audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
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96-AT-221-1004

TO: Nicolas P. Retsinas, Chairman, Mortgagee Review Board, H

FROM: Kathryn Kuhl-Inclan
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Waters Mortgage Corporation
Non-Supervised Mortgagee
Plantation, Florida

Attached is our report on Waters Mortgage Corporation for selected HUD-insured Section 203(k) rehabilitation home loans originated in Florida. The report identifies significant loan origination deficiencies which warrant action by the Mortgagee Review Board.

We have provided a copy of our report to William M. Heyman, Director, Office of Lender Activities and Land Sales Registration, to facilitate preparation for the Mortgagee Review Board meeting. We are continuing to review additional loans originated by Waters Mortgage Corporation. We will keep you advised of the results.

Should you or your staff have any questions, please contact Nancy H. Cooper, Assistant District Inspector General for Audit, at (404) 331-3369.

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Executive Summary

We completed a review of Waters Mortgage Corporation, a non-supervised mortgagee, generally for the period July 1, 1993, through May 6, 1994. We extended some tests through August 10, 1995. The audit objective was to determine if Waters Mortgagee originated HUD-insured Section 203(k) rehabilitation home loans according to HUD requirements. We reviewed Waters Mortgage as part of a HUD-wide review to determine if the Section 203(k) Program promotes home ownership in an effective, efficient, and economical manner.

Our test of 107 loans, all to the same borrower, showed that Waters Mortgage did not originate the 203(k) loans in accordance with HUD requirements.

We identified

In all 107 loans we reviewed, Waters Mortgage did not follow HUD loan origination requirements. In 79 cases Waters Mortgage furnished HUD false or incomplete data to use in deciding whether to insure the loans. Waters Mortgage did not require the borrower to make a downpayment and approved even more loans after the borrower had failed to timely complete the property rehabilitation work for previous loans. For 95 of the loans, Waters Mortgage approved ineligible and unsupported closing costs which were paid to Waters Mortgage and the borrower.

As a result, HUD insured abnormally high risk loans totaling $3.7 million which it may not have insured if Waters Mortgage had provided complete and accurate information to HUD. At the completion of our review, 8 properties with loans totaling $572,550 were in the process of being conveyed to HUD, and 3 other loans totaling $237,450 were in default. Also, because the borrower did not timely complete the rehabilitation work, the borrower sold 44 of the 107 properties. The buyer of the 44 properties obtained new 203(k) loans from Waters Mortgage which totaled $218,500 more than the original loans further increasing HUD's risk.

Waters Mortgage did not exercise prudent lending practices or place proper emphasis on protecting HUD's interests in the loan origination process. We are recommending that the Mortgagee Review Board take appropriate sanctions against Waters Mortgage.

We discussed our review results with the Waters Mortgage Chief Executive Officer during our review. He generally did not agree with the audit finding. We have included his comments in the appendices supporting the audit finding as appropriate. We also sent Waters Mortgage a copy of our draft report on March 18, 1996. Waters Mortgage declined to submit formal written comments for inclusion in this report.

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Abbreviations

CFR	Code of Federal Regulations
FHLMC	Federal Home Loan Mortgage Corporation
HUD	U.S. Department of Housing and Urban Development

Introduction

Background

Waters Mortgage Corporation is a non-supervised mortgagee which originates loans in Florida and other states. The main office is located at 8751 Broward Boulevard, Suite 500, Plantation, Florida. Waters Mortgage also has offices in Georgia, Illinois, Virginia, and Texas.

Waters Mortgage originates HUD-insured loans, including 203(k) loans. The 203(k) Program is HUD's primary program for the rehabilitation and repair of single family properties. The program enables the borrower to finance both the acquisition and rehabilitation of a property with just one loan, at a long-term fixed (or adjustable) rate.

Audit objectives, scope and methodology

Our objective was to determine if Waters Mortgage originated HUD-insured 203(k) rehabilitation home loans according to HUD requirements. Our audit generally covered the period July 1, 1993, through May 6, 1994. We extended some tests through August 10, 1995. Our audit included a review of Waters Mortgage's system of administrative controls and practices. We reviewed 107 loans originated by Waters Mortgage consisting of 67 in Riviera Beach, 28 in Deerfield Beach, and 12 in Miami.

The loans in each location involved the same borrower, seller, and settlement agent and were closed at the same time. The loans in Riviera Beach and Deerfield Beach were for co-located properties. We made detailed reviews of the loan origination files for four Riviera Beach loans, for two Deerfield Beach loans, and for two Miami loans. Because much of the documentation in each of the 3 groups of loans was nearly identical, we scanned the loan origination files for the remaining 99 loans.

For all 107 loans, we verified selected data on the settlement statements. We inspected selected units in Riviera Beach and Deerfield Beach. We reviewed the rehabilitation escrow summary files for eight Deerfield Beach and seven Riviera Beach loans. We verified the mortgage status for all 107 loans. All of our samples were selected on a judgment basis.

We performed the audit from August 7, 1995, through March 18, 1996 in accordance with generally accepted government auditing standards.

Waters Mortgage Failed to Originate Loans According to HUD Requirements

Waters Mortgage did not exercise prudent lending practices or comply with HUD requirements in the origination of HUD 203(k) loans. In 79 of 107 loans we reviewed, Waters Mortgage furnished false or incomplete data to HUD to use in deciding whether to insure the loans. Waters Mortgage did not require the borrower (a non-profit) to make a downpayment and approved the borrower even after it had failed to timely complete the property rehabilitation work on previous loans. For 95 of the loans tested, Waters Mortgage paid ineligible and unsupported closing costs to itself and to the borrower. As a result, HUD insured abnormally high risk loans totaling $3.7 million which it may not have insured if Waters Mortgage had provided complete and accurate information to HUD. At the completion of our review, 8 properties with loans totaling $572,550 were in the process of being conveyed to HUD, and 3 other loans totaling $237,450 were in default.

Criteria

Title 24 of the Code of Federal Regulations, Part 200.163(b) states that:

> The mortgagee shall exercise due diligence when underwriting mortgages. Due diligence means that care which a mortgagee would exercise in obtaining and verifying information for a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment. Compliance with HUD's handbook requirements will be considered by HUD to be the minimum exercise of due diligence in the underwriting of mortgage loans. The mortgagee shall determine the eligibility of the property and prospective borrower in accordance with program requirements included in 24 CFR part 203.50.

Applicable HUD requirements are included in Handbook 4240.4 REV-2, 203K Handbook, Rehabilitation Home Mortgage Insurance; and Handbook 4155.1 REV-4, Mortgage Credit Analysis for Mortgage Insurance on One to Four Family Properties.

We reviewed 107 loans originated by Waters Mortgage from July 1, 1993, through May 6, 1994, as shown on Appendices E-G. The loans were made in three groups to the same borrower, New Day Outreach Centers, Inc., a non-profit organization.

Origination deficiencies

All 107 loans included significant origination deficiencies which are summarized on Appendix A and discussed in detail in Appendices B-D.

For 79 loans, Waters Mortgage gave HUD documents which Waters Mortgage knew included false information about the borrower's downpayment. In 67 cases, the purchase price of the properties was improperly inflated resulting in excess loan proceeds of $342,336. Waters Mortgage used $167,098 of the $342,336 so that the borrower did not have to make downpayments for the loans. Waters Mortgage kept the remaining $175,238. About 8 months later, Waters Mortgage approved 12 more loans when it knew the borrower did not have sufficient assets to make the required downpayments. For the borrower's downpayments on the 12 loans, Waters Mortgage used $31,668 of the $175,238 which it had kept from the closing of the earlier loans.

Waters Mortgage approved 12 loans when it knew that the borrower was not a good credit risk. At the time Waters Mortgage approved the 12 loans, the borrower was behind schedule in completing property rehabilitation work for 95 previous loans. Waters Mortgage did not give HUD this information.

For 95 loans, Waters Mortgage was paid $16,675 for ineligible closing fees and $8,400 for unsupported closing fees. Waters Mortgage also approved ineligible closing fees of $15,364 which were paid to the borrower.

Although HUD required the rehabilitation work to be completed within 6 months, the borrower had not completed the rehabilitation of 40 properties when we inspected them over 23 months after the loan closings.

As a result of the origination deficiencies, HUD insured abnormally high risk loans totaling $3.7 million which it may not have insured if Waters Mortgage had provided complete and accurate information to HUD. All 107 loans initially went into default. The borrower subsequently sold 95 of the properties and the new buyer assumed 51 of the loans. For the other 44 properties, the original loans were paid off and Waters Mortgage issued new 203(k) mortgages. The 44 replacement loans totaled $218,500 more than the original loans further increasing HUD's risk. As of March 8, 1996, 52 of the remaining 63 loans (107 less 44) were current, and 11 loans totaling $810,000 were in default. The properties for 8 of the 11 loans totaling $572,550 were in the process of being conveyed to HUD.

The problems occurred because Waters Mortgage did not place proper emphasis on protecting HUD's interests in the loan origination process.

Recommendation

We recommend that the Mortgagee Review Board take appropriate sanctions against Waters Mortgage.

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Internal Controls

In planning and performing our audit, we considered the internal control systems of Waters Mortgage Corporation to determine our auditing procedures and not to provide assurance on internal control. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specific objectives. Internal control consists of interrelated components, including integrity, ethical values, competence, and the control environment which includes establishing objectives, risk assessment, information systems, communication, managing change, and monitoring.

We determined that the following internal control category was relevant to our audit objectives:

- Origination of HUD 203(k) loans

We evaluated the control category identified above by determining the risk exposure and assessing control design and implementation.

A significant weakness exists if internal control does not give reasonable assurance that the entity's goals and objectives are met; that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, we concluded that weaknesses existed with Waters Mortgage Corporation's procedures for originating HUD 203(k) loans. The weaknesses are discussed in the finding.

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Follow-Up On Prior Audits

Charles J. Boyer, Certified Public Accountant, performed the last audit of Waters Mortgage Corporation for the year ended August 31, 1995. The report contained no audit findings.

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Deficiencies in Loan Origination

No. Loans	Cash to Close Not Verified	Down-payment Falsified	Ineligible/ Unsupported Closing Fees	Faulty Underwriting Decision	Rehab Work Not Timely Completed
67[1]		X	X		X
28[2]			X		X
12[3]	X	X		X	
Totals	12	79	95	12	95

[1] Loans for 67 properties in Riviera Beach, Florida. See Appendix E for the case numbers, amounts, and loan status. See Appendix B for a discussion of the origination deficiencies.

[2] Loans for 28 properties in Deerfield Beach, Florida. See Appendix F for the case numbers, amounts, and loan status. See Appendix C for a discussion of the origination deficiencies.

[3] Loans for 12 properties in Miami, Florida. See Appendix G for the case numbers, amounts, and loan status. See Appendix D for a discussion of the origination deficiencies.

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Narrative Case Presentation
Riviera Beach Loans

Transaction: 67 HUD-insured loans totaling $2,001,250 closed September 7, 1993, see Appendix E for individual case numbers and loan amounts

Borrower per HUD-1s: New Day Outreach Centers, Inc.

Seller per HUD-1s: Global Housing, a non-profit corporation.

Location of properties: Riviera Beach, Florida

Status of loans as of March 8, 1996: 16 loans were paid off and were replaced with new loans, the other 51 loans were current

Summary

Waters Mortgage submitted a HUD-1, Settlement Statement, to HUD for each of the 67 loans which included false information on the amount paid by the borrower for the property and the source of the borrower's downpayment. Instead of paying $342,336 of mortgage proceeds to the seller of the property, Global Housing, as was indicated on the HUD-1s, Waters Mortgage used $167,098 as the borrower's downpayment and closing costs, and Waters Mortgage and the borrower kept the remaining $175,238. Waters also charged ineligible closing costs of $15,303.

False statements for the amount paid for the property and for the source of the borrower's downpayment

Waters Mortgage, the borrower, the closing agent, and the rehabilitation contractor conspired to furnish false information to HUD regarding the borrower's purchase of the 67 properties. The false information was provided so the borrower would not have to make a downpayment and pay closing costs from its own resources.

HUD Handbook 4155.1 REV-4, Mortgage Credit Analysis for Mortgage Insurance on One to Four Family Properties, paragraph 2-10, and HUD Handbook 4240.4 REV-2, 203K Handbook, Rehabilitation Home Mortgage Insurance, paragraph 4-9, state that the borrower's cash investment in the property must equal the difference between the amount of the insured mortgage and the total cost to acquire the property, including prepaid expenses.

Each HUD-1 falsely stated the amount of mortgage proceeds paid to the seller of the property. The HUD-1s showed Global Housing was paid $596,530 as follows:

Number of Loans	Gross Amount Due Seller Per Property	Gross Amount Due Seller Total
2	$ 8,310	$ 16,620
16	8,375	134,000
10	8,660	86,600
2	8,925	17,850
16	8,950	143,200
5	9,380	46,900
16	9,460	151,360
67		$ 596,530

After reductions for settlement charges, the HUD-1s showed that Global Housing was paid a total of $592,336. However, the closing disbursement records showed no loan proceeds were disbursed to Global Housing. The records showed loan proceeds of $219,573 were paid to the Federal Home Loan Mortgage Corporation (FHLMC), $175,238 was paid to Waters Mortgage, $30,427 was paid the borrower for items paid outside of closing, and the balance was used as the borrower's downpayment. The HUD-1s showed that the borrower paid $167,098 to close the loans. This information was also false because the borrower made no such payments. The $167,098 was the net amount of loan proceeds not disbursed at closing ($592,336 - $219,573 - $175,238 - $30,427).

The $167,098 for the borrower's downpayment and the $175,238 paid to Waters Mortgage were generated from an unnecessary sale of the 67 properties. The circumstances involved are summarized in Appendix H. Waters Mortgage originated the loans on the basis that the borrower purchased the properties from Global Housing. However, the borrower did not need to purchase the properties from Global Housing because on July 28, 1993, the borrower completed an agreement to buy the 67 properties from the Federal Home Loan Mortgage Corporation (FHLMC) for $250,000 making a deposit of $12,500 at that time. The borrower could have purchased from FHLMC for $250,000 if it had been able to make a downpayment of about $160,000 from its own funds to close the 203(k) loans. Apparently the borrower did not have the funds and arranged to make the purchase for $596,530 from Global Housing. The price increase generated the additional mortgage proceeds of $342,336, $167,098 used for the borrower's downpayment and $175,238 paid to Waters Mortgage.

The manner in which the property sale was processed further documented the unnecessary nature of the transaction. As shown in Appendix H, the HUD-1s for the HUD insured loans were dated September 7, 1993. However, the HUD-1 for Global Housing's purchase of the properties from FHLMC was not dated until September 17, 1993, and the borrower did not assign its sales agreement with FHLMC to Global Housing until September 21, 1993.

The sole reason for the borrower purchasing the properties from Global Housing instead of FHLMC was to generate additional cash for the benefit of the borrower.

The person who signed the HUD-1s for Global Housing was an owner of the company with which the borrower contracted to perform the rehabilitation work for the 67 Riviera Beach properties and the 28 Deerfield Beach properties (see Appendix C). The Global Housing representative had a power of attorney from Global Housing which showed the borrower had a contract to purchase the 67 properties from FHLMC and that the contract had been assigned to Global Housing. The Global Housing representative stated that the property transfer was made through Global Housing because the borrower did not have enough money to buy the properties. The closing agent stated that the Global Housing representative was not present at the closing of the loans but signed the HUD-1s a few days later.

The closing agent's files included a document dated September 13, 1993 signed by the Global Housing representative in which Global Housing agreed that the closing agent would disburse the sales proceeds due Global Housing to the borrower. This document was not provided to HUD.

After the loan closings were completed September 7, 1993, the closing agent still had $175,238 in loan proceeds left from the amount due the seller. The closing agent paid the $175,238 to Waters Mortgage. Based on Waters Mortgage's records and statements of a Waters Mortgage official, Waters Mortgage used the $175,238 for the following purposes:

Purpose	Amount
Paid to borrower September 22, 1993	$ 14,573[1]
Paid to borrower September 28, 1993	75,000
Paid for the benefit of borrower January 1994	25,493
Paid to borrower April 4, 1994	6,474
Borrower's cash downpayment to close 12 203(k) loans in Miami May 6, 1994	31,668
Paid for security services, Riviera Beach properties	11,760
Paid to Global Housing February 1, 1994	10,000
Not accounted for	270
Total	$ 175,238

The Uniform Residential Loan Application for each loan showed that source of the borrower's downpayment would be a gift from a nonprofit organization. A Waters Mortgage official confirmed that the borrower's downpayment was a gift from Global Housing. The closing

[1] $45,000 less $30,427 for amounts paid by borrower outside of closing.

agent's files included an agreement signed by the Global Housing representative stating that Global Housing would donate approximately $350,000 to the borrower and a letter from the agent to Waters Mortgage dated September 9, 1993, requesting Waters Mortgage's approval of the agreement.

HUD Handbook 4155.1 REV-4, paragraph 2-10, states that (1) the donor of a gift for the borrower's cash investment may not be a person or entity with an interest in the sale of the property, such as the seller, builder, or any entity associated with them and (2) gifts or credits from these sources must be subtracted from the sales price, and may not be considered as assets to close.

HUD Handbook 4240.4 REV-2, paragraph 7-2, states that HUD will permit a government agency or non-profit organization:

> "to provide a gift of funds (typically in the form of a credit or a grant) to the purchaser who is seeking an insured mortgage. (Transactions in which a builder or other party funds the downpayment through the local community in order to sell a house are not permitted.) The key ingredients in any such program are the involvement of a governmental agency or non-profit organization and the methods used to generate the funds they provide to the purchaser."

The claimed gift by Global Housing to the borrower fails this test for two reasons. First, the Global Housing representative was the rehabilitation contractor and was seeking to profit from the loan originations. Second, and more importantly, was the method used to generate the funds. The funds were generated by an unnecessary mark-up of the property sales price by $346,530 ($596,530 - $250,000).

A Waters Mortgage official stated that inflating the sales price to generate funds for the borrower was in accordance with HUD guidelines and that HUD's interest was protected because the properties' appraised value was more than the loan amounts. The official's reasoning was incorrect and unsound. The sales price mark-up improperly diverted $342,336 to Waters Mortgage and the borrower, inflated the HUD-insured loans by about $328,000, and greatly increased HUD's risk on the loans. In addition, the borrower's stated objective was to repair and sell the properties to benefit lower income families. The mark-up will increase the sales prices of the units when sold to low income families. Instead of HUD sanctioning such a procedure as the Waters official implies, HUD would be better off to waive the borrower's downpayment requirement and include only the lower sales price in the insured loan.

Waters Mortgage improperly originated the 67 loans. Waters Mortgage had sufficient knowledge that (1) HUD's requirements for the borrower's source of funds for its downpayment and closing costs were not met and (2) the loans were inflated by an unnecessary mark-up of the property sales prices.

Excessive fees were paid to Waters Mortgage

Waters Mortgage was paid $15,303 from the mortgage proceeds for excessive fees as follows:

Type of Fee	Amount
Building permits	$ 8,945
Surveys	3,075
Document preparation	3,283
Total	$ 15,303

HUD Handbook 4155.1 REV-4, paragraph 1-7, states that closing costs must be reasonable and that document preparation costs are eligible only if the work is performed by a third party not controlled by the lender.

Waters Mortgage did not have documentation to support its charges of $20,100 for building permits shown on the HUD-1s. We reviewed records of the City of Riviera Beach and determined the charges should have totaled only $11,155. The difference of $8,945 was ineligible.

For surveys, Waters Mortgage charged $350 per property for a total of $23,450. However, Waters Mortgage's records showed that the survey actually cost $225 per property plus a proportionate share of the cost for common areas of about $79 per property. The total supported cost was $20,375. The difference of $3,075 was ineligible.

Waters Mortgage charged a document preparation fee of $49 to each loan for a total of $3,283. The HUD-1s showed the fees were paid to a third party as required. However, a Waters Mortgage official stated that no such payments were made because Waters Mortgage prepared the loan documents. The Waters Mortgage Chief Executive Officer agreed that the document preparation fees were ineligible. He stated that the fees were charged by mistake.

Rehabilitation was not completed timely

HUD Handbook 4240.4 REV-2, paragraph 5-2.A. provides that rehabilitation take no longer than 6 months from the date of closing. A lender may consider the loan to be in default if work has not started within 30 days of the closing date; if the work ceases for more than 30 consecutive days; or if the work has not made reasonable progress during the rehabilitation period.

The borrower did not complete the rehabilitation work in a timely manner as required. Waters Mortgage closed the loans on September 7, 1993. The rehabilitation work was not timely completed, and on August 1 and September 1 , 1994, the loans went into default. On February 14, 1995, over 17 months following the loan closings, the borrower sold the 67 properties. The buyer assumed 51 of the loans. For the other 16 properties, the original loans were paid off, and Waters Mortgage issued 16 new 203(k) loans to the buyer at amounts which totaled $45,600 more than the old loans. We inspected the 67 properties on August 10, 1995, 23 months after the closings. Repairs had not been completed on 18 of the 67 properties. See Appendix I for a graph of the rehabilitation period.

Although 16 of the initial 67 loans were paid off, HUD's risk was not terminated, but instead increased, due to the new higher valued 203(k) loans issued by Waters Mortgage.

Narrative Case Presentation
Deerfield Beach Loans

Transaction: 28 HUD-insured loans totaling $768,700 closed July 1, 1993, see Appendix F for individual case numbers and loan amounts

Borrower: New Day Outreach Centers, Inc.

Location of Properties: Deerfield Beach, Florida

Status of Loans as of March 8, 1996: All of the loans were paid off and replaced with new 203(k) loans.

Summary

The HUD-1s showed ineligible consulting fees of $15,364 paid to the borrower. Waters Mortgage also received ineligible fees of $1,372 and unsupported fees of $8,400 at loan closing. The loans went into default and, without completing the rehabilitation work, the borrower sold the properties and paid off the loans. Waters Mortgage originated new 203(k) loans at increased loan amounts totaling $172,900. When we inspected the properties 25 months after closing, the rehabilitation work for 22 of the properties was still not complete.

Ineligible consultant fees included in the mortgages

The HUD-1s showed charges of $15,364 to the borrower for consultant fees paid to the borrower. The charges ranged from $518 to $671 per property and were in addition to separate plan review fees of $100 per loan. The Maximum Mortgage Worksheets completed by Waters Mortgage showed the consultant fees were included in the mortgages.

The consultant fees were not eligible. Mortgagee Letters 92-33 and 94-11 limit eligible consultant services to those related to the rehabilitation work. Further, Mortgagee Letter 94-11 limits eligible consultant services to services by an independent party in preparing the architectural exhibits. The borrower was not an independent party, and, according to the borrower, the services performed were not related to the rehabilitation work.

The Waters Mortgage Chief Executive Officer thought the fees were eligible based on guidance he said he received from HUD.

Ineligible fees were paid to Waters Mortgage

Waters Mortgage charged a document preparation fee of $49 to each loan for a total of $1,372. HUD Handbook 4155.1 REV-4, allowed document preparation fees only if the work was performed by a vendor not associated with the lender. The HUD-1s showed the fees were paid to such a vendor. However, Waters Mortgage had no support for the payments and a Waters Mortgage official confirmed that no such payments were made because Waters Mortgage prepared the loan documents itself. The Waters Mortgage Chief Executive Officer agreed that the document preparation fees were ineligible. He said they were charged by mistake.

Unsupported fees were paid to Waters Mortgage

The HUD-1s for each of the 28 loans showed $300 for building permit fees paid to Waters Mortgage. Waters Mortgage did not have support for the payments totaling $8,400.

Rehabilitation was not completed timely

The borrower did not complete the rehabilitation work in a timely manner as required. Waters Mortgage closed the loans on July 1, 1993. The rehabilitation work was not completed and the loans went into default on September 1, 1994. On January 18, 1995, over 18 months following the loan closings, the borrower sold the properties and the loans were paid off. Waters Mortgage issued 28 new 203(k) loans to a new identity-of-interest buyer at amounts totaling $172,900 more than the old loans. We inspected the properties on August 10, 1995, 25 months after the closings. We determined that the repairs had not been completed on 22 of the 28 properties. See Appendix I for a graph of the rehabilitation period.

Although the initial 28 loans were paid off, HUD's risk was not terminated, but instead increased, due to the new higher valued 203(k) loans issued by Waters Mortgage.

Narrative Case Presentation
Miami Loans

Transaction: 12 HUD-insured loans totaling $887,000 closed May 6, 1994, see Appendix G for individual case numbers and loan amounts

Borrower: New Day Outreach Centers, Inc.

Location of Properties: Miami, Florida

Status of loans as of March 8, 1996: 1 current, 11 in default of which 8 were being conveyed to HUD

Summary

Waters Mortgage submitted a HUD-1, Settlement Statement, to HUD for each of the 12 loans which included false information about the borrower's cash payment to close the loans. The HUD-1s showed payments of $31,668, but we determined that the borrower, in fact, made no cash payments. Also, Waters Mortgage approved the loans when it knew the borrower was behind schedule in completing the rehabilitation work for the 28 203(k) loans in Deerfield Beach and the 67 203(k) loans in Riviera Beach.

Assets to close the loans were not verified

HUD Handbook 4155.1 REV-4, paragraph 2-10, requires the lender to verify all funds for the borrower's investment.

Waters Mortgage did not verify that the borrower had sufficient funds to close the loans. The Uniform Residential Loan Applications showed the borrower's source of funds for the downpayments and settlement charges would be the borrower's cash savings of $22,670. Waters Mortgage obtained bank confirmations for the $22,670. However, the borrower needed $31,668 to close the loans.

False statements regarding the borrower's downpayment

Each HUD-1 showed the borrower made a cash payment to close the loan. The amounts shown ranged from $245 to $3,481 and totaled $31,668. However, the settlement agent's records showed the borrower made no cash payments at closing.

HUD Handbook 4155.1 REV-4, paragraph 2-10, and HUD Handbook 4240.4 REV-2, paragraph 4-9, require the borrower's cash investment in the property to equal the difference between the amount of the insured mortgage and the total cost to acquire the property, including prepaid expenses.

A Waters Mortgage official stated that funds for the borrower's downpayments came from the money retained by Waters Mortgage from the closing of the 67 Riviera Beach 203(k) loans on September 7, 1993. As discussed in Appendix B, Waters Mortgage improperly kept $175,238 from the closing of the Riviera Beach loans. The money should not have been used to close the Miami loans. The result of the transaction was that the borrower made no downpayment for the Miami loans.

Decision to approve the loans was not prudent

Waters Mortgage approved the 12 loans even though the borrower had failed to make adequate progress in completing the rehabilitation work on the 28 Deerfield Beach and the 67 Riviera Beach loans.

HUD Handbook 4240.4 REV-4, paragraph 1-17, states that a 203(k) loan must be an acceptable risk as defined by HUD. For each loan, Waters Mortgage obtained from the borrower a Rehabilitation Loan Rider which permitted Waters Mortgage to declare the loan in default if the rehabilitation work was not timely started or completed. Handbook 4240.4 REV-2, paragraph 5-2.A. provides that rehabilitation should take no longer than 6 months from the date of closing. HUD Handbook 4155.1 REV-4, paragraph 3-2, states that HUD expects the application package to contain sufficient documentation to support the lender's decision to approve the loan.

Waters Mortgage closed the Miami loans on May 6, 1994. At that time, the borrower had surpassed the required 6 month completion period for the 28 Deerfield Beach loans by 4 months and for the 67 Riviera Beach loans by 2 months. Waters Mortgage's rehabilitation escrow records showed that, at best, the rehabilitation of the 95 properties would not be completed for several more months. All of the 95 loans subsequently went into default. When we inspected the properties in August 1995, the rehabilitation on 40 of the properties was still not completed. See Appendix I for a graph of the rehabilitation period.

Waters Mortgage was fully aware of the delays in the rehabilitation work for the first 95 loans and should not have approved the 12 Miami loans given the borrower's poor performance. The Waters Mortgage Chief Executive Officer stated that they thought the slow progress on the Deerfield Beach and Riviera Beach loans was the fault of the contractor instead of the borrower. This reasoning was unsound because it was the borrower's responsibility to ensure the contractor performed on schedule and delays in completing the rehabilitation work increased the risk of default by the borrower.

In the loan application packages it gave HUD for the 12 loans, Waters Mortgage did not include: (1) information on the borrower's poor performance in completing the earlier 95 loans, and (2) justification for approving the loans given that poor performance.

All of the Miami loans went into default after only 3 or 4 payments. As of March 8, 1996, 11 loans totaling $810,000 were in default. The properties for 8 loans totaling $572,550 were in the process of being conveyed to HUD.

Loans Reviewed, Riviera Beach, Florida

Loan Number	Loan Amount	Status
092-5813752	$ 37,950	Current
092-5813769	37,950	Current
092-5813775	37,950	Current
092-5813781	37,950	Current
092-5813798	27,950	Current
092-5813802	27,950	Current
092-5813819	40,250	Current
092-5813825	40,250	Current
092-5813831	37,950	Current
092-5813848	37,950	Current
092-5813854	27,950	Current
092-5813860	27,950	Current
092-5813877	37,950	Current
092-5813883	37,950	Current
092-5813892	37,950	Current
092-5813904	37,950	Current
092-5813910	27,950	Current
092-5807162	27,950	Paid off
092-5807179	27,950	Paid off
092-5807185	27,950	Paid off
092-5807191	27,950	Paid off
092-5807206	27,950	Paid off
092-5807212	27,950	Paid off
092-5807372	27,950	Paid off
092-5813299	27,950	Paid off
092-5813303	27,950	Paid off
092-5813311	27,950	Paid off
092-5813326	27,950	Paid off
092-5813332	27,950	Paid off
092-5813349	27,950	Paid off
092-5813355	27,950	Paid off
092-5813361	27,950	Paid off
092-5813378	27,950	Paid off
092-5804563	27,950	Current
092-5804577	27,950	Current
092-5804586	27,950	Current
092-5804592	27,950	Current
092-5804607	27,950	Current
092-5804613	27,950	Current
092-5804625	27,950	Current

Loan Number	Loan Amount	Status
092-5804636	27,950	Current
092-5804642	27,950	Current
092-5807097	27,950	Current
092-5807104	27,950	Current
092-5807110	27,950	Current
092-5807127	27,950	Current
092-5807133	27,950	Current
092-5807145	27,950	Current
092-5807156	27,950	Current
092-5813594	27,950	Current
092-5813609	27,950	Current
092-5813615	27,950	Current
092-5813621	27,950	Current
092-5813638	27,950	Current
092-5813644	27,950	Current
092-5813650	27,950	Current
092-5813667	27,950	Current
092-5813673	27,950	Current
092-5813689	27,950	Current
092-5813696	27,950	Current
092-5813700	27,950	Current
092-5813717	27,950	Current
092-5813723	27,950	Current
092-5813737	27,950	Current
092-5813746	27,950	Current
092-5804540	29,950	Current
092-5804557	29,950	Current
Total	$ 2,001,250	

Loans Reviewed, Deerfield Beach, Florida

Loan Number	Loan Amount	Status
092-5776570	$ 26,950	Paid off
092-5776587	26,500	Paid off
092-5776593	26,500	Paid off
092-5776608	27,350	Paid off
092-5776013	31,550	Paid off
092-5777104	26,500	Paid off
092-5776007	26,500	Paid off
092-5775076	31,550	Paid off
092-5774800	31,550	Paid off
092-5776535	26,500	Paid off
092-5776529	26,500	Paid off
092-5776564	31,550	Paid off
092-5775053	27,350	Paid off
092-5775047	26,500	Paid off
092-5775030	26,500	Paid off
092-5775024	26,950	Paid off
092-5774977	26,950	Paid off
092-5774960	26,500	Paid off
092-5774823	26,500	Paid off
092-5774817	27,350	Paid off
092-5775018	26,950	Paid off
092-5775001	26,500	Paid off
092-5774993	26,500	Paid off
092-5774983	27,350	Paid off
092-5775062	27,350	Paid off
092-5776512	26,500	Paid off
092-5776036	26,500	Paid off
092-5776021	26,950	Paid off
Total	$ 768,700	

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Loans Reviewed, Miami, Florida

Loan Number	Loan Amount	Status
092-6174564	$ 68,250	Default
092-6174570	67,950	Default
092-6174587	73,800	Default
092-6174608	75,950	Default
092-6174818	77,000	Current
092-6174824	78,050	Default
092-6174830	81,300	Default
092-6174853	84,500	Default
092-6174876	58,850	Default
092-6174882	68,400	Default
092-6174899	78,300	Default
092-6174918	74,650	Default
Total	$ 887,000	

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Sequence of Documents, Riviera Beach Loans

Document	Date of Document	Date Recorded
Loan Application, Borrower to Waters Mortgage	7/23/93	NA
Sales Agreement, FHLMC to sell properties to Borrower for $250,000	7/28/93	NA
Sales Agreement, Global to sell properties to Borrower for $596,530	none	NA
HUD-1 Settlement Statement, Global sells properties to Borrower	9/7/93	NA
Agreement, Global to donate approximately $350,000 to Borrower	9/7/93	NA
Letter, settlement agent to Waters Mortgage discussing Global's gift to Borrower and excess loan proceeds to be kept by Waters Mortgage	9/9/93	NA
Warranty Deed, Global to Borrower	9/13/93	10/1/93
Letter, settlement agent to Waters Mortgage confirming Global's agreement to receive no sales proceeds and requesting instructions for disbursing excess loan proceeds	9/14/93	NA
HUD-1 Settlement Statement, FHLMC sells properties to Global	9/17/93	NA
Power of Attorney, Global to representative	9/18/93	9/27/93
Assignment of FHLMC and Borrower's Sales Agreement to Global	9/21/93	NA
Warranty Deed, FHLMC to Global	9/21/93	9/27/93

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