U.S. Department of Housing and Urban Development
Office of Inspector General
Pacific/Hawaii District
450 Golden Gate Avenue, Box 36003
San Francisco, California 94102-3448

Audit Memorandum
2001-SF-1806

September 28, 2001

TO: D. Jackson Kinkaid
Secretary, Mortgagee Review Board, VD

//SIGNED//
FROM: Mimi Y. Lee
District Inspector General for Audit, 9AGA

SUBJECT: Limited Review – Golden Home Mortgage and Its Direct Endorsement Sponsors
Section 203(b) and 203(k) Mortgage Loan Insurance Programs
Concord, California

We completed a limited review of Golden Home Mortgage's origination process for Federal Housing Administration (FHA) insured loans to nonprofit organizations low and moderate-income first-time homebuyers. The purpose of our review was to determine whether Golden Home Mortgage and its direct endorsement sponsors ensured that the loan amounts and property sales prices were proper.

Neither Golden Home Mortgage nor its sponsors, SCME Mortgage Bankers (according to company officials, the mortgage company changed its name from Southern California Mortgage Exchange to SCME in the mid-nineties) and Western Sunrise Mortgage DBA Crossland Mortgage, prevented nonprofit mortgagors from exceeding the Department of Housing and Urban Development's (HUD's) 10 percent profit limitation on properties purchased from HUD at a 30 percent discount. The nonprofits had purchased the properties from HUD through a program that gave them 30 percent off the list price and made FHA's 203(k) loans available for the properties' purchase and rehabilitation. HUD's stated purpose for giving the discounts was that the nonprofits pass the discount on to low and moderate-income homebuyers. The homebuyers, however, paid an average of $10,500 more for their homes than HUD intended. This also increased HUD's mortgage insurance risk and the homebuyers' liability an average of $10,800. Further, the price and mortgage increases also resulted in higher fees for Golden Home and its associates.

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BACKGROUND

HUD's Single Family Mortgage Insurance Programs help low and moderate-income families purchase homes by reducing downpayments and lender fees. Under these programs, HUD insures approved mortgages against losses on mortgage loans. In the past, the FHA has administered the programs.[1]

HUD acquires single-family properties as a result of foreclosure of FHA insured mortgages. Following foreclosure, mortgage lenders have the right to deed the properties to the Secretary of HUD in exchange for the mortgage insurance benefits.

HUD provided a 30 percent discount for homes located in a revitalization area.

HUD disposes of acquired properties through its Property Disposition Program, administered by the Office of Single Family Housing, Real Estate Owned (REO) Division. Its mission is to reduce the property inventory in a manner that expands homeownership opportunities, strengthens neighborhoods and communities, and ensures a maximum return to the mortgage insurance funds. In line with those goals, HUD offered qualified nonprofit organizations the opportunity to purchase certain properties directly (that is, without bidding) from HUD at a discount off the list price. The discounted properties were those the REO Division had determined were not eligible for mortgage insurance because they required more than $5,000 worth of repairs to meet HUD's minimum property standards (MPS). If the properties were located in an area HUD had designated as a revitalization area, HUD offered nonprofits a 30 percent discount. Otherwise, the discount was 10 percent.

Discounted properties cannot be resold for more than 110 percent of discounted purchase price.

To meet its mission, HUD put restrictions on properties it sold at a 30 percent discount. The nonprofits agreed to rehabilitate the properties, ensure they met MPS, and then resell them to low and moderate-income families whose incomes did not exceed 115 percent of the median income for the area. To ensure affordability, HUD required the nonprofits sell the properties for no more than 110 percent of their net development cost. HUD's goal generally required two separate mortgage loans. HUD made funding available for the nonprofits' purchase and rehabilitation by allowing the nonprofits to obtain insured 203(k) rehabilitation loans. HUD also offered standard insured 203(b) loans to the low and moderate-income families. ***In cases where the same lender made both the 203(k) and the 203(b) loan on the same property, HUD required the lender ensure the nonprofit sold the properties to income eligible families for no more than 110 percent of its net development cost.***

In order to participate in HUD's discounted direct sales program and mortgage insurance program, nonprofits had to be approved. One of the items they had to submit with their applications was an affordable housing plan describing how they were going to implement the program. Each of the nonprofits in our review stated in their affordable housing plan they would only sell the homes purchased from HUD to first-time homebuyers.

[1] The abbreviations FHA and HUD are often used interchangeably.

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Golden Home Mortgage was a loan correspondent. A loan correspondent may participate in direct endorsement of FHA mortgages in a limited way, provided a direct endorsement lender approved by HUD sponsors it. Under this arrangement, the loan correspondent will take the initial loan application, handle the appraisal assignment with HUD, procure verifications of deposit and employment and the credit report, close the loan after it has been underwritten, and submit the loan package to HUD for insurance endorsement.

The direct endorsement approved sponsor must perform the underwriting of the property and the borrower and complete the underwriter certification. SCME and Western Sunrise Mortgage DBA Crossland Mortgage were direct endorsement lenders and sponsored loans originated by Golden Home Mortgage. In January 2001, Wells Fargo Mortgage bought Western Sunrise Mortgage DBA Crossland Mortgage. The purchase occurred subsequent to the endorsement of the loans included in this review.

We initiated a review of Golden Home Mortgage due to a complaint.

Based on a complaint we received, we initiated a review of Golden Home Mortgage, then located at Concord, California. We planned to perform a comprehensive review of the mortgagee's processing of FHA loans. While our review was in process, a parallel review was undertaken by HUD's Department of Enforcement, Quality Assurance Division. The Quality Assurance team found the same types of processing problems we were noting. As a result of its review, HUD's Mortgagee Review Board (MRB) has withdrawn Golden Home's approval to process FHA loans. In addition, the MRB is seeking civil money penalties from Golden Home.

The Quality Assurance team and our initial review work identified numerous violations of HUD requirements by Golden Home. In its letter to the Mortgagee Review Board, the Quality Assurance team said Golden Home:

- Failed to ensure there were only arms length transactions between the nonprofit mortgagors, the real estate agent, and the loan officer;
- Did not ensure the nonprofit mortgagors did not exceed the 10 percent profit limit on properties purchased from HUD with a 30 percent discount;
- Miscalculated maximum mortgage amounts, causing HUD to over-insure FHA loans;
- Miscalculated maximum mortgage amounts, causing HUD to over-insure FHA loans;
- Prepared misleading closing instructions that resulted in inaccurate and misleading HUD-1 closing statements;
- Caused borrowers to sign blank loan documents;
- Provided false housing counseling certifications;
- Provided false information concerning face-to-face interviews with borrowers;

- Failed to resolve discrepancies in the sales contracts and other loan documents; and
- Obtained multiple appraisals on properties, and failed to question or explain rapid and substantial increases in property value.

We limited our review due to actions already taken by the MRB.

Because of the efforts of the Quality Assurance team and action by the MRB, we modified our review objectives. Instead of documenting each of Golden Home's loan processing deficiencies, we limited further work to determining the effect on homebuyers when the mortgage company failed to ensure the sales price did not exceed HUD's limit and the effect on HUD when the resulting loans were insured.

OBJECTIVES AND METHODOLOGY OF LIMITED REVIEW

Thus, the objectives of our review were to determine if the mortgage companies: (1) ensured properties HUD sold to nonprofit organizations at a 30 percent discount were resold to eligible low and moderate-income homebuyers at no more than 110 percent of the nonprofits' development costs, and (2) correctly calculated the maximum mortgage amounts for the insured loans. To accomplish our objectives we:

- ✓ Reviewed pertinent laws, regulations, HUD Handbooks, Mortgagee Letters, and other directives related to Property Disposition and loan processing;
- ✓ Interviewed the executive directors and other officers at participating nonprofit organizations;
- ✓ Discussed issues with officials at Golden Home Mortgage, SCME Mortgage Bankers and Western Sunrise Mortgage DBA Crossland Mortgage;
- ✓ Reviewed quality assurance plans for loan processing at Golden Home Mortgage and SCME Mortgage Bankers;
- ✓ Reviewed processing files from HUD REO, Golden Home Mortgage, SCME Mortgage Bankers, and Western Sunrise Mortgage DBA Crossland Mortgage; and
- ✓ Recalculated maximum mortgage amounts and maximum allowed sale prices for selected properties HUD sold at 30 percent off list price.

We reviewed loans related to ten sampled properties.

Golden Home Mortgage provided a list of 418 loans it had originated for nonprofit organizations between October 1, 1997 and October 7 1999. We used HUD's Single Family Insurance System (SFIS) to identify 37 properties where the same lender funded the nonprofits' 203(k) loans and the first-time homebuyers' 203(b) loans. From those, we selected a non-statistical sample of ten properties to review.

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For each property, we obtained the necessary files and calculated the net development cost and the maximum sales price. HUD's property disposition file provided documentation of the nonprofit's purchase price and costs associated with purchasing the property. This information was also in the lender's loan origination file for the nonprofit's mortgage. The lender also provided the rehabilitation file documenting money spent on rehabilitation from loan proceeds. The lender's loan origination file for the new mortgage obtained by the homebuyer provided the sales price and the seller's and buyer's associated costs.

Because of our limited scope, we did not test or assess management controls, nor did we rely on them. The review generally covered the period September 3, 1997 through May 3, 1999. We accomplished the file reviews intermittently between January 2000 and December 2000. The review was conducted in accordance with generally accepted government auditing standards.

FINDING

THE LOAN CORRESPONDENT AND ITS SPONSORS DID NOT ASSURE PURCHASE DISCOUNTS WERE PASSED ON TO HOMEBUYERS.

Neither Golden Home Mortgage nor its sponsors, SCME Mortgage Bankers and Western Sunrise Mortgage DBA Crossland Mortgage, prevented nonprofit mortgagors from exceeding the Department of Housing and Urban Development's HUD's limitation on resale prices for properties purchased from HUD at a 30 percent discount. The nonprofits had purchased the properties from HUD through a program that gave them 30 percent off the list price and made FHA's 203(k) loans available for the properties' purchase and rehabilitation. HUD's stated purpose for giving the discounts was that the nonprofits pass the discount on to low-and-moderate-income homebuyers. To meet its purpose, HUD restricted the nonprofits from selling the properties for more than 110 percent of each property's net development cost. The homebuyers, however, paid an average of $10,500 more for their homes than HUD intended. This also increased HUD's mortgage insurance risk and the homebuyers' liability an average of $10,800. Further, the price and mortgage increases also resulted in higher fees for Golden Home and its associates.

We believe Golden Home knowingly inflated the home prices and mortgages to increase profits for itself and its associates. Although Golden Home processed the loan applications and originated the mortgages, the loans were underwritten and funded by direct endorsement sponsors SCME and Western Sunrise. The sponsors were ultimately responsible for ensuring the sales prices did not exceed 110 percent of the nonprofits' development costs and the maximum mortgage calculations were in accordance with HUD requirements. However, the sponsors' quality control procedures were not effective in preventing these errors.

HUD put restriction on properties sold to nonprofit organizations at a 30 percent discount in order to pass on savings to low-income homebuyers.

HUD's written procedures and policies clearly disclose the restrictions HUD imposed when it sold properties to nonprofits at a 30 percent discount. To qualify for a 30 percent discount, the properties had to be in a designated redevelopment area. The

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properties also had to be in need of at least $5,000 worth of repairs to meet HUD's minimum property standards.[2] The nonprofits had to agree they would rehabilitate the properties and then sell them to owner/occupants with low and moderate incomes. HUD limited the sales price so the bulk of the discount would be passed on to the buyers. This was done by restricting the price to 110 percent of net development costs as defined by HUD. The 10 percent overage was expected to cover the nonprofits' overhead costs.

HUD Handbook 4310.5–Rev-2, *Property Disposition Handbook – One to Four Family Properties*, provides program policy and processing requirements for HUD's Single Family Property Disposition Program (SFPD). Chapter 10 of the handbook discusses direct (noncompetitive) sales to governmental entities and private nonprofit organizations. Under the discounted sales program, approved nonprofit organizations could purchase certain distressed properties from SFPD at 30 percent below the list price. When the nonprofits purchased the properties, they agreed to rehabilitate the properties and resell them to first-time homebuyers whose incomes did not exceed 115 percent of median income for their area.

Resale restrictions on 30 percent discount properties were expanded in Housing Notice 94-74, *Revisions to SFPD Sales Procedures* which stated: "…it is reasonable to expect that a nonprofit sponsor, like any other developer, is entitled to a fee which covers costs. This fee should include overhead and staffing related to the project. Some fluctuation in the developer's fee is to be expected, however, as a general rule, it is not anticipated that a nonprofit should realize more than a six to 10 percent rate of return on HUD properties purchased at the 30 percent discount…."

Subsequent Mortgagee Letters (ML) strengthened and clarified the resale price restriction. ML 96-21 and ML 97-5 restrict nonprofit agencies from selling properties for more than 110 percent of their net development cost, if the nonprofits purchased the properties from HUD at a 30 percent discount.

ML 96-21 defined the net development cost as "…the total cost of the project including items such as acquisition cost (including the cost of rehabilitation), fees to prepare the work write-ups and cost estimates, permits and survey expenses, insurance and taxes, excluding overhead and any developer's fee. Basically, the nonprofit organizations recoup their legitimate costs while, at the same time, keep the property affordable to the income level of their target buyers."

ML 97-5 defined the net development cost as "…the total cost of the project including items such as acquisition cost, architectural fees, permits and survey expenses, insurance, rehabilitation, and taxes. Total costs incurred by the purchaser, including those for acquisition financing, management fees and selling expenses related to the project can also be included, but are expected to be reasonable and customary for the area in which the property is located. The purchaser can also include up to three months mortgage payments (principal and interest only), less all rents received. The net development cost cannot include gifts to the eventual purchaser for the down payment, financing or closing costs, nor any other related expenses associated with that buyer's purchase of the property."

[2] Properties needing repairs estimated at under $5,000 could be offered with FHA insured financing. If needed repairs exceeded $5,000 the properties were offered without Section 203(b) financing and the regulations referred to them a "uninsurable." However, they were still eligible for Section 203(k) financing.

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ML 97-5 stated, "the lender is responsible for analyzing the closing documents to assure the nonprofit or government entity is not making in excess of a 10 percent profit…. If the sales price exceeds 110 percent of the net development cost, then the excess profit must be used to pay down the existing mortgage. Supporting documentation must be reviewed by the underwriter prior to closing the loan. The lender is not required to recalculate the profit if the nonprofit or government entity sells the house on a new loan that the lender does not originate (since the lender is not in control of the new loan); however, it is the nonprofit or government entities' responsibility to make sure they are in full compliance with all HUD requirements. *The profit on the sale of one property cannot be offset by the lesser profit or loss on another property.*" (Emphasis added.)

The nonprofit organizations did not pass discounts on to homebuyers.

For the ten 203(k) financed property sales we reviewed, homebuyers paid a total of $104,993, or an average of $10,500 each in excess of the amounts HUD intended (as detailed in Appendix A). Only one property did not exceed 110 percent of the nonprofit's net development cost. Prices for the other nine properties exceeded 110 percent of the net development costs by amounts ranging from $5,409 to $17,540. The profit percentage ranged from 16 percent to 32 percent.

Golden Home's loan manager monitored profits from sale of properties.

The nonprofits relied on a real estate broker and Golden Home's loan manager to oversee all aspects of their affordable housing programs. The loan manager kept records on the properties and project costs, and calculated the net development costs for the nonprofits. The loan manager calculated the profits realized and prepared the annual reports HUD required. The annual reports contained certifications that all 30 percent discount properties were sold to income eligible people. The reports also contained incorrect purchase and rehabilitation and sales information to show the profits did not exceed an average of 10 percent for the 30 percent discount properties. The loan manager and the real estate broker told the nonprofits they were experts on HUD programs. The loan manager said that profits were not restricted to 10 percent on *individual* properties (which is clearly contrary to ML 97-5), but that annual profits could not exceed an *average* of 10 percent. We spoke to two of the nonprofits' directors who said they relied on the knowledge of the real estate agent and the loan manager. They were unable to explain the annual reports prepared by the loan manager.

How the loan manager arrived at net development costs was not clear from the reports he submitted to HUD. Nevertheless, we can identify at least one error in his profit calculations. He improperly included an amount for overhead cost, one of the items HUD expected nonprofits to absorb and was specifically to be excluded from net development cost. Because of the loan manager's role in administering the nonprofits' affordable housing programs, it is clear Golden Home Mortgage should have been aware HUD's resale restrictions were violated.

Golden Home's calculations improperly inflated mortgage amounts.

Excessive sales prices increased maximum mortgage amounts for all respective homebuyers. Golden Home inflated the mortgage amounts further by failing to follow HUD's procedures and including

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amounts labeled "borrower-paid closing costs" in six of ten maximum 203(b) mortgage calculations. These costs should not have been included because the nonprofit sellers provided the money for closing costs. As detailed in Appendix B, the excessive sales prices and the improper inclusion of closing costs increased the mortgage amounts by an average of $10,772.

APPENDIX B

The six 203(b) loans including "borrower paid closing costs" were initiated prior to December 21, 1998, when HUD allowed the maximum mortgage to include them. Under the regulations then in effect, the closing costs could be included even if the borrower obtained the money to pay them as a gift from a relative or from a nonprofit agency. In the cases we reviewed, however, the funds did not meet HUD's criteria for gift funds. Although the nonprofits referred to the money they provided for closing costs as "equity gifts," they did not meet HUD's definition of gift funds.

ML 96-18, Section IV, addressed the issue of gifts from nonprofit agencies to assist homebuyers. It stated, "…we do not believe it to be appropriate to approve quid pro quo arrangements whereby assistance is only available if the buyer obtains financing with a particular lender or buys a particular builder's property…. The source of funds for a gift must be totally unrelated to the loan transaction. If the homebuyer may only use the builder, developer, lender, real estate firm, etc. that contributed the funds, the program will, in all likelihood, be unacceptable for FHA mortgage insurance." In all of the cases we reviewed, the homebuyers had no discretion to choose the real estate agent or lender, and the nonprofits only provided the closing funds for properties they were selling.

The source of funds to close was not an issue for the four loans initiated after December 21, 1998. After that date, Mortgagee Letter 98-29 eliminated borrower paid closing costs from the maximum mortgage calculation. Golden Home complied with the rule change.

The higher sales prices and mortgage amounts benefited Golden Home and its associates while increasing HUD's risk.

Higher sales prices resulted in larger mortgage amounts, higher fees for Golden Home Mortgage (as detailed in Appendix C), and higher commissions for the loan officers and the real estate broker. Golden Home earned an origination fee of one percent of the mortgage amount on each loan. For the 203(k) loans, it received a supplemental origination fee for the additional work involved in processing the rehabilitation loan. The sponsors paid Golden Home a yield spread premium (YSP) on 18 out of 20 loans and a service release premium (SRP) on 10 out of the 20 loans (two loans per property). For the 20 loans (ten 203(k) loans to nonprofits and ten 203(b) loans to first-time homebuyers), the total percentage based fees totaled $86,155.

There were two loan officers working in the Golden Home branch office that processed these loans. One was the loan manager who, along with the real estate broker, administered the affordable housing programs for at least eight nonprofits. The other was engaged to marry the real estate broker. Golden Home confirmed the loan officers were paid commissions, but did not disclose the rates. The real estate broker earned a six percent commission on each of the sales, so the $104,993 cumulative increase in the sales price for the 10 sales to first-time homebuyers earned him an additional $6,300.

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In addition, homebuyers were burdened with higher sales prices, resulting in higher mortgage amounts and payments.

The first-time homebuyers paid for the increases in sales prices and mortgage amounts. This negated or reduced HUD's intent to help people with low and moderate-incomes in becoming homeowners. HUD intended nonprofit organizations would pass most of the 30 percent discount on to these homebuyers. The targeted homebuyers were not necessarily very knowledgeable about the real estate industry. They responded to advertisements placed by the real estate broker, who offered the chance to purchase a HUD home with no downpayment. The broker provided a list of properties available from the nonprofits he worked with and arranged the financing through Golden Home. We believe the homebuyers trusted HUD was involved and would ensure their interests were protected. They also felt this was a unique opportunity to become a homeowner.

The loan sponsors were responsible for monitoring profits if it underwrote both loans.

The lender is not required to monitor the profit if the nonprofit organization sells the house on a new loan the lender does not originate (since the lender is not in control of both loans). The Single Family Acquired Asset Management System (SAAMS) shows that during 1998 and 1999, HUD sold a total of 314 properties at a 30 percent discount just to the nonprofits with programs administered by Golden Home's loan manager and the same real estate broker. In most of those cases, although both loans were originated by Golden Home, the loans to the nonprofits and the loans to the first-time homebuyers were underwritten by different sponsors. In those cases, HUD puts the sole responsibility for ensuring the profits do not exceed 10 percent with the nonprofits. However, it may be difficult or impossible for homebuyers who were overcharged to obtain relief, since many nonprofits do not have significant resources. Nevertheless, we identified 37 cases where the lender was the same for both the nonprofit and the first-time homebuyer, but there could be more.

Current HUD regulations offer a remedy for homebuyers when the sales price exceeds the limit of 110 percent of net development costs and both the rehabilitation loan and the homebuyer's loan were funded by the same lender. The lender is required to use the excess profit to pay down the mortgage. HUD does not currently offer a regulatory remedy to homebuyers when different lenders make rehabilitation loans and homebuyers' loans.

AUDITEE COMMENTS FROM SCME MORTGAGE BANKERS

SCME Mortgage Bankers provided written comments dated August 3, 2001. We held an exit conference with officials from SCME on September 27, 2001.

SCME acknowledged the criteria cited in the draft memorandum that restricted profits on 30 percent discount properties to 10 percent. However, SCME said it did not restrict the profits because the former Director of the San Francisco Single Family Loan Division instructed participants not to monitor the profits because the restriction would not apply on a per property basis, but on an aggregate to all properties purchased at a 30 percent discount and resold during a calendar year. SCME provided a statement from its former Vice President describing a meeting where she heard the instructions from the former Director. The Vice President said the former Director acknowledged the per property requirement, but said it would not be followed in the

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San Francisco jurisdiction. SCME also said that, prior to issuance of Mortgagee Letter 97-5 in March 1997, it believed HUD requirements were that aggregate profits should not exceed 10 percent. In addition, SCME officials said it is common practice to ask the local office for clarification or interpretation of HUD regulations, and it would be unreasonable to expect every answer in writing.

SCME did not agree 203(b) loans were improperly inflated by the inclusion of gift funds in the maximum mortgage calculation. SCME cited Mortgagee Letter 97-5, which said, "As a reminder, non-profit borrowers are allowed to provide a gift for the cash investment in the property to assist a low- or moderate- income family or a first-time homebuyer in obtaining a new FHA insured mortgage."

Finally, SCME does not agree there was any harm to either homebuyers or HUD. SCME believes homebuyers who paid more than HUD intended for their homes were not harmed because they did not pay more than the appraised market values and because they did not have to provide the cash for the down payments or closing costs. SCME does not recognize any harm to HUD because the objective of promoting homeownership was achieved, and HUD was able to move foreclosed properties out of its inventory.

OIG EVALUATION OF SCME MORTGAGE BANKERS' COMMENTS

We found no evidence the 10 percent profit restriction for each property was waived. HUD officials do not have the authority to waive regulations verbally. We do not suggest the mortgage company should ask HUD to answer every question or clarification in writing. However, if the mortgage company believes an individual at HUD is instructing them to ignore a clear requirement, they should obtain clarification from Headquarters, and they should certainly obtain written evidence of any waivers.

Regarding the gift funds, we agree HUD allowed nonprofit organizations to gift money for downpayments and closing costs to certain homebuyers. However, despite the fact the funds were labeled gifts, the nonprofits included these amounts in their calculation of net development costs and in the sale price of the homes. As discussed in the finding, the homebuyers were also required to obtain their loans through Golden Home Mortgage, contrary to HUD's requirement of free choice.

Our evaluation of Wells Fargo's comments addresses the no-harm issue.

AUDITEE COMMENTS FROM WELLS FARGO HOME MORTGAGE

Wells Fargo Home Mortgage provided written comments dated September 2, 2001. We held an exit conference with officials from Wells Fargo on September 20, 2001.

Wells Fargo officials reviewed our calculations of net development cost and profits realized on the sale of homes to first-time homebuyers. As a result, Wells Fargo agreed the sales prices exceeded HUD's guidelines. Wells Fargo disagreed, however, the homebuyers suffered financial losses. An official said Wells Fargo found one homebuyer had subsequently sold the

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property for more than the purchase price paid to the nonprofit organization and the other three properties in our sample were assessed for amounts far in excess of the purchase prices.

Wells Fargo stressed it realizes the importance of meeting HUD/FHA regulations and believes it has effective quality control policies and procedures. All of the transactions in the report occurred prior to Wells Fargo's purchase of Western Sunrise/Crossland Mortgage. Nevertheless, Wells Fargo staed it was willing, in order to facilitate resolution of these issues, to indemnify the remaining active loans.

OIG EVALUATION OF WELLS FARGO'S COMMENTS

We were gratified by Wells Fargo's comments although we do not agree homebuyers suffered no harm. Both the homebuyers and HUD suffered harm when nonprofit organizations failed to pass the discounts provided by HUD on to the intended recipients. Regardless of future home values, people paid thousands of dollars more for their homes than they should have leaving them with less money to apply to other needs.

RECOMMENDATION

We recommend you take appropriate action on the issues presented in this report.

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Appendix A

NONPROFITS' RESALES TO FIRST-TIME HOMEBUYERS

Property Address	Nonprofit Buyer	Net Development Cost	Resale Price	Excess Resale Price	NP's profit % per audit	Broker's Commission on Excess Price
2050 101st Av., Oakland, CA	Agape Villages	$ 94,309	$ 114,732	$ 10,922	22%	$ 659.52
546 S 19th St., Richmond, CA	Agape Villages	$ 139,298	$ 161,091	$ 7,863	16%	$ 471.78
617 22nd St., Richmond, CA	NCLT	$ 90,409	$ 104,859	$ 5,409	16%	$ 324.54
333, 335, 337, 339 29th St. Richmond, CA	Aim To Please	$ 155,989	$ 182,697	$ 11,109	17%	$ 666.55
46 Delta Dr., Bay Point, CA 94565	Clara's Cove	$ 79,450	$ 104,935	$ 17,540	32%	$ 1,052.40
1618 Emeric Rd., San Pablo, CA	Agape Villages	$ 81,589	$ 102,275	$ 12,527	25%	$ 751.62
57 Manville Av., Pittsburg, CA	Shelter	$ 81,900	$ 102,275	$ 12,185	25%	$ 731.10
1427 Rice St., Vallejo, CA	VNH	$ 103,766	$ 111,670	$ 0	8%	$ 0.00
665 Stone Harbor Dr., Pittsburg, CA	Aim To Please	$ 109,139	$ 128,558	$ 8,505	18%	$ 510.30
716 Sycamore St., Oakland, CA	Clara's Cove	$ 101,034	$ 130,000	$ 18,863	29%	$ 1,131.78
	TOTAL	$ 1,036,883	$ 1,243,092	$ 104,993		$ 6,299.59
	AVERAGE	$ 103,688	$ 124,309	$ 10,499		$ 629.95

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Appendix B

EXCESS MORTGAGE AMOUNTS FOR FIRST-TIME HOMEBUYERS

Property Address	DE Lender (sponsor)	Nonprofit Seller	Closing Costs Included in Mortgage	Excess Resale Price	Excess 203(b) Mortgage Amount	Overcharge on Loan Origination Fee
101st Av., Oakland, CA	Crossland	Agape Villages	$ 0	$ 10,992	$ 8,760	$ 88
S 19th St., Richmond, CA	Crossland	Agape Villages	$ 0	$ 7,863	$ 7,638	$ 76
22nd St., Richmond, CA	SCME	NCLT	$ 2,895	$ 5,409	$ 7,475	$ 75
29th St. Richmond, CA	Crossland	Aim To Please	$ 0	$ 11,109	$ 10,792	$ 108
Delta Dr., Bay Point, CA	SCME	Clara's Cove	$ 2,839	$ 17,540	$ 19,048	$ 190
Emeric Rd., San Pablo, CA	SCME	Agape Villages	$ 2,685	$ 12,527	$ 14,213	$ 142
Manville Av., Pittsburg, CA	SCME	Shelter	$ 2,743	$ 12,185	$ 13,887	$ 139
Rice St., Vallejo, CA	SCME	VNH	$ 2,839	$ 0	$ 2,697	$ 27
Stone Harbor Dr., Pittsburg, CA	SCME	Aim To Please	$ 3,200	$ 8,505	$ 10,781	$ 108
Sycamore St., Oakland, CA	Crossland	Clara's Cove	$ 0	$ 18,863	$ 12,424	$ 124
		TOTAL	$ 17,201	$ 104,993	$ 107,715	$ 1,077
		AVERAGE	$ 1,720	$ 10,499	$ 10,772	$ 108

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Appendix C

FEES PAID TO GOLDEN HOME MORTGAGE

Sponsor	Loan Type	Origination Fee	Supplemental Origination Fee	Processing Fee	YSP	SRP	Broker Total to Golden Home	Loan Amount	Percent of Loan Amount
Western Sunrise	K	$ 858	$ 369	$ 400	$ 1,394	$ 215	$ 3,235	$ 85,800	4%
Western Sunrise	B	$ 1,101	$ N/A	$ 400	$ 2,240	$ 1,400	$ 5,140	$ 110,062	5%
Western Sunrise	K	$ 1,339	$ 1,320	$ 400	$ 2,343	$ 335	$ 5,737	$ 133,900	4%
Western Sunrise	B	$ 1,565	$ N/A	$ 400	$ 2,400	$ 4,772	$ 9,138	$ 156,499	6%
SCME	K	$ 899	$ 1,068	$ 400	$ 1,460	$ 0	$ 3,827	$ 89,900	4%
SCME	B	$ 1,025	$ N/A	$ 400	$ 2,086	$ 1,304	$ 4,814	$ 104,859	5%
Western Sunrise	K	$ 1,540	$ 1,271	$ 400	$ 2,694	$ 385	$ 6,289	$ 153,950	4%
Western Sunrise	B	$ 1,775	$ N/A	$ 400	$ 1,588	$ 2,495	$ 6,258	$ 177,490	4%
SCME	K	$ 803	$ 926	$ 400	$ 1,104	$ 0	$ 3,232	$ 80,260	4%
SCME	B	$ 1,026	$ N/A	$ 400	$ 1,826	$ 1,044	$ 4,296	$ 102,573	4%
SCME	K	$ 794	$ 600	$ 400	$ 1,191	$ 0	$ 2,985	$ 79,400	4%
SCME	B	$ 1,000	$ N/A	$ 400	$ 2,034	$ 1,017	$ 4,451	$ 99,973	4%
SCME	K	$ 786	$ 792	$ 400	$ 1,179	$ 0	$ 3,157	$ 78,600	4%
SCME	B	$ 1,000	$ N/A	$ 400	$ 1,399	$ 1,017	$ 3,816	$ 99,973	4%
SCME	K	$ 999	$ 688	$ 400	$ 2,996	$ 0	$ 5,082	$ 99,850	5%
SCME	B	$ 1,093	$ N/A	$ 400	$ 1,390	$ 1,223	$ 4,106	$ 109,283	4%
SCME	K	$ 1,031	$ 378	$ 400	$ 1,804	$ 0	$ 3,613	$ 103,100	4%
SCME	B	$ 1,253	$ N/A	$ 400	$ 1,753	$ 1,785	$ 5,192	$ 125,331	4%
Western Sunrise	K	$ 974	$ 888	$ 400	$ 1,825	$ 243	$ 4,330	$ 97,350	4%
Western Sunrise	B	$ 1,209	$ N/A	$ 400	$ 2,307	$ 1,538	$ 5,455	$ 120,949	5%
Totals		$ 22,067	$ 8,300	$ 8,000	$ 37,015	$ 18,773	$ 94,155	$ 2,209,102	4%
	TOTAL OF % BASED FEES				$ 86,155				

ORIGINATION FEE: 1% of the loan amount

SUPPLIMENTAL ORIGINATION FEE: 1.5% of the portion of the loan allocated for rehabilitation

YSP: The lender paid a Yield Spread Premium to the broker for negotiating an above par interest rate. It was a varying percentage of the loan amount depending on the terms.

SRP: The lender paid the broker a Service Release Premium for the right to service the loan. It was a varying percentage of the loan amount depending on the terms.

Appendix D

PROPERTIES WITH THE SAME SPONSOR FOR BOTH LOANS

		Property Address	DE Lender (sponsor)	(k) Endorsement Date	(b) Endorsement Date
1*	2050	101st Av., Oakland, CA	Crossland	2/5/99	4/16/99
2	2514	108th Av., Oakland, CA	SCME	5/7/98	7/30/98
3	925 W	17th St., Pittsburg, CA	SCME	9/22/99	12/29/99
4*	546 S	19th St., Richmond, CA	Crossland	5/26/99	7/17/00
5*	617	22nd St., Richmond, CA	SCME	5/18/98	10/7/98
6*	333, 335, 337, 339	29th St. Richmond, CA	Crossland	3/3/99	4/28/99
7	1369	64th Av., Oakland, CA	SCME	1/15/99	4/27/99
8	3350	68th Av., Oakland, CA	SCME	6/18/98	9/16/98
9	8	Amelia Way, Pittsburg, CA	SCME	6/26/98	10/30/98
10	301	Baltic Sea Court, Pittsburg, CA	SCME	2/24/99	5/7/99
11	91	Bella Monte Av., Pittsburg, CA	SCME	7/20/98	1/22/99
12	56 S.	Bella Monte Av., Pittsburg, CA	SCME	9/18/98	12/28/98
13	1170	Columbia St., Pittsburg, CA	SCME	3/26/99	11/12/99
14*	46	Delta Dr., Bay Point , CA	SCME	7/20/98	2/9/99
15	910	Donner Pass Rd., Vallejo, CA	SCME	2/23/98	6/16/98
16	1831	Dunn Av., Richmond, CA	SCME	7/10/98	9/14/98
17	4520	Ellen St., Oakland	SCME	10/15/98	1/19/99
18*	1618	Emeric Rd., San Pablo, CA	SCME	8/25/98	9/30/98
19	827	Florida Av., Richmond, CA	SCME	4/2/98	6/22/98
20	3525	Florida Av., Richmond, CA	SCME	10/26/98	4/1/99
21	2115	Georgia St., Vallejo, CA	SCME	1/27/98	4/1/98
22	2600	Giant Rd. #46, San Pablo, CA	SCME	7/20/98	9/9/98
23	320	Homeacres Av., Vallejo, CA	SCME	5/3/99	8/9/99
24	727	Illinois St., Vallejo, CA	SCME	9/27/99	1/4/00
25	516	Laurel St., Vallejo, CA	SCME	8/31/99	11/12/99
26	14 W	Leland Rd., Pittsburg, CA	SCME	6/26/98	12/28/98
27	20	Lou Ann Ct., Pittsburg	SCME	7/16/98	12/23/98
28	276	Madison Av., Pittsburg, CA	SCME	5/3/99	9/13/99
29	2335-37	Maine Av., Richmond, CA	Crossland	11/25/98	5/7/99
30	637	Maine St., Vallejo, CA	SCME	1/14/98	8/13/99
31*	57	Manville Av., Pittsburg, CA	SCME	8/10/98	12/29/98
32	118	Polaris Dr., Pittsburg, CA	SCME	1/29/98	3/31/98
33*	1427	Rice St., Vallejo, CA	SCME	1/14/98	3/31/98
34	26	Salisbury Dr., Pittsburg, CA	SCME	7/17/98	4/2/98
35	515	Steffan St., Vallejo, CA	SCME	4/3/98	7/21/98
36*	665	Stone Harbor Dr., Pittsburg, CA	SCME	4/29/98	7/13/98
37*	716	Sycamore St., Oakland, CA	Crossland	3/1/99	7/15/99

* Properties selected for review and discussed in this report

Appendix E

SCME MORTGAGE BANKERS' WRITTEN RESPONSE

August 3, 2001

VIA FACSIMILE AND FEDERAL EXPRESS

Mimi Y. Lee
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
Pacific/Hawaii District
450 Golden Gate Ave, Box 36003
San Francisco, CA 94102-3448

Dear Ms. Lee:

This is in response to your letter of June 25, 2001, in which you provided SCME Mortgage Bankers, Inc. ("SCME") with a draft audit memorandum (the "Draft Memorandum" or the "Memorandum") resulting from your recent audit of Golden Home Mortgage ("Golden"), and invited us to respond to the findings that relate to SCME. In particular, the Memorandum indicates: (i) SCME should have ensured that the properties HUD sold to nonprofit organizations at a 30 percent discount were resold for no more than 110 percent of the nonprofit's development costs, and (ii) Golden Home Mortgage ("Golden" or "Golden Home") incorrectly calculated the maximum mortgage amounts for insured loans.

As detailed herein, SCME did not restrict nonprofit organizations from making more than a 10 percent profit on individual transactions involving properties that they had acquired at a 30 percent discount, because HUD's Field Office Director instructed all San Francisco area 203(k) lenders to apply the 10 percent limit on an aggregate basis. Furthermore, Golden Home correctly calculated the maximum mortgage amounts on the loan transactions in which SCME was the sponsor. A brief background discussion and our response to the Memorandum follows.

I. Background

A. SCME Mortgage Bankers

SCME is a residential mortgage lender headquartered in San Diego, California. SCME was founded in 1984 under the name Southern California Mortgage Exchange. The company originally focused on government lending in the San Diego area. In the late 1980s, the company expanded its lending operations throughout California. Expansion continued in throughout the mid 1990s, and the company's name was changed to SCME.

Currently, SCME is licensed to operate in 14 states, operates on a wholesale and retail basis, and has offices in Phoenix, AZ, Anaheim Hills, CA, Concord, CA, Rancho Cucamonga, CA and San Diego, CA. SCME is an approved Ginnie Mae issuer and Fannie seller/servicer. The company also is approved by the Department of Veteran's Affairs under the Automatic Lender Program and by the Federal Housing Administration under the Direct Endorsement Program.

B. The Draft Memorandum

In January 2000, the Department of Housing and Urban Development's ("HUD" or the "Department") Quality Assurance Division and Office of Inspector General ("OIG") visited SCME's offices, interviewed our staff and reviewed a number of 203(k) loan files. In January 2001, the Office of Inspector General visited our office and performed a second review of the loan files. We understand that the Department's review of SCME was related to its review of FHA loan correspondent Golden Home Mortgage. The Department initiated its review of Golden based on a complaint it had received about the company. The purpose of the Department's review was to determine whether Golden Home and its sponsors ensured that loan amounts and property prices were proper.

On June 25, 2001, the OIG provided SCME with a copy of the Draft Memorandum. The Memorandum describes several issues that the OIG identified in connection with Golden Home's 203(k) loan origination activities. Because SCME is one of Golden Home's sponsors, the OIG has invited SCME to comment on the Memorandum.

The Draft Memorandum describes findings in connection with a number of loans originated by Golden Home. This response only addresses those loans with respect to which SCME was the sponsor.[3]

II. SCME's Response To The Draft Memorandum

The Draft Memorandum contains two major findings. The Memorandum indicates : (i) SCME should have ensured that the properties HUD sold to nonprofit organizations at a 30 percent discount were resold for no more than 110 percent of the nonprofit's development costs, and (ii) Golden Home incorrectly calculated the maximum mortgage amounts for insured loans. SCME's response to each of these findings is set forth below.

A. HUD Instructed San Francisco 203(k) Program Participants To Use An Aggregate Calculation

The Memorandum indicates that when HUD sells properties to nonprofit developers at a 30 percent discount, the developers must comply with certain requirements in connection with

[3] In particular, SCME was the sponsor for both the 203(k) and 203(b) loans associated with the following six properties: 617 22nd Street, Richmond, CA; 46 Delta Drive, Bay Point, CA; 1618 Emerle Road, San Pablo, CA; 57 Manville, Avenue, Pittsburg, CA; 1427 Rice Street, Vallejo, CA; and 665 Stone Harbor Drive, Pittsburg, CA.

the resale of such properties. For example, the developers may not resell such properties for more than 110 percent of their "net development costs." According to the Draft Memorandum, Golden Home and SCME did not ensure that nonprofits complied with this restriction. The Memorandum indicates that in cases where the same lender makes the 203(k) and subsequent 203(b) loan on the same property, the "[l]ender is responsible for analyzing the closing documents to ensure the nonprofit or government entity is not making in excess of a 10% profit . . ." The Memorandum cites to Housing Notice 94-74, Mortgagee Letter 96-21 and Mortgagee Letter 97-5 in connection with this finding.

SCME did not restrict nonprofit developers' profits as described above because HUD's San Francisco Field Office Director instructed 203(k) program participants that the 10 percent profit limitation did not apply on a per transaction basis, but rather applied on an aggregate basis to all properties that a nonprofit purchased at a 30 percent discount and resold during a calendar year.

As indicated in the Draft Memorandum, HUD's requirements originally provided that "as a general rule, it is not anticipated that a nonprofit should realize more than a six to 10 percent rate of return on HUD properties purchased at the 30 percent discount . . ." Mortgagee Letter 94-74. This requirement was commonly interpreted as meaning that any given nonprofit organization should not earn an aggregate profit of more than 10 percent on discounted properties in any given year.

In March 1997, HUD issued a mortgagee letter that revised this requirement to indicate that the 10 percent profit limitation applied on a per transaction rather than an aggregate basis. Mortgagee Letter 97-5. In response to this new guidance, SCME revised its policies and procedures to reflect the new requirement. We learned, however, that HUD's San Francisco Field Office had informed 203(k) program participants that the new, "per transaction" requirement would <u>not</u> apply in the San Francisco area. Because we were concerned about this departure from Mortgagee Letter 97-5, Pam Gallardi, SCME's Vice President of Operations and Underwriting, flew to San Francisco and attended the San Francisco Field Office's April 1997 203(k) meeting.

Ms. Gallardi has provided a written statement in connection with the Draft Memorandum.[4] <u>Exhibit A</u>. As detailed in Ms. Gallardi's statement, at the April 1997 meeting,:

> . . .which was standing room only, the topic was Mortgagee Letter 97-05. The director of the San Francisco field office (James McClanahan) was in charge of the meeting. In this meeting Mr. McClanahan stated that the San Francisco office would not be changing the method in which nonprofits' development costs were handled. (Previous to [Mortgagee letter 97-5], an aggregate of the 10% profit was allowed, rather than each transaction standing alone.) When Mr. McClanahan was asked by a sponsor's representative to clarify, as his instructions were in direct conflict with the mortgagee letter, he again stated that the San Francisco field office would be proceeding in the same

[4] Ms. Gallardi no longer is employed with SCME, but agreed to provide a written statement in connection with this matter.

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manner as before. . . . All sponsors that wanted to originate 203(k) loans had no choice except to comply with the directives of the field office.

We note that it is not uncommon for HUD's requirements to vary by geographic region, or for a Field Office to adopt its own interpretation of HUD's guidelines. SCME's management did believe that it was important to verify that HUD's San Francisco Field Office had opted to continue the aggregate profit requirement after HUD issued Mortgagee Letter 97-5. However, once our Vice President of Operations and Underwriting heard HUD's Field Office Director instruct all of the 203(k) lenders attending the April 1997 meeting to continue with the aggregate approach, we believed that we were in compliance with HUD's requirements in using that approach.

SCME has always been committed to following all of the Department's rules, regulations and guidance. In this instance, when we were uncertain about HUD's position on an issue, we sought clarification from the applicable Field Office, and then followed that office's instructions. Under these circumstances, we do not believe that HUD should impose liability on SCME.

B. Loan Amounts Were Calculated Correctly

The Draft Memorandum also alleges that Golden Homes did not properly calculate the maximum mortgage amounts. In particular, the Memorandum states that Golden Home (i) calculated the nonprofits' mortgages when they purchased properties from HUD by basing the mortgage amounts on HUD's list prices instead of using the actual prices paid by the nonprofits after deducting their discounts, and (ii) improperly included closing costs in mortgage calculations when the nonprofits provided gift funds to borrowers on their transactions. Each of these findings is at variance with the facts.

1. HUD Auditors Used Incorrect Purchase Price When Calculating Loan Amounts

Contrary to the allegation set forth in the Draft Memorandum, Golden Home calculated the maximum mortgage amounts on the nonprofits' loans using the actual prices paid by the nonprofits after deducting their discounts. Attached for your review are the 203(k) maximum mortgage worksheets for each of the six 203(k) loans with respect to which SCME was the sponsor. Exhibit B. As documented on the attached worksheets, in each of these transactions, the actual, discounted property prices were used to calculate the maximum mortgage amount. This finding is in error.

2. Golden Homes Did Not Use Improper Gift Funds

The Draft Memorandum states that in six 203(b) loan transactions, the loans included closing costs when such costs were paid for using gift funds that did not meet HUD's criteria for gift funds.[5] According to HUD, in these six transactions, the nonprofit developer provided gift

[5] Each of the six loans at issue in this finding were originated prior to December 21, 1998, when HUD allowed the maximum mortgage amount to include closing costs even if the borrower received the money to pay them as a gift from a relative or nonprofit agency. After December 21, 1998, HUD did not permit closing costs to be included in the maximum mortgage calculation.

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funds to the borrower, even though Mortgagee Letter 96-18 states that "[t]he source of funds for a gift must be totally unrelated to the loan transaction. If the homebuyer may only use the builder, developer, lender, real estate firm, etc. that contributed the funds, the program will, in all likelihood, be unacceptable for FHA mortgage insurance."

In this case, the auditors are mistaken about the applicability of Mortgagee Letter 96-18. In contrast to this case, in which the <u>nonprofit developer is also the seller of the property selected by the borrower</u>, Mortgagee Letter 96-18 addresses situations in which a builder or developer provides contributions to nonprofit agencies, which, in turn, provide funds to borrowers who are required to buy properties owned by the builder or developer who contributed the funds. Accordingly, Mortgagee Letter 96-18 states :

> . . . in evaluating downpayment and other assistance plans administered by non-profit agencies and units of government, lenders and the local FHA office will consider whether there is an identity-of-interest between the <u>donor</u> (e.g., builder, developer, etc.) and the <u>recipient of the funds</u> (e.g., non-profit agency) . . . If the homebuyer may only use the builder, developer, lender, real estate firm, etc., that contributed the funds, the program will in all likelihood be unacceptable for FHA mortgage insurance.

(<u>emphasis</u> <u>added</u>).

In short, Mortgagee Letter 96-18 does not apply in cases where the nonprofit owns the property the consumer has decided to purchase. This finding is in error.

* * * *

We believe that the foregoing should resolve the Department's concerns in connection with SCME. However, after you have reviewed this response, we would appreciate an opportunity to meet with the OIG to further discuss the Memorandum as it applies to SCME.

If you have any questions about the foregoing response, or need any additional information, please contact our counsel on this matter, Melanie Hibbs, at 202-778-9203.

Thank you for your consideration.

Sincerely,
SCME Mortgage Bankers, Inc.

Enclosures

<u>Statement of Pamela Galardi</u>

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I was the Vice President of Operations and Underwriting at SCME Mortgage Bankers from November 5, 1984 through August 25, 2000. My job responsibilities included supervising SCME's loan origination and underwriting policies for loans originated under the Department of Housing and Urban Development's 203(k) loan program.

While I was employed at SCME, I worked primarily out of the company's corporate headquarters in San Diego. However, when SCME opened its San Francisco branch in June 1996, I visited that branch at least once a month to supervise its loan origination policies and procedures. Additionally, I acted as the San Francisco office's interim branch manager for several weeks in early 1997.

In March, 1997, HUD issued a mortgagee letter addressing issues pertaining to non profit's, and their participation in the 203k program. The memo was a change in the way the San Francisco field office had previously directed Lenders to handle Non-Profit's and the 203k loan originations. The San Francisco field office held weekly Lender meetings and I attended the next one schedule for 203k Lenders, (held the first Wednesday in April, 1997) so that I could hear how the field office would be addressing these issues. The meeting was widely attended by ALL Lenders and Correspondents that were then involved with originating 203k loans, and processing Non Profit borrowers.

In this meeting, which was standing room only, the topic was of course, the mortgagee letter 97-05. The director of the San Francisco field office (James McClanahan) was in charge of the meeting. In this meeting he stated that the San Francisco office would not be changing the method in which Non Profit's development costs were handled. (Previous to this mortgagee letter, an aggregate of the 10% profit was allowed, rather than each transaction standing alone.) When Mr. McClanahan was asked by a Sponsor's representative to clarify, as this comment was in direct conflict with the mortgagee letter, he again stated that the San Francisco field office would be proceeding in the same manner as before. During this meeting, Mr. McClanahan also stated that when a nonprofit organization provides gift funds to a consumer in connection with a property that had been rehabilitated using 203(k) funds, the gift funds should not be excluded from the net development costs.

All other Sponsor's had no choice if hey wanted to originate 203k loans, except to comply with the directives of the field office. I can't speak for all present, but I know that our company's belief was that Mr. McClanahan had knowledge of information not available to Lenders, such as the Mortgagee Letter was to be rescinded, or modified. (which would not be the first time a Mortgagee Letter was rescinded in part of in it's entirety)

In regards to the issue of the mortgage amounts being inflated, due to closing costs being added to the acquisition cost, this is an incorrect interpretation by the auditors. A Gift given by a non profit has always been allowed. (Per 4155-1 rev 4 section 2-10C. Gift Funds. An outright gift of the cash investment is acceptable if the donor is a relative of the borrower, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low and moderate income families or first time homebuyers . . .) Further down into this section, it states. "Only family members may provide equity credit as a gift on a property being sold to other family members. The above restrictions for gifts and equity credit may be waived by the local FHA office provided the seller

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is operating or contributing to an acceptable affordable housing program. The only Non Profits that were approved to purchase the HUD REO properties had to be involved in providing affordable housing to low to moderate income borrowers.

The auditors are confusing "gift" money provided by the non profits, with "seller credit" of closing costs, and attempting to use the latter's guidelines. Each of these files contained a bona fide gift letter, acknowledged by the designated signatory of the Non Profit Seller.

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Appendix F

WELLS FARGO HOME MORTGAGE'S WRITTEN RESPONSE

800 LaSalle Avenue
Suite 1000
Minneapolis, MN 55402-2021
612-343-3400

September 7, 2001

Mimi Y. Lee
District Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
450 Golden Gate Avenue, Box 36003
San Francisco, CA 94102-3448

Re: Limited review – Golden Home Mortgage

Dear Ms. Lee:

We are in receipt of your letter dated June 25, 2001 pertaining to the above referenced review. In your audit of FHA insured loans originated by Golden Home Mortgage, you identified issues for which Wells Fargo Home Mortgage has responsibility due to the acquisition of Crossland Mortgage. We are responding to the draft report provided for our review and comment. We understand that final action has not been determined at this time but the issue may be considered for the Mortgagee Review Board after your review of our response and comments.

The June 25th letter states, neither Golden Home Mortgage nor its direct endorsement sponsors (SCME Mortgage Bankers and Western Sunrise Mortgage DBA Crossland Mortgage) prevented non-profit mortgagors from exceeding HUD's 10% profit limitation on properties purchased from HUD at a 30% discount. The non-profits had purchased the properties from HUD through a program that gave them 30% off of the list price and made FHA's 203(k) loans available for the properties' purchase and rehabilitation. To ensure affordability, HUD required the non-profits sell the properties for no more than 110% of their net development cost. *In cases where the same lender made both the 203(k) and the 203(b) loan on the same property, HUD requires the lender to ensure the non-profit sold the properties to income eligible families for no more than 110% of its net development costs.*

Of the ten properties identified by HUD where the non-profit organizations realized a gain in excess of HUD's guidelines, Western Sunrise Mortgage DBA Crossland Mortgage Company underwrote both the non-profit loan as well as the subsequent borrower loan on four properties.

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WFHM has reviewed the detail on the four properties and agree that the sales price on the second transaction exceeded HUD guidelines. Although we agree that the sales prices were in excess of the HUD requirements for non-profits, it does not appear that the borrowers have suffered financial losses as a result of Golden Home's actions. As part of our investigation into the issues identified, we reviewed the disposition and approximate values of all four properties underwritten by WFHM. The current assessed value (typically lower than the current market value) for all three active loans is greater than the original sales price paid by the borrowers. The fourth property (716 Sycamore), has been sold for $16,500 more than the purchase price paid to the non-profit organization.

All of the transactions occurred prior to the acquisition of Crossland Mortgage by Wells Fargo Home Mortgage (WFHM). While WFHM continues to provide 203k loans to non-profit entities, the processing and underwriting of these loans is centralized in one location. We believe this centralization provides better controls and oversight of the 203k non-profit transactions.

As part of our on-going training, communication will be provided to all appropriate personnel including an overview of the program to reiterate HUD's guidelines and increase awareness of the program. WFHM is also proposing an additional notification on our non-profit loans regarding the re-sale guidelines as it pertains to the 203k properties. While we acknowledge the lender has the responsibility to ensure the final underwriting/sales price is acceptable, we also agree with HUD's comment that the non-profits must pass the discount on to the buyers, making only enough 'profit' to cover costs. We believe the non-profits bear responsibility to administer their programs according the HUD's guidelines, just as WFHM has the responsibility to adhere to HUD's guidelines.

WFHM Quality Control processes include sampling and review of HUD insured properties according to HUD's guidelines. We utilize statistical sampling of loan production, which includes transactions involving non-profit organizations. All loans included in our statistical sampling are reviewed for compliance to HUD origination guidelines. The sampling methodology and testing is in accordance with the Quality Control requirements set forth by HUD. In addition, WFHM also has additional controls in place to monitor production, performance and quality of our correspondent lenders.

Our relationship with Golden Home was terminated March 7, 2001 as a result of the administrative action taken by HUD on Golden Home. WFHM is aggressive in the termination of clients when their performance does not meet HUD and/or WFHM criteria.

We believe that WFHM centralized processing and underwriting of the non-profit loans and the proposed disclosure to the non-profit organizations will address the issue of compliance with the profit limits of this program. WFHM agrees with HUD's intent to help people with low and moderate-incomes in becoming homeowners. As a company, we have undertaken many initiatives to provide loans to those who may otherwise not qualify. We clearly do not agree with the actions of the broker and we no longer have a business relationship with Golden Home.

Although this issue occurred prior to the acquisition to facilitate resolution we would be willing to indemnify the three remaining active loans.

We realize the importance of meeting HUD/FHA regulations and thank you in advance for your consideration concerning this matter.

Sincerely,

Kevin Buechler
Group Vice President
Credit Risk Management

cc: James Engelhardt, EVP Credit Risk Management
Eric Malchodi, Sr VP Risk Management
Denise Peters Brennan, VP Deputy General Counsel

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Appendix G

DISTRIBUTION

Secretary, Mortgagee Review Board, VD
Secretary, S
Deputy Secretary, SD
Chief of Staff, S
Acting Associate General Deputy Assistant Secretary for Administration, HR
Acting Assistant Secretary for Congressional and Intergovernmental Relations, J
Deputy Assistant Secretary, Office of Public Affairs, W
Deputy Assistant Secretary for Administrative Services, Office of the Executive Secretariat, AX,
Deputy Assistant Secretary for Congressional and Intergovernmental Relations, JI
Deputy to the Chief of Staff for Policy & Programs, S
Deputy to the Chief of Staff for Operations and Intergovernmental Relations, S
Special Counsel to the Secretary, C
Senior Advisor to the Secretary, C
Director, Center for Faith-Based and Community Initiatives, K
Chief Executive Officer for Administrative Operations and Management, S
Assistant Secretary for Housing/Federal Housing Commissioner, H
General Counsel, C
Deputy General Counsel for Housing Finance and Operations, CA
General Deputy Assistant Secretary for Housing, H
Assistant Secretary for Policy Development and Research, R
Assistant Secretary for Community Planning and Development, D
Assistant Deputy Secretary for Field Policy and Management, SDF
President, Office of Government National Mortgage Association, T
Assistant Secretary for Fair Housing and Equal Opportunity, E
Director, Office of Departmental Equal Employment Opportunity
Chief Procurement Officer, N
Assistant Secretary for Public and Indian Housing, P
Director, Office of Departmental Operations and Coordination, I
Office of the Chief Financial Officer, F
Chief Information Officer, Q
Acting Director, Enforcement Center, V
Acting Director, Real Estate Assessment Center, X
Director, Office of Multifamily Assistance Restructuring, Y
Assistant to the Secretary and White House Liaison, S
Press Secretary/Senior Communications Advisor to the Secretary, S
Director, Office of Healthy Homes and Lead Hazard Control, L
Director, National Office of Labor Relations, I
Secretary's Representative, 9ES
Departmental Audit Liaison Officer, FM
Deputy Assistant Secretary, Office of Native American Programs, PI
Acquisitions Librarian, Library, AS

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Mr. Armando Falcon, Director, Office of Federal Housing Enterprise Oversight, 1700 G Street, NW, Room 4011, Washington, DC 20552

Ms. Sharon Pinkerton, Senior Advisor, Subcommittee on Criminal Justice, Drug Policy & Human Resources, B373 Rayburn House Office Building, Washington, DC 20515

Ms. Cindy Fogleman, Subcommittee on Oversight and Investigations, Room 212, O'Neil House Office Building, Washington, DC 20515

Mr. Stanley Czerwinski, Associate Director, Housing and Telecommunications Issues, United States General Accounting Office, 441 G Street, NW, Room 2T23, Washington, DC 20548

Mr. Steve Redburn, Chief Housing Branch, Office of Management and Budget, 725 17th Street, NW, Room 9226, New Executive Office Building, Washington, DC 20503

Mr. Andy Cochran, Senior Counsel, House Committee on Financial Services, 2129 Rayburn House, Office Building, Washington, DC 20515

The Honorable Fred Thompson, Ranking Member, Committee on Governmental Affairs, 340 Dirksen Senate Office Building, United States Senate, Washington, DC 20510

The Honorable Joseph Lieberman, Chairman, Committee on Government Affairs, 706 Hart Senate, Office Building, United States Senate, Washington, DC 20510

The Honorable Dan Burton, Chairman, Committee on Government Reform, 2185 Raybur Building, House of Representatives, Washington, DC 20515

The Honorable Henry A. Waxman, Ranking Member, Committee on Government Reform, 2204 Rayburn Building, House of Representatives, Washington, DC 20515

SCME Mortgage Bankers, 6265 Greenwich Drive, Suite 200, San Diego, CA 92122

Wells Fargo Home Mortgage, 800 LaSalle Ave., Suite 1000, Minneapolis, MN 55402