



March 8, 1996
Audit Case Number 96-DE-221-1003

TO: Emelda P. Johnson, Deputy Assistant Secretary for Single Family Housing, HS

FROM: W. D. Anderson, District Inspector General for Audit, 8AGA

SUBJECT: City Wide Mortgage, Inc.
Limited Review of Title Insurance Charges and Related Fees
Smyrna, Georgia

We have completed a limited review of City Wide Mortgage, Inc. located in Smyrna, Georgia. The review was conducted in response to complaints received, as well as at the request of the Assistant United States Attorney, District of Colorado. The objective of our review was to determine whether mortgagors were overcharged for title insurance policies obtained as part of refinancing their federally backed home mortgages.

We found that City Wide Mortgage did not accurately disclose to mortgagors the actual costs associated with refinancing home mortgages. In addition, the review found that City Wide Mortgage was, in effect, obtaining an unearned fee by inflating the title insurance charge on the HUD-1 settlement statement. The overcharge was used to cover the cost of a third party to conduct a file review and disburse the loan proceeds. We also determined that City Wide Mortgage charged more than the HUD authorized amount and did not follow prudent business practices in the disclosure of the disbursement of loan proceeds.

Should you have any questions, please contact Ernest Kite, Assistant District Inspector General for Audit, at (303) 672-5452.

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Executive Summary

City Wide Mortgage, Inc. did not accurately disclose to mortgagors (borrowers) the actual costs associated with the settlement of refinancing their home mortgage. The settlement statement, also commonly known as the HUD-1, was completed with information that did not represent the actual cost of refinancing the mortgage and the related settlement charges. In addition, the charges for title insurance that appeared on the settlement statement were higher than the actual cost of the lender's title insurance policy. As a result, the mortgagor was overcharged for the lender's title insurance policy and was not aware of the overcharge due to the inadequate disclosure of the actual fees and charges on the HUD-1 settlement statement. It appears the improper charges occurred because of City Wide Mortgage's lack of knowledge or disregard for loan settlement requirements set by HUD and the Real Estate Settlement Procedures Act of 1974 (RESPA). The improper disclosure on the settlement statement is a direct violation of the Real Estate Settlement Procedures Act of 1974 as well as HUD requirements for direct endorsement mortgagee (lender) practices. City Wide Mortgage also disregarded the maximum fees allowable, as set by the HUD State Office, for the purchase of a home with federally related financing.

Improper disclosure of title insurance charges and related fees

Our review disclosed that City Wide Mortgage overcharged mortgagors for lender's title insurance policies for refinanced federally insured mortgages. For the sample of Colorado loans evaluated during our review, all were overcharged for lender's title insurance policies. The overcharges ranged between \$12 and \$370, with an average overcharge of approximately \$289 per policy. In addition, other settlement fees for items such as recording, endorsements, and tax certificates were also incorrectly shown on the settlement statements.

The exact reason for not disclosing the actual charge for title insurance on the HUD-1 settlement statement was unclear. Regardless, the overcharge for title insurance and the lack of proper disclosure of the charges, both are violations of HUD requirements and RESPA. Not only were the requirements of RESPA violated, but the spirit of promoting full disclosure of settlement fees and charges to borrowers was also disregarded.

Overcharges considered unearned fees

The practice of charging City Wide Mortgage customers above the actual cost for a lender's title insurance policy constitutes an unearned fee according to RESPA and HUD guidelines. Since City Wide Mortgage did not require a separate settlement fee on the HUD-1 for the disbursement and compliance loan review, then the cost should have been paid by the mortgagee and covered by the loan origination fee.

In addition, the mortgagor should not be required to pay for a charge that was not fully disclosed on the settlement statement, as required by RESPA and HUD guidance. City Wide Mortgage either was unaware of the proper procedures or chose to disregard the instructions for the accurate completion of the HUD-1.

Fees charged above HUD authorized amount

City Wide Mortgage consistently charged above the maximum amount authorized for title insurance in the State of Colorado. The Denver HUD Field Office developed a schedule of permissible closing costs and fees that are considered reasonable and customary for the area. The schedule stipulates that the maximum amount to be charged for a lender's title policy in the State of Colorado is the actual cost of the policy for refinanced loans. We found mortgagors were overcharged approximately \$289, on average, for each loan reviewed. As can be seen, mortgagors paid fees for lender's title policies in excess of the amount authorized by the HUD developed schedule of permissible closing costs and fees.

Our review also disclosed that if the cost for the disbursement of loan proceeds and compliance file review were placed on the HUD-1 settlement statement, the majority of the fees would have been above the HUD maximum allowable amount according to the schedule of permissible closing costs and fees.

Settlement fees charged in other states also questionable

In addition to reviewing loans originated in Colorado, we evaluated a sample of various loans originated from other states where City Wide Mortgage had loan origination offices. We performed a cursory review of settlement fees, specifically title insurance fees, for the nationwide sample. We found the same practice of overcharging mortgagors for title insurance for the national sample as was found for the Colorado sample. The overcharge was used to compensate a third party for disbursing loan proceeds. The disburser even had detailed written instructions of how to split the title insurance charge on the HUD-1 settlement statement between all parties.

The Office of Housing should consider administrative action

We recommend the Office of Housing consider taking appropriate administrative action against City Wide Mortgage

based upon the seriousness of the violations of HUD requirements cited in the report. The action should include the permanent withdrawal of City Wide Mortgage's HUD/FHA direct endorsement approval as well as the possible debarment of City Wide Mortgage officials from participating in any Federal programs.

The Office of Housing should also consider taking action against the owners of City Wide Mortgage, Inc. based upon the violations of the Real Estate Settlement Procedures Act detailed in the report.

Auditee Comments

The draft finding was provided to City Wide Mortgage officials and their legal representative on September 22, 1995. An exit conference was held on October 23, 1995. The comments received from Karsh & Fulton, P.C. on behalf of City Wide Mortgage have been incorporated in the report as appropriate.

The response on behalf of City Wide Mortgage to the draft finding is included as Appendix B. The attachments accompanying the response have not been included but have been provided to the Office of the Deputy Assistant Secretary for Single Family Housing for their information and use.

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Abbreviations

FHA	Federal Housing Administration
HUD	U.S. Department of Housing and Urban Development
RESPA	Real Estate Settlement Procedures Act

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Introduction

City Wide Mortgage was incorporated on March 23, 1989 under the laws of the State of Georgia. Its principal business activity was to originate and market mortgage loans to investors. The corporate headquarters were located in Smyrna, Georgia, a suburb of Atlanta, with satellite loan origination offices in Arizona, Colorado, Florida, Illinois, Nevada, North Carolina, South Carolina, Virginia, and Washington. Due to the increase of interest rates and the decrease in demand for mortgage refinances, City Wide Mortgage closed operations in December 1994. However, according to the Georgia Secretary of State, City Wide Mortgage, Inc. is still registered as an active going concern corporation in the State of Georgia as of March 1995, when audit field work concluded in Atlanta, Georgia.

Audit objective

The objective of the review was to determine whether City Wide Mortgage, Inc. properly charged mortgagors for title insurance connected with refinancing FHA backed mortgages. To accomplish this audit objective, we reviewed FHA loan case binders, documentation provided by Stewart Title and Title America of Denver. Also, audit work was conducted in Atlanta, Georgia at the offices of Charles Gallagher, Attorney at Law, and McManus & Associates (Patriot Title), both former disbursing agents for City Wide Mortgage, Inc. Preliminary review of Patriot Title's disbursement files for City Wide loans was conducted at the Law office of Kennedy and Christopher, located in Denver, Colorado. In addition, the loan files of City Wide Mortgage, Inc. were reviewed at the offices of their attorney, Mr. A. J. Block. Audit site work was conducted during the period of January through March, 1995.

Scope

Our review covered loans closed by City Wide Mortgage, Inc. during the period of January 1, 1993 to May 31, 1994. The review sample consisted of 70 loans for properties located in Colorado and an additional 40 loans for properties located in Arizona, Georgia, Illinois, Nevada, North Carolina, South Carolina and Virginia.

As part of the review, we examined select FHA case binders for loans originated by City Wide Mortgage and files of Western Escrow, an associate company of City Wide Mortgage. In addition, we reviewed loan disbursement documentation for loans in the Colorado sample at the office of Charles Gallagher. Documentation for loans in the Colorado and nationwide sample were also reviewed at the

offices of John J. McManus & Associates (Patriot Title) and their Colorado based legal counsel, Kennedy and Christopher. We concluded the review by examining files belonging to City Wide Mortgage. City Wide Mortgage files for all loans in the Colorado and nationwide sample could not be located; therefore, conclusions were based upon the information available at the time of the review.

We also conducted interviews with the owners of City Wide Mortgage, City Wide's attorneys, employees of John J. McManus & Associates (Patriot Title) and Charles Gallagher, both former disbursing agents. In addition, we talked to officials with Stewart Title of Denver, Title America of Denver, and with various HUD Officials.

We conducted the review in accordance with generally accepted government auditing standards.

Improper Disclosure of Title Insurance Charges and Related Fees

City Wide Mortgage, Inc. did not accurately disclose to mortgagors (borrowers) the actual cost of fees associated with the settlement of refinancing their home mortgage. The settlement statement, also commonly known as the HUD-1, was completed with information that did not accurately represent the actual cost of refinancing the mortgage and the related settlement charges. In addition, the charges for title insurance that appeared on the settlement statement were often higher than the actual cost of the lender's title insurance policy. As a result, the mortgagor was overcharged for the lender's title insurance policy and was not aware of the overcharge. The overcharges ranged between \$12 and \$370, with an average overcharge of approximately \$289 per policy. The exact reason for City Wide's practice of not disclosing the actual charge for title insurance on the HUD-1 settlement statement was unclear.

Since City Wide Mortgage is no longer an active going concern, and the loan origination offices have been closed, we could not determine the rationale for not fully disclosing all loan settlement fees and charges. The improper disclosure on the settlement statement is a direct violation of the Real Estate Settlement Procedures Act (RESPA) of 1974 as well as HUD requirements for direct endorsement mortgage (lender) practices. Not only were the requirements of the Real Estate Settlement Procedures Act violated, but the spirit of promoting full disclosure of settlement fees and charges to borrowers was also disregarded.

City Wide Mortgage's practice was to charge the mortgagor for the cost of a new title policy. The amount charged to the mortgagor on the settlement statement was obtained by a City Wide Mortgage employee from a title insurance rate schedule. However, City Wide Mortgage paid the reissue rate for the lender's title policy obtained. The fee charged to the mortgagor, above the actual cost of the lender's title policy, was used to compensate the firm hired to disburse the loan proceeds and conduct compliance file reviews.

City Wide Mortgage officials do not agree with the conclusions expressed in the report. City Wide Mortgage asserts that the audit report mischaracterizes the business relationship between City Wide Mortgage, Inc. and the parties who disbursed loan proceeds. City Wide officials maintain that the third party disburser of loan proceeds was the agent of the title company who issued the title insurance policy, not City Wide Mortgage. City Wide officials also contend mortgagors were not overcharged for title insurance and all related charges were properly disclosed. They also insist the HUD-1 accurately represented the actual costs of refinancing and other related settlement charges.

History of City Wide Mortgage's title insurance program

City Wide Mortgage's principal business activity was to originate and market mortgage loans to investors. The Company had satellite offices in several states, with the company's headquarters in Smyrna, Georgia, a suburb of Atlanta.

Originally, when the outlying loan origination offices opened, the closing of the loans, as well as disbursement of loan proceeds, were handled by a closing agent. The closing agent was located in the same area as the outlying City Wide office. City Wide Mortgage experienced problems with having each originating office handle the closing and disbursing of loan proceeds and decided to centralize the disbursement function to the Atlanta area, where their headquarters were located. City Wide Mortgage arranged for Mr. Charles Gallagher, an attorney with whom they had worked previously, to handle the function of disbursing loan proceeds. Mr. Gallagher's office was at a centralized location near City Wide's main office. Mr. Gallagher served in this capacity from the fall of 1992 until September, 1993 when Patriot Title & Abstract Company took over the function of disbursing loan proceeds. Disbursement of loan proceeds resulting from loans in the states of Florida and Washington were not part of the centralized funding mechanism.

Patriot Title & Abstract Company was a wholly owned business of John J. McManus & Associates, an Atlanta law firm. Patriot Title conducted compliance reviews of the loan files and disbursed the loan proceeds. The purpose of the compliance review was to evaluate the collateral documents. They would then communicate back to City Wide Mortgage any problems found so issuance of the final title policy, and funding of the loan from the investor, would not be delayed. Patriot Title ended their business relationship with City Wide Mortgage and ceased operations in June, 1994.

Disclosure requirements

The Real Estate Settlement Procedures Act of 1974, also commonly known as RESPA, was enacted to reform the real estate settlement process to ensure that consumers throughout the nation were provided with greater and more timely information on the nature and costs of the settlement process. RESPA applies to all real estate transactions secured by a Federally related mortgage loan. The Act requires full disclosure to borrowers by the lender of all fees and actual

costs associated with obtaining a Federally related mortgage loan. The overall purpose for creating RESPA was to fully disclose all information about the real estate transaction to the uninformed mortgagor.

In addition, HUD Handbook 4000.2 Rev-2, Mortgagee's Handbook - Application through Insurance (Single Family), explains procedures and guidance on the origination and closing of HUD/FHA single family mortgages. Chapter 5-3 of the handbook states customary and reasonable closing costs and other fees and charges may be collected from the borrower by the mortgagee. This includes charges for title examination and title insurance. Chapter 5-5 of the handbook also states that payment for services, above that actually paid for the service by the mortgagee, is prohibited and considered an unearned fee. Charging above the actual amount for a service is also considered a violation of the Real Estate Settlement Procedures Act.

Direct Endorsement
program requirements

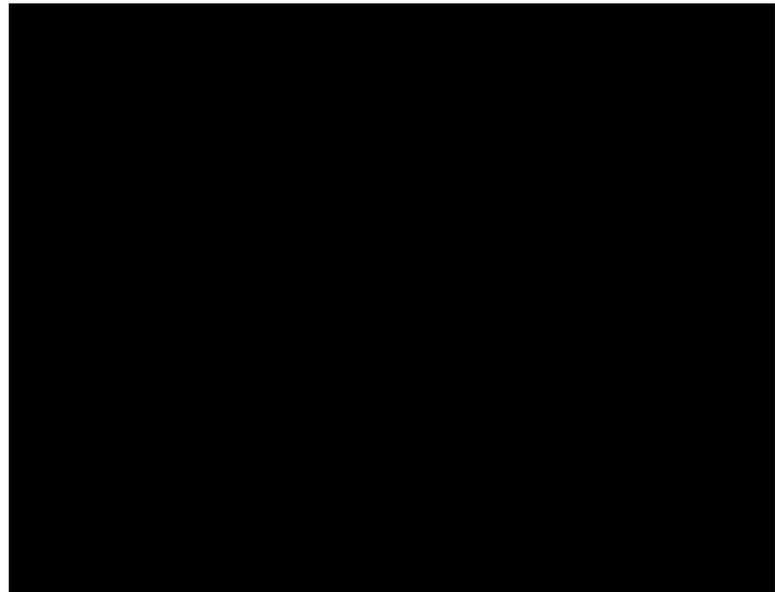
City Wide Mortgage, Inc. was approved and participated in the Single Family Direct Endorsement program. The Single Family Direct Endorsement loan program was designed to give mortgagees the responsibilities involved in originating and closing mortgage loans without prior HUD review. Program requirements are described in HUD Single Family Direct Endorsement Program Handbook 4000.4 REV-1 CHANGE-1. The handbook states mortgagees are responsible for complying with all applicable HUD regulations and handbook instructions. It also notes authority to participate in the Direct Endorsement program is a privilege and a Direct Endorsement mortgagee must conduct its business operations in accordance with accepted sound mortgage lending practices, ethics and standards. The handbook goes on to require the mortgagee to monitor and evaluate the performance of personnel used for the Direct Endorsement program. All loans reviewed during the audit were originated under the Direct Endorsement program and should have followed all applicable guidance and rules that regulate the program.

Mortgagors charged above
actual cost for title
insurance

Our review disclosed that City Wide Mortgage overcharged mortgagors for lender's title insurance policies for refinanced Federally insured mortgages. The sample of Colorado loans evaluated during our review

concluded that all mortgagors were overcharged for lender's title insurance policies. The overcharges ranged between \$12 and \$370. Appendix A-1 schedules the mortgagor overcharges by loan number for the Colorado sample.

On an average each mortgagor in the review sample was overcharged approximately \$289 for lenders' title insurance policies obtained when they refinanced their home mortgage. The following chart compares the average amount charged to mortgagors on the HUD-1 settlement statement for title insurance, the average cost of a title policy, and the average amount each mortgagor was overcharged for the title policy, for loans included in our review sample for the State of Colorado.



The Real Estate Settlement Procedures Act (RESPA), as well as HUD Handbook 4000.2 Rev-2, provide guidance on the permissible loan related fees that may be charged on a FHA backed loan and prohibits charging the mortgagor a price above that actually paid for the service. In addition, Title 24 of the Code of Federal Regulations, Part 203.27 states the mortgagee may collect from the mortgagor reasonable and customary amounts, but not more than the amount actually paid by the mortgagee for the fee or charge. This includes title examination, title insurance, and any related fees.

For loans originated in Colorado, employees of Western Escrow of Denver, an associate company of City Wide Mortgage, handled the closing of loans with the mortgagor. The closing documents were prepared by City Wide Mortgage employees in the Smyrna, Georgia office and sent to their Colorado office. All mortgage documents were signed in Colorado by the Western Escrow representative and the mortgagor. The mortgage package of all executed documents was then sent to City Wide Mortgage's office in Smyrna, Georgia by an overnight express service.

Once the loan package with the executed loan documents arrived at City Wide's headquarters office, it was forwarded to Charles Gallagher or Patriot Title & Abstract Company for disbursement of the loan proceeds. After the right of rescission period, the loan proceeds were disbursed. Neither Mr. Gallagher nor Patriot Title could provide written documentation from City Wide Mortgage informing them of the way to disburse loan proceeds. Based upon our review of the disbursement of loan proceeds, it was concluded that the HUD-1 document was disregarded. Based upon our review, we found the difference between what was charged to the mortgagor for title insurance and amount paid for the reissue title policy, was the compensation for the disbursement of loan proceeds and the compliance file review.

Our review of the loans originated in the State of Colorado by City Wide Mortgage, Inc. concluded that the disclosure of title and settlement fees charged on the HUD-1 settlement statement were improper; title fee overcharges were used to compensate a third party to disburse loan proceeds; the overcharges are considered unearned fees according to RESPA and HUD guidelines; and the fees charged were above the HUD authorized amount.

In addition, analysis during the audit showed in some cases, City Wide Mortgage not only charged the mortgagor for the full basic rate of the lender's title insurance policy, but also included an additional amount for owners' extended coverage. Owners' extended coverage provides for mechanic's lien protection, survey protection, and gap protection which are not included in a lender's title policy obtained at the basic rate.

1. Improper disclosure of title and settlement charges on HUD-1

As part of our review of the 70 loans originated in Colorado, we compared the amount charged for title insurance (line 1108) on the HUD-1 settlement statement to the rate schedule for the respective title company. Adequate information to complete the analysis could be obtained for only 54 of the 70 loans. The comparison of the title insurance rate schedules and the HUD-1 settlement statement revealed that the amount shown on the HUD-1 settlement statement was:

- below the basic rate on the title insurance rate schedule for 1 loan;
- equal to the basic rate for 10 loans;
- between the basic rate and the owners' extended coverage rate for 3 loans;
- equal to the owners' extended coverage rate for 29 loans; and
- above the owners' extended coverage rate for 11 loans.

However, only a basic lender's title policy, obtained at a reissue rate, was issued for each of the loans by the title companies.

The reason for not disclosing the actual charge for title insurance on the HUD-1 settlement statement was unclear. Since City Wide Mortgage is no longer an active going concern and the loan origination offices have been closed, we could not interview the individuals responsible for preparing the settlement statements and related documents. Not only were the requirements of RESPA and HUD regulations violated, but the spirit of promoting full disclosure of settlement fees and charges to borrowers was also disregarded.

Auditee comment

City Wide officials maintain the actual costs associated with refinancing loans were accurately disclosed to mortgagors. City Wide asserts the title companies charged City Wide one fee for title insurance based on the title company's rate schedule which City Wide in turn charged to the mortgagor. City Wide also contends the title companies did not itemize their charges, therefore neither did City Wide. City Wide also

stated any mistakes made in the form of disclosure were unintentional.

City Wide officials point out that Appendix A to the HUD-1 permits a single overall fee to be listed on line 1108 of the HUD-1 even when title companies performed a number of settlement services. City Wide maintains that they were charged a single fee for title insurance, and they listed that fee on line 1108 of the HUD-1. Officials admit that there may have been a problem with the form of the disclosure because the HUD-1 did not list on line 1108 the item numbers of settlement services that might have been covered in the overall fee.

OIG evaluation of auditee comment

The comparison of the HUD-1 settlement statements and title insurance commitments or, where available, itemized invoices from the title insurance companies showed City Wide Mortgage was charged less than the amount charged to mortgagors for title insurance policies. The invoices reviewed were addressed and mailed to City Wide Mortgage. Therefore, City Wide was aware of the actual cost of the title insurance policy. In addition, it was found that some title insurance commitments had "Reissue Rate" printed next to the amount charged for title insurance. For these loans, City Wide should have been aware the title policy obtained was at a reduced rate compared to the rate listed on the title insurance company's rate schedule.

Appendix A to the HUD-1 settlement statement does permit the total cost of title insurance to be placed on line 1108. However, if the total cost of title insurance is placed on line 1108, a notation must be added to indicate that the cost includes charges for any items on lines 1101 through 1107 of the settlement statement. If no additional notations are added, the amount on line 1108 represent the cost of only the title insurance policy.

For example, the mortgagor for FHA case number 051-7826342 (City Wide loan number 9360092) was charged \$634.00 on line 1108 of the HUD-1 settlement statement. However, both the commitment for title insurance and the itemized invoice from the title company show the cost of the title policy was \$321.00. A notation was not made on line

1108 to indicate that the \$634.00 charge included any other items besides title insurance.

2. Title fee overcharge used to compensate third party to disburse loan proceeds

City Wide Mortgage officials assert that charging the mortgagor to compensate Mr. Gallagher and Patriot Title for disbursing loan proceeds and conducting a compliance file review was an acceptable practice. The officials of City Wide Mortgage said they did not receive any of the money charged for title insurance and were not responsible for the way the loan proceeds were disbursed since this function was handled by Charles Gallagher and Patriot Title. While our review did not disclose that City Wide Mortgage profited from the overcharging of mortgagors for lender's title policies, ultimately the mortgagee is responsible for ensuring that the entire origination and settlement process follows all applicable requirements and guidelines. This includes proper disclosure of the actual cost of all fees and charges.

One aspect of the fee paid for the disbursement of loan proceeds and the compliance file review, that is questionable, is the variable structure of that fee. The fees received by Mr. Gallagher and Patriot Title for the Colorado sample of loans reviewed, ranged between \$0 to \$370.75. The difference in fees received for the service is questionable since the amount of work that a compliance file review and the disbursing activity entails would change very little based upon the amount of the loan. Neither Mr. Gallagher nor Patriot Title could provide a logical rationale for the amount received for their services. Given the fact of the large variance in fee for the compliance file review and disbursement of proceeds, it could be concluded that the fee was arbitrary, and would not be considered a reasonable and customary closing cost as permitted by HUD Handbook 4000.2 Rev-2.

Both Mr. Gallagher and Patriot Title explained the compensation they received as the balance of what was charged to the mortgagor on the HUD-1 settlement statement for title insurance less the actual cost of the title policy. But neither had a written agreement with City Wide Mortgage stipulating the services that they were to perform nor the compensation to be received.

Auditee comment

City Wide officials contend there never was a separate charge to, or payment by, City Wide to compensate Charles Gallagher

or Patriot Title for any services. The disbursing of loan proceeds was compensated by, and as agents of, their respective title company. City Wide officials acknowledged the responsibility for how loan proceeds were disbursed; however, City Wide asserts they are not responsible for how title companies and their agents split the title insurance fee.

City Wide also questioned the report's conclusion that loan proceeds were not disbursed according to the HUD-1 settlement statement. City Wide officials insist Charles Gallagher and Patriot Title knew how to disburse loan proceeds. City Wide officials maintain that loan proceeds were disbursed according to the HUD-1 settlement statement.

OIG evaluation of auditee comment

A review of loan proceed disbursements showed Charles Gallagher and Patriot Title were compensated directly from loan proceeds and not by their respective title companies, as City Wide officials have asserted. Compensating Patriot Title and Charles Gallagher directly from loan proceeds is in noncompliance with the information listed on the HUD-1 settlement statement.

The audit showed loan proceeds were not disbursed in accordance with the HUD-1 settlement statements. For loan proceeds to be disbursed in accordance with the HUD-1 settlement statement, the amount of the disbursement should match the dollar amount listed on the settlement statement for that specific item. The disbursement would also need to be for the specific service listed on the settlement statement, such as the origination fee, an endorsement or a tax certificate. The results of audit work showed loan proceeds were not disbursed in the manner described above.

3. Overcharge considered unearned fees

The practice of charging City Wide Mortgage customers above the actual cost for a lender's title insurance policy constitutes an unearned fee according to RESPA and HUD guidelines. Section 8(b) of the Real Estate Settlement and Procedures Act of 1974 prohibits the mortgagee from charging the mortgagor a fee for a service that was not performed. The Act goes on to say that an unearned fee is constituted when a person accepts any portion, split, or percentage, of any charge made or received, for the rendering of a real estate settlement service, in connection with a transaction involving a federally related mortgage loan, other than for services actually performed.

Since City Wide Mortgage did not require a separate settlement fee on the HUD-1 for the disbursement and compliance loan review, then the cost should have been paid by the mortgagee and covered by the loan origination fee. In addition, the mortgagor should not be required to pay for a charge that was not fully disclosed on the settlement statement as required by RESPA and HUD guidance. The HUD-1 settlement statement provides a specific area (line 1101) for settlement agent fees, which would include such services as disbursing loan proceeds and conducting a compliance file review. Appendix A of the settlement statement provides guidance on where the specific settlement charges should be placed on the statement. City Wide Mortgage either was unaware of the proper procedures or chose to disregard the instructions for the accurate completion of the HUD-1.

Auditee comment

City Wide officials dispute the conclusion that charging the mortgagor above the actual cost for a lender's title insurance policy constitutes an unearned fee according to RESPA and HUD guidelines. City Wide contends the mortgagor was charged the same fee for title insurance that City Wide was charged by the title insurance company. Officials assert the actual cost of title insurance was fully disclosed on the HUD-1 settlement statement.

City Wide Mortgage also pointed out that Federal Regulations specifically permit title companies to pay its agents for services performed. The Regulations go on to allow the payment of compensation to any person for services performed. City Wide officials maintain the disbursing was paid by their title company, not City Wide, for disbursing loan proceeds and other related services.

OIG evaluation of auditee comment

City Wide Mortgage in effect did collect an unearned fee as a result of not properly disclosing all title insurance and related fees on the HUD-1 settlement statement. Since the proper disclosure of settlement costs were not made to mortgagors, City Wide Mortgage would be responsible for compensating the provider for the services. Therefore, City Wide Mortgage, in effect, collected an unearned fee because the mortgagor paid for fees that City Wide Mortgage should have paid due to City Wide's inadequate disclosure on the settlement statement.

The Office of Inspector General does not dispute that compensation to a title company is allowed for services performed. However, in order for the mortgagee to collect from the borrower for those allowed fees, they must be fully disclosed in accordance with RESPA and HUD guidelines on the settlement statement.

4. Fees charged above HUD authorized amount

City Wide Mortgage consistently charged above the maximum amount authorized for title insurance in the State of Colorado. The Denver HUD Field Office developed a schedule of permissible closing costs and fees that are considered reasonable and customary for the area. The schedule of fees was developed for the area in accordance with HUD Handbook 4000.2 Rev-2. The Schedule of Permissible Closing Costs and Fees to be charged to mortgagors on HUD/FHA insured loans, dated May 1, 1992, itemized allowable charges for loans in the State of Colorado. The schedule stipulates that the maximum amount to be charged for a lender's title policy in the State of Colorado is the actual cost of the policy for refinanced loans.

Our final review sample of FHA loans disclosed that mortgagors were charged anywhere from \$515 to \$715 for lender's title insurance policies. These charges did not include endorsements, tax certificates, or recording fees. The actual cost of lender's title policies on the sample ranged between \$240 and \$585 resulting in an average overcharge of \$289 for the loans reviewed. As the above example illustrates, mortgagors paid fees for lender's title policies in excess of the amount authorized by the HUD developed Schedule of Permissible Closing Costs and Fees.

Our review also disclosed that if the cost for the disbursement of loan proceeds and compliance file reviews were placed on the HUD-1 settlement statement, the majority of the fees would have been above the HUD maximum allowable amount, according to the schedule of permissible closing costs and fees, dated May 1, 1992. As mentioned previously, the amount the mortgagors paid for disbursing the loan proceeds and the compliance file review ranged between \$0 to \$370.75, with an average charge per loan of \$252. The maximum amount allowable for a loan settlement fee for the State of Colorado was \$100.

Auditee comment

City Wide asserts that they did not charge mortgagors above the maximum amount authorized for title insurance in the State of Colorado. City Wide officials maintain that they were not charged a separate fee for the disbursement and compliance review services, but were charged one inclusive title insurance fee for all title related services. City Wide contends that mortgagors were charged the same amount the mortgagee paid for the title insurance policy.

City Wide goes on to say that neither the HUD Schedule of Permissible Closing Costs and Fees nor the HUD handbook address disbursement or compliance review fees. City Wide officials believe that even if there had been a separate disbursement or compliance review fee, neither the HUD Schedule nor the HUD handbook prohibit or specifically limit the amount for such a fee.

OIG evaluation of auditee comment

As stated above a comparison of the HUD-1 settlement statements and title insurance commitments or, where available, itemized invoices from the title insurance companies showed mortgagors were charged more than the amount charged to City Wide Mortgage for title insurance policies. The title insurance invoices were addressed and mailed to City Wide Mortgage. Therefore, City Wide was aware of the actual cost of the title insurance policies.

In addition, fees for disbursing loan proceeds and conducting a compliance review should be classified as a settlement or closing charge and placed on line 1101 of the settlement statement. The Schedule of Permissible Closing Costs and Fees for the State of Colorado, developed in accordance with HUD Handbook 4000.2 REV-2, limited costs associated with loan settlement to \$100.

Careless business practices

Based upon our review, it appears that City Wide Mortgage did not have an adequate system in place to ensure the correct completion of the HUD-1 settlement statement prior to the loan closing. As a result, the settlement statements were not consistently filled out to reflect the actual charges and costs of the real estate transactions. Thus, the HUD-1 settlement statement did not reflect how the funds were actually disbursed. For example, for the settlement statements of the 61 loans reviewed for properties in Colorado, all 61 had charges above the actual cost for the title policy. In addition,

the following settlement charges were also incorrectly shown on the settlement statements of the loans reviewed:

- 19 were incorrectly charged for recording fees;
- 17 were incorrectly charged for endorsements; and
- 6 were incorrectly charged for tax certificates.

A lack of oversight by City Wide management, and coordination of the outlying loan origination offices and associate Western Escrow offices, appears to have contributed to the lack of attention to detail on preparing the settlement statements. The Certified Public Accountant's report for the period ending February 28, 1994, cites City Wide Mortgage for not conducting annual on-site reviews at all branch offices. This lack of proper oversight of the branch offices may have contributed to lax procedures for communicating the correct settlement figures to the home office for completing the HUD-1 settlement statements. The improperly prepared settlement statements resulted in mortgagors not knowing the actual cost of the real estate transaction as well as how the funds from their refinanced mortgage were disbursed.

Auditee comment

Officials from City Wide Mortgage admit that HUD-1 settlement statements were incorrectly completed. However, officials assert that management hired a number of qualified individuals to monitor and teach RESPA compliance, as well as monitor the overall compliance and quality control of the loan origination process.

OIG evaluation of auditee comment

Regardless of the number of qualified individuals hired by City Wide management to monitor and teach compliance with RESPA, numerous cases of noncompliance with RESPA and HUD guidelines were found during the audit.

Settlement fees charged in other states also questionable

In addition to reviewing loans originated in Colorado, we evaluated a sample of various loans originated from other states where City Wide Mortgage had loan origination offices. Our evaluation determined that the settlement fees charged in the other states were also questionable. The nationwide sample consisted of 40 loans originated in Arizona, Georgia, Illinois, Nevada, North Carolina, South Carolina, and Virginia.

We performed a cursory review of settlement fees, specifically title insurance fees, for the nationwide sample. We found the same practice of overcharging mortgagors for title insurance with the national sample. The overcharge was used to compensate a third party for disbursing loan proceeds. Patriot Title even had detailed written instructions of how to split the title insurance charge on the HUD-1 settlement statement between all parties.

For example, in Illinois we found Intercounty Title disclosed to the mortgagor that a settlement fee of \$175 was charged for the service of disbursing loan proceeds by Patriot Title. However, Patriot Title was compensated above the \$175 fee disclosed to the mortgagor. Patriot Title was paid the \$175 plus the balance of the title insurance invoice after the title company was paid.

Auditee Comments

The draft finding was provided to City Wide Mortgage officials and their legal representative on September 22, 1995. An exit conference was held on October 23, 1995. The comments received from Karsh & Fulton, P.C. on behalf of City Wide Mortgage have been incorporated in the report as appropriate.

City Wide Mortgage does not agree with the overall conclusions reached in the audit report. City Wide officials believe the audit report contains erroneous conclusions regarding improper disclosures and overcharges to borrowers by City Wide Mortgage. City Wide also feels the report mischaracterizes the business relationship between City Wide Mortgage and Charles Gallagher and Patriot Title, the parties that disbursed loan proceeds.

City Wide Mortgage's response to conclusions reached in the finding are presented at the end of each section of the finding. City Wide Mortgage's response to the draft finding is included as Appendix B in its entirety. The attachments accompanying the response have not been included in Appendix B but have been provided to the Office of the Deputy Assistant Secretary for Single Family Housing for their information and use.

OIG Evaluation of
Auditee Comments

The results of audit work show City Wide Mortgage did not accurately disclose to mortgagors the actual cost of fees associated with the settlement of refinancing their home mortgage. Regardless of who disbursed loan proceeds, City Wide Mortgage, as a HUD Direct Endorsement program participant, was compelled to follow HUD guidelines and requirements and ensure all aspects of the loan transaction were completed in accordance with applicable requirements.

OIG's evaluation of specific auditee comments are addressed after each individual section of the finding.

Recommendations

The Office of the Deputy Assistant Secretary for Single Family Housing should:

- 1A. Evaluate the conditions cited in the finding and initiate debarment action against City Wide Mortgage officials and related parties, as considered appropriate.
- 1B. Refer the conditions cited in the finding to the Mortgagee Review Board for their review and appropriate enforcement action, as necessary, against City Wide Mortgage Officials.
- 1C. Evaluate the seriousness of the Real Estate Settlement Procedures Act violations cited in the report and initiate the appropriate enforcement actions, as necessary.

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Internal Controls

Our review of the internal controls of City Wide Mortgage, Inc. was limited to the controls associated with obtaining and disclosing the cost of the lender's title insurance policy for refinanced FHA backed loans. Controls over the disbursing of loan proceeds in accordance with the HUD-1 settlement statement, as required by RESPA, were also assessed. We reviewed loan records to determine whether City Wide Mortgage, Inc. complied with laws and regulations that prescribe requirements for internal controls over obtaining lender's title insurance and the disbursement of loan proceeds for direct endorsement mortgagee operations. For the loans reviewed, we found noncompliance with these laws and regulations as described in the Executive Summary and Finding. The prevalent extent of noncompliance for loans reviewed suggested that the mortgagee also may not have fully complied on other loans which we did not test.

In planning and doing our audit, we considered internal controls of the functions of obtaining lender's title insurance policies and the disbursing of loan proceeds in order to determine our audit procedures and not to provide assurance on internal controls.

Internal controls are management's adopted plans, methods; and procedures to assure resources are used within the laws, regulations, and policies; that the resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in the reports.

Internal controls assessed

We determined that the following controls were relevant to our audit objective and each was assessed during our review:

- Controls to assure that the actual cost of title insurance for the lenders' policy was shown on the HUD-1 settlement statement.
- Controls to assure that loan proceeds were disbursed in accordance with the HUD-1 settlement statement.

Significant weaknesses in internal controls do not give reasonable assurance that resources are used consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss and misuse; and that reliable data are obtained and maintained, and fairly disclosed in the financial statements and reports.

Assessment procedures

The following audit procedures were used to evaluate internal controls:

- Review of records associated with obtaining lender's title insurance policies, including records from the applicable title insurance companies.

- Review of FHA case binders.
- Review of files from Western Escrow, the associate escrow company of City Wide Mortgage, Inc.
- Review of records associated with the disbursement of loan proceeds.
- Review of City Wide Mortgage's loan origination files.
- Analysis of actual cost for the lender's title insurance policy compared to the amount charged to the mortgagor on the HUD-1 settlement statement.
- Interviews with officials from HUD, Stewart Title of Denver, Title America of Denver, the law office of Charles Gallagher, and McManus & Associates (Patriot Title). We also interviewed the principals of City Wide Mortgage: Mr. B.C. Johnson and Mr. George Jennings.

Significant weaknesses

Based on our review, the following items are internal control weaknesses:

- The amount charged to the mortgagor for the lender's title insurance policy was not the actual cost or amount disbursed to the title company.
- The amount paid to the third party disburser was above the authorized amount for settlement of a loan according to the rates set by the HUD Colorado Office.
- Charging mortgagors above the actual cost for a lender's title insurance policy constitutes an indirect unearned fee according to RESPA and HUD guidelines.
- Charging the mortgagor for the full basic rate of the lender's title insurance policy when the policy was obtained at a reissue rate. In addition some mortgagors were also charged for owner extended coverage for title policies when all that was issued was a basic lender's title insurance policy.

These significant weaknesses are discussed in the finding.

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Follow Up On Prior Audits

This was the Office of Inspector General's first review of City Wide Mortgage, Inc.

KPMG Peat Marwick, Certified Public Accountants, prepared the most recent audit report. It covered the 12-month period ending February 28, 1994. The Independent Auditors' Report on Compliance With Specific Requirements Applicable to Major HUD-Assisted Programs noted the following instances of noncompliance (findings):

- The Quality Control Department's review of insured mortgages originated by the mortgagee was not conducted and results were not submitted to management within 90 days of the loan closing, as required by the general and specific elements included in HUD Handbook 4060.1.
- All branch offices did not receive an annual on-site review.
- The payoff statements in a sample of 8 of 59 files reviewed for refinanced mortgages did not match the payoff amount indicated on the HUD-1 settlement statement.
- The per diem interest calculation indicated on the HUD-1 settlement statement was incorrect for two loans reviewed.
- The escrow assignment letter in the loan file of a refinanced mortgage did not match the escrow assignment amount indicated on the HUD-1 settlement statement.
- The monthly escrow for hazard and flood insurance indicated on the HUD-1 settlement statement of a loan selected for test work did not agree to the premium amounts indicated on the policies included in the loan file.
- The appraisal fee charged to a borrower exceeded the maximum HUD allowable charge. The allowable FHA appraisal fee that can be charged to a borrower in South Carolina was \$225 at the time of the loan closing. According to the HUD-1 settlement statement, the borrower was charged an appraisal fee of \$250. Thus, the borrower was overcharged \$25 for the appraisal.
- Documentation in nine loan files indicated that the up-front Mortgage Insurance Premium (MIP) was not submitted to HUD within 15 days of the loan closing. The HUD Statement of Account indicated that a late charge was assessed and remitted by the investor.
- The company did not maintain fidelity bond coverage. After January 8, 1993, all mortgagees must maintain fidelity bond coverage of at least \$300,000.

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