was drawn to my supposed lack of thoroughness, I believe the audit demonstrated a greater lack of thoroughness than I was accused of. It seems as though David Whitacre and Legend Mortgage Company is being held to a higher degree of risk for verifying the accuracy of issues than others are.

Thankfully, their audit has provided me with the opportunity to clarify and resolve these questions. I am encouraged to have the opportunity to provide the auditors with the information and insights if they had known they would have pursued.

Personal FHA Background

For all of my adult life since college graduation, I have been involved with learning the mortgage business from the ground up. I spent 11 years developing relationships with HUD offices across the country when establishing new branch offices for Carl I. Brown and Company, my only prior employer. I was always taught to hold, and have always carried, the utmost respect for the Department in areas of compliance. I have paid careful attention to both HUD and federal regulations when exercising guidance of lending operations. I have both seen and worked in the arena of opportunities provided to individuals using programs designed by HUD. In short, I have made FHA loan origination, its management and implementation, the focus of my entire professional life. During my eleven-year tenure at Carl I. Brown & Company, I experienced nearly every function of FHA lending from origination through servicing.

As Senior Vice President, I oversaw over fifty retail branch offices nationally, the largest ever national FHA streamline refinance effort, and a servicing portfolio of nearly four billion dollars comprised of (mostly) HUD insured loans. My responsibilities led me to groundbreaking work in FHA origination areas involving adjustable-rate financing and streamlines, as well as FHA servicing areas involving assignments and special forbearance. In the area of loan servicing, I was asked by a staff member of Washington HUD to bring to bear ideas in default management which helped to shape HUD policies in mortgage assignments, special forbearance, and the streamlining of delinquent FHA mortgages.

As a sign of my history, as a record of my awareness of the concerns FHA has in the lending arena, I am attaching a copy of an article I wrote in a national publication. During this period, I was asked by HUD to provide my perspectives in the area of default resolution (see Exhibit #1). I have not only been aware of HUD guidelines all of my professional life, I have explored many more subtle issues relating to FHA lending. In many ways, I have always been a student of FHA financing.

My capacity as Senior Vice President of Carl I. Brown and Company also challenged me to work with the Department consistently in audits involving the company on a national basis, quality control, insuring, and indemnification issues involving fraud and faulty origination. I have lived out experiences, which have clearly demonstrated to me the negative ramifications to all parties who fail to follow prudent lending practices from HUD's perspective. I have had to monitor, discipline and, in some instances, terminate employees who did not comprehend the importance of following HUD guidelines and demonstrating prudent lending practices. For various reasons, I am acutely sensitive to the nature of the mortgage business as it relates to following HUD guidelines, faulty origination practices, and fraud.

It was an exciting decision that my family made with me in 1993 to come to Chicago and try to establish a base of business. We made this decision with the knowledge that I might eventually open my own mortgage brokerage business and try to build it into a reputable mortgage banking institution as my predecessors and teachers had done. I left a well-paying salaried position to pursue a dream, and selected Chicago because of the stability of the marketplace.

Incorrect Conclusions

While I appreciate your staffs presence and in-depth effort at attempting to look at these four loans in question, and others at our firm**,** I was completely shocked at the audit findings and the recommendations put forward. The tone of the audit, as well as the factual renditions, is laced with accusatory inferences of wrongdoing and ill intent. While I trust that the auditors themselves did not intend any mean-spiritedness, I will say that, at least the conclusions drawn as a result of the findings are inaccurate. Of all people, I know better than to believe that quick profits are a lifeline in the mortgage business.

I would never have jeopardized a personal business venture, especially one in its infancy (a business which supports my family) for the fees generated by closing the loans in question. Legend Mortgage has always felt to me like one of my own children. I would no sooner have jeopardized Legend than I would have one of my own two flesh and blood daughters.

Far from it. There was no financial motive here great enough, nor could there ever be, to cause me to disregard my inherent respect for HUD regulations, a respect which I have felt all my professional life, in the first few months of my new business. I would have been nothing less than stark raving mad, and believe that my reputation with HUD, its staff, and its affiliate agencies and offices nationally preclude that presumption.

Legend Mortgage Company was financially successful from the onset, because of the competence of its employees, and did not rely on fees from loans originated in the theater of Dollars Express for either survival or success, as all of our company's financial records from it's inception show. I do not mean to sound flippant but, simply put, the company was doing very well without the fees these loans brought forth.

It occurs to me that the auditors present at our office for a period of months should have also had an opportunity to witness our company in action, and should have observed an atmosphere of respect for precision and ethics. Their observations along these lines, if any, obviously did not motivate a different set of conclusions based on their findings.

It also occurs to me, in reviewing the audit, there appears to be syllogistic thinking at play. In other words, the auditors observed that if A equals B, and B equals C, then A must equal C. Said differently, if the sky is blue, and water is blue, then the sky is water. Sometimes it is easy to make accurate observations and consequently draw incorrect conclusions.

Pre-Judgment

I am also aware it has become common knowledge at HUD, and in the general lending community, that Dollars Express exported a loan fraud scheme that contributed to a national earthquake which ultimately affected 203(k). It may have been virtually impossible for the auditors not to draw conclusions prior to the audit taking place. There was great notoriety surrounding this scheme. Therefore, during this audit, it must have been difficult for the auditors to develop findings that spoke to prudent lending practices in the glare of the agency spotlight on the Dollars Express scandal.

I am looking at the idea that, while well intended, the facts may have been viewed in the context of a pre-formulated conclusion or theory. Therefore, I feel prejudged, since the auditors themselves may have felt that they would look foolish if their report did not motivate a set of punitive conclusions, when they were aware that Dollars Express had already been the subject of tremendous scrutiny. The Dollars Express fraud scheme resulted in massive indemnification involving millions of dollars, and was potentially one of the most financially violent and visible FHA 203(k) loan schemes in the United States.

Failure to Segregate Findings

With all due respect to the auditors, who obviously did a fine and thorough job with respect to what they saw and understood, I feel that their findings and conclusions are more a focus on the results of the Contractor's loan fraud scheme than they are an accurate and realistic measurement of the responsibilities, actions, and efforts of myself or Legend Mortgage Company. Page two (paragraph five) through page four (paragraph one) of the audit findings, as well as other specific areas of the audit, represent findings relating to the Contractor's involvement which was unknown to me and my company during the entire period of dealings with the 203(k) loan referrals.

Inclusion of these findings leads to the implication that my company and I had knowledge of, or participated in, his practices. That is ever so far from fact and truth. It is inappropriate for findings that relate to the Contractor's involvement to be formally included in the scope of an audit that are intended to evaluate my company and me, because it is not fair to be judged for another's actions. The overall constancy of the audit findings have been corrupted by a failure to properly segregate the Contractor's actions, Carl I. Brown and Company's actions, and my company's and my actions.

Guilt Through Association

If this audit is to be handled in a manner which is formally reasonable and factually correct, then the Contractor's actions must be properly excluded, because to include Contractor findings in my audit creates the inference of knowledge and participation. Failing to segregate these matters also creates the false impression of fault or culpability on my part for events out side of my awareness and control. It is neither fair nor reasonable to imply guilt through association, or to cast a dark shadow over other facts and events through this type of inclusion.

I say this based on the observation that a careful examination and understanding of our awareness, circumstances, and efforts is crucial to the heart of the matter of whether we acted in accordance with HUD guidelines and in a manner consistent with prudent lending practices. Including findings that properly relate to the Contractor's, or to Carl I. Brown and Company's actions, only serves to confuse matters. It blurs the lines of responsibility, and prevents a more precise, even, responsible, and measured evaluation of whether or not Legend Mortgage followed HUD guidelines and acted in a manner which reflected prudent lending practices.

The audit also fails to ask some very fundamental questions of the Borrowers involved, like what the Borrowers knew when, and what knowledge they intentionally withheld from me. As a result, the audit overlooks basic circumstances present that will confirm that Legend did diligently follow HUD guidelines as they were communicated to us and did faithfully illustrate prudent lending practices.

Clearly and unequivocally, I deny any knowledge of strawbuyer relationships during the origination process and closing of the four loans in question, nor was I, or my staff**,** party to any arrangement to procure financing (verbal, written, or implied) for any strawbuyer.

Historical Context

Directly prior to April of 1995, the starting point of Legend Mortgage Company, my employment with Carl I. Brown and Company consisted of managing a branch office based in Naperville. At this point in time, Carl I. Brown and Company maintained a separate retail branch office in Oak Brook that also housed the FHA underwriting staff.

The Oak Brook office began originating a large volume of 203(k) loans with Dollars Express. Because of the volume of loans originated via Dollars Express, the local Carl I. Brown and Company FHA underwriter communicated to me both directly and indirectly that all pertinent FHA underwriting issues involving Dollars Express had been both communicated to and cleared by the local FHA office. There were issues such “as-is" values, payoff balances on underlying loans, and maximum 203(k) mortgage amounts involving properties owned more than, and less than one year.

Carl I. Brown and Company's senior underwriter based at the corporate headquarters in Kansas City had also been involved with looking at, monitoring, and approving all issues relating to Dollars Express. This was especially true because the local underwriter who was approving all of the Dollars Express-related loans was relatively inexperienced at underwriting. She had just moved from the position of the branch manager’s lead processor to the position of FHA underwriter.

Because I began witnessing a volume of loans being written, right at the genesis of the 203(k), I knew that the company was breaking new ground in terms of loan volume and use of the 203(k). I was interested in confirming that HUD was approving of the structure, compliance, and volume of the Dollars Express loans. I watched carefully, seeing both a flowering use of the 203(k) program, and being mindful of the need for HUD's involvement.

I felt this way not because I thought something was potentially wrong, but because I was very interested in becoming proficient at 203(k). I was excited about seeing the 203(k) used liberally, and was also mindful that problems sometimes could occur when new programs came on the scene. Many times during my tenure at Carl I. Brown and Company, I had seen new programs arrive that later had to be modified based on unforeseen circumstances, much like a new car model coming out that ultimately needs to be recalled due to lack of testing.

FHA 203-K Emerges

This represented a timeframe where the FHA 203(k) loan was only beginning to become active again. The local FHA office was expressing encouragement and motivation to lenders to participate actively in the 203(k) marketplace. There was an environment of "go out and write them." In retrospect, there were many issues that were invisible to originators, lenders, and FHA in the 203(k) theater. None involved were experienced enough with the program to even know what to look for, to see warning signals, and to ward off abuse.

Indeed, it appeared that the 203(k) was a solution to many problems, and that everyone could win through its application. In addition, it appeared that HUD was really pushing the program with liberal, permissive, and encouraging approaches, for all the right reasons. Washington HUD set quotas or goals that geared the local HUD offices for significant 203(k) volume, and the local offices seemed eager to shine on the 203(k) national stage.

Communication Channels With HUD

Washington HUD, with all the best intentions, rolled out the revised 203(k) program based on the premise that it had been completely refined for use. Local HUD offices all across the country were encouraged to foster lender participation to facilitate 203(k) volume. It was not until after abuse began to appear that the national attitude changed, and Washington HUD began to solicit local HUD offices to comment freely on the program, and invite input on potential revisions to it.

It is very important to note here that, during this time, the local HUD office, again for all the right reasons, strongly discouraged any origination or processing staff to contact them directly for questions. Because of the overwhelming volume of FHA loans, the local HUD office communicated that only the FHA underwriters of the various firms could ask questions. There were memorandums put out from the local HUD office to that effect.

Being relatively gregarious in nature, I did attempt, independently, to communicate with the local HUD office on various occasions when I arrived in Chicago. Although I was now (only) a branch manager, somewhere in my thinking was the idea that I had been very accustomed to establishing relationships with HUD offices myself in my previous capacity as Senior Vice President. I called HUD locally on a few occasions to ask questions that were generally related to how HUD approached things on a regional basis (i.e. how they looked at qualifying ratios, etc.).

My communication attempts were not well received. The local HUD office was strained, and communicated to Carl I. Brown and Company's underwriter that they should be calling, not me. I was cautioned by my employer not to be bothersome to the local HUD office. I became sensitive to the issue of not communicating directly with the local office, and not over-staying my welcome there, because I had been cautioned about their policies. I drew the conclusion, as instructed, that I would have to communicate to HUD through the underwriters.

I always felt that, because of this required communication channel to HUD, I had to depend on and trust the FHA underwriters at Carl I. Brown and Company at both local and national levels to communicate 203-K issues, especially those involving Dollars Express, to the Department. I did, in fact, rely on what I was being told by the underwriters at Carl I. Brown and Company. --------------- was the local Carl I. Brown and Company FHA underwriter, ---------- the senior FHA underwriter based in Kansas City, and ------------ the national 203-K appraiser/coordinator also based in Kansas City. All were actively engaging the various topics with the Department. The situation had been fully and completely discussed with HUD. All issues had been approved. Everything was okay. Don't worry about it.

Based on my previous experience with Carl I. Brown and Company, I felt the company would always respect HUD's perspectives, since they had done so in the past, through all of my eleven years with them. I wholeheartedly believed communication with HUD was taking place in the theater of 203(k) loans involving Dollars Express, and was told repeatedly (after asking repeatedly) that it was.

The Contractor and Dollars Express

When Dollars Express appeared on the scene, it appeared to all that the Contractor was a "visionary" of sorts as far as the 203(k) was concerned. He seemed to be a legitimate entrepreneur who had been able to create a circumstance where the program could work successfully "en masse." Carl I Brown and Company's Oak Brook branch office wrote scores of loans involving the Contractor, each following a similar pattern.

During the period of time that Legend Mortgage was beginning, Dollars Express approached me and complained that the Oak Brook Carl I. Brown and Company office was overloaded with his files and processing time was way off. He did not feel he was getting the special attention a major supplier of business should get.

I did not solicit Dollars Express business. Dollars Express solicited me using credible complaints that appeared to be predictable in some ways. I began to work on these loans as a normal business practice, not as a party to his later identified scheme. I had no knowledge of any scheme.

My company did not rely on this business for financial sustenance or overall profitability. Legend had early on established a strong link with, and a visible presence in, the rehab community. We rapidly developed a community of real estate investors, contractors, Realtors, and non-profit organizations who came to us because we were beginning to establish ourselves as the most credible and knowledgeable lender in the 203(k) marketplace. We had developed a seminar strategy early to broadcast both the program and our services, which vaulted us into a position of visibility and access.

Also, I felt like the downsides to dealing with these loans was the fact that I may appear to be in competition with my previous employer. In addition, there was generally a lot of pressure to perform quickly. Many times, the Contractor called me to complain that things were not happening quickly enough, sometimes hourly. Generally speaking, I did not face this type of pressure to work at such a fast pace with other clients. In the end, both these factors were not weighty enough for me not to accept the business.

There were many 203(k) lenders soliciting the Dollars Express account. From the mortgage banking community, Commonwealth and General Motors Acceptance Corporation, and from the mortgage brokerage community, Alliance and Anchor were among some I was aware of. Their solicitation of this business confirmed the impression that there was nothing foul in the air.

I engaged a small number of 203(k) loans with Dollars Express, some of which are the focus of this audit. I observed that scores of loans had been, and were being, closed through the Underwriter's Oak Brook office. When I asked Carl I. Brown and Company again about communication with HUD, I was told that obviously HUD was informed because they had both reviewed and insured all of the 203(k) loans in question. Part of the attitude I encountered was: "Why was I still asking these types of questions? Why didn't I 'get it'? We have already taken care of all of this."

In fairness, part of this attitude may have been attributable to the fact that I was now leaving Carl I. Brown and Company to start Legend Mortgage Company. Although it was a friendly departure and I would continue to do business with Carl I. Brown and Company in the wholesale arena, I was beginning to be seen as an outsider who represented competition to their local retail efforts, especially with respect to 203(k) lending.

The Borrowers I originated these loans for were referred to me by Dollars Express, similar to how Realtors referred buyers for purchases.

This was a normal, accepted lending practice.

Face-to-face Applications

The Contractor suggested that the appropriate procedure would include the Contractor or his staff filling out the loan applications with the Borrowers. The Contractor suggested that this was an appropriate format for business dealings because the Borrowers had an established relationship with the Contractor in the area of property rehabilitation that predated the use of FHA 203(k) financing. The Borrowers had already worked in conjunction with the Contractor, and there was a well-established relationship and track record of successful rehab projects.

The Borrowers had also provided all types of credit documents to the Contractor so as to enable the Contractor to provide them to the preferred or selected lender. He explained that this was how business was conducted with other lenders, and wanted me to get with the program.

There was no reason at the time for me to suspect that there was fraudulent intention in the heart of the Contractor. I was aware of multiple previous transactions between the Contractor and Carl I. Brown and Company. The general perception was that the Contractor's goal had been to effectively centralize the point of contact and documentation with the Contractor for the benefit of the Borrower, Contractor, and lender. Indeed, it appeared that the Contractor's system of business was sensible and ethical, especially since so many 203(k) transactions had already been closed with Carl I. Brown and Company. I had always thought that for development to occur efficiently and on a large-impact scale, control was a central component. So some of the Contractor's thinking made a lot of sense to me.

Notwithstanding, I took the position that a face-to-face interview and application would have to occur with each of the Borrowers, because such was a fundamental HUD requirement. I took this position with the full knowledge that the Contractor could easily have elected to simply not do business with Legend, because this type of direct involvement with the Borrower seemed to be at odds with the Contractor's perspective on organization, communication, and control. Clearly, the Borrowers had given the Contractor the complete authority to select lenders on their behalf. The Contractor made this decision, not the Borrower.

Still, I knew that a face-to-face interview was a HUD requirement, and I insisted on it. I also gently informed Carl I. Brown and Company's corporate underwriting department that they may want to look at the idea that face-to-face applications were required in relationship to their local branch office. I did not know if face-to-face applications were in fact being sidestepped elsewhere, but I knew that I would not.

By informing Carl I. Brown and Company of this possibility, I felt that I had done the most proper and responsible thing. My impression at the time was that the possible lack of face-to-face applications was a result of laziness or eagerness, not subterfuge. In addition, I did not know for certain that what I was being told was true. Carl I. Brown and Company could look into it themselves since I had informed their management.

To me, face-to-face applications represented not only a compliance issue, but also a control issue to insure success as a businessperson. It was also critical from a disclosure standpoint in terms of payments, cash requirements, feasibility, etc. From the outset, I would not relinquish this HUD requirement. The Contractor threatened to pull this new business and send it to Carl I. Brown and Company, or one of the other lenders that were strongly courting his favor. I basically told him to go ahead and pull it. I was firm and would not move.

My impression was that the Contractor was approaching me because he knew that Legend was becoming skilled in terms of the 203(k). It was much more familiar to us than it was to other lenders, who were just starting to get in the water. There were stories circulating about inexperienced lenders trying to do 203(k) with horrific results. I assumed that the Contractor wanted to do business with me because I knew more about 203(k). I felt like I was a desirable commodity because of my growing 203(k) exposure.

Borrowers Provide Documents to Contractor

The Contractor acquiesced to my position on this matter, and proceeded on the basis that the Contractor would provide credit documents to Legend that had been provided to the Contractor by the Borrower. In this manner, the Borrower would not be asked to reproduce documents they had already given. This procedure made sense to me because there did not appear to be any fraudulent intent. Also, the mere fact that the Contractor was in possession of all of these personal, private documents obtained directly from the Borrower seemed to assume permission for the second party to provide them to me, something I could easily confirm with the Borrower directly.

It would not be difficult for me to review these documents and assess their validity. When I visited with the Borrower directly, I could confirm that these documents were valid, which is what I did. There was no reason to suspect fraud, but I was generally aware that these documents were coming from the Contractor. I would have to balance the Contractor's (and Borrower's) desire for central control and communication with the Contractor, with HUD's guidelines and prudent lending practices. I did this even though I was told by the Contractor this was not happening elsewhere.

Validation and Confirmation

In the presence of the Borrower, I could (and did) thumb through bank statements, tax returns, and paystubs and refer to them in our discussions. I could (and did) confirm employers, wages, addresses, telephone numbers, income, etc. This type of casual confirmation was couched in language like: "Just to make sure we have the correct, most current information, can you look at this address and let me know if it's still accurate? Are you still married to ---------- and does she still work at Ameritech?"

Even in the scope of the audit findings, this view is confirmed. These initial packages consisted of basic credit information, which was generally extremely thorough. To my knowledge, there was never an instance where tax returns, paystubs, W-2's, or bank statements were either manufactured or falsified, either by the Contractor or Borrower. In retrospect, this was one of the big positive credibility factors in the entire landscape of Dollars Express. These investors were generally very creditworthy. There were long job histories, strong incomes, low-to-reasonable consumer debt loads, excellent credit records, etc.

The audit findings refer to documents faxed to our office from the Contractor with a focus on documents that were later identified as having been forged. I think the more relevant observation here is that there was, in fact, a majority of documents that came through the Contractor's office. One has only to look at the amount and numbers of documents faxed from the Contractor's office to Legend to see the overwhelming patterns of the Borrower consistently providing documents to the Contractor, not the lender directly.

Retrospectively, the vast majority of these documents provided through the Contractor were in fact, accurate. The Borrower's habit of providing the requested documents through the Contractor, instead of directly to me, is the strongest evidence of the Borrower's preference for communication directly with the Contractor. Prior to the application, at the application, and after the application, the Borrowers were providing documents to the Contractor.

Since I took strong steps to confirm that the initial documents were valid, I assumed that further documents provided were likely valid. I had no evidence to the contrary. Nothing else I was seeing caused me to conclude otherwise. Both my staff and myself scrutinized the majority of elements in the credit package. Moreover, the overwhelming pattern we saw was that the information the documents reflected was true. The Borrowers did work where they had reported, they did bank there, they did make so-and so, they did have the loan obligations presented, they did live there, their phone number was such-and-such. Everything appeared to be real. In addition, we confirmed these items were accurate, both directly and indirectly.

Direct Requests To Borrowers

I pointed out to the Contractor that**,** most likely, additional documents were going to be needed beyond the scope of what was provided initially. The Contractor informed me that he had informed the Borrower that he wanted additional requests of the Borrower to be made through the Contractor, since the Borrower would not like to be assailed with requests. Matters like this would be better handled through the Contractor, whom we had come to believe the Borrower relied on as a central point of contact. Most likely, I was told, the Borrower had already provided to the Contractor most items I would eventually request.

I felt that additional or further documents should be requested directly from the Borrower, and took the position that I would be able to make such requests with an attitude and style that did not cause unnecessary hardship for the Borrower. Again, I did not believe the Contractor to be ill-intended; rather, I believed that the Contractor was operating from a frame of reference that was ultimately addressing a level of efficiency and control that described a successful developer/rehabber. And thusly, there appeared to be a reasonable line of logic to it.

The Contractor agreed to essentially let me do my business the way I have always done, even though it was in direct conflict with his philosophy and style. He resisted on each of these steps that involved control. He maintained that other lenders did not take these measures that I had insisted on. As a result, I was frequently burdened with towing the line on my policies. However, the fee income that could be generated through Dollars Express was not worth jeopardizing our infant company, Legend Mortgage, and in that sense would not provide long term stability.

I was well aware of these issues at the time, experienced in witnessing negative consequences of other approaches, sensitive to the birth of Legend Mortgage, and determined not to compromise.

I tested the new waters with Dollars Express, and tried to exert control on every front the Borrower and Contractor would allow me. I remember contacting the first Borrower about application procedures, and remember being told by the Borrower that the Contractor had all of these things, and that I should talk to them about it. In essence, I was being bothersome and repetitive. Each of the Borrowers in question had the same attitude. This is what I had to work with. I was faced with balancing my following HUD regulations using prudent lending practices, performing 203(k) loans effectively and quickly, and serving the Borrowers and the Contractor.

When the Contractor provided these documents to me, I reviewed them and formed a skeletal loan application based on the information and documents provided. Based on this review, a letter was formatted that I sent directly to the Borrower (with a copy to the Contractor) for additional documents needed to complete an initial credit package (i.e. updated paystubs, bank statements, etc.). It is normal business practice to copy requests of borrowers to all involved in the transaction as a courtesy, to both help communicate more effectively, and create an air of accountability.

This correspondence included the thought that once the Borrower had gathered the documents, then a face-to-face application would be scheduled at the Borrower's convenience. Face-to-face applications occurred on each loan in question, as they have on all loans Legend has performed where required by HUD, at the Borrower's home or office, my office or home (in one instance), or the Contractor's office.

Each time that I began communicating with a Borrower, they were always in each and every instance already aware of me and my company, and the fact that we were going to be handling a loan for them. This observation confirmed for me that the Borrower knew exactly what was going on. No Borrower ever said something like: "Why are you calling me? I have no knowledge of a loan going through you." They all knew of me, of my company, the loan being pursued, and the property in question.

Borrowers Respond Through Contractor

On most occasions, the requested documents would ultimately come from the Contractor's office, because it had become obvious that the Borrowers preferred to deal with the Contractor's office. Many Borrowers simply resisted or refused giving me documents directly. They always routed then through the Contractor.

The Contractor also had a habit of contacting me when I had just begun to work on a loan. Sometimes, the Contractor would call several times during the course of a day. He would ask me what was needed or missing on files. I assumed this was normal for his high volume, fast-paced business. This was also often the case wherein I also had previously experienced the same type of attitudes from national homebuilders. Frequently, when I was pressed for answers, I might thumb through my file and offer opinions to the Contractor on lacking documentation. Before I was able to generate a request letter to the Borrower, the documents would appear on our fax.

There were requests for documents that were sent off to the Borrowers, documents that subsequently showed up on our fax machine from the Contractor's office. The Borrowers would later confirm in discussions that they had gotten our request and delivered the documents to the Contractor. Evidently, the Contractor was also advising the Borrowers to do the same. In this manner, I heard, the Contractor would be able to keep files updated so that future projects could be pursued without repetitive and unnecessary requests of the Borrower by the (various) lender(s).

The message I got through this was basically that the Contractor was going to continuously act as the communication center for the Borrower, and this was the preference of the Borrower, which the Borrower confirmed to me through both speech and actions. In addition, I saw the possibility that the Contractor was trying to insure things were responded to correctly the first time. The Borrowers may have been afraid of making mistakes. Because of the volume of projects taking place, and the possibility that many lenders were ultimately going to be involved, the reasoning seemed to have validity.

Contractor-Borrower Relationship

I observed that this circumstance was occurring not because of fraudulent intent; rather, it appeared that the Borrower and Contractor did in fact enjoy a solid, trusting relationship. It seemed especially important that I not become duplicative with requests, since it generally produced a negative reaction from the Borrower, who preferred their relationship with the Contractor. Duplicate requests also produced a negative reaction from the Contractor, who would readily point out that my insistence on direct (lender) involvement was bothersome and unnecessary (both of which I heard on several occasions).

I never once heard a Borrower working with Dollars Express question Dollars Express. I never once heard any type of dissatisfaction or expression of mistrust or abuse. I never once heard a statement that reflected anything other than an attitude of confidence, and a confirmation of their successful relationship and history together.

At the time the face-to-face application took place, there was not a "rubber stamp" atmosphere, as the audit suggests the Borrowers observed. This characterization is both unfair and inaccurate. There was a concerted effort on my part to attempt to make the process simple because of the negative reactions both Borrower and Contractor exhibited when attempts were made to initiate more thorough direct contact and control.

Simply put, I was not shoving documents under the Borrower's nose to sign for the purpose of not disclosing or explaining things accurately or thoroughly. I was pre-preparing as much of the application as possible based on documents the Borrower had already provided to the Contractor. I provided copies of plan reviews, maximum mortgage worksheets, and good faith estimates in each situation. All loans were disclosed thoroughly and accurately.

All of the Borrowers involved with the Contractor reflected an attitude towards me that spoke to: "Why are you bothering me with this when I already gave it to the Contractor?" "Can we just get this over with because I already understand what is happening here?" and "I have already discussed all of this with the Contractor, why are you going over this again?" They were not rude to me openly, but their attitude was clear. I got the distinct feeling that I was out of the circle of things somehow.

Again, I never believed there was a fraudulent intent here on the part of Borrower or Contractor, these observations brought about the conclusion that the Contractor's perspective had validity. There seemed to be a strong need and a good use for centralized communication and organization with the Contractor in an environment where a lot of rehab/203(k) volume was taking place.

Stable and Creditworthy Borrowers

I never believed I was taking loan applications with mentally challenged or disabled adults. These were people who were consistent and stable. They were professional, long-term wage earners who were both wellspoken and responsible. Almost without exception, their credit histories were virtually impeccable, which spoke directly to the idea that they understood what financial obligations were, and were concerned about meeting them.

With the benefit of hindsight now, the historical tapestry of the Dollars Express loan debacle bears out the fact that many of the Borrowers did understand the obligations they were committing to, and the accompanying liability. It's unfortunate that this audit is the subject of loans to Borrowers who claim they thought they had no liability, or who claim they believed their liability had been passed to the Contractor, or who simply were not in a financial position to respond to it. But there were also evidently many Borrowers who did understand the possible eventual implications of their initial actions. After the scam collapsed, it is my understanding that many Borrowers met their obligations, completed the rehabilitation, or executed sales successfully without walking away from their liability or allowing their credit to be damaged. I imagine they just took the loss, because they avoided foreclosure, and saved their credit.

I did not know at any time during the process that these Borrowers were being specifically directed as to what to do. Surely it's obvious to you as well that one of their specific directions was not to include me in all the arrangements that had been made between them and the Contractor. I did not see the details of their "side understandings" because, by design, they were invisible to me.

Based on the stability, responsibility, and credit-worthiness of the Borrowers, I believed that they had their eyes wide open about what they were doing. There was never any pattern of fiscal irresponsibility or lack of creditworthiness. After fourteen years in the mortgage business, after originating hundreds of millions of dollars worth of HUD-insured mortgages, I knew that ideal credit histories do not result by chance. They result from a high level of awareness of financial responsibility, and the actions that follow that awareness. These Borrowers had all, without exception, demonstrated that.

I cannot be held responsible as a scapegoat for a deception that I was never a party to. The bottom line is that Dollars Express perpetuated a get-rich quick scheme on unsuspecting Borrowers, who obviously did not know any better. Unfortunately, it appears that after the fact these individuals, who were personally involved, now point fingers everywhere except at themselves. Is it possible that this fraud, by the Borrower and Contractor, causes them to need to paint me as a culprit?

In many ways, I cannot blame the Borrowers. In retrospect, I can see that they believed everything that Dollars Express told them. In retrospect, I wish that I could have seen through the scheme and protected them from it.

The Dollars Express Machine

At the time, though, things looked quite different. Scores of loans had already closed. Properties were being purchased and rehabbed "en masse." A strong re-sale effort was evidenced by all of the real estate salespeople working in the Contractor's theater of operations. Someone was actually doing the 203(k) correctly, and doing it in a manner that could be very effective on a volume basis. All of the empirical results of the Contractor's thinking were positive and visible for everyone to see: no defaults, rehabbed properties, happy investors, busy Realtors, etc.

The marker boards that lined the walls of the Dollars Express office space displayed scores of addresses, each marked carefully by investor, with time lines and construction stages checked off in careful sequence showing progress, progress, progress. It was a visual confirmation for all to see that all of it was real, successful, and full of integrity. Properties were marked "sold" and "assumed" and "vandalized." There were twenty or thirty full-time employees there, all orbiting at different levels on various issues. There were sub-contractors in and out picking up checks, real estate salespeople responding to the "no down payment" radio program calls, and weathered signs stacked against the wall saying "Buy this fully rehabbed property with No Money Down!"

My impression was that the Contractor was on to something really good, a systematic approach that was both ethical and profitable. After all, the south side of Chicago was the rehab Mecca for the world. How could he have not been legitimate to have an operation so big, organized, and well run?

During the time the face-to-face application took place, if there were further missing documents needed, or if there appeared to be ratio or down payment issues, then I was sensitive to the idea that the loan had not yet fully unfolded. The plan review and appraisal had not yet been completed. I was not yet fully prepared to completely and precisely evaluate the transaction because all of the specifics were not yet known.

I sometimes felt that it would be more appropriate to determine first whether or not the Borrower had provided further documentation to the Contractor prior to pointing out a potential issue to the Borrower or making any additional requests of the Borrower. They generally acted as if I was just bothering them, and reflected an attitude of "Why didn't you already know I had this other account? I already gave this stuff to the Contractor!"

Collusion

My intention here is not to blame the Borrower. But I will point out that the audit findings avoid completely the simplest and most fundamental observation. The Borrower and the Contractor had engaged in a relationship with each other that entailed an agreement that resulted in deception to the lender. Both Borrower and Contractor discouraged lender involvement. I had to push to have a measure of involvement as lender, and push carefully because both Borrower and Contractor were discouraging it.

At no point in time did any Borrower reveal that they had no intention of making any payments, or that there was a side agreement with the Contractor to make all of the cash investment. At no point in time did the Contractor reveal that the inspector had been influenced or paid off to approve rehabilitation work never completed.

Each Borrower clearly understood they were applying for a home loan with both financial obligations and liability. It should be evident, based on the circumstances I have shared, that I clearly risked not writing any loans for either Borrower or Contractor because of my insistence on face-to-face applications and interviews. I risked not writing any loans because of my direct contact and involvement with the Borrower, which I was always told was not the custom or practice of any other lender. I knew that I was HUD's gatekeeper, and whether or not I had reason to believe there was foul play, I knew that I must proceed prudently.

Hypocrisy

For a Borrower to suggest that I was performing actions without their approval or permission, for a Borrower to suggest that I was somehow conducting an application in a "rubber stamp" atmosphere, which implies ill intentions and questionable motives, is an unfortunate re-writing of history, and sadly hypocritical. I wish the Borrower could say more simply that they wished I could have known the ultimate damage of the scheme, and so knowing, would have been able to protect them. However, I cannot be blamed or held responsible for the deception. A murderer cannot accuse a gun dealer of murder because the gun dealer sold a gun the murderer used to kill.

I do know in my heart, however, that the Contractor ultimately led the Borrowers to slaughter knowingly or unknowingly. I am slow to fault the Borrower for the deception that the Contractor perpetrated on them. In retrospect**,** the Contractor was a brilliant con artist, and successfully fooled all those around him.

Recent Scams

Evidently, the Contractor is still at it. I saw him in a newspaper article describing his indictment recently that I am attaching (see Exhibit #2). The article describes how the face of Christianity was used as a mask to perpetuate similar fraud. Borrowers were attracted through Christian radio programs. One of the perpetrators represents himself as a "Reverend." The company's goal is to give back to the community through redevelopment and below-fair-market resale terms to needy families. No investment required. No payments have to be made. You just make money, help the community, and serve Christ in the process.

Nothing is sacred. There are no moral or humane boundaries in play. No one suspects. Everyone is fooled. Everyone is taken. No one seems to be willing to actually believe that this kind of evil is present and at large. No one wants to believe that a human being would deliberately set out to injure others in this manner. Is it a surprise that all the victims involved in the scheme this audit addresses were duped? Is it a surprise Borrowers, lenders, and HUD itself were duped? How many times will this continue to happen?

Dollars Express and Affordable Housing

This newly exposed scheme echoes of the past one. Affordable housing was the banner Dollars Express sailed under, the headline that identified what it was all about. There was a Chicago Bears football player who attended and spoke at a banquet the Contractor held for the scores of investors who participated in this grand rehabilitation effort. The themes of his speech, and of the evening, were helping needy families, rebuilding the inner city, and filling the gaps in social assistance the federal government could not address. Individual Borrowers received applause from hundreds when awards were given to them based on completed projects that they had participated in. The more you did, the more you helped needy families, the more you helped the city, and the more money you made.

Some lender heard the Contractor speaking on a radio program on the subject of his affordable housing program. He was touting all the benefits of his socially-oriented entrepreneurialism. The (anonymous) lender either sent the audiotape to the local HUD office, or notified them of the radio show. Evidently, the Contractor had commented on the idea that new investors would be able to participate with no cash investment required. The local HUD office, in response, tried to contact lenders who were doing business with Dollars Express, to attempt to determine what he meant by his comments.

The local HUD office also contacted me. I contacted the Contractor, who (again) reminded me that the rehabilitation efforts he was involved with were very large in scale, and did not just operate within the boundaries of FHA programs. His business also involved other conventional and uncommon lending vehicles, some of which were private sources, and did not have the same requirements as 203(k). No, his comments did not pertain to FHA or 203(k). I never heard the tape, and so I just passed on the explanation. I concluded that there was not a real concern about all of this, because HUD had not called Dollars Express on their own.

Refining Disclosure Efforts

One of the thoughts that occurred to me at the time was that it might be helpful to develop a disclosure that spoke to the idea of the responsibilities of the 203(k) borrower in general. The 203(k) was a new and unusual lending tool, and was spawning all kinds of not-before-seen collaborations, formal and informal partnerships, and experimental approaches. I thought that perhaps I should look at the idea of spelling out responsibilities and obligations more clearly, so that lines could not be blurred in the excitement. People were testing the boundaries of what was permissible, and I wanted to try to stay as clear as I could in my communication.

I had already seen that some of the HUD disclosures produced by the

Department could be modified or improved because I was experiencing where the rubber-met-the-road in terms of the loan's use. One of the projects we undertook was to design a 203(k) good faith estimate (that was RESPA friendly) so as to attempt to more clearly and accurately delineate cost centers present inside a 203(k) loan.

We had found that the standard good faith estimate was not useful in terms of the mechanics of the 203(k) loan. With a refined disclosure, we could cause a borrower to understand more effectively what they were being charged for and why. We could reveal the dynamics of the rehabilitation and relate it to the project as a whole. Also, we could more accurately communicate cash requirements for approval and closing purposes, and elaborate on monthly payment requirements. I am attaching our disclosure that resulted from that effort during that time (see Exhibit #3).

To my knowledge, we are the only 203(k) lender that has developed, or currently uses such a tool, and have found it to be very helpful to borrowers and us. We make it our custom to provide a complete copy of the plan review, the 203(k) maximum mortgage worksheet, and our (custom) good faith estimate to each and every borrower, as was the case with the Borrowers involved with Dollars Express. This way, we could be assured that each Borrower had the opportunity to review the specifications of repairs, cash requirements, and monthly payment obligations on every 203(k).

In addition, and more importantly, I developed a disclosure that also bore Dollars Express Borrowers in mind. I was looking for a prudent and noncontroversial vehicle to remind people of a few things, specifically their obligations and duties in relationship to the loan. Again, when the 203(k) got fired up again, there were many different people in the rehab theater trying to collaborate together: investors, rehabbers, contractors, Realtors, non-profits, etc. And we wanted to prudently communicate where liability ultimately rested.

This disclosure, titled "Notification of 203(k) Disclosures," summarized relevant responsibilities in the 203(k) process. It also included sample formats of documents used on a 203(k) loan that were unique. We began the disclosure with an introduction, and moved to the thoughts that the Borrower read the forms carefully, call the Legend originator regarding any questions, and consult legal counsel of choice "as an option strongly suggested by the above representative but not a mandatory requirement of the program."

The genesis of this disclosure involved the observation that it was important for borrowers to understand their obligations, and where the contractor's role would start and stop. Although I had no reason to believe at the time there was any kind of malfeasance taking place, I was sensitive to the idea that I needed to act as a gatekeeper, both on my company's and HUD's behalf.

We began using it on all 203(k) loans, and used it on all the loans in the theater of this audit. I recall showing and explaining it to the Contractor prior to its implementation. He did not appear to take issue with it, in light of the idea that I explained that this disclosure would become part of all loans at Legend as a matter of policy. His acceptance of this caused me to feel confidence in the Borrower's understandings. But that is part of the deceptive tactics for one involved with deceit. It did not appear to be in conflict with his perspective, or the Borrowers, which I felt was a good thing. I am enclosing it for your review (see Exhibit #4).

Borrow B's Loan

At this juncture, it may be helpful to bring one aspect of Borrower B's loan into focus. The circumstance I will address was a problem not mentioned in the scope of the audit, but I feel obligated to bring it to bear in the course of my response. I have previously made the general observation that, without exception, the documents initially provided by the Borrower through the Contractor appeared to be mechanically accurate. I have stated that both my staff and me were able to directly and indirectly verify that documents were correct as far as their validity was concerned.

I clearly recall Borrower B's loan because it was one of the first written. I remember that the initial package included information regarding an existing loan that Borrower B held on the subject property that was with a lender I had not heard of. Since this was a refinance transaction, I would need to verify the outstanding mortgage on the property. The underlying lender had an address on Western Avenue, which was the same street Dollars Express resided.

I remember thinking that there are many businesses involving rehabilitation on Western Avenue, an area that I was only beginning to become familiar with. There were insurance companies, appraisal firms, contracting firms, credit repair businesses, etc. At the time I began developing the application, I had no reason to believe the lender was fictitious or affiliated with Dollars Express. The names were not the same either.

I remember later seeing, during the time the loan was being processed, that someone who also worked with Dollars Express was handling the mortgage verification. I thought about it, and concluded that the company the loan resided with may have been affiliated with Dollars

Express indirectly. That seemed to make sense. Dollars Express was a large company that was engaged in all kinds of rehabilitation efforts, many of which did not pertain to 203(k), and had been engaged with volume rehab on the south side of Chicago for many years.

I concluded I was just seeing a new animal here that I had not seen before. I was learning more about the rehab theater, and expected to see things I had not been exposed to before. After all, this was not Realtor business, or refinance business. It was an entirely new culture for me.

The loan in question was on the original loan application that was presented to Borrower B. Borrower B saw it and signed it. He did not question it, nor lead me to believe it was artificial somehow. I know this is true because the loan stands out in my mind, and I remember the sequence involved with it. I always enjoyed going to the fire station Borrower B worked at. I ended up visiting there three or four times. I looked at the fire trucks, and petted the Dalmatian on duty. I also told Borrower B I needed some painting done to my personal home, and asked him if he was interested because he did some painting on a moonlight basis.

I did not believe that there was anything false, fraudulent, or surreptitious about this underlying loan. It was reflected on the application Borrower B saw and signed. He never questioned it during my confirmation process. Also, the indebtedness appeared on his copies of the good faith estimate and maximum mortgage worksheet. In retrospect, this event, and this loan, stands out in my mind as a real exception to the idea that the information that came to me from the Borrower through the Contractor was always accurate. It also speaks to the idea that it was easy for one thing to slip through the cracks when everything surrounding it was powerfully factual and accurate.

Cash Requirements Unknown at Application

It may be purposeful to next make the observation that when the loan applications were initially developed, I was aware that we were not dealing with final figures because the plan reviews and appraisals were not completed as of the date of the application in most instances. I was aware that exact figures had not yet come into focus. Also, there was no chain-of title requirement that had developed yet from a regulatory standpoint at the time that any of these loan applications were written. As such, on refinance transactions, there was frequently little or no cash investment required at closing in the absence of a chain-of-title requirement.

Costs and cash needed could vary in large percentages when plan reviews, appraisals, and actual costs were determined, and this usually only occurred after the point of the initial loan application. Loans for purchase transactions on regular non 203(k) type mortgages can be figured very closely as far as cash requirements are concerned. Refinance transactions on regular non 203(k) type mortgages tend to begin to vary more as far as cash requirements are concerned due to principal balances varying from what is disclosed versus what is verified.

But 203(k)'s are quite different. At application, the K funds can only be guess-timated at based on what would be needed predicated on expected amounts. Refinance 203(k)'s where the borrower purchased the property with one loan, and then applied for a 203(k) refinance loan cannot be defined tightly at loan application. Payoff figures, as-is values, rehabilitation costs and contingency reserves, after-improved values, and escrow commitment amounts cannot be known at application. These variables ultimately define cash requirements.

Accordingly, I proceeded with applications with information I had available to me based on the initial credit package provided to me from the Borrower through the Contractor. I knew that I did not know exactly what cash was required. Once the aforementioned factors were present, we would know exactly what was needed and could re-visit the issue if necessary.

203(k) loans were, and are, a very different animal as far as cash requirements are concerned. The loans themselves, and therefore the applications, were moving constantly as they unfolded. During this time, as we first began performing 203(k)'s, we simply recognized that the cash requirements would change, and approached the loan as a changing entity. In some respects, this observation is true in general of all types of loans, and became the topic of a few both general and specific discussions I had with the auditors.

Evolving Loan Applications

The auditors seemed to have difficulty understanding this phenomenon, since they have never originated 203(k) loans themselves. I could tell they felt there was something wrong with things being added to a loan application. They reflected an air of suspicion when items were added to a credit package when those same items were not reflected on the initial application.

It is frequently the case that loans are, in some respects, originated in processing. Put differently, there are daily instances where people apply and information is not available to put on a loan application. For example, if a paystub and W-2 forms are not available, the income section may not be completed until receipt of those items, because a borrower is never able to verbally share the precise income amount an underwriter will ultimately count towards qualifying. This requires analysis.

If a borrower does not reflect adequate funds to close at application, then sections may remain blank on the application until the borrower communicates back what approach they have elected based on communicated options. Would you ever see on an application: "Maybe a gift, maybe a secured loan, or maybe cashing in a 401-K"? Would you ever see under income: "Maybe $2,000 per month"? Are debts frequently added to an application because the borrower neglected to bring information at an initial face-to-face interview? Of course they are. This is a daily event in mortgage originating at the street level.

The audit suggests that items may have been added to the loan application with surreptitious intent. If you follow the line of thinking to its fullest extent, there is no allowance being made for the observation that things can and do change after an application takes place.

As examples, if a borrower applies when employed in one place, then changes jobs, is there a difference between the application and the credit file? If a debt shows up on someone's credit that was not on the initial application, is there a difference between the loan application and the credit file? If a borrower ends up spending some of their funds in a savings account, no longer has the balance reflected on the initial application, and elects to get a gift from a relative for closing purposes, is there a difference between the initial application and the credit file? Would the gift have ever been shown on the initial application when the decision was made after the fact to get the gift?

The Gap Never Disappears

The credit file is the ultimate final expression of the application. The credit file expands, articulates, alters, corrects, illuminates, and defines the initial application. There is never a precise similarity or identical relationship between an initial application and the credit file that expresses it. Anyone who is involved with the actual originating process understands this gap, and works to narrow it as much as possible. But the gap never disappears.

The initial application operates within a theater of changing information and circumstances. It is a changing entity in so far as the credit file will ultimately speak to the facts in a way that the initial application cannot. The credit file itself clarifies the borrower's credit information. The entire loan process intrinsically recognizes and speaks to the idea that the initial application will never be absolutely accurate. All initial information given is constantly being transformed as it is understood and verified.

In this area, the audit findings cast a menacing shadow over differences between the initial applications and the credit packages. The suggestion, both directly and indirectly, is that Legend purposely and deceitfully added things to the Borrower's applications without their knowledge, and inserted manufactured and forged documents into their credit files.

Simply put, those allegations and suggestions are false. I did not, nor did anyone else at Legend Mortgage Company, ever, at any time, intentionally add information to loan applications without fully believing that the information was true, and without receiving either direct, or what we perceived was indirect, confirmation from the Borrower.

Practices and Customs Important

I have tried to take great lengths in sharing the practices and customs of the Contractor and Borrowers. If the Borrowers were to have been asked if it was their practice to furnish documents to the Contractor to in turn provide to me, if they were to have been asked if they generally tried to cause the Contractor to be the controlling agent in relationship to their dealings with me and my company, a different picture emerges than the one the audit findings portray. I can't help but believe there was collusion.

Suffering and Anger

I know that the Borrowers eventually suffered terribly because of the scheme perpetuated by the Contractor. I do not wish to overlook the obvious, and I sympathize with their pain and frustration. I am certain all of their families, and perhaps their marriages, suffered as a result as well. But if the Borrowers were so terribly concerned about exactly what was happening in relationship to their 203(k) loan, if it was a priority for them to maintain involvement at every step, then why would they provide documents directly to the Contractor instead of us, and operate in a manner that let us know clearly that we should expect their responses to us from the Contractor? Is it reasonable for them to select one or two issues and demand accountability to have communicated with them directly for confirmation when every step of the way, on every other issue, they told us through speech and actions to look to the Contractor for confirmation?

The answer was, and is, very simple. They are angry. They are angry at the Contractor for duping them in such an inhuman way, they are angry at themselves for believing what was too good to be true, and they are angry at me for not knowing better and for not saving them somehow. Anger is a powerful emotion, and can easily distort both reality and history.

Distortions

How are history and reality distorted through anger? To illustrate, I ask one simple question: If a Borrower maintains that they had no knowledge of a partnership agreement, if they maintain that they did not have the opportunity to point out that no such agreement existed, then if they did, would it have made a difference?

Since we now know that the Borrower and Contractor had a side understanding to the effect that the Contractor would make all of the cash required investment, since we know that the Contractor had guaranteed to the Borrower they would never have to make any payments on the loan, since we know that most Borrowers already had both title to the property and an existing loan on it, since we know that the Borrower had a demonstrated history of trusting and relying on the Contractor for direction, how could it be reasonable for a Borrower to say, or even imply, that they would have pointed out the partnership agreement was erroneous in nature and interrupted the loan process as a result?

Gain?

Based on our current knowledge of the side understandings that existed between the Borrower and Contractor, what would the Borrower have had to gain by taking the opportunity to point out that the partnership agreement they allege they were not aware of, the partnership source of funds they allege was not reflected on the initial application, was fabricated? Based on the representations of the Contractor, they would have gained absolutely nothing as a result.

Loss?

What did the Borrower have to lose by pointing it out? They clearly would have lost the ability for the rehabilitation project to progress, which was intended to lead to resale of the property, and an additional payment to the Borrower. The Borrower would have violated the side understanding with the Contractor as well, a Contractor who had guaranteed the initial cash investment as well as liability for the mortgage payments. The Borrower would have jeopardized receipt of the payment expected as a result of fruition of the project. The Borrower, who already had ownership of the property in most instances, would have been saddled with the underlying loan, which in most instances was on its way to ballooning. The Borrower would have been left with an incomplete project on the south side of Chicago, without a partner, without a contractor, without a collaborator, without the benefit of more experienced direction, and without access to the visible resale machine the Contractor had built.

Common Sense

If the Borrower had been asked by the auditor if this knowledge of the partnership agreement (a knowledge the Borrower denied having) would have caused them to interrupt the loan process, and the Borrower answered truthfully, they would have said that it would not have. The Borrower clearly relied on the Contractor's direction every step of the way based on side understandings between them. The partnership agreement would have only represented a vehicle to accomplish or implement the agreement between them that they held to be more consequential. Given the circumstances, the Borrower would have had absolutely no incentive whatsoever, everything to lose and nothing to gain, in pointing out that the partnership agreement was not real. This thinking is just common sense.

To suggest otherwise is simply unrealistic. To suggest otherwise is to fly in the face of any reasonable standard of objective or rational thinking. The powerful and overwhelming previous history of the Borrower relying on and trusting the Contractor's leadership clearly precludes the possibility. The Borrower had ample opportunities to bring up a whole variety of issues that would have exposed the scheme. I am aware that, at this point, I would be able to point out literally hundreds of opportunities the Borrower had all throughout the 203(k) loan process to share that there were discrepancies between what me and my company were communicating, and what the Contractor had shared with them. The entire loan process was riddled with ample opportunities to do so.

Selective Thinking

For the Borrower to suggest that they would have selectively taken one opportunity to point out a discrepancy, for the Borrower to suggest that they would have expressed a questioning attitude towards the Contractor, for the Borrower to suggest that they would have openly and publicly accused the Contractor of malfeasance, when they had opportunities to do the same every step of the way simply does not hold water.

Ample Opportunities

Without belaboring the point, I will just name a few. When my office contacted the Borrower to inform them of the amount they needed to bring to closing, which was and is our custom, did the Borrower seize the opportunity and say "I am not supposed to bring in any money, the contractor is"? When the Borrower was informed of the monthly payment required on the loan by me, my office, or in the form of a payment coupon booklet at a later time, did they seize the opportunity and say to us "I am not supposed to be making the payments, the Contractor is"? Did any ever say "I want you to know that, although I am signing all of these documents for this loan, I actually won't be putting up any money or making any payments, because the Contractor agreed to do that"?

There were literally scores of events all throughout the loan process that gave the Borrower opportunities to question things at different phases. No Borrower ever took any opportunity to expose the side understandings that existed between themselves and the Contractor. All of this begs the obvious question: If you are denying knowledge of this agreement, would it have made a difference if you saw it? If you are saying that it would have, how is that consistent with any of the other actions that you took?

Moreover, two of the Borrowers on loans questioned in the scope of the audit are of the ------ family. ------- worked for Dollars Express, and obviously worked closely in partnership with the Contractor. Members of the ------- family became involved as investors. I always believed that -------, Borrower C, and Borrower A were brothers and sisters. If they are not brothers and sisters, then they are clearly closely blood-linked. Because there was a family member who worked for the Contractor, does this also not speak to the assumption that their own family members would have a good picture of the Contractor and his practices? Would anyone not have assumed this would be true? Would there have been any reason at the time, and is there any reason now, to suspect or believe that family members would purposely betray each other?

Are the auditors aware that Borrower A had begun working for Dollars Express as well? My impression was that Borrower A was beginning to work in the area of recruiting new investors in the Dollars Express theater of operations. On occasion, I saw her in the Contractor's office working in that capacity. Isn't it then somewhat of a cop-out for her to allege that she was not aware of what was happening, when she worked there? Would it be wise for her to acknowledge otherwise?

Would we not have also naturally assumed a high level of awareness existed because both --------------- and Borrower A were employees? Would we have assumed that they were not aware of what was happening in the surroundings of their own place of employment? Would it have been reasonable to assume that the documents that bore Borrower C's and Borrower A's signatures, coming from Borrower A's and ----------- place of employment were likely valid? Would it not have been offensive for us to ask if they were real because it would have implied that their own family members were criminal?

In fact, most of the Borrowers appeared to have some link or connection to Dollars Express that transcended the boundaries of an unfamiliar and cold business relationship. Some Borrowers were employees, some had relatives who were employees, and some had close friends who were employees. It was a community of people who seemed to both have a history together in some fashion, and trust each other almost implicitly. This observation, again, created the impression that the Borrowers had their eyes wide open.

Credibility

Adding a partnership agreement was no different than adding a gift to any normal purchase transaction. Adding a lease agreement to a loan file was no different than adding a real estate contract sent by a Realtor. The fact that these documents were signed by the Borrower, the fact that we had been trained by the Borrower and the Contractor to rely on the Contractor as the central contact point, the fact that we witnessed overwhelming credibility in terms of the documents we received from the Borrower through the Contractor, all told us that what we were looking at and experiencing was real, valid, and reflective of integrity.

I was ever aware that the Contractor had a growing level of familiarity with the 203(k). He knew how the mathematics worked on a 203(k). I had not seen him try to approach 203(k) projects that could not be done. All of the 203(k) loans he was involved with worked. He had been a party to scores of approvals and closings with the Oak Brook Carl I. Brown and Company office. I generally got the impression that he had a very good sense of cash requirements, values, rehabilitation amounts, feasibility issues, and qualifying. He had the ability and know-how to originate loans himself. I had not heard about any of the loans that he was involved with being rejected.

Every problem or obstacle was ultimately worked through. Since the Contractor did demonstrate these skills, and since the Borrower had already provided him with bank statements, I also tended to assume that the mechanics of the loan had already been evaluated from these different perspectives. This circumstance tended to make me question myself more closely rather than questioning the Borrower more closely. In short, I would operate with fewer skepticism’s about whether or not a loan would work, because I had clear evidence that there was a strong track record of every loan working.

Again, I believed that what I was seeing was a positive. It only acted to confirm the impression that a volume 203(k) approach would require a clear and decisive mind that could evaluate all these circumstances and deal with them. I had no idea that there was a giant invisible wall, behind which lurked a dark reality of deception, collusion, and fraud.

Partnership Agreements

With all of my years of experience in FHA lending, with all of my knowledge and exposure brought about by overseeing the production of hundreds of millions of dollars of FHA loans on a monthly basis throughout the United States when I operated in the capacity as Senior Vice President of Carl I. Brown and Company, with all of my voracious reading of HUD guidelines, I had never been involved with a loan where a partnership agreement existed.

No Written HUD Guidelines

From the start, I was unfamiliar with the nature and purpose of the agreement. In many ways, I was unclear about exactly what it was, why it was being used, what purpose it was to serve, how it came about, how it should be documented, and what HUD thought of all of it. There was absolutely no mention of it in any of the HUD regulations. There were no clear definitions in any of HUD's literature, mortgagee letters, or any other known HUD source.

No Direct Parallels

The concept of the partnership agreement could be seen and looked at in so many different ways, because it could be compared to so many different seemingly parallel events in a loan. Was it an entity that would take title? Was it formed for liability purposes? Was it an income source? Was it an asset pool? Was it an entity created for tax purposes? Would it reduce capital gains? Is that why it was formed? Would it result in a K-1 partnership return? Would it reduce expenses somehow? Was it an entity that was formed from profits of previous projects the Borrowers and the Contractor were involved with? Would it have it's own separate bank account? Were the amounts shown on the agreement actual cash investments, or were they something else? Were they payments or credits for services rendered from one to the other?

On many occasions, especially when I was with my previous employer, I was told I was too brainy somehow, and that I was not looking at things in their simplest light. Since I graduated with honors in literature and philosophy at an Ivy League institution on an academic scholarship, I was taught to question thoroughly and analyze carefully. This background had also sometimes acted as a detriment to me in the business world of give and-take. So I was, and am, sensitive to the idea of not over-doing it on factual, procedural, or policy matters. I am aware that sometimes I can reason too much, sometimes to a fault. And I learned that HUD did not want those kind of time-consuming inquiries from "men-in-the-field."

New Animal

No one I knew of in the entire mortgage industry had any background or experience in this area. No associate of mine had ever used one or seen one used. I talked to and telephoned numerous people to determine if any had experience with partnership agreements and came up with nothing.

Like other new animals the 203(k) theater seemed to be populated with, I concluded that the partnership agreement was just another new animal. I was simply unaware of it previously and I, along with others in my business, had not before witnessed this animal. Well, there were a lot of new things with 203(k). Since I couldn't get my arms around the idea, and had no historical guidance from others in the mortgage business, I had to rely on specific guidance from underwriters and HUD.

Easily Debated One Way or Another

It is difficult for me to both listen to and digest current opinions about what documentation should have accompanied the agreements in the past as far as bank statements, initial investment verification, etc. There is no written guidance anywhere to support any particular view. It is obvious these opinions are both made with the benefit of hindsight and are easily argued from one particular point of view. Documentation requirements, in hindsight, could be argued from a large range of perspectives, because the partnership agreement exhibits characteristics of so many different loan elements simultaneously.

Hindsight

In hindsight, one could just as easily now take the position that a partnership tax return, an audited financial statement, or bank account statements solely in the name of the specific partnership were required. Conversely, one could argue that if an FHA borrower has ownership in an S corporation or a partnership, then the lender is not required to reach back in time and verify that the borrower had the funds to initially capitalize the venture. One could point out that if a borrower owns stock, then there is no HUD requirement that the lender reach back in time to verify the source of funds used to purchase the stock. None of these recent approaches are ultimately valid because the partnership agreements fit into no known category comfortably.

No clear written HUD guidelines or HUD standards did exist in terms of spelling out what was needed to document a partnership agreement. Because of this circumstance, and because the partnership agreement has no clear parallel category, the possibilities are endless, and could be argued and debated a whole variety of ways.

I believe the idea of the partnership agreement had first been brought to the Contractor by one of the lenders soliciting his account that was not currently doing business with the Contractor (General Motors Acceptance Corporation I believe). The Contractor explained to me that partnership agreements were now in use on the 203(k) loans he was closing at Carl I. Brown and Company. By the time I was more involved with it, the Contractor had already discussed it and cleared it with Carl I. Brown & Company. All the research had evidently been done ahead of me before I was exposed to using the partnership agreements on Dollars Express 203(k) loans.

My focus then went into identifying whether or not the agreements were acceptable to HUD. If they were acceptable, and the Contractor and Borrowers anticipated using them, I needed to know what documentation was required to submit for underwriting purposes. In a gift situation, for example, the source of the funds and accompanying transfer receipts were clearly defined as the process for identifying and documenting funds. The partnership agreements, however, were not defined anywhere in writing, so I made every reasonable effort to confirm what was needed.

Carl I. Brown and Company Confirms HUD Guidelines

Carl I. Brown and Company's underwriters advised me that HUD approved of the concept, even though it did not appear anywhere in the regulations. Further, the local HUD office would define parameters and create definitions. In essence, the partnership agreements would be determined by regional HUD guidance.

I did not just add and submit, as the tone of the audit suggests. I made phone calls to the appropriate HUD designee, which in this case were the local and national FHA underwriters of Carl I. Brown and Company. I followed instructions carefully after being told that all of the elements in terms of acceptability and documentation were discussed with, and approved by the local HUD office. Who was I to question them? Why would I have reason to believe what I was being told was untrue?

All of my history at Carl I. Brown and Company confirmed the observation that the company did historically communicate liberally with HUD, especially in new areas of lending, and usually always moved to completely and definitively clarify matters with the Department where interpretation could exist. I knew this because I had first-hand knowledge of this history, and I had previously been a participant in it. This was the culture of the company. The senior underwriter, frequently discussed issues with ---------------, -------------, ------------, and, on occasion, ----------- of Washington HUD (I apologize if any name spellings are inaccurate).

Historical Credibility

On a variety of issues, the company I was previously employed with would actively and responsibly seek guidance on subtle or ambiguous issues. There was a general awareness, based on actual events in previous history, that situations could arise where a local HUD office offered guidance on a topic that later turned out to be at variance with Washington HUD's perspective. Since the company had previously suffered because of these types of misunderstandings, resulting in consequences I had witnessed, the company prided itself on both its access to, and focus on, Washington HUD as arbitrator. The company itself was national in scope, and therefore relied heavily on nationally-based HUD guidance.

I made every effort to confirm the acceptability of the partnership agreement itself, as well as the attendant required documentation, from

HUD's perspective. Every effort, both verbally and in writing, was made on my part to proceed in accordance with what would be considered normal HUD requirements with regard to partnership agreements. I initially made those efforts through the underwriters, both national and local, at Carl I. Brown and Company. I confirmed with them many times what had been discussed and verified with HUD, and was repeatedly told these topics had been very specifically and carefully examined and explored. After all, the same company was closing scores of these types of loans themselves using the same agreements. If they did not know, who did? If they did not have the most at stake in insuring HUD had approved this, who did?

Partnership agreements were included in the Borrower B and Borrower A files submitted to the underwriters at Carl I. Brown and Company. I followed the procedural and documentation requirements exactly as they defined them for me. There were no underwriting conditions made as to verification of initial investment. There were no underwriting conditions made as to any other required documentation like bank statements, partnership tax returns, or partnership financial statements, or any other attendant or supporting records.

Like the Old Gift Requirements

It is no coincidence that the initial Borrower A loan application reflects the idea of a gift from a partnership. I used the term gift from partnership on Borrower A's loan because it was a remembrance of the earlier Borrower B loan. I believe the Borrower B loan was the first loan where a partnership agreement was used. Based on specific underwriting requirements that were communicated to me by Carl I. Brown and Company's underwriters, the only documentation required by FHA, I was told at the time, for the partnership agreement to work was the agreement itself. There were absolutely no other documentation requirements, not even bank statements from the Contractor's account. I remember thinking to myself that it reminded me of the old HUD requirements pertaining to gifts. In earlier years, before HUD changed their guidelines, gift letters themselves were the only documentation required in connection with a gift. No source of funds as far as the donor's account was concerned. No documentation of receipt of funds to the recipient. Because the documentation requirements of the partnership agreement reminded me of the old gift rules, I remember that this is the reason I called it a gift from partnership. Again, no other documents were needed. The partnership agreement was self-defining, self-documenting, and self-verifying.

This was the underwriter's call to make, not mine. The whole partnership agreement issue was a new and untested area for me. I left it totally to the underwriter to determine what was needed. Underwriters establish guidelines. I responded to the definitions and parameters I was given to the letter. I did exactly what I as told to do. This was, and is, normal and prudent lending practice.

I believe that these circumstances help to clarify another area where the audit fails to segregate findings properly. Findings that should properly relate to Carl I. Brown and Company are being portrayed as findings relating to Legend Mortgage. Instructions, guidance, and input came from Carl I. Brown and Company to its correspondent lender, Legend Mortgage, and should be attributable to Carl I. Brown and Company, not Legend Mortgage.

Contractor Complaints Worsen

After the time frame of the Borrower B and Borrower A loans, circumstances seemed to begin to change with respect to the business between the Contractor, the Borrowers, and Carl I. Brown and Company. The Contractor, who had previously complained about deteriorating performance, lack of attention, and poor service at the local Carl I. Brown and Company office, now approached me with, again, what appeared to be a valid complaint or concern.

Assumptions Collapse

Now the Contractor was saying that the local branch office was not handling the assumption transactions properly on the 203(k) escrow commitment installment loans. Indeed, one of the oddities of the 203(k) program was that the originator of the initial 203(k) loan was, in some ways, implicitly responsible for helping to facilitate an assumption. Yet, there was basically no financial incentive to handle the assumption transaction. Since no fees (other than a flat $500) were charged on the assumption package, there was essentially no commission to be made. Therefore, it would not be the natural priority or focus of the originator, since the originator would likely tend to be concerned more with income-producing projects.

It made sense to me that this might happen. I recognized the potentially devastating shock waves of this circumstance. If assumptions were not taken seriously, then payments would continue to accrue, profitability would wane, and properties could sit vacant and remain vulnerable to vandalism. The Contractor expressed confidence that I knew better than to allow something like this to happen, and solicited me for a more volume intensive business relationship. He explained that, without a strong assumption focus and effort, real problems could occur. I agreed.

A Volume of Loans

At this juncture, I began to see that Legend could become involved with a volume of loans. We would perhaps no longer be just a minor compliment to the lion's share of the business that was taking place at Carl I. Brown and Company. We could potentially become the main lender handling these transactions. I felt it was appropriate that I verify, somehow on my own, that HUD had reviewed the use of partnership agreements. I felt the best approach was to try to break the circle that existed at Carl I. Brown and Company, and move new loans to other lenders and underwriters. I could direct those involved to communicate with HUD, and observed they would likely have a desire to do so on their own without my input, since there would be a need to conduct an independent HUD verification process in this unexplored area.

Partnership Agreement Requirements Change

Around this time, the underwriters at Carl I. Brown and Company had informed me that HUD had changed their documentation requirements for partnership agreements, and that HUD was now requiring bank statements from the partnership account, which was also the general operating account of the Contractor. This change in procedure led me to believe, again, that communication was taking place with the Department. How else could this change have come about unless there was an open dialogue?

A Tight Circle

At the same time, I saw a relatively tight circle of originators, underwriters, plan reviewers, and appraisers at Carl I. Brown and Company who were involved with the Dollars Express loans. I also saw that almost everyone involved had a direct financial interest in the loans closing I discussed using other lenders with the Contractor, who had not appeared open to this in the past. He agreed to my approach. In the past, he also had insisted on using the staff appraiser and plan reviewer at Carl I. Brown and Company. I persuaded him to use a different plan reviewer and appraiser.

There was anywhere between thirty to forty new loans that were referred to me during this period. It represented a lot of work, and it also represented a tremendous amount of income. I would guess that the fee income generated to my company would have been anywhere between $200,000 to $300,000, all in virtually one shot.

Resolve

I resolved that I would not close one of the loans that involved a partnership agreement until such time I had established independently, outside of the circle, that HUD was approving. Not one. even when I began Legend Mortgage Company in April 1995, Carl I. Brown and Company was my only wholesaler for FHA loans. I had left on good **terms,** wanted to send them all of my FHA production, and stay on good terms through an active, mutually profitable business relationship. After all, I had spent eleven years with them. There was a lot of history, many memories, and many deep relationships.

By August of 1995, 1 had worked to expand my own circle. Mortgage Now and Malone Mortgage Company were two new wholesalers that I had the ability to sell FHA loans to. Mortgage Now had a local office, which had been formed largely by previous employees of Carl I. Brown and Company. The FHA underwriter there had previously worked side by side with the local Carl I. Brown and Company underwriter who handled approving the Dollars Express loans.

Direct Communication with HUD

The first loan outside the Carl I. Brown and Company circle was Borrower C, one of the subjects of this audit. I brought the file over to the Mortgage Now underwriter, and explained to her what it was. I told her that she needed to pick up the phone and call the local HUD office about the acceptability of partnership agreements in general, and determine if the Contractor's bank statements were required or acceptable for documentation purposes. The underwriter did not feel comfortable with partnership agreements in general, which gave me confidence she would really look into it.

Verbal HUD Confirmation

The Mortgage Now underwriter communicated later to me that she had contacted the local HUD office, and upon request, had faxed a copy of the partnership agreement to them. Not a good sign. It seemed to say that HUD had not seen or reviewed it in the past as I had been told. She included her branch manager in the communication with the local office. The branch manager also witnessed everything that happened at this juncture. The response she got was that the partnership agreement and accompanying Contractor bank statements were acceptable, and that HUD would be issuing a letter forthcoming that would change the requirements for partnership agreements shortly. For now, everything was okay until the changes came about.

Not Blaming HUD

I am not suggesting here, nor would I ever suggest, that HUD somehow should have been able to intuit what was actually happening. I am not pointing out these events to castigate HUD in general or the local HUD office specifically. In retrospect they, like we, could only respond to what was seen, not what was invisible. These events all go to the question of whether or not I, and Legend Mortgage, followed HUD regulations as we knew them, and whether or not we acted prudently. But, I do wonder why I would ever be made more liable?

I will also point out that there are many things that have changed since these past events as far as my experience with the local HUD office is concerned. The staff at the local HUD office has become extremely accessible to me. They are very willing to answer questions and engage in a dialogue on various 203(k) (and other) issues. The office has provided valuable guidance, and continues to assist in creating daily definitions for our pursuits. I do not believe that the local office could ever have fully known the ramifications of the use of partnership agreements in conjunction with Dollars Express. All of us were duped as a result of an extremely well hidden agenda. But, I must ask again, "Why would I ever be held more **liable?"**

The Mortgage Now underwriter still seemed uncomfortable to me. She did not like partnership agreements regardless of what HUD had said. I was left with no formal reason to reject the loan. Neither was the underwriter. On one hand, HUD had said okay. On the other, the underwriter was not at ease. I was not about to push it, because I saw this. I told her to drop it. I would not ask her to approve it, even though there was no factual basis to deny it, and I would not hold it against her or Mortgage Now. This would not affect our future business relationship.

Written HUD Confirmation

The letter, which I believe eventually resulted directly from this event, is attached (see Exhibit #5). The letter describes that a detailed description of the investment strategy had been provided to HUD by Dollars Express, and that essentially, HUD was clearly defining what would be required on applications taken after September 1, 1995. I was relieved when I read it. HUD had, in writing, reviewed and responded to the entire issue. HUD had looked into everything. HUD would have had the opportunity to question anything that was unclear or suspect. There was no greater evidence I could ever ask for to confirm that all that had been done in the past as far as partnership agreements were concerned had been acceptable. Unambiguous, written definitions were provided for the future.

More Direct Communication with HUD

The Borrower C loan was then sent to Malone Mortgage Company. I had a good working relationship with the senior FHA underwriter. The senior FHA underwriter was already well aware of the volume of 203(k) loans at Carl I. Brown and Company with Dollars Express, an awareness that most of the 203(k) lending community in the area had. She was very interested in looking into the loan and the issue. I spoke to her about our mutual desire for her to contact the local HUD office, explain the matter thoroughly, and describe exactly what documentation was present so that compliance could be absolutely insured.

More Verbal HUD Confirmation

The senior FHA underwriter was, as I was, extremely focused on being as precise, as detailed, and as thorough as possible with her discussions with HUD. We both were well aware of the idea that since the partnership was an unusual matter, it was absolutely imperative to approach this issue with 100% certainty. Neither one of us wanted to be dealing with an insuring issue down the road (which is precisely what I am doing now). Accordingly, we discussed several times prior to her making contact with HUD, the absolute importance of being thorough and accurate. We also discussed the absolute need of documenting the discussion, whatever the results were. She reviewed the recent letter from HUD regarding partnership agreements and made the call.

More Written HUD Confirmation

The results of that telephone call are attached (see Exhibit #6). There really is not much to say because the documents speak for themselves. I am absolutely certain that every issue regarding the partnership agreement and required documentation was discussed. The senior FHA underwriter and I discussed in advance the vital importance of going over each and every documentation issue related to partnership agreements. She maintains that to this day that this is what she did. I am confident there was no requirement made by HUD to verify the initial investment made into the partnership by the Borrower. The credit file exhibits, as well as her later written confirmation, clearly speak to the idea that the down payment was coming from the Contractor's account. Other than what was in the credit package, no other documents were needed. I am confident I did everything within my abilities, and more than most would have done or would have thought to do, to act prudently in insisting on and directing clear communication with HUD on these matters, and responding accordingly.

Clear Questions Clear Answers

The questions to HUD were clear, precise, and simple. Are partnership agreements allowable on FHA loans? Is the form of this partnership agreement acceptable? What precise documentation is needed since I have never dealt with this before? All I have for funds verification in this file is bank statements from the Contractor, is that okay? Is anything else needed? Is HUD going to insure this loan? I am going to make notes in our file pertaining to this discussion, etc., etc.

Prudence in Lending

In August of 1995, I had every financial incentive to not break the circle that was present at Carl I. Brown and Company. I could very easily have continued closing loans there. They had not yet stopped doing business with Dollars Express. I could very easily have left them there, not moved outside, not made these attempts to communicate with HUD, and generated a lot of fee income in the process. I sought, and achieved, a meaningful dialogue with the Department through the channel they had expressed a preference for, the FHA underwriter. The dates, facts, circumstances, financial incentives, and records speak for themselves.

In pursuing confirmation outside of the circle that had formed, in pushing things in this direction, I believe I can say reasonably that I was the only person in the entire Dollars Express fiasco that tried to break up the circle at Carl I. Brown and Company, and speak to HUD through other underwriters outside it. There is only one possible conclusion that can be drawn as a result, the conclusion that also represents the truth. My incentive and motivation came from my desire to follow HUD guidelines and exercise prudent lending practices.

I made every effort to proceed in accordance with HUD requirements with regards to partnership agreements. Every other incentive around me led in directions that did not include making the efforts I made. It was not financially beneficial to pursue what I felt was necessary and responsible. It was not comfortable procedurally to do what I did either.

Scam is Exposed

The Borrower C loan was closed. We kept working on the loans we had. Shortly after that time, I was told that the Contractor had been making all of the payments on the loans, which had now accumulated to around **fifty** or sixty thousand dollars a month. There may be coming difficulties with making the payments, because the Contractor did not have that kind of income stream.

I canceled my business with the Contractor the moment I heard it. It was like a lightning bolt which instantly lit the landscape around me for an instant. It was a house of cards that was going to collapse. I knew it instinctively. It was a pyramid scheme with a finite end, one that would have many victims left in its wake. I informed the Contractor that our business together was over. I immediately rejected every Borrower's loan **file** that was in the theater of Dollars Express. I canceled loans that were already approved. I stopped closings that were already set **up,** even those that did not involve partnership agreements. The companies that had approved these loans were baffled. HUD has already checked out these loans, what's the problem? Let's close. What are you doing?

I shut it all down as fast as I could make a telephone call. The invisible wall had come down, and I saw the beginnings of what was on the other side of it. I knew that scores of loans could default. I saw this as potentially one of the largest HUD disasters in the country. I had never before witnessed, or even heard of, anything of this scale. One of my earliest thoughts was that it was likely one of the Borrowers was going to kill the Contractor, or arrange for his assassination. The south side of Chicago can be a rough place that operates with it's own system of justice.

What Did Happen and What Did Not Happen

While the audit attempts to speak to what the auditors think did happen, it clearly does not speak to what did not happen. The loans that did not close, the transactions I intentionally delayed so that I could get a clear confirmation from HUD, the deals that I ultimately prevented from consummating, are all together as strong an indicator as there is in illustrating that I, and my company, made every effort to act prudently and on HUD's behalf as well as our own. The auditors looked at what did take place, but could not see the ramifications of what did not take place.

It is as important to evaluate the actions I did not take as it is to evaluate the actions I took. I could have shuttled thirty or forty loans through Carl I. Brown and Company and made a quarter of a million dollars in the process. There was no evidence that anything was afoul at that point. There were no defaults, no clear problems, and ample and reasonable confirmation from HUD to proceed with closings. There literally had not been one single complaint, ever, from any Borrower on any issue. There were no complaints from any of the lenders involved. There were no complaints for HUD. Had I not delayed these loans, had I not taken a determined position to seek further confirmation, the entire loan debacle and the resulting damage would have ultimately been significantly increased. What else could I have done?

Uncompleted Rehab Work

Rumors began to circulate concerning the appraiser, Dollars Express, and rehabilitation work that was never done. I began to see more of what was on the other side of the wall. I remembered back to when I had requested an opinion, at the very beginning, from the underwriting department at Carl I. Brown and Company, during the time I was still employed there. I asked whether or not it was appropriate for an individual to function as both appraiser and plan reviewer.

Our parent company, via its national 203(k) coordinator, advised us that there was no conflict here, and that HUD did not have a problem with this. We were advised to use the company's staff appraiser for plan reviews and 203(k) appraisals rather than our own selections, because he was familiar with the area and was better equipped to handle the volume. From a cost and profitability standpoint, use of the staff appraiser would also help to defray the cost of his salary and other related expenses.

It was rather reluctantly, one could even say under protest, that we used him, since we had previously experienced problems with his lack of timely and efficient performance the prior year. Since that time, we had not used him on any branch appraisals. I had actually fired him at a previous point in time for his incompetence and irresponsibility. But the message from our corporate office was that the appraiser had turned a new cheek, and had come back to life as a competent appraiser/consultant because of the 203(k) program. We loyally followed the corporate line of thinking, and helped them to facilitate their agenda by using him again.

Appraisals

If there were inflated appraisals, if the values were too high in HUD's eyes or the eyes of a review appraiser, then I was unaware of the problem. I know that different pockets in the vast inner city of Chicago can experience varying values based on neighborhoods and a whole host of various characteristics. I also saw many appraisals that came in below the initial target value the Contractor anticipated, which therefore gave the appraisals credibility in my mind. I was unaware appraised values were inflated from HUD's perspective, and cannot and will not begin to address whether this assessment is valid or not. I am not an appraiser, and do not have the technical ability to underwrite appraisals. My company, and I, relied completely on the FHA appraiser and the FHA underwriter to review appraisals and the values reflected therein. In the area of appraised values, we leave decisions and evaluation to more experienced minds and eyes. This is a common and prudent lending practice.

When I became Legend Mortgage Company, the wholesale office offered their staff consultant/appraiser, to correspondents as a Service on 203(k)'s. The Contractor insisted he be used, since he was both familiar and responsive. Since no problems were perceived at that point, I had no reason to discourage this approach. Indeed, it appeared that the appraiser's work had improved dramatically. The appraiser was seen as an ever-present fixture at the Dollars Express office. Also, there were many occasions that arose when, by the time I had the loan referred to me, I was told that this consultant/appraiser had already reviewed the project because it had been previously anticipated that the loan would go to Carl I. Brown and Company. It was only because of poor service in the processing area that the decision had been later made to refer the loan to Legend.

Construction Draws

My company generally handled the entire construction draw process on all 203(k)'s we originated. We collected, forwarded, and recorded all attendant lien waivers, construction permits, inspections, and checks so that we could control and oversee the disbursements. However, on the loans we sold to Carl I. Brown and Company, Legend was taken out of the loop. Since the Contractor and the 203(k) staff at Carl I. Brown and Company's corporate office were accustomed to one another because of the vast volume of projects, the Contractor went directly to Carl I. Brown and Company for draws without involving me. I was never involved with any of these procedures on any of these loans.

I believe this area is another example of how the audit fails to properly segregate findings. In the case of each loan outside of Borrower C, I and my company were never involved in any of the inspections or draw processes. Because the three loans had been assigned to Carl I. Brown and Company as lender, and because Carl I. Brown and Company entirely and fully handled the construction draw processes, Legend Mortgage was not in any way, shape, or form involved with this aspect of the 203(k)'s. It is inappropriate for these findings to appear in the scope of an audit relating to my company and me because the presence of these findings implies malfeasance on my company's part.

In retrospect, had the use of the staff consultant/appraiser not been mandated initially, our involvement in the Contractor's deals would likely have been terminated from the onset. The entire setup, as we now know it, would never have worked for the Contractor. The only loan where Legend was involved in the draw procedures was the only transaction closed outside of the Carl I. Brown and Company circle, which was Borrower C's. This fact was evidenced in our files.

Although the auditors could not confirm all work was completed under the Borrower C 203(k) because of vandalism, they were able to confirm that the property had been completed according to the 203(k) specifications ultimately. I have no doubt that the property was completed properly during the 203(k) inspection process because I had directed use of a plan reviewer other than the appraiser. I also feel this is a noteworthy illustration of my prudent attempts to break the circle at Carl I. Brown and Company, which produced more positive results in turn.

Forged Signatures

Borrower C evidently shared in his interview with the auditors that he had his name forged on the inspection performed, and that he himself had never visited the property. Without being repetitive and belaboring previous observations I have made, I will simply say that I had no knowledge of any forged signatures. I also had no reason to believe that signatures had been forged.

This is also true, obviously, of any and all forged signatures that occurred in relationship to any of the Dollars Express loans. No one caught them, myself or anyone else. If we had, I have no reason to believe, based on all that I have shared here, that the Borrower would have confirmed their signature had been forged. Based on their arrangement with the Contractor, they likely would have said let me call you back, and proceeded to get direction from the Contractor. The agreement between the Borrower and Contractor obviously included a system of checks and balances involving what was communicated to whom when, which actively prevented others from seeing what was behind the invisible wall.

Like the partnership and lease agreements we received I, along with everyone else, had no reason to suspect they had been forged. You do not throw red flags up when there is no reason to suspect anything is wrong, when there is no inkling or likelihood that a document is not real. In the course of processing any loan, it is common for a Realtor or a builder to fax through documents requested from the borrower. Real estate contracts, letters of explanation, lease agreements, paystubs, bank statements, and sometimes credit reports, all would be typical examples. Just as we would not be inclined to pick up the phone and ask the borrower, in a situation like this, whether they actually signed the contract, a lease, or a letter, we were not inclined to do so on these loans. There was no reason to even suspect the signatures were forged.

Actual Partner Providing

Since the partnership agreement was being provided by one of the actual partners, there was further reason to accept it, because it no longer was a third party document. The Contractor was a first party to the agreement. We also naturally assumed that the Contractor had the Borrower's permission to send it to us. This was true not only because of the Borrower's past track record of providing documents directly to the Contractor, but also because the Contractor was supplying an agreement that was his copy of an agreement that he had executed with the Borrower. In some ways, it was completely natural that, as a party to the agreement, as the partner, he could and would also be able provide the document to us. Similarly, if we receive a gift letter directly from a donor, a donor who is not our borrower, and the gift affidavit was signed by the borrower, we would have no reason to question the borrower as to the legitimacy of their signature, because the donor is also making a representation of their own that will be used in the context of the loan.

Applications and Partnership Agreements

The draft of the audit findings and discussions with the auditors themselves has continuously addressed the idea that the initial and/or final applications that the Borrowers signed did not illustrate the partnership agreement as a source of funds. I have already made observations about circumstances where it is common for initial applications to reflect later additions or modifications during the process of originating and processing a loan, and I will not reiterate those thoughts here.

The Borrower B loan does not reflect the partnership agreement under source of funds on the initial loan application. It is clear that when the initial application took place, partnership funds were not part of the picture. The loan was initially submitted sometime before 5-27-95 (the date of the underwriter's approval) because there is a processor's certification to the underwriter concerning Borrower B's Kemper stock fund that was dated 5-495 regarding an underwriting condition #59. Evidently, the loan was first underwritten prior to the second and final underwriting. Neither the initial underwriter's review sheet or the initial underwriting conditions appear in the file, the reason for which escapes me. It appears that the initial underwriter was questioning cash needed for closing, and more than likely one of the options the underwriter was looking at was evidence that the stock account had been liquidated.

I am assuming the Borrower and/or the Contractor was advised that we would need evidence that the stock account was cashed in. Subsequently our office received a fax of a partnership agreement between Borrower B and Dollars Express. We had no reason to suspect this was at all problematic, for all the reasons I have previously described. The agreement was then forwarded to the underwriter, who forwarded an approval without further requirements. The underwriter did not make any requirement to change the 1003, the final application, which would be signed by the Borrower at closing. Neither underwriter nor processor added the item to the final application. Assuming that it is a requirement for the partnership agreement to appear on the initial or final 1003, this circumstance was obviously a last minute oversight on the part of both my office and the underwriter. I do not believe it is a material oversight, based on all I have shared here.

Both the Borrower A and the Borrower C initial applications reflect the partnership agreements. There is no reason for me to engage a debate on whether or not the partnership agreement appeared at the time that they signed them. As matter of record, I fully believe that the initial applications did contain this information at the time that they were signed. I have reviewed them again and tried to put myself back at that place and time in my memory. I used the term "gift from partnership" on Borrower A's initial application because I remembered Borrower B's partnership agreement, and the absence of any other documentation requirements outside of the agreement itself. I also recall that I reflected the partnership agreement and a $15,000 amount on the document prior to the face-to-face applications taking place because the question came to my mind as to what dollar figure would be appropriate to reflect. Would I use the amount reflected on the other agreements that described initial partnership investment, or would I use my estimate for what was needed at closing? Believing that it would be safer to use the higher amount for application purposes, I used the $15,000 number. The issues I considered at the time strengthen this memory.

The audit findings claim that, in the case of Borrower A's loan, I had stated that I would have had no knowledge of the partnership agreement prior to the agreement being foxed to our office. That is not true in the case of Borrower A's loan, and I do not recall ever saying that. It would have been true on Borrower B's loan though. Maybe the auditors and I got our wires crossed here. The probability is that, based on the initial review of Borrower A's credit package given to us from her through Dollars Express, discussions would have taken place regarding source of funds to close. I would have been told there was a partnership agreement when I pointed to a potential shortage of funds to close.

In any case, the Borrower C final application that was signed at closing did reflect both the partnership agreement and the dollar amount, so the question becomes moot on that loan. Borrower C's final 1003 application reflected the existence of the partnership agreement and the corresponding amount. I assume he read his closing documents. He did not question it or object to it. He was given the opportunity to speak to it if he felt compelled to. Because of the Contractor's fraudulent representations to the Borrowers, there would not have been a reason or likelihood for a Borrower C to point out something like this. Nor would there have been a reason or likelihood for any other Borrowers to do so.

The underwriter did not require the partnership agreement to be added to the final 1003 on the Borrower A loan. If Borrower A maintains a specific recollection of the absence of the partnership agreement on her initial application, a recollection which I find incredible and one that I disagree with in terms of probability, then if the Inspector General's office can direct me to an appropriate forensic laboratory, I can sponsor an analysis of the original document. If this disagreement, or this issue, is central to HUD's evaluation of me and my company, then modem science should enable a precise determination of the matter. Notwithstanding, for all the reasons I have previously cited, I believe this question is largely irrelevant in terms of drawing the conclusion that my company and me acted prudently, and in accordance with HUD requirements.

Borrower D's Loan

In the case of Borrower D, the only loan examined in the audit without a partnership agreement, there are two central issues needing to be addressed. First, as to the presence of a falsified lease agreement, I had no reason to believe the lease was manufactured or forged. Like other documents, I assumed the Borrower's signature and the Contractor's possession of the document was adequate confirmation that the delivery of the lease to us from the Contractor implied the Borrower's permission for the Contractor to do so. This was a standard pattern all along. We had no reason to believe it was not valid.

The initial signed loan application reflects the lease amount. I will not debate whether or not it was added at a later time and am again amazed at the incredible memory the Borrower demonstrates in precisely recalling that this section was incomplete three years later. In any event, the final 1003 application did reflect the lease agreement and the corresponding monthly lease amount. The Borrower did have ample opportunity to review this information in connection with the loan closing and point out it was in error. If the Borrower did see it, at any point in the process, I will suggest again that he would not have pointed it out because of the agreement between the Contractor and the Borrower.

With respect to the issue of verifying assets to close on Borrower D's loan, I share the view that the auditor's have on this loan. It clearly was in error for the 401-K plan not to have been more closely scrutinized in terms of its value and remaining balance. My processing staff, the underwriter, and I all missed the boat. The initial application reflects a larger balance in the savings plan than eventually turned out to be the case. It was unclear whether or not this account was a savings account or a 401-K from the onset. A pre-tax loan payment against a 401-K appeared on the paystub. The proper identification of this account, as well as a detailed investigation of the remaining balance, did not fully take place after the loan application was taken. If income tax ramifications should have been accounted for, they were not properly taken into consideration.

Clearly, the underwriter had no issue with what was presented in the file, as there were no further approval requirements made. We gave the underwriter our complete credit **file,** knowing that her approach may or may not agree with ours, aware that there could be further requirements. Obviously, there were none on this loan. If there had been, we would have requested more documentation or performed more analysis in an attempt to comply. I do not pre-underwrite loan files, nor do I re-underwrite them after an underwriter has reviewed them. The file was neither processed nor underwritten as required by the 4155 in the area of using 401-K funds for closing.

I will point out that, in retrospect, the income tax ramifications could have been avoided in terms of valuing the assets needed to close. The auditors point to the idea that the remaining balance in the 401-K, minus resulting income taxes if cashed, did not come up to the amount needed to close. If the underwriter had required that the Borrower provide evidence that a loan had been taken out against the 401-K in an amount needed to close, a balance that was available in the account on this particular loan, then HUD requirements would have been met. There would not have been income taxes due, and the resulting loan obligation would not have been counted against the Borrower's qualifying. Therefore, there would not have been a shortage of funds in the account. In any case, this was not done either. It was an unintentional omission of unknown information. It was an honest mistake, both the Underwriter's and ours.

Chain of Title Requirements

The final mechanical issue I need to address relates to the chain-of-title requirement in relationship to the Borrower C loan. I agree with the auditors that Mortgagee Letter 95-40, which requires that the lowest sales price within the previous year be used for 203(k) maximum mortgage calculation purposes, went into effect on September 13, 1995. The appraisal was completed 6-3-95. The initial loan application and 203(k) maximum mortgage worksheet was completed on 8-25-95, prior to the effective date of the Mortgagee Letter.

The Mortgagee Letter does not speak to how the new requirement applies (i.e. loan application date, appraisal date, approval date, or closing date). I will not attempt to interpret the meaning of the requirement as it appears in Mortgagee Letter 95-40, I can only point to the idea that the timing between the application, worksheet, and Mortgagee Letter is significant. Malone Mortgage could well have referred to the date on the application, appraisal, and worksheet, and concluded no title search was required based on the wording of the Mortgagee Letter. They may not have received the Mortgagee Letter until some time after September 13. They may not have understood its contents completely, and like other lenders, needed clarification of it so they could implement it properly. When HUD implemented the chain-of-title requirement, many lenders did not understand it fully, myself included. But I can't speak for Malone's underwriters on these matters, I can only point to possibilities.

In general, the FHA underwriter will make these requirements if needed, and the underwriter made no requirements in this case. Also wholesale lenders, like Malone Mortgage and Carl I. Brown and Company, perform the chain-of-title research when mortgage brokers submit 203(k)'s to them, since they want to insure compliance themselves. They do not rely on the mortgage broker in general for this research. This is true in the Chicago area at least. As a result, Legend Mortgage does not run title reports to satisfy the chain-of-title requirement, because we know our efforts would be duplicative.

The Aftermath

One of the comments made to me by the auditors was that they were surprised that I had not called the Borrowers, or talked with them, after the Dollars Express fiasco became known. Once the facts of the scam became known, once the invisible wall had dropped, it was evident to me that the Borrowers had been severely wounded by the Contractor. I did not feel it was appropriate to point out the obvious to them and to share my regrets, just like I would not feel comfortable going to visit a car wreck victim right after a crash occurred, when that victim was surrounded by family and doctors. It did not seem appropriate or timely for me to inject myself into the middle of it. They were in a lot of pain. I felt like they were probably in shock and disbelief, were in the process of trying to get their arms around the damage and the ramifications of it all, and were exploring possible responses or remedies.

What had happened was obvious. What was there to say? I was aware that there were lawsuits beginning to be filed, because foreclosures were rapidly approaching. I knew that a legal morass was potentially underway. During this time, I did not even know if it was legally appropriate for me to communicate with them. Legend Mortgage Company was never, at any time, named in any suit brought by any Borrower. We were never drawn into any legal conflict. I always believed, and continue to believe to this day, that I and/or my company were never named or brought into any suit because we acted prudently and responsibly throughout. I also assumed the Borrowers saw this was true, remembered my involvement and meetings with them, and knew I had been duped right along side them.

I did communicate with the Contractor's partner, who called me a few months after the train came off the tracks. He was courteous and genial towards me, and shared that he was not associated with the Contractor anymore. He could not believe the fraud that had been perpetrated on his family members, who now nearly disowned him for involving them with Dollars Express. I remember his Cadillac was being repossessed the day he called. And his wife was trying to communicate to their various family members and Carl I. Brown and Company to look for solutions to the crisis.

He asked if I could speak to any of the other independent 203(k) investors or non-profit organizations that my company was working with, so that they could look at the idea of potentially purchasing some or all of the properties involved with the scheme. I told him I felt sorry for his situation with his family, and explained that I would help any way I could. Over the ensuing days, I spoke with his wife because he appeared to be emotionally incapacitated by it all, and was fearful of answering his phone personally because so many people were extremely angry. I performed a rough analysis of the property portfolio she brought to me. It became very clear, almost right away, that there was no possibility of selling the properties because of the outstanding indebtedness that had been styled by construction draws for work that was never done. She thanked me for my effort and understanding. I wished her and her family well, and asked her to give my best to any --------------- involved with all of this.

Hidden Value

What value was hidden in all of these events? How did our experience with Dollars Express help us? We all learned: me, my company, various other mortgage companies, underwriters, appraisers, plan reviewers, HUD officials, even auditors. Since these events occurred, we gained invaluable understanding of things to watch out for in the theater of 203(k) lending. I hope we can smell a rat a mile away now, because we know what to look for. I hope we are more familiar with the subtle signals, and more attuned to the faint warning signs. We look beyond the apparent, beyond the obvious, and beyond appearances carefully and regularly. We learned new disclosure techniques, new origination practices, and above all, gained the knowledge that a mortgage company engaged in 203(k) lending must ultimately control every aspect of the entire project, start to finish.

Statistics

Since Legend Mortgage Company opened in April 1995, it has closed 598 FHA loans. Over ninety five percent of our business is FHA. Out of those 598 loans, 278 are FHA 203(k) rehabilitation loans. 47% of our entire FHA loan production is 203(k). The local HUD office tells me that we are by far the most active 203(k) originating lender in the state, probably the Midwest. Based on statistics I have had glimpses of, we may be the most active 203(k) originating office in the United States. Through viewing these statistics, one can see clearly that Legend Mortgage Company is, at its very essence, an FHA 203(k) lender.

I have also heard of general statistics concerning FHA 203(k) delinquencies throughout the United States when I have attended various FHA seminars and symposiums. If I look at the delinquency rates on the FHA 203(b) and FHA 203(k) loans that Legend Mortgage Company has produced over a three year period, then I can see that we are performing at a level that is significantly below the national averages I have heard of. Our loans are performing, and our 203(k) loans are faring well.

Delinquency Evaluations

As part of my response to the audit findings, I am formally requesting that the most recent delinquency data available to the Department on Legend Mortgage Company be pulled and compared to the most recent delinquency data available for both FHA 203(b) and FHA 203(k) loans on a national basis. Based on the precise numbers and percentages I have provided, the Department can get a crystal clear picture of our overall performance as an FHA correspondent, especially with respect to 203(k).

There is no better evaluation possible that will clearly speak to our concern for following FHA guidelines and exercising prudent lending practices. At the risk of sounding self-congratulatory, I am both very proud and humbled that Legend Mortgage has become one of the finest FHA 203(k) operations in the country, if not the finest. I am very proud of our work in 203(k), and have chosen to share some articles that have been written which includes us (see Exhibit #7). Our statistics will speak for themselves in this matter. I feel they need to be seriously looked at and considered in the context of this audit, and am formally requesting that this type of evaluation occur.

Legend Mortgage Company

I also believe that it is safe to say that our local HUD office informally recognizes Legend Mortgage as a leader in the local 203(k) marketplace. We enjoy an excellent relationship with the local HUD office, and have worked hard to earn their respect as an honest and knowledgeable 203(k) lender. As only one example, when the escrow commitment aspect of the 203(k) loan evaporated, and the program no longer could be used to facilitate no down payment re-sales, I worked closely in conjunction with the local HUD office to explore different approaches that would allow us to continue effective work in the low-to-moderate income community.

Because Legend Mortgage Company, I am told, works with more nonprofit organizations, churches, towns, cities, municipalities, and housing authorities than any other lender in the Illinois 203(k) theater, we are also indirectly involved with the purchase of scores of HUD-owned properties on an ongoing basis. Through this credibility and track record, we were able to successfully seek the Department's approval to allow the organizations we work with to gift all funds needed to low-to-moderate income residents to purchase a Direct-Sale originated, fully rehabbed property from them. We provided both the necessary impetus and regulatory background needed to implement this effort.

As a result, homeownership has been accessed by dozens of families who otherwise would have been denied. I am attaching the most recent listing of "zero-down" properties that our company provides to hundreds of real estate organizations and non-profit groups in Chicagoland on a monthly basis (see Exhibit #8). As far as we know, out of the 112 properties that appear, 64 have sold and closed. Since our delinquency rates generally include these "zero-down" transactions, Legend's FHA portfolio performance also implicitly rejects the theories of critics who argue that a cash investment from a first-time homebuyer is an indispensable component of loan performance. These are the same critics who preferred to see the escrow commitment feature of 203(k) done away with.

Legend Mortgage Company is a living, functioning testament to the ideas that 203(k) can work successfully on a volume basis, that the 203(k) loan can be properly administered and controlled by a lender, that non-profit groups can participate in FHA 203(k) with integrity, and that low-to moderate income families can realize homeownership without a cash investment and still perform on their mortgage loan. And in the process of demonstrating these ideas through our non-negotiable statistics, we illustrate our prudent approaches to FHA lending.

With God's grace, Legend Mortgage Company has also been able to participate in a Christian marriage ministry based in Phoenix, Arizona called Life Partners. Legend has been able to share gifts of financial support, a computer network system, a sophisticated laptop computer for visual presentations, and the recent development of a Web Site for the ministry. The ministry focuses on men learning to become more understanding towards their wives and families. In the area of housing, Legend has been able to help stabilize families through assisting in creating a new physical living space, and through this ministry has been able to reach deeper into the hearts of families.

A Request

I would also like to be able to request that ---------- of the Chicago HUD office is given a copy of this audit response. She has been instrumental in helping to guide us. She has helped us to learn and grow. I would like her to share in this dialogue concerning Dollars Express. She is very familiar with the issues, and knows us well through our work. I have not enjoyed being placed in a position throughout this entire audit process that appears to put us at odds. I have the highest level of respect for her and trust that she will approach these matters in a balanced and even fashion. The audit findings point to the idea that had all been properly disclosed to her, she would have rejected the loans in question. I could not agree more. Had I known more, I would never have originated them. I do not believe we are at odds.

I would also like to thank the reader of this text for bearing with me. These are complex matters that have required me to be lengthier than I anticipated. Forgive me for being long-winded.

Closing

In closing, I want to say that I hope that I have not portrayed critical or judgmental attitudes towards the Borrowers in the course of offering this historical account. I hope that I have not treated them harshly somehow in the course of this response. They were, and are still, the primary victims of the deception these loan files only begin to record. They will likely live out the rest of their lives with unrest because of it. I wish that I could have prevented this from happening to them. It is easy to overlook the human tragedy that has occurred here when dealing with mechanical issues relating to loans. And it was a great tragedy for all those who were touched by it.

I also hope that I have been helpful in terms of shedding new light on the audit findings. Most of what I have shared here would not have been evident to the auditors, who only had the benefit of documents in a loan file and interviews that were not completely informed.

Thank you for the opportunity to dispel the negative conclusions of the draft audit findings. Since clearly many people were involved in and ultimately therefore also bear the responsibility for the types of problems described in the audit findings, I hope that it will also be clear that David Whitacre and Legend Mortgage Company cannot justly be the focus of liability for them.

I, and Legend Mortgage Company, did act in accordance with HUD guidelines, and demonstrated a high standard of prudent lending practices all throughout the course of business involving the loans in question, and in all of our dealings with Dollars Express.

I am hopeful that the Department will see this clearly now, and will also see fit to resolve this audit in a manner that is fair, balanced, and reasonable towards Legend Mortgage Company. Legend Mortgage Company and I need to be able to continue what I believe is excellent work in the area of FHA 203(k), and FHA lending in general.

Thank you for your consideration, and for the opportunity to respond.

Distribution

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Acting Secretary's Representative, Midwest
Director, Office of Housing, Illinois State Office (2)
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