loanDepot LLC, Foothill Ranch, CA

Federal Housing Administration Single-Family Mortgage Insurance

Golden State Finance Authority Downpayment Assistance

Office of Audit, Region 9
Los Angeles, CA

Audit Report Number: 2015-LA-1010
September 30, 2015

To: Kathleen A. Zadareky
Deputy Assistant Secretary for Single Family Housing, HU

Dane M. Narode
Associate General Counsel for Program Enforcement, CACC

//SIGNED//

From: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

Subject: loanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements.

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of loanDepot, LLC's use of downpayment assistance programs in conjunction with Federal Housing Administration (FHA)-insured loans.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.

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loanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements

Highlights

What We Audited and Why

We audited loanDepot, LLC, based on a referral from the U.S. Department of Housing and Urban Development's (HUD) Quality Assurance Division detailing a separate lender that originated Federal Housing Administration (FHA)-insured loans containing ineligible downpayment assistance gifts. The focus on loans with Golden State Finance Authority (Golden State) gifts was a result of a separate audit (2015-LA-1009) on loanDepot's use of downpayment assistance. Our objective was to determine whether loanDepot originated FHA loans containing Golden State downpayment assistance grants in accordance with HUD FHA requirements.

What We Found

loanDepot's FHA-insured loans with Golden State downpayment assistance gifts did not always comply with HUD requirements, putting the FHA insurance fund at unnecessary risk, including potential losses of $5.5 million for 62 loans with ineligible gifts and $16.1 million for 178 loans that likely contained ineligible gifts. Looking forward 1 year, this is equivalent to at least $16 million in potential losses for loans that would contain ineligible gifts and have a higher risk of loss in the first year. Also, loanDepot inappropriately charged borrowers $13,726 in fees that were not customary or reasonable. This condition occurred because loanDepot relied on Golden State, accepted the Platinum Downpayment Assistance Program structure, and did not conduct its own due diligence with regard to premium pricing, gifts, and fees. The ineligible loans put borrowers at a disadvantage due to higher monthly mortgage payments, including the burden of funding the downpayment assistance program through premium interest rates.

What We Recommend

We recommend that HUD determine legal sufficiency to pursue civil and administrative remedies against loanDepot for incorrectly certifying that mortgages were eligible for FHA mortgage insurance. We also recommend that HUD require loanDepot to (1) stop originating FHA loans with the ineligible gifts; (2) indemnify HUD for the 62 loans with ineligible gifts; (3) indemnify HUD for loans that likely contain ineligible gifts from the remaining 233 loans; (4) reimburse borrowers for $13,726 in fees that were not customary or reasonable; (5) reduce the interest rate for borrowers who received ineligible gifts; (6) reimburse borrowers for overpaid interest as a result of the premium interest rate; and (7) update all internal controls to include specific HUD requirements on gifts, premium rates, and allowable fees.

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Background and Objective

The Federal Housing Administration (FHA) was created by Congress in 1934 and provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA is the largest insurer of mortgages in the world, having insured more than 34 million properties since its inception. FHA's Mutual Mortgage Insurance Fund provides lenders with protection against losses as a result of homeowners defaulting on their mortgage loans. Lenders bear less risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance. FHA generally operates from self-generated income and only recently began receiving part of its funding from taxpayers.

Under most FHA programs, the borrower is required to make a minimum downpayment of at least 3.5 percent of the lesser of the appraised value of the property or the sales price. Additionally, the borrower must have sufficient funds to cover borrower-paid closing costs and fees at the time of settlement. State housing finance agencies are significant sources of home-ownership assistance programs, such as assistance with closing costs or rehabilitation. A majority of these programs include providing funding to borrowers for the FHA minimum cash investment. Although the U.S. Department of Housing and Urban Development (HUD) does not approve downpayment assistance programs, the lenders using the programs must ensure that funds provided comply with HUD FHA requirements.

On July 9, 2009, loanDepot, LLC, a nonsupervised lender, was approved to originate FHA-insured loans. It received direct endorsement authority on May 3, 2010. Under FHA's Direct Endorsement program, approved lenders may underwrite and close mortgage loans without FHA's prior review or approval. The lender serves consumers across the Nation under the names loanDepot, imortgage, Mortgage Master, and LDWholesale. It is licensed in all 50 States and operates four online direct-lending business centers, with dual headquarters located at 26642 Town Centre Drive, Foothills Ranch, CA, and 5465 Legacy Drive, Suite 400, Plano, TX. The lender also operates 130-plus retail branch locations under imortgage and Mortgage Master.

Between October 1, 2013, and January 31, 2015, loanDepot identified 308 FHA-insured mortgage loans that included downpayment assistance from the Golden State Finance Authority (Golden State). Since 2010, Golden State[1] has administered the Platinum Downpayment Assistance Program to help low- to moderate-income home buyers purchase a home through participating lenders. The downpayment assistance is provided as a non-repayable grant to be used toward a borrower's downpayment, closing costs, or both.

Our objective was to determine whether loanDepot originated FHA loans containing Golden State downpayment assistance grants in accordance with HUD FHA requirements.

[1] Golden State is a California housing finance agency and a duly constituted public entity and agency. It changed its name on January 27, 2015, and was previously known as the California Rural Home Mortgage Finance Authority Homebuyers Fund.

Results of Audit

Finding: loanDepot's FHA-Insured Loans With Golden State Finance Authority Downpayment Assistance Gifts Did Not Always Meet HUD Requirements

LoanDepot's FHA-insured loans that included Golden State Finance Authority (Golden State) downpayment assistance gift funds did not always comply with HUD FHA requirements. In addition, loanDepot improperly charged fees that were not customary or reasonable. A review of 75 loans endorsed from October 1, 2013, to January 31, 2015, determined that 62 loans included ineligible downpayment assistance gifts. This condition occurred because loanDepot relied on Golden State, accepted the Platinum program structure, and did not conduct its due diligence with regard to premium pricing, minimum cash investment, and gifts. As a result, loanDepot put the FHA insurance fund at unnecessary risk, including potential losses of $5.5 million for the 62 loans with ineligible gifts and $16.1 million for the 178 loans that likely contained ineligible gifts. Looking forward 1 year, this is equivalent to at least $16 million in potential losses for loans that have a higher risk of loss in the first year. FHA borrowers were also charged $13,726 in fees that were not customary or reasonable. Additionally, the ineligible loans put borrowers at a disadvantage due to higher monthly mortgage payments imposed, including the burden of funding the downpayment assistance program through the premium interest rate.

loanDepot Allowed Ineligible Downpayment Assistance

loanDepot inappropriately originated FHA loans with ineligible downpayment assistance gifts provided through the Golden State Platinum program. It allowed premium pricing to be used as a source of funds for borrowers' downpayments and allowed gifts that were not gifts as defined by HUD. Using data obtained from loanDepot, we identified 308 FHA-insured loans endorsed from October 1, 2013, through January 1, 2015, that contained gifts from Golden State. Our review of 75[2] FHA loans identified 62[3] loans that contained ineligible downpayment assistance gifts. Extrapolating the 62 loans to the audit universe of 308 loans resulted in a projection that loanDepot originated 235 loans totaling $42.6 million that contained ineligible downpayment assistance gifts. On an annualized basis looking forward 1 full year, this is equivalent to at least $31.9 million in loans that would contain ineligible downpayment assistance. We predict that if a review was conducted of the 233 remaining loan records in the audit universe, those loans not in the sample

> loanDepot allowed ineligible Golden State downpayment assistance gifts for at least 235 loans totaling $42.6 million.

[2] See the Scope and Methodology section for details on the statistical sample.

[3] Of the 75 loans reviewed, 10 contained downpayment assistance from Golden State; however, we determined that the borrowers provided enough funds to cover the required 3.5 percent minimum cash investment and 3 loans did not contain ineligible downpayment assistance from Golden State.

of 75, there would be at least 178 loans, or $32.2 million in loans that would contain ineligible downpayment assistance, and it could be more.

Statistical sample projections[4]	Total loans	Ineligible loans	Unpaid principal balance	Estimated loss to HUD (risk)
Audit sample	75	62	$ 11,061,603	$ 5,530,801[5]
Potential review of remaining loans	233	178	$ 32,254,273	$ 16,127,137[6]
Extrapolated to audit universe	308	235	$ 42,636,551	$ 21,318,275[7]
1 year forward			$ 31,977,413	$ 15,988,706[8]

As a requirement for Golden State Platinum program participation, borrowers were given predetermined mortgage interest rates (premium rate) that were above the prevailing market rate of interest for mortgages without downpayment assistance, equating to premium pricing. Although the interest rates were set by Golden State, loanDepot accepted the rates and applied them to the FHA loans. As the lender, loanDepot was obligated to conduct its due diligence and ensure that planned downpayment assistance gifts met the requirements described in HUD Handbook 4155.1. The Golden State downpayment assistance gifts allowed by loanDepot did not comply with HUD's requirements for premium pricing and the description of acceptable gifts, making the FHA loans ineligible for mortgage insurance.

- According to HUD Handbook 4155.1, paragraph 5.A.2.i, the funds derived from a premium-priced mortgage may never be used to pay any portion of the borrower's downpayment. Each loan with a Golden State downpayment assistance gift was given a higher than market interest rate (premium rate) as a part of program participation.[9] The FHA loans' premium prices were used to fund the program by recapturing the downpayment assistance and the programs' operating costs and fund future downpayment assistance through the sale of the increased market value bundled loans. When the premium pricing was used to pay any portion of the borrower's downpayment, the loan would be ineligible even when the source of the downpayment

> FHA borrowers were given higher than market interest rates in exchange for Golden State downpayment assistance.

[4] See the Scope and Methodology section for details on the sample and projections.
[5] Recommendation 1B
[6] Recommendation 1C
[7] Recommendation 1A
[8] Recommendation 1D
[9] Interviews with loanDepot and Golden State employees confirmed that FHA loans with downpayment assistance received higher than market interest rates (premium rate), compared to FHA loans without downpayment assistance.

was considered acceptable to HUD, such as a housing finance agency. Premium pricing is permitted by HUD only to allow lenders to pay a borrower's closing costs and prepaid items. In this case, the premium pricing was used to increase the market value of the bundled loans (mortgage-backed securities) when sold to recapture the downpayment assistance and the programs' operating costs and fund future downpayment assistance. This is an ineligible use. In addition, loanDepot failed to disclose the premium pricing on both the settlement statement and the good faith estimate as required by FHA and the Real Estate Settlement Procedures Act.

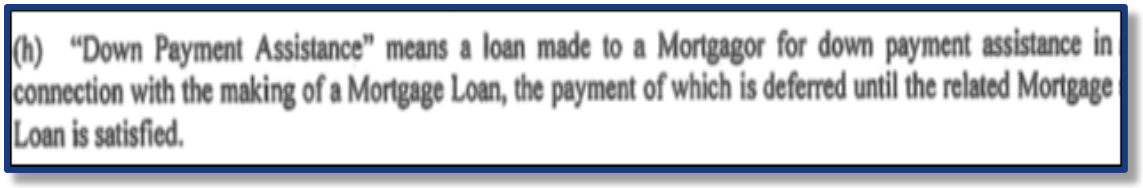
- To be considered a gift, HUD Handbook 4155.1, paragraph 5.B.4.a, states that there must be no expected or implied repayment of the funds to the donor by the borrower. The Golden State downpayment assistance gifts were not true gifts as defined by HUD. Since loanDepot did not ensure that the downpayment assistance gifts were repaid, either directly or indirectly, they were not true gifts. The downpayment assistance gifts were indirectly repaid by the borrowers through the premium rate in conjunction with Golden State's funding mechanism. To receive downpayment assistance, borrowers had to agree to mortgage interest rates (premium rates) that were above the prevailing market rate of interest for mortgages without downpayment assistance. The borrowers would pay back a substantial portion of the downpayment assistance gifts through higher mortgage payments over the life of the loans. In addition, the required premium interest rate enabled Golden State to be reimbursed after the bundled mortgage-backed security sale. Therefore, repayment was expected or implied.

> loanDepot allowed gifts that did not meet HUD's requirement that there be no expected or implied repayment.

- The downpayment assistance gifts could be considered financed, again indicating that the gifts were not true gifts. The commitment or gift letter, signed by the borrower and Golden State, referred to the gifts as financed (see first excerpt below). In addition, the U.S. Bank[10] lender agreement, signed by loanDepot and U.S. Bank, referred to the downpayment assistance gift as a "loan" (see second excerpt below). Given the language and the funding mechanism discussed below, it can reasonable be concluded that borrowers financed their own downpayment assistance gifts through the premium interest rate.

> The down payment and closing costs assistance financing available in conjunction with the first mortgage will be provided in the form of a non-repayable grant from CHF. There are no second liens filed against the property or repayment requirements associated with the use of the grant funds.

[10] U.S. Bank was the servicer for all loans with Golden State downpayment assistance.


(h) "Down Payment Assistance" means a loan made to a Mortgagor for down payment assistance in connection with the making of a Mortgage Loan, the payment of which is deferred until the related Mortgage Loan is satisfied.

- Golden State downpayment assistance was not always documented appropriately.[11] In our review of the 75 sample loans, we identified 10 loans for which the gift letters were not signed by the borrowers and two loans for which the gift transfers were not documented appropriately.

Downpayment Assistance Program Depended on a Circular Funding Mechanism

The Platinum program used by loanDepot and administered by Golden State[12] was structured with the intention of using premium interest rates to generate revenues to perpetually fund the downpayment assistance program. To do this, Golden State worked with U.S. Bank to raise capital. An agreement between loanDepot and Golden State, dated September 6, 2013, stated that loanDepot would review and process applications for potential borrowers to determine their eligibility for the downpayment assistance program in a timely manner and in good faith and efficiently complete the application process. There was also an agreement between loanDepot and U.S. Bank, dated July 3, 2013, in which loanDepot agreed to sell mortgage loans to U.S. Bank.

loanDepot qualified borrowers for both the FHA mortgage loans and downpayment assistance gifts at the same time. Once the borrower was approved by the loan officer, he or she reserved the downpayment assistance gift funds on behalf of Golden State through the National Homebuyer's Fund reservation portal. Downpayment assistance gift funds were reserved at the same time the predetermined premium interest rate was locked, which was valid for 60 days. The agreement to purchase the loan became an enforceable commitment between loanDepot and U.S. Bank. At closing, loanDepot provided the downpayment assistance gift funds on behalf of Golden State. When purchasing the servicing rights, U.S. Bank also reimbursed loanDepot for the advanced downpayment assistance gifts. The FHA mortgage loans were then pooled into mortgaged-backed securities by U.S. Bank on behalf of Golden State, which purchased the pooled loans. Golden State reimbursed U.S. Bank for the payment to loanDepot of the advanced gift funds. Finally, Golden State sold the premium-priced pooled mortgage-backed securities as part of the "to be announced"[13] securities market. The premium interest rate attached to the FHA loans with downpayment assistance allowed Golden State to obtain a higher selling price.

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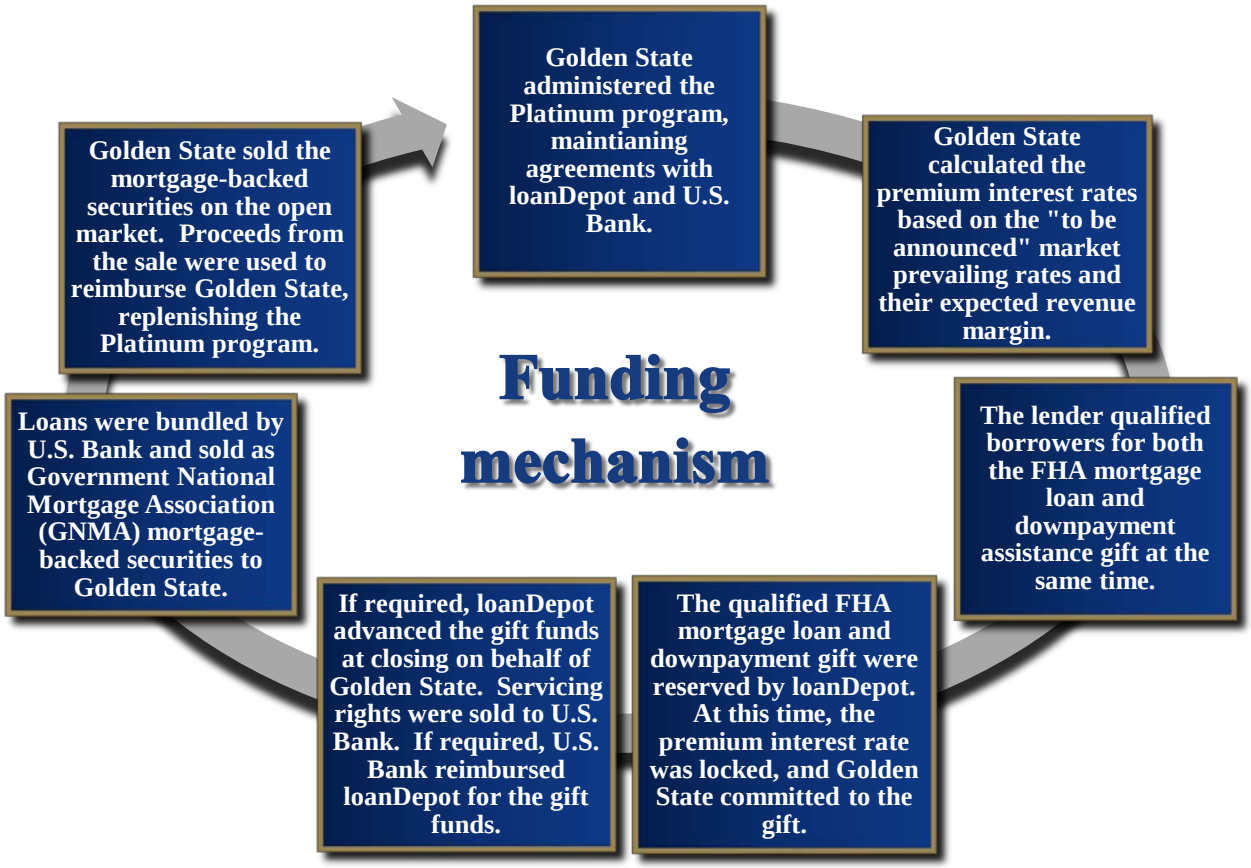
[11] See appendix D.

[12] Applicable program guidelines are published by National Homebuyers Fund, Inc., the program administrator, in the lender term sheet.

[13] The "to be announced" securities market is a forward, or delayed delivery, market for 30-year and 15-year fixed-rate single-family mortgage-related securities. A "to be announced" trade represents a forward contract for the purchase or sale of single-family mortgage-related securities to be delivered on a specified date. Parties to a "to be announced" trade agree upon the issuer, coupon, price, product type, amount of securities, and settlement date for delivery.



Downpayment assistance, even when provided by State and local housing finance agencies, must meet requirements in HUD Handbook 4155.1. Neither HUD's interpretive ruling (Federal Register 5679-N-01) nor its related Mortgagee Letter 2013-14 contemplated the use of premium pricing by a lender to reimburse a housing finance agency. The Housing and Economic Recovery Act of 2008 amended section 203(b)(9)(C) of the National Housing Act to preclude the abuse of the program when a seller (or other interested or related party) funded the home buyer's cash investment after the closing by reimbursing third-party entities, including, specifically, private nonprofit charities. Similarly, it would be contrary to the intended purpose of the Housing and Economic Recovery Act to allow a local government entity to do the same thing.

Fees Were Not Always Reasonable or Customary

Fees of $13,726 were charged and collected by loanDepot, which were not customary or reasonable to close FHA mortgage loans (see appendix E). These fees were charged in association with the Golden State Platinum program and were not required to close the FHA mortgage loan. Fees identified as not customary or unreasonable were listed as bond-funding fees and a lock extension on the HUD-1 settlement statements. For example, we identified funding fees ranging from $150 to $300. In addition, we identified a lock extension fee that was not applicable to the Platinum program as the premium rate was predetermined and nonnegotiable.

FHA Borrowers Receiving Downpayment Assistance Gifts Paid More

The ineligible loans with the required premium interest rates imposed on FHA borrowers resulted in higher monthly mortgage payments, compared to those of qualified FHA borrowers who did not receive downpayment assistance. In addition, the premium interest rates placed the burden of funding the downpayment assistance program squarely on the borrower, which put an unnecessary burden on borrowers who otherwise would not have been eligible for an FHA mortgage loan. Neither loanDepot nor Golden State required disclosure to the borrowers that the downpayment assistance received came with a higher than market interest rate (premium rate). Although a borrower may have discussed the premium rate with the lender during the origination process, there was no assurance that borrowers were fully aware of the premium rate and its impact on their FHA mortgage loan.

Conclusion

loanDepot's FHA-insured loans with Golden State downpayment assistance gifts did not always comply with HUD requirements, putting the FHA insurance fund at unnecessary risk, including potential losses of $5.5 million for 62 loans with ineligible gifts and $16.1 million for 178 loans that likely contained ineligible gifts. Looking forward 1 year, this is equivalent to at least $16 million in potential losses for loans containing ineligible gifts that would have a higher risk of loss in the first year. Also, loanDepot inappropriately charged borrowers $13,726 in fees that were not customary or reasonable. This condition occurred because loanDepot relied on Golden State; accepted the Platinum program structure; and did not conduct its own due diligence on gifts, minimum cash investment, premium pricing, and fees. The ineligible loans put borrowers at a disadvantage due to higher monthly mortgage payments imposed, including the burden of funding the downpayment assistance program through the premium interest rate.

Recommendations

We recommend that HUD's Associate General Counsel for Program Enforcement

1A. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies (31 U.S.C. (United States Code) 3801-3812, 3729, or both), civil money penalties (24 CFR (Code of Federal Regulations) 30.35), or both against loanDepot, its principals, or both for incorrectly certifying to the integrity of the data, to the eligibility for FHA mortgage insurance, or that due diligence was exercised during the origination of 234 loans with potential losses of $21.3 million.

We recommend[14] that HUD's Deputy Assistant Secretary for Single Family Housing require loanDepot to

1B. Indemnify HUD for the 62 FHA loans with ineligible downpayment assistance gifts, resulting in funds to be put to better use of $5,530,801.

1C. Indemnify HUD for FHA loans that likely contained ineligible downpayment assistance from the remaining 233 loans in the audit universe, resulting in funds to be put to better

[14] See appendix A for an explanation of funds to be put to better use.

use of $16,127,137. HUD must review the 233 loans to determine whether they were insurable without the ineligible downpayment assistance gift.

1D. Immediately stop originating FHA loans with ineligible downpayment assistance gifts that result in a premium interest rate for the borrower, resulting in funds to be put to better use of $15,988,706.

1E. Reimburse $13,726 to FHA borrowers for the fees that were not customary or reasonable.

1F. Collaborate with the applicable loan servicers to reduce interest rates for FHA borrowers who received downpayment assistance, were charged a premium interest rate, and have not refinanced or terminated their original FHA loan.

1G. Reimburse FHA borrowers for overpaid interest as a result of the premium interest rate for those who received downpayment assistance, were charged a premium interest rate, and have refinanced or terminated their original FHA loan.

1H. Update all internal controls (e.g. policies and procedures, checklists, etc.) to include specific guidance on HUD FHA rules and regulations governing downpayment assistance, premium interest rates, and allowable fees.

Scope and Methodology

We performed our onsite audit fieldwork from June 8 through June 23, 2015, at the loanDepot corporate office in Foothills Ranch, CA, and the loanDepot office in Scottsdale, AZ.[15] Our audit period covered loans endorsed from October 1, 2013, to January 1, 2015.

To accomplish our objective, we

- Reviewed HUD regulations and reference materials related to single-family requirements;
- Interviewed appropriate loanDepot management and staff personnel;
- Interviewed Golden State management involved with the Platinum program;
- Reviewed documentation, including agreements, for the Platinum program;
- Reviewed loans that contained an ineligible downpayment assistance gift; and
- Reviewed a stratified, systematic, statistical sample of 75 FHA loans originated with a grant from the Platinum program.

We obtained from loanDepot a list of FHA loans that contained Golden State Platinum downpayment assistance during our audit period. During our audit period, there were 308 loans totaling more than $55 million. We selected a stratified, systematic, statistical sample of 75 loans to determine whether loanDepot originated FHA loans containing Golden State downpayment assistance gifts in accordance with HUD FHA requirements. The sample was designed to detect ineligible loans and estimate the total number of loans and the associated dollar amount of loans with the same deficiencies in the audit universe. In addition, the sample projected the dollar amount of loans affected in a 1-year period following the audit universe timeframe, along with the dollar amount predicted if a review of the 233 remaining loan records in the audit universe was conducted.

Based on a stratified, systematic sample of 75 loan records designed to minimize error, we can make the following statements[16]:

> We found that 62 of the 75 loan files reviewed contained ineligible downpayment assistance from Golden State in which (1) each loan with a downpayment assistance gift was given a higher than market premium rate as a part of program participation and (2)

[15] The audit was conducted concurrently as part of an overall review of loanDepot's use of downpayment assistance. The audit objective for the initial audit, report 2015-LA-1009, was to determine whether loanDepot originated FHA loans containing downpayment assistance (other than Golden State) in accordance with HUD FHA regulations.

[16] See appendix A for calculations on potential risk (loss) and funds to be put to better use.

the downpayment assistance gifts were indirectly repaid by the borrower through the premium interest rate and program fees. This is equivalent to a weighted average of 82.8 percent of the loans that met these criteria and a weighted unpaid balance average of $150,903 per loan. Deducting for statistical variance to accommodate the uncertainties inherent in statistical sampling, we can still say – with a one-sided confidence interval of 95 percent – that 76.4 percent of the loans met these criteria and the weighted unpaid balance per loan is $138,430, and it could be more.

Per loan average:	$\$150{,}903.26 - 1.95^{17} \times \$6{,}396.36 \approx \$138{,}430.36$
Audit universe projection:	$\$46{,}478{,}203.94 - 1.95^{17} \times \$1{,}970{,}078.63 \approx \$42{,}636{,}550.61$
Percent of loans:	$82.81\% - 1.667 \times 3.79\% \approx 76.49\%$
Audit universe projection:	308 loans * 76.49% = 235.58 ineligible loans
Annualized projection:	($42,636,550.61 / 16[18]) * 12 months = $31,977,412.96

Extrapolating this amount to the 308 audit universe, this is equivalent to at least 235 loans or $42.6 million in loans that meet this standard, and it could be more. On an annualized basis looking forward 1 full year, this is equivalent to at least $31.9 million in loans that would contain ineligible downpayment assistance, and it could be more. We predict that if a review was conducted of the 233 remaining loan records in the audit universe, those loans not in the sample of 75, there would be at least 178 loans, or $32.2 million in loans that would contain ineligible downpayment assistance, and it could be more.

Remainder of universe:	233 loans * $138,430.36[19] = $32,254,273.41
Remainder of universe:	233 loans * 76.49% = 178 potentially ineligible loans

We used data maintained by loanDepot to determine the audit universe of 308 loans. We validated the data using the HUD Single Family Data Warehouse[20] to ensure that the 308 loans were all valid FHA loans. We determined that the computer-processed data provided by loanDepot were reliable for the purpose of the audit.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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[17] One-sided confidence interval

[18] Represents the number of months in the audit period

[19] The weighted average monthly unpaid balance of $138,283 was applied to the entire remaining 233 loans (308 – 75) as it incorporates potential errors; therefore, there was no need to reduce the 233 to 177 before calculating the dollar amount.

[20] Single Family Data Warehouse is a large collection of database tables dedicated to supporting analysis, verification, and publication of FHA single-family housing data.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls intended to ensure that FHA loans originated with downpayment assistance gifts met HUD FHA requirements.
- Controls intended to ensure that fees paid by FHA borrowers were properly disclosed, reasonable, and customary.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

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

- loanDepot did not have adequate controls to ensure that FHA loans originated with downpayment assistance gifts met HUD FHA requirements (finding).
- loanDepot did not have adequate controls to ensure that fees paid by FHA borrowers were disclosed and reasonable in accordance with HUD FHA requirements (finding).

Appendixes

Appendix A

Schedule of Questioned Costs and Funds To Be Put to Better Use

Recommendation number	Unreasonable or unnecessary 1/	Funds to be put to better use 2/
1B		$ 5,530,801
1C		$16,127,137
1D		$15,988,706
1E	$13,726	
Totals	**$13,726**	**$37,646,644**

1/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business. In this instance, the unreasonable costs were those fees charged to FHA borrowers that were not customary or reasonable, such as bond program fees (see appendix E).

2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this instance, implementing recommendations 1B, 1C, and 1D will reduce FHA's risk of loss to the insurance fund. The amount noted for recommendation 1B was calculated as follows: unpaid principal for 62 loans with ineligible gifts ($11,061,603) multiplied by the 50 percent FHA loss severity rate. The amount noted for recommendation 1C was calculated as follows: $138, 430 (average unpaid balance per loan with ineligible gifts) multiplied by 233 loans (308 loan universe minus 75 sample loans) equals $32,254,273 multiplied by the 50 percent FHA loss severity rate.[21] The amount noted for recommendation 1D reflects the statistical sample projection results annualized ($31,977,413), looking forward 1 full year, multiplied by the 50 percent FHA loss severity rate.[22]

[21] See Scope and Methodology section for details on the sample, projection, and calculations.

[22] The 50 percent loss rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for the first quarter of fiscal year 2015, based on actual sales.

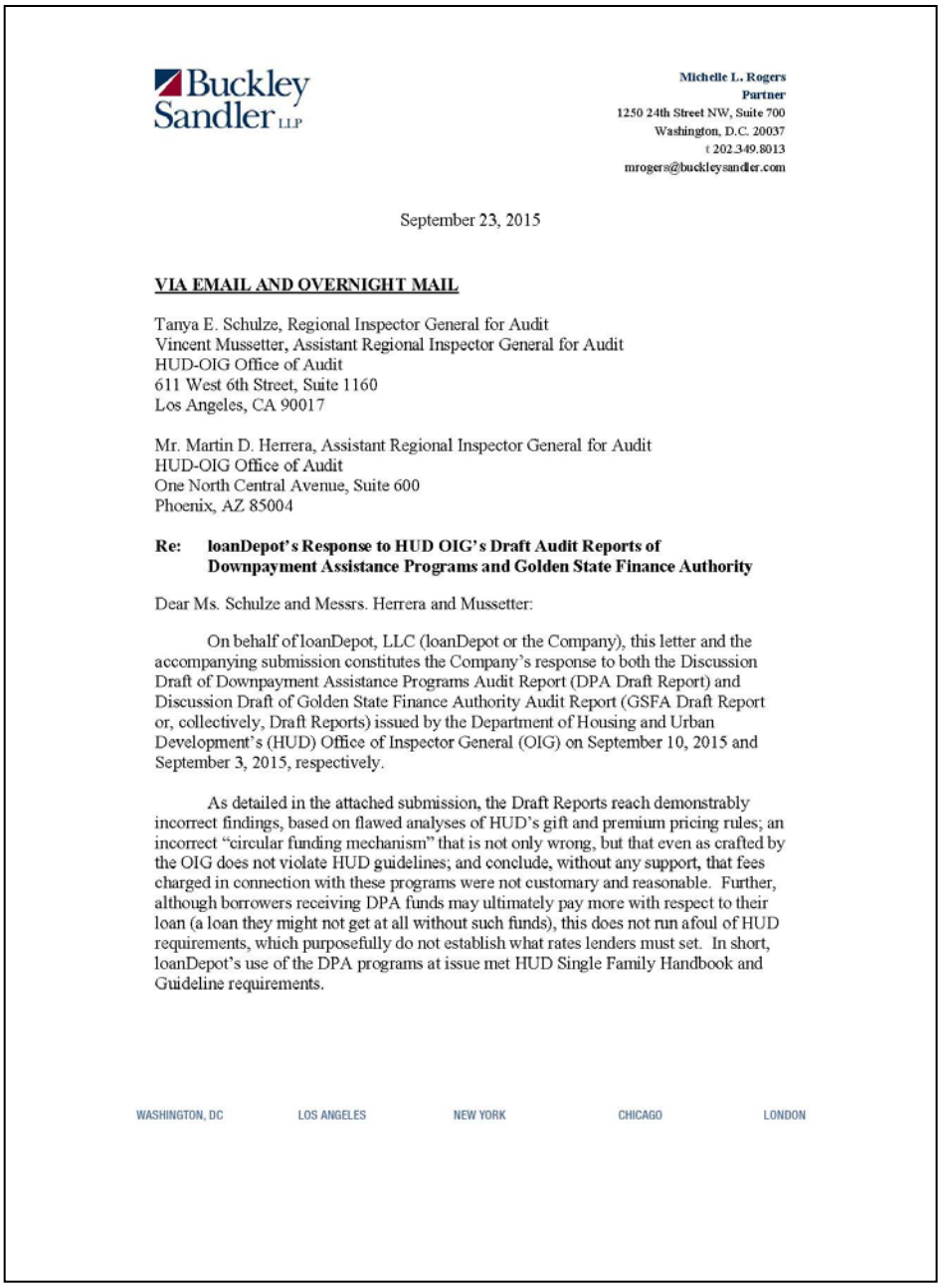
Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Comment 1
Comment 2
Comment 3



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September 23, 2015

VIA EMAIL AND OVERNIGHT MAIL

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Re: loanDepot's Response to HUD OIG's Draft Audit Reports of Downpayment Assistance Programs and Golden State Finance Authority

Dear Ms. Schulze and Messrs. Herrera and Mussetter:

On behalf of loanDepot, LLC (loanDepot or the Company), this letter and the accompanying submission constitutes the Company's response to both the Discussion Draft of Downpayment Assistance Programs Audit Report (DPA Draft Report) and Discussion Draft of Golden State Finance Authority Audit Report (GSFA Draft Report or, collectively, Draft Reports) issued by the Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) on September 10, 2015 and September 3, 2015, respectively.

As detailed in the attached submission, the Draft Reports reach demonstrably incorrect findings, based on flawed analyses of HUD's gift and premium pricing rules; an incorrect "circular funding mechanism" that is not only wrong, but that even as crafted by the OIG does not violate HUD guidelines; and conclude, without any support, that fees charged in connection with these programs were not customary and reasonable. Further, although borrowers receiving DPA funds may ultimately pay more with respect to their loan (a loan they might not get at all without such funds), this does not run afoul of HUD requirements, which purposefully do not establish what rates lenders must set. In short, loanDepot's use of the DPA programs at issue met HUD Single Family Handbook and Guideline requirements.

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Nevertheless, even if OIG disagrees with the Company's analysis as set forth in the attached response, it cannot disagree with HUD's, which as recently as last month rejected the logic OIG continues to apply here. Such an effort by OIG is not only unjust, but clearly reveals OIG's attempt to exceed its mandated authority.

In addition to the incorrect conclusions in the Draft Reports, the process of reaching those outcomes was flawed. By completely ignoring HUD's recent guidance in support of these programs, OIG not only reached questionable results, but also violated Government Auditing Standards by failing to consider contrary authority and relying on incorrect analyses and facts and unsupported assumptions, including a flawed sampling approach.

These factual, legal, and process issues raise more than just valid points of disagreement about the Draft Reports; they raise fundamental due process concerns. Constitutional due process requirements for governmental action require, at a minimum, both appropriate notice and a meaningful opportunity to be heard before the government may determine facts or pronounce judgment.[1] Both are absent here, first in OIG's attempt to change existing HUD rules contrary to established and recently affirmed HUD guidance, and second, in its refusal to grant the Company a meaningful time to respond—a collective thirteen business days to respond to two reports that took OIG six months to investigate and finalize.

Given the seriousness of the findings, which include seeking indemnifications and recommending potential fines and penalties, and based on the reasoning set forth in the Response, loanDepot requests OIG withdraw the Draft Reports without publication.

Finally, despite our strong disagreement with any publication of the faulty reports, to the extent that OIG proceeds with publication, consistent with the Company's discussion with OIG during its exit meeting on September 15, 2015, we understand that OIG will include an independent, full copy of this Response with the published GSFA Draft Report *and* the DPA Draft Report, reflecting that the Company has responded to each of the audits.

Sincerely,

Michelle L. Rogers

[1] *See Mathews v. Eldridge*, 424 U.S. 319, 348 (1976) ("The essence of due process is the requirement that a person or entity in jeopardy of serious loss (be given) notice of the case against him and opportunity to meet it.") (internal quotations omitted).

Enclosures

cc: Edward L. Golding, Principal Deputy Assistant Secretary for Housing
Dane M. Narode, Associate General Counsel for Program Enforcement
Kathleen A. Zadareky, Deputy Assistant Secretary for Single Family Housing
Joy L. Hadley, Director, Office of Lender Activities and Program Compliance
Justin D. Burch, Director, Quality Assurance Division
Jeremy Kirkland, Counsel to the Inspector General
Peter Macdonald, General Counsel, loanDepot

loanDepot's Response to the U.S. Department of Housing and Urban Development Office of Inspector General's Draft Audit Reports of Downpayment Assistance Programs and Golden State Finance Authority

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September 23, 2015

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On behalf of loanDepot, LLC (loanDepot or the Company), the below reflects the Company's response to the Discussion Draft of Downpayment Assistance Programs Report (DPA Draft Report) and Discussion Draft Golden State Finance Authority Audit Report (GSFA Draft Report) (collectively, Draft Reports) issued by the Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) on September 10, 2015 and September 3, 2015, respectively. For the reasons stated below, the Company strongly disagrees with the factual findings and legal analysis contained within the Draft Reports, as well as the flawed audit process that was used in crafting the Draft Reports.

I. Executive Summary

Downpayment Assistance (DPA) programs and the state and local housing finance agencies (HFAs) that offer them have a long history of government support and approval. loanDepot, along with many other mortgage originators, engages with various HFAs—many of which are directly linked to HUD's state specific websites under "homeownership assistance"[1]—to offer these programs to help borrowers finance their home purchases, within the confines of clearly established law and guidelines issued by HUD expressly upholding their legality. Without DPA funds, many of these homebuyers would be unable to afford a home responsibly. Yet, in a radical departure from established law and guidance, and decades of accepted practice, OIG has taken the position that DPA programs are improper under HUD's premium pricing and gift funds rules and guidance. OIG is wrong.

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As recently as last month, HUD restated its commitment to HFA-run DPA programs, both times expressly rejecting the very analysis and assumptions used by OIG in its Draft Reports here. First, in July 2015, Edward Golding, Principal Deputy Assistant Secretary of the Office of Housing, released the following statement:

> In light of a recent audit by HUD's Office of Inspector General, I want to take this opportunity to reaffirm FHA's support of certain down payment assistance programs, like those run by State Housing Finance Agencies. These programs help creditworthy families buy their first homes in communities across the country – responsibly expanding access to credit.
>
> The intent of our rules regarding down payment assistance is clear and allows HFAs the discretion necessary to fund these programs appropriately. HUD is taking active steps to completely resolve the issues raised in the audit and to provide proper clarity and guidance to the market.[2]

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[1] *See* Nevada Rural Housing Authority; California Housing Finance Agency, http://portal.hud.gov /hudportal/HUD?src=/states/nevada/homeownership/buyingprgms (last visited Sept. 23, 2015).

[2] Statement of Ed Golding, Principal Deputy Assistant Secretary of the Office of Housing, FHA's Position on Down Payment Assistance Programs (July 20, 2015), (hereinafter "HUD Housing Statement"), http://www.calhfa.ca.gov/HUDOpinionEdGolding07-20-15.pdf. A copy of the statement is attached for your reference as Exhibit A.

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Next, on August 11, 2015, HUD's Office of General Counsel (OGC) released a memorandum detailing why the DPA programs are acceptable, and again expressly rejecting OIG's conclusions:

> First, FHA's Interpretative Rule, Docket No. FR-5679-N-01, published on December 5, 2012 and Mortgagee Letter 2013-14, published on May 9, 2013 superseded previous FHA guidance in regards to governmental entities DPA programs. Second, neither the Interpretative Rule nor the Mortgagee Letter placed restrictions on how a governmental entity may fund its DPA programs. Finally, the use of funds derived from the sale of mortgages with higher than market interest rates does not constitute premium pricing as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities.[3]

Comment 2

Notably, and prior to all of this, HUD issued an interpretative rule, stating that relevant prohibition on seller-funded downpayments does not prohibit the Federal Housing Administration (FHA) from insuring mortgages originated as part of the homeownership programs of Federal, state, or local governments or their agencies when such agencies also directly provide funds toward the required minimum cash investment.[4]

Comment 4

Surprisingly, OIG's Draft Reports completely ignore HUD's stated position and analysis, without even a passing reference. Instead, OIG relies on the same inaccurate information and assumptions to reach baseless conclusions that not only contradict existing HUD guidance, but which sparked the above statements from HUD in the first instance. In intentionally ignoring HUD's administrative process in favor of its own interpretation, OIG's Draft Reports reach flawed conclusions, contravene basic auditing standards, and result in a gross overreach well beyond OIG's authority, and a violation of due process.

Comment 7

OIG's insistence in continuing to advance these theories in the face of HUD's own objections makes little sense. To suggest that the use of a government-affiliated DPA program, in compliance with established law and guidelines, has harmed HUD and should result in monetary penalties is a completely unsupported (and unsupportable) argument. In fact, to loanDepot's knowledge, not a single claim for FHA insurance has been filed on the loans cited by HUD in its Draft Reports, or on *any* bond-affiliated FHA loan originated by loanDepot and sold to U.S. Bank.

Comment 8

Moreover, even if OIG had the authority to rewrite HUD guidance as it seeks to do here—and make no mistake, it does not have such authority—it cannot invalidate DPA programs

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[3] Memorandum from Helen Kanovsky, General Counsel (August 11, 2015) (hereinafter "OGC Memo"), http://portal.hud.gov/hudportal/documents/huddoc?id=prmssrcefndsgoventdpa.pdf. A copy of the memorandum is attached for your reference as Exhibit B.

[4] *See* FHA: Prohibited Sources of Minimum Cash Investment Under the National Housing Act—Interpretive Rule, 77 Fed. Reg. 72,219, 72,222 (Dec. 5, 2012) (Interpretive Rule).

and penalize loanDepot for its participation in them through a retroactive enforcement process. If OIG wishes to revisit HUD's standards, it must start with the agency itself. As it stands, this unacceptable regulation by fiat approach will completely undercut the current system, harming not only mortgage originators and DPA programs, but the individuals who rely on these funds to realize homeownership.

For these reasons, detailed and supported by authority below, loanDepot requests that OIG reconsider its findings, withdraw, and/or decline to publish the Draft Reports.

II. Relevant Background

A. loanDepot's Commitment to Compliance and Communities

loanDepot is a non-depository lender subject to federal and state oversight, committed to compliance and maintaining a strong partnership with the FHA. The Company currently ranks in the top-10 originators of FHA single-family loans, and has been a committed and compliant FHA partner since it began originating FHA loans. During the previous three years, loanDepot has originated over 17,500 FHA residential mortgage loans,[5] all while maintaining (i) an FHA compare ratio no greater than 97% (*e.g.*, at one point the Company's compare ratio was 15%), and (ii) a supplemental performance metric and mix-adjusted seriously delinquent rate (SDQ) rate below the FHA Portfolio Supplemental Performance Metric and FHA Portfolio Benchmark SDQ Rate, respectively.[6]

In addition to its commitment to a strong partnership with FHA, loanDepot is equally committed to the communities it serves. loanDepot offers a variety or mortgage products so that it is able to lend to all consumers, including those in low-to-moderate income census and majority-minority census tracks, and first-time homebuyers. To that end, loanDepot—like many other mortgagees, and consistent with established and accepted HUD Guidelines—has allowed its customers to use DPA programs when purchasing homes.

Studies have consistently shown that the inability to save for a downpayment and closing costs is the single biggest obstacle to homeownership.[7] These programs provide a path to homeownership for working families who have the ability and established credit to maintain monthly payments, but lack the downpayment necessary to complete the purchase. A

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[5] *See* Neighborhood Watch Early Warning System, loanDepot.com – 30096 Portfolio, https://entp.hud.gov/sfnw/public/ (enter Early Warnings-Single Lender search engine and search "loanDepot") (last visited Sept. 23, 2015).

[6] The Supplemental Performance Metric was implemented by HUD on August 17, 2015 and is an additional tool used to evaluate mortgagees by providing comparison to FHA risk tolerances. *See* Press Release, HUD, FHA Announces New Lender Performance Measure to Expand Credit Access to More Eligible Borrowers (Aug. 17, 2015), http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2015/HUDNo_15-107 (last visited Sept. 15, 2015).

[7] Hearing Before the Housing and Community Opportunity Subcomm. (Statement of John C. Weicher, HUD Assistant. Secretary for Housing) (Mar. 24, 2004), http://archives.hud.gov/testimony/2004/test032404.cfm.

disproportionate number of these aspiring homeowners are first-time homebuyers, minorities, legal immigrants, women-headed households, and single-parents.[8] Homeownership is critically important to financial security; significantly, housing equity has been described as the most important source of wealth for most low- and moderate-income households.[9] Indeed, the Golden State Finance Authority (GSFA)—the state housing finance agency that is the focus of the GSFA Report—helped more than 66,000 individuals and families purchase a home by providing $66.2 million in DPA grants over the past two decades.[10] Without such assistance, these potential homebuyers would either remain renters or seek loans through the riskier, higher-cost products. To prohibit assistance from DPA programs, which OIG's actions would inevitably do, would disproportionately impact a portion of the population that HUD historically has sought to assist.[11]

B. The Audit and Draft Report

1. The Audit Process

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On March 5, 2015, OIG commenced a survey of the Company's participation in DPA programs between October 1, 2013 and January 31, 2015. Subsequent to this audit, OIG expanded the first audit and initiated a secondary audit into loanDepot's participation in the GSFA DPA program during the same time period, based on the high volume of DPA loans originated by loanDepot through the GSFA. Over more than five months, OIG reviewed files and interviewed employees, leading to the subject Draft Reports. The Company has fully cooperated with all requests throughout the audit process, as OIG has acknowledged. On September 3, 2015, just before the holiday weekend, the Company received the GSFA Draft Report. Shortly after, on September 10, 2015, the Company received the DPA Draft Report. Despite requests that loanDepot be afforded appropriate time to review and respond to the detailed Draft Reports that took OIG six months to craft, OIG declined repeated requests for extension, affording the Company less than two business weeks to respond. Specifically, on September 10, 2015, the Company formally requested a two-week extension, until October 1, 2015, to submit its response, which it subsequently reiterated during the September 15, 2015 exit

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[8] Hearing on Homeowner Downpayment Assistance Programs and Related Issues: Before the Subcommittee on Housing and Community. Opportunity, House Committee. on Financial Services (Testimony of Ann Ashburn, President of AmeriDream, Inc.) (June 22, 2007), http://archives.financialservices.house.gov/hearing110/htashburn062207.pdf.

[9] Lisa A. Fowler & Stephen S. Fuller, *A Comprehensive Analysis of Non-Profit Down Payment Assistance* 24 (2007).

[10] *About Golden State Finance Authority (GSFA): Who We Are and What We Do,GSFA,* http://gsfahome.org/admin/about.shtml.

[11] Indeed, HUD not only embraces the goals of the HFA-run DPA programs, but it also seeks additional enhancements and means "to responsibly *increase* access for underserved borrowers," not limit it. This includes an initiative to increase and encourage borrowers to undergo housing counseling, which is consistent with HFA practices as they general offer counseling services. *See Blueprint for Access: What FHA is Doing to Expand Access to Mortgage Credit for Underserved Borrowers* (May 13, 2014), http://portal.hud.gov/hudportal/documents/huddoc?id= BlueprintAcess5_9_2014.pdf. (last visited Sept. 23, 2015).

meeting. OIG denied the requests, and ultimately offered only four additional business days to respond.[12]

In the meantime, and throughout this process, HUD OIG has argued with another entity about the same issues—HUD itself. Specifically, in July 2015, OIG released its audit report on NOVA Financial & Investment Corp. (NOVA), which included the finding that NOVA's FHA-insured loans with DPA gift funds did not always comply with HUD FHA rules and regulations. According to OIG, this non-compliance was caused by: lack of due diligence on the DPA programs; NOVA's reliance on the HFA's program guidelines; and NOVA's practice of determining an implied eligibility based on the reputation of the participating servicer. Sub-findings included violation of premium pricing and gift funds rules and guidance. Specifically, OIG found that the DPA funds did not constitute a true gift because they were indirectly repaid by the borrowers through a premium rate circular-funding mechanism. OIG argued that, while NOVA did not directly reimburse the HFAs, NOVA indirectly reimbursed the HFAs since the purchase agreement between the investment bank and the HFAs provided that the HFAs would be reimbursed for the DPA grant from the sale proceeds when the loans were sold to U.S. Bank and as Ginnie Mae (GNMA)-insured mortgage backed securities (MBS). This funding mechanism resulted in higher mortgage payments, due to higher interest rates, for borrowers receiving DPA, who otherwise would not have been eligible for an FHA mortgage loan as compared to other qualified FHA borrowers.

Comment 4

As noted above, in response to OIG's audit report on NOVA, on July 20, Edward Golding, Principal Deputy Assistant Secretary of the Office of Housing, released a statement "reaffirm[ing] FHA's support of certain down payment assistance programs, like those run by State Housing Finance Agencies," going on to say that "[t]he intent of [the] rules regarding down payment assistance is clear and allows HFAs the discretion necessary to fund these programs appropriately."[13] Likewise, the OGC released their legal analysis, concluding that:

> Because the practices engaged in by NOVA do not represent premium pricing as defined by FHA requirements, and because FHA does not restrict the source of the funds used for the DPA provided by governmental entities, we cannot support the OIG's conclusion that NOVA violated FHA requirements concerning premium pricing or the provision of gifts.[14]

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Although OIG's Draft Reports make the same arguments, and although the Reports were issued after HUD's recent, public statements in support of the DPA programs rejecting OIG's arguments, none of these materials are referenced in OIG's Draft Reports.

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[12] *See* Exhibit C, Sept. 10 Letter to HUD; Exhibit D, Email from P. Macdonald to T. Schulze regarding Extension (Sept. 16, 2015).

[13] *See* HUD Housing Statement, *supra* n. 3.

[14] *See* OGC Memo, *supra* n. 4.

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2. The Draft Reports Findings

The Draft Reports contain largely identical arguments,[15] with the GSFA Draft Report acting as an illustrative example of the larger group of DPA programs at issue in the DPA Draft Report. All of the DPA programs in the Draft Findings are government-run HFA programs. As such, the discussion of findings will focus on the GSFA Draft Report, with the understanding that the arguments in opposition to the GSFA Draft Report are analogue and applicable to the findings in the DPA Draft Report. The GSFA Draft Report asserts that loans made by loanDepot under HUD's FHA single-family loan program utilizing DPA program gift funds from GSFA—a duly constituted public entity and agency, organized in 1993 and existing under and by virtue of Title 1 of the Government Code of the State of California—failed to comply with HUD FHA requirements for DPA gifts. Specifically, the GSFA Draft Report claims that loanDepot made loans with ineligible DPA funds; the DPA program was dependent on a "circular funding mechanism;"[16] loanDepot charged borrower fees that were not always customary or reasonable; and FHA borrowers that received DPA gifts paid more.[17]

III. Response

The Draft Reports are fundamentally flawed in both substance and in process. They include demonstrably incorrect findings and analyses regarding HUD's gift rules; craft a "circular funding mechanism" theory that is not only incorrect, but even as described, would not contradict HUD's guidance; and conclude, without any support, that fees charged in connection with these programs were not customary and reasonable. In fact, the pricing of DPA loans does not run afoul of HUD requirements, which purposefully do not establish what rates lenders must set. In short, loanDepot's use of the DPA programs at issue meet HUD Single-Family Handbook (HUD Handbook) and Guidelines requirements regarding eligible gifts, premium pricing requirements, and gift fund documentation. Nevertheless, even if the OIG disagrees with the analysis provided by loanDepot, it cannot override that of HUD, which is exactly what the Draft Reports seek to do. For these reasons and those detailed below, OIG should withdraw the Draft Reports.

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[15] The only unique findings in the DPA Draft Report concern secondary financing and discount fees, found on pages 7 and 8 of the DPA Draft Report, respectively. These unique findings are addressed independently in the arguments below.

[16] What OIG references as a "circular funding mechanism" is the process where the development authorities partner with lenders to fund a borrower's downpayment so that the borrower can qualify for an FHA loan. Those borrowers receiving downpayment assistance would also receive a premium rate on their FHA loan. These premium rate loans, like most other loans, are bundled and sold as asset-backed-securities to investors. Proceeds of the security sale are then used to reimburse development authorities and fund new downpayments.

[17] These findings are identical to the findings of the DPA Draft Report.

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A. Response to the Specific Audit Findings

1. loanDepot DPA Programs Meet HUD Handbooks and Guidelines Requirements and are Eligible Gift Funds (Subfinding #1)

OIG asserts that loans made utilizing DPA funds fail to meet HUD Handbook and Guidelines requirements and are ineligible gift funds. To the contrary, DPA program funds meet HUD Handbook and Guidelines requirements and are eligible gift funds because DPAs meet HUD's "gift" requirements, DPAs meet HUD's gift documentation requirements, and funds are otherwise provided in a manner consistent with HUD's requirements. Importantly, HUD agrees.

a. DPAs Meet FHA "Gift" Requirements[18]

Contrary to OIG's assertions, DPA funds utilized for purposes of making FHA loans, including those provided through the Golden State Platinum program, meet FHA gift requirements as set forth by HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One-to Four-Unit Mortgage Loans (4155.1). The DPA funds do not require borrowers to directly or indirectly repay funds to the donor nor do they require enhanced due diligence.

HUD Handbook 4155.1, paragraph 5.B.4.a, states that "to be considered a gift, there must be no expected or implied repayment of the funds *to the donor by the borrower*."[19] To conclude that repayment of the funds to the donor by the borrower is expected and/or implied simply because the borrower pays a higher interest rate and program fees misconstrues the manner in which interest rate is paid and the DPA programs are funded.

First, borrowers do not have any obligation to repay the DPA funds to the HFA donor. The interest rate is paid to the ultimate purchaser-holder of the premium tax-exempt single-family bond or GNMA or Fannie Mae MBS, *not* to the HFA. In fact, no portion of the interest rate is used to repay the DPA funds, either to the HFA or the ultimate purchaser-holder, if the borrower pays off the mortgage early, which the borrower is entitled to do. Indeed, few borrowers stay in a loan for 30 years at all.[20] Further to the GSFA Draft Report, despite the fact that loanDepot and the purchasing lender agreement may refer to the DPA as a "loan," the language clearly indicates on the grant commitment letter that it is a "non-repayable grant" that will not result in a lien against the property, which more directly aligns itself as a gift.

Second, the HFA DPA programs are funded in whole or in part from the capital markets, through either the sale of bonds or the sale of MBS that are backed by the program loans. They

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[18] The GSFA Draft Report found that loanDepot "allowed gifts that were not gifts as defined by HUD." GSFA Draft Report, at 4; *see also* DPA Draft Report, at 7.

[19] Emphasis added.

[20] *See* Li-Ning Huang, *Why Haven't Nearly Half of Mortgage Borrower's Refinanced?*, *FM Commentary*.(Feb. 6, 2014), http://www.fanniemae.com/portal/about-us/media/commentary/020614-huang.html. ("Results show that the majority of homeowners surveyed refinanced after owning their homes between 6 and 15 years.").

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are not funded by the interest rate paid by the borrower. The OGC Memo reaffirms FHA's position that "neither the Interpretive Rule [FR-5679-N-01] nor the Mortgagee Letter [2013-14] placed restrictions on how a governmental entity may fund its DPA programs." Specifically, the OGC Memo notes that "FHA's determination not to place restrictions or prohibitions on how a governmental entity raises funds to support its DPA programs through either the Interpretive Rule or the Mortgagee Letter is in keeping with FHA's previous guidance." Further, whether the HFA donor is repaid upon the subsequent bundled MBS sale is irrelevant, as such payment to the HFA is not by the borrower.

Moreover, loanDepot performed all due diligence obligations imposed upon it by applicable HUD Handbook and Guidelines with respect to DPA gift funds, and no enhanced due diligence was required simply because of the nature of the DPA funding. The HUD Handbook mandates simply that "the lender *must* be able to determine that the gift funds were *not* provided by an unacceptable source, and were the donor's own funds."[21] With respect to satisfying this obligation, the HUD Guidelines provide as follows:

> 4155.1 5.B.4.b **Who May Provide a Gift**: . . . a governmental agency or public entity that has a program providing home ownership assistance to
> - low- and moderate-income families, or
> - first-time homebuyers.
>
> 4155.1 5.B.4.c **Who May Not Provide a Gift**: The gift donor may *not* be a person or entity with an interest in the sale of the property, such as
> - the seller
> - the real estate agent or broker
> - the builder, or
> - an associated entity.
>
> 4155.1 5.B.4.e **Gift Donor's Source of Funds**: As a general rule, FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction.

The HUD Interpretive Rule specifically concluded that:

> NHA Section 203(b)(9)'s "prohibited sources" provision [does] not includ[e] funds provided directly by Federal, State, or local governments, or their agencies and instrumentalities in connection with their respective homeownership programs.[22]

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[21] 4155.1 5.B.4.d.

[22] Interpretive Rule, Docket No. FR-5679-N-01 (Dec. 5, 2012).

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It appears, from the Draft Reports, that OIG is conflating the obligations applicable to individual donors with those applicable to HFAs, which are inherently less risky, and thus treated differently in HUD Guidelines. First, loanDepot confirmed that the DPA funds came from an HFA, which HUD has determined is an acceptable source.[23] Second, loanDepot verified that the funds did not come from a person or entity with an interest in the sale of the property, *i.e.*, loanDepot, the seller, the real estate agent, the broker, the builder, or an associated entity.[24] Third, loanDepot determined that the funds from the HFA were the HFA's own funds.[25]

Significantly, neither the HUD Handbook, the Interpretive Rule, nor any Mortgagee Letter requires loanDepot to investigate how or from where the HFA received funding. Indeed, through the OGC Memo, FHA reaffirmed that "FHA does not place restrictions or prohibitions on how a governmental entity elects to raise funds to support its DPA program" and has discussed HFAs in that context.[26] OIG can cite no authority, because none exists, to impose a duty upon loanDepot to perform any further due diligence for HFAs created by Federal, state, or local governments or their agencies or instrumentalities.

b. DPA Gift Funds were Documented Appropriately[27]

Of the 165 loans reviewed, OIG alleges that 15 loans failed to appropriately document gift letters and 55 loans failed to adequately document gift transfers. To the contrary, not only did loanDepot locate evidence of the DPA gift letters, but also located reasonable evidence documenting the transfers.

First, with respect to satisfying the gift fund letter obligation, HUD Handbook 4155.1, paragraph 5.B.5.a provides as follows:

> The lender must document any gift funds through a gift letter, signed by the donor and borrower. The gift letter must
> - show the donor's name, address, telephone number
> - specify the dollar amount of the gift, and
> - state
>   - the nature of the donor's relationship to the borrower, and
>   - that no repayment is required.

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[23] *See* 4155.1 5.B.4.b and Interpretive Rule.

[24] *See* 4155.1 5.B.4.c and e.

[25] *See* 4155.1 5.B.4.d.

[26] *See generally*, Mortgagee Letter 2013-14 (defining "government entity") and Interpretive Rule (describing and discussing HFAs in a manner that satisfies the definition of "government entity" set forth in Mortgagee Letter 2013-14).

[27] The Draft Reports found that "Golden State downpayment assistance was not always documented appropriately" and in certain instances "gift transfers were not documented appropriately." GSFA Draft Report, at 7; *see also* DPA Draft Report, at 7-8.

Comment 10

Contrary to OIG's claims, not only did loanDepot's review locate sufficient gift letter documentation for all 15 loans identified by OIG, but also confirmed, such documentation was provided to OIG when the loan files were initially sent to OIG. Specifically, in accordance with HUD requirements, the documentation enclosed (i) shows the donor's name, address, and telephone number, (ii) specifies the dollar amount of the gift, and (iii) states that the funding is provided in the form of a "non-repayable" grant from the relevant DPA program.

Second, with respect to evidencing the gift transfer, based on a review of the loans identified by OIG as lacking documentation evidencing the transfer of funds, loanDepot confirmed the loans identified contained documentation providing reasonable evidence that the gift transfers took place as contemplated by HUD Handbook 4155.1, paragraph 5.B.5.b.[28]

c. The Two DPA Programs Providing Assistance via Secondary Funding Were Compliant With Applicable Rules and Guidance[29]

Comment 11

The DPA Draft Report includes, as part of its first subfinding, allegations regarding two DPA programs offering DPA through secondary financing, or "silent seconds." The funds at issue were compliant with the rules and guidance applicable to the loan mechanism. The California Housing Finance Agency (CalHFA) and the Nevada Housing Division's (NHD) silent second programs are logistically identical. The borrower executes a promissory note and deed of trust to the benefit of either CalHFA or NHD on or around the time of the closing of the senior mortgage. The funds from this silent second are advanced to the borrower either directly from the HFA or by loanDepot on behalf of the HFA. These loans have flat interest rates and are deferred until certain triggering events, explained in detail in the promissory notes. Events that can trigger payment are senior loan refinancing sale of the property or a senior lien pay-off.

As explained above, the DPA funds at issue met the applicable requirements and did not come from prohibited sources. To the extent that loanDepot advanced the funds on behalf of the HFA, the proper documentation was provided such that, per HUD's own guidance, the funds advanced were legally considered to be the HFA's.[30] Thus, again, the funds did not come from a prohibited source. The Mortgagee Letter directly addresses this exact fact pattern. Understanding that existing guidance may be unclear, HUD cleared the way for HFAs and lenders to contract with one another in order to meet the logistical needs of both parties and the borrower. Loans for which loanDepot advanced funds all included the proper paperwork and

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[28] Specifically, the documentation provided by the HFA for the two referenced loans, included three pages: (i) the Reservation Confirmation, (ii) the Notice of Down Payment / Closing Cost Assistance Grant, and (iii) a signature page. The "Notice of Down Payment" form confirms the grant was approved but does not specifically say that CHF will have a legally enforceable obligation to provide these funds. Note, however, the final HUD-1 combined with the "Notice of Down Payment" can be used as evidence the funds were received and used to close the transactions.

[29] DPA Draft Report, at 7.

[30] *See* Mortgagee Letter 2013-14.

Comment 11

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agreements with the relevant HFAs. Per HUD's own guidance, these silent seconds did not come from a prohibited source.

OIG goes on to argue that the secondary financing was indirectly repaid through a premium interest rate. First, this argument is wholly unsupported. If OIG means to say that the "circular funding" mechanism applies to silent seconds, it does not. To the extent any silent seconds were made in support of mortgage loans containing premium interest rates, these rates were provided in a manner consistent with HUD's current premium pricing requirements.[31] OIG's final argument appears to be that the cost for participating in the secondary financing program was not included in the amount of the second lien and thus violated HUD guidance.[32] However, the amount of the second lien was the advanced funds plus a flat interest rate. This was the only amount repaid by the borrower and was the complete cost of participating in the HFA program. There were no penalties for prepayment of the lien and, because it was a flat rate, the borrower knew at all times how much was and would be due under the lien. That OIG argues the "secondary financing was indirectly repaid by the borrower . . . when the deferred repayment was made"[33] shows a fundamental misunderstanding both of the secondary financing programs and HUD guidance.

2. The Manner in Which DPAs are Funded Does Not Make Them Ineligible Gift Funds[34] (Subfinding #2)

OIG alleges that the Golden State DPA program is part of a "circular funding mechanism," and that the other DPA programs at issue have similar funding mechanisms, that are ineligible because they would place borrowers in a premium rate on their FHA loan, such that these premium rate loans are bundled and sold as asset-backed-securities to investors. Proceeds of the security sale are then used to reimburse development authorities and fund new downpayments. OIG's "circular funding mechanism" argument as a means for asserting DPA funds are ineligible gift funds is flawed because (i) Housing and Economic Recovery Act (HERA) allows for DPA programs, (ii) FHA's interpretation that DPA programs are eligible gift funds is accurate and supported by the HUD Handbook and Guidelines, and (iii) FHA recently reaffirmed its support of DPA programs.

a. OIG's "Circular Funding Mechanism" Theory Relies on Incorrect Assumptions and Analysis to Reach its Conclusion

As an initial matter, premium pricing is specifically allowed by HUD Guidelines.[35] ("Lenders may pay a borrower's closing costs, and/or prepaid items by 'premium pricing.'"). OIG's "circular funding mechanism" analysis implies that loanDepot's premium pricing practices provided a source of funding for the DPA programs at issue, and that those funds were

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[31] *See supra*, III.A.2.a.

[32] 4155.1, 5.C.1.b.

[33] DPA Draft Report, at 7.

[34] GSFA Draft Report, at 7; DPA Draft Report, at 6-7.

[35] *See* 4155.1, 5.A.2.i.

used to pay a portion of borrowers' downpayments through DPA programs, including Golden State's DPA program. In order to reach this conclusion, however, OIG conflates legitimate fee payments with improper pricing and makes several assumptions regarding the mortgage securities market that are unsupported.

Although OIG seems to indicate that the costs of participating in a downpayment assistance secondary financing program may only be included in the second lien, this assumes that the downpayment assistance received by the borrower came in the form of secondary financing rather than as a gift. As noted, many DPA programs, including Golden State, provide DPA in the form of a "non-repayable grant" that will not result in a lien against the property. This type of DPA meets HUD Guidelines requirements regarding eligible gifts.[36] As such, there is no second lien in which the majority of the DPA programs' fees, including Golden State's program fees, could be included; accordingly, the fees associated with the gift are appropriately included among the fees that can be subject to premium pricing and passed directly through to the borrower. In collecting these program fees from the borrower through premium pricing, loanDepot (i) identified the borrower closing costs and/or prepaid expenses being paid by loanDepot on the relevant Good Faith Estimates (GFEs) and the HUD-1 Settlement Statement; (ii) reduced the principal balance of the appropriate mortgage loans by the appropriate overage amount when premium pricing resulted in excess; and (iii) has not utilized these funds to pay debts, collection accounts, escrow shortages, or missed mortgage payments or judgments.

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OIG argues that in order to receive DPA from the DPA programs at issue, including Golden State, borrowers must agree to premium pricing and a higher interest rate than mortgages without downpayment assistance. This argument misconstrues both the purpose of premium pricing and the reality of the mortgage securities market. loanDepot offers premium pricing to consumers as a means of financing their closing costs and/or prepaid expenses over the term of the loan through an increased interest rate, rather than through the payment of such costs/expenses at closing. Like other mortgagees, loanDepot specifically offers premium pricing because it believes providing consumers with additional financial flexibility to deal with unexpected expenses and contingencies following a home purchase can be beneficial to consumers. Borrowers are not required to accept premium pricing, but they may choose to accept premium pricing in order to finance allowable closing costs and prepaid items

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OIG notes that borrowers receiving assistance through the DPA programs and Golden State's HFA DPA program generally agree to mortgage interest rates above the prevailing market rate for mortgages without such assistance, and assumes that such a difference in rate is a requirement of the DPA program in order to reach a "targeted revenue margin." However, such an assumption discounts entirely the notion that the interest rates on such loans are a function of the risks associated with those loans. Borrowers who qualify for DPA are inherently riskier than borrowers with the ability to provide their own downpayment. Accordingly, the interest rate offered to participants of such programs will necessarily reflect that increased risk. Borrowers are not required to accept the higher interest rate, but are free to provide their own downpayment and receive rates closer to the market rate. Indeed, the OGC Memo expressly reaffirmed that DPA programs do not violate FHA restrictions on premium pricing, where the rates agreed upon

[36] *See supra* III.A.1.a.

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by the borrower and lender are rates available to homebuyers participating in the DPA programs. We note that this interpretation is consistent with the Tiered Pricing Rule where mortgages are not compared to the market rate, but to "those mortgages that are closely parallel in important characteristics affecting pricing and charges, such as level of risk or processing expenses."[37]

Similarly, the at-issue DPA programs, Golden State, and loanDepot do not require a target revenue margin before originating a loan with DPA; rather they fund loans at rates that are saleable on the secondary market based on the inherent risk of the loan. The sales prices are not predetermined by loanDepot, the DPA programs, or Golden State, as OIG suggests, but are valued based on current market conditions. OIG implies that the difference between the interest rate offered to the borrower using DPA and the market rate represents "premium pricing" and that those funds may only be used to finance the borrower's closing costs and/or prepaid items. However, this difference in interest rate is not "premium pricing;" it is the inherent difference in price between a loan with DPA (DPA pricing) and one without. As the OGC has noted, "the use of funds derived from the sale of mortgages with higher than market interest rates *does not constitute premium pricing* as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities."[38] OIG's position on this issue is further belied by HUD's recognition that "different types of mortgages involve differing levels of risk, processing expenses or other factors that differentiate them and necessitate pricing variation."[39]

OIG's insistence that entities that package, buy, and sell MBS that include loans with DPA pricing receive additional funds because of such pricing and therefore receive a financial benefit is inaccurate. This fundamental misconception is necessary for OIG to reach its final conclusion that the additional funds derived from the packaging and sale of DPA-priced mortgages into MBS eventually returns to the pool of funds used by Golden State and similar HFA DPA programs to pay a portion of future minimum contributions for additional borrowers, and complete what OIG alleges is an improper "circular funding mechanism."

In applying this logic, however, OIG seeks to apply the rules that were developed to address seller-funded downpayment assistance (SFDPA) to HFA DPA, which is an expressly different category of financing. As HUD explained before HERA was passed in 2008,

> [T]he situations that cause FHA concern are those in which a so-called charitable organization provides a so-called gift to a homebuyer from funds that it receives, directly or indirectly, from the seller. In these cases, there is a clear *quid pro quo* between the homebuyer's purchase of the property and the seller's 'contribution' or payment to the charitable organization. This is also true if the contribution to the charitable organization comes

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[37] 24 C.F.R. § 202.12(a)(7).

[38] Emphasis added.

[39] 59 Fed. Reg. at 9077 (Feb. 25, 1994)

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from an entity, other than the seller, that has an expectation of being reimbursed by the seller.[40]

And as HUD explained in 2012 after the passage of HERA, the provision prohibiting SFDPAs does not prohibit FHA from insuring mortgages originated as part of the homeownership programs of Federal, state, or local governments or their agencies when such agencies also directly provide funds toward the required minimum cash investment.[41]

b. HERA's Plain Language Allows for DPA Programs

OIG's findings that the DPA funds at issue come from "prohibited sources," as defined by HERA § 203(b)(9)(C), arise from a purposeful misreading of the statutory text. In addition to the text of HERA, the legislative history, statutory purpose, and HUD's own interpretive rule have made clear that DPA programs run by or affiliated with governmental entities are not prohibited sources of downpayment funds.

In its GSFA Draft Report findings, OIG does not argue that the language of HERA prohibits the (patently incorrect) "circular funding mechanism" employed by the parties at issue. Rather, OIG argues that "it would be contrary to the *intended* purpose of [HERA]"[42] to allow local governments to use this method to fund DPA programs.[43] However the text of HERA only prohibits the receipt of funds from either (i) parties that financially benefit from the primary transaction (between homeseller and homebuyer) or (ii) any third party that is reimbursed by any of the parties in the first group.[44]

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[40] Standards for Mortgagor's Investment in Mortgaged Property, 72 Fed. Reg. 56,002 (Oct. 1, 2007).

[41] *See* Interpretive Rule, 72222.

[42] GSFA Draft Report, at 8. (Emphasis added.)

[43] The well-established rules of statutory interpretation require that "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6 (2000) (internal quotation marks omitted) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989), in turn quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). When engaging in statutory construction, "[the court's] starting point must be the language employed by Congress . . . and we assume that the legislative purpose is expressed by the ordinary meaning of the words used." *Immigration and Naturalization Serv. v. Phinpathya*, 464 U.S. 183, 189 (1984) (internal quotation marks omitted) (quoting *Am. Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982)). Legislative history should not be a consideration in interpretation unless the language of the statute is unclear or ambiguous. *Ratzlaf v. United States*, 510 U.S. 135, 147-48 (1994) ("[Courts] do not resort to legislative history to cloud a statutory text that is clear."); *Barnhill v. Johnson*, 503 U.S. 393, 401 (1992) (appeals to legislative history are well taken only to resolve statutory ambiguity).

[44] HERA, Pub. L. 110-289, § 2113, amending § 203(b)(9)(C) of the National Housing Act.

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The legislative history of HERA also supports the position that the Act's prohibition on certain sources of downpayment funding only applies to *seller-funded* DPA programs.[45] The Golden State DPA program at issue in the GSFA Draft Report is a California joint powers authority and a duly constituted public entity and agency, as are most of the other at-issue DPA programs. The few programs that are not directly related to a state or local government are still not "seller-funded" under any possible interpretation of that term. The Golden State DPA program at issue in the GSFA Draft Report is not funded by the seller and thus is not within the scope of prohibited sources contemplated by the drafters of HERA.[46]

Furthermore, interpreting HERA to prohibit government-affiliated DPA programs would undermine the very purpose of the Act, which was to clear the way for governments and government-affiliated programs to provide needed housing assistance.[47] The Golden State DPA programs at issue in the findings are government-related. Interpreting HERA's funding prohibition to apply to these programs would frustrate the overarching purpose of the Act, which is to provide necessary funds to promote homeownership amongst low- and middle-income borrowers and to stabilize neighborhoods in the wake of the housing crisis.[48] In fact, HUD has expressly stated its position that HERA's prohibitions on certain funding sources do not apply to government-run or affiliated DPA programs.[49] This includes Federal, state, and local government programs and instrumentalities.

c. FHA's Interpretation that DPA Programs are Eligible Gift Funds Is Accurate and Supported by the HUD Handbook and Guidelines

OIG has indicated its position is that HUD has never approved of the types of funding Golden State and other HFAs use to fund their DPA programs.

In its effort to limit SFDPA funded downpayment assistance programs prior to HERA, in its 2007 final rule, HUD explained that

> The situations that cause FHA concern are those in which a so-called charitable organization provides a so-called gift to a homebuyer from funds that it receives, directly or indirectly, from the seller. In these cases, there is a clear quid pro quo between the homebuyer's purchase of the property and the seller's "contribution" or payment to the charitable organization. This is

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[45] *See* 154 Cong. Rec. S6354-S6356 (July 7, 2008), http://gpo.gov/fdsys/pkg/CREC-2008-07-07/html/CREC-2008-07-07-pt1-PgS6354-2.htm. *See also* Interpretive Rule, at 72,222 ("This bill eliminates the seller-funded down payment assistance program.").

[46] 154 Cong. Rec. S6354-S6356, at S6355, (July 7, 2008), http://gpo.gov/fdsys/pkg/CREC-2008-07-07/html/CREC-2008-07-07-pt1-PgS6354-2.htm

[47] *See* Interpretive Rule.

[48] *See id.*

[49] *Id.* at 13.

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> also true if the contribution to the charitable organization comes from an entity, other than the seller, that has an expectation of being reimbursed by the seller.[50]

In *Nehemiah Corporation of America v. Jackson*, 546 F. Supp. 2d 830, 842 (E.D. Cal. 2008), the court recognized that with this final rule, HUD intended to limit SFDPA programs which were previously permissible. ("[A]ttempt at banning seller-funded DPA indirectly indicated that HUD's prior policy was to permit the practice . . . " and "seller-funded DPA was previously permitted.").

HUD's reasoning is noteworthy since "Section 2113 of [HERA], signed into law on July 30, 2008, amended the NHA with language that is identical in relevant part" to the language contemplated in the 2007 final rule.[51] In short, DPA programs have always been permitted by HUD, and the provisions in HERA limiting SFDPA programs were confined to those situations in which DPA programs were reimbursed for their assistance. Accordingly, HERA clarified that the cash investment required for FHA insured loans may not:

> consist, in whole or in part, of funds provided by any of the following parties before, during, or after closing of the property sale:
>
> (i) The seller or any other person or entity that financially benefits from the transaction/
>
> (ii) Any third party or entity that is reimbursed, directly or indirectly, by any of the parties described in clause (i).[52]

OIG argues that the Golden State DPA program, and other relevant DPA programs, are a "circular funding mechanism" that is ineligible because proceeds from the sale of securities backed by premium rate loans are used to reimburse the DPA program and fund future downpayments. However, not only is the statutory text contrary to the reading, so too is the legislative history and purpose of HERA, neither of which support the position that such funding is impermissible. HUD has issued at least one interpretive rule that expressly endorses government-affiliated DPA programs that use the bond market as a funding structure. As explained in HUD's December 29, 2012 interpretation, the provision prohibiting seller funded downpayments does not prohibit FHA from insuring mortgages originated as part of the homeownership programs of Federal, state, or local governments or their agencies when such agencies also directly provide funds toward the required minimum cash investment.[53]

This interpretation is consistent with HUD's stated purpose to avoid seller funded DPA programs and is logical. Interpreting section 203(b)(9)(C) to preclude governments and their affiliated entities from providing DPA for FHA-insured mortgages would undercut a central

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[50] 72 Fed. Reg. 56,002.

[51] Interpretive Rule, at 72,221.

[52] 12 U.S.C.A. § 1709(b)(9)(c).

[53] *See* Interpretive Rule, at 72,222.

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purpose of these programs and frustrate the statutory purpose the FHA to encourage and support homeownership.[53]

The Golden State DPA program, along with the other DPA programs at issue, is not funded by the seller and thus is not within the scope of prohibited source of funds considered by the drafters of HERA. Unlike the SFDPA programs contemplated in *Nehemiah* and HERA, Golden State and other similar HFAs do not operate on *a quid pro quo* basis in which they are reimbursed by the seller for their assistance and are not funded by sellers. Rather, the funds used for DPA meet HUD Handbook and Guideline requirements. OIG asserts that loanDepot's premium pricing practices provided a source of funding for the DPA programs at issue. However, loanDepot premium pricing offerings were provided for the benefit of consumers, so that they could finance their closing costs and/or prepaid expenses, not as a source of funds for borrower downpayments or as a means of generating funding for Golden State's DPA program.[55]

Further, the DPA funds at issue constitute eligible gift funds under applicable HUD Guidelines, because there is no expected or implied repayment of the funds to the donor by the borrower, and no portion of the interest rate is used to repay the DPA funds, either to the HFA or the ultimate purchaser-holder, if the borrower pays off the mortgage early.[56] These gift funds and transfers were documented appropriately and loanDepot performed all the appropriate due diligence required by the applicable HUD Guidelines, including HUD's Interpretive Rule stating that funds provided directly by Federal, state, or local governments, or their agencies and instrumentalities in connection with homeownership programs are not prohibited.[57]

d. The FHA Has Reaffirmed its Support of DPA Programs; HUD Has Been Aware of DPA Programs for Many Years, Has Conducted an In-Depth Review of These Programs, and Supports the Use of DPA Programs

In 2004, HUD conducted a review of DPA programs, including their self-funding structure driven by premium bonds and MBS and directly addressed in a communication from the National Association of Local Housing Finance Agencies.[58] At that time, no contrary guidance was issued, and no negative statements were made about the exact same "circular funding" mechanism OIG now claims is inappropriate. And as mentioned previously, HUD has issued at least one interpretive rule regarding DPA program funding that expressly endorses government-affiliated DPA programs that use the bond market funding structure.

Specifically, the 2012 HUD Interpretive Rule (24 C.F.R. § 203) and HUD Mortgagee Letter 2013-14 discuss in detail HFA-funded DPA. The Mortgagee Letter confirms lender ability to advance DPA funds on behalf of an HFA, and the Interpretive Rule discusses the

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[54] Interpretive Rule, at 72,222.

[55] *See* 4155.1 5.A.2.i.

[56] *See id.* at 5.B.4.b.

[57] *See id.* at 5.B.4.h; 5.B.5.a-b.

[58] *See* attached Exhibit E.

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various means by which HFAs derive DPA funds, including various public funds raised from taxable and tax-exempt bonds. In the current market, HFAs generally sell MBS, bundled in large portfolios, to investors. Because bundling generally decreases the risk associated with the security, the securities sell for higher prices, leading to lower mortgage rates for consumers. The proceeds from the sale of these securities are then used to fund the DPA program. As noted above, this same issue was raised in 2004 and reviewed by HUD without any negative findings.

HUD has continued to support these programs, including in the statement issued by Edward Golding, Principal Deputy Assistant Secretary of the Office of Housing, "reaffirm[ing] FHA's support of certain down payment assistance programs, like those run by State Housing Finance Agencies,"[59] and the OGC Memo, rejecting OIG's analysis and interpretation.

3. loanDepot Charged Borrower Fees that were Customary and Reasonable[60] (Subfinding #3)

OIG claims that 101 loans had fees that violated HUD requirements because they were not reasonable or customary, as is required by FHA guidelines. For 44 of those loans, the fee was identified as the "bond-funding fee;" for 56 of those loans, the fee was identified as the "bond program settlement fee."[61] In both cases, these fees were legitimate as part of the DPA program charges

The bond-funding fee and bond settlement fee are legitimate fees imposed as part of the DPA programs, including the Golden State DPA program. The DPA programs operate in largely the same manner, so the Golden State DPA program will be used as an example of what these fees are and how they are communicated to the borrower. The Golden State DPA program is a program provided by the GSFA, which is a public entity/agency in California. It has made a term sheet for the DPA program publicly available that specifically states that there is a funding fee in connection with the DPA program. The term sheet states that the funding fee is paid to the servicer (*i.e.*, it is a third party fee), and it also specifically permits the lender to charge customary and reasonable closing costs and fees to the borrower. In other words, the funding fee is a closing cost paid to a third party, and nothing places this fee in a special category that would prohibit the borrower from paying for it as a customary and reasonable closing cost or fee. This fee is also certainly customary as numerous housing agency products require payment of a funding fee. FHA has made a conscious policy decision to permit lenders to pass these fees

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[59] *See* HUD Housing Statement, *supra* n. 3.

[60] Both the DPA Draft Report and GSFA Draft Report found that fees "charged and collected" by loanDepot were not customary or reasonable to close FHA mortgage loans. Specifically, OIG stated that the "fees were charged in association with the Golden State Platinum program and were not required to close the FHA mortgage loan," and "fees were charged in association with the downpayment assistance programs and were not reasonable or customary for closing an FHA mortgage loan." GSFA Draft Report, at 8; DPA Draft Report, at 8.

[61] The 45th loan included a $726 lock extension fee that was used for its intended purpose as the borrower received an extension of time to close. This is consistent with HUD guidelines that allow reasonable fees as part of DPA program participation.

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along to borrowers and, if OIG disagrees with that policy decision, it should take up the issue directly with HUD without involving loanDepot.[62]

a. The Funding Fee, Present in Guidelines for HFAs Throughout the Country, is Clearly Customary and Reasonable

Like all of the DPA programs at issue in the Draft Reports, the Golden State DPA Program has a term sheet or matrix that specifically addresses the points and fees that may be paid by the borrower. Under the relevant section, the term sheet states that the lender may charge the borrower an origination fee as well as customary and reasonable closing costs and fees with full disclosure in accordance with, among other things, FHA, federal, state, and local laws and regulations. The section also states that a funding fee of $300 applies to every loan.

OIG concluded that the bond funding fees were not customary, or were unreasonable or unnecessary, and states that "[u]nreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business."[63] However, it provides no basis for its determination, nor does it disclose any market research that was conducted to determine whether these fees are prevalent in the marketplace—customary—or whether the amounts charged were similar to those charged by other lenders—reasonable.

A simple search of the internet and review of the U.S. Bank Housing Finance Authority guidelines show that the funding fee is a common feature of these programs. For example, there are similar funding fees in a majority of the states. Housing authorities also disclose on their website that funding fees may be assessed to borrowers. The Ohio Housing Finance Agency informs borrowers that a $350 funding fee "may apply to your [loan program]."[64] The Texas State Affordable Housing Corporation website states that:

> Lenders have the ability to charge the following fees to assist home buyers with TSAHC's Homeownership Programs:
> - $300 Funding Fee (DPA Programs only) . . .
>
> In an effort to provide you with the most down payment assistance possible, we do not allow lenders to charge you origination points. However, lenders may collect all other reasonable and customary fees and closing costs, provided all fees are fully disclosed in accordance with federal, state and local regulations. [65]

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[62] *See, e.g.*, Mortgagee Letter 2006-04: Revised Borrower's Closing Costs Guidelines (Jan. 27, 2006).

[63] GSFA Draft Report, Appendix A, at 14; DPA Draft Report, Appendix A, at 13.

[64] *See* Ohio Housing Finance Agency, *First-Time Homebuyer Program*, https://ohiohome.org/homebuyer/first_time.aspx#fees.

[65] Texas State Affordable Housing Corporation, *Frequently Asked Questions*, http://www.tsahc.org/homebuyers-renters/faq.

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The CalHFA FHA Loan Program also lists a $300 master servicer funding fee per loan, reflecting that it is customary to charge funding fees for FHA loans.[66]

The GSFA Draft Report notes that OIG "identified funding fees ranging from $150 to $300," but then attaches Appendix E which provides a list of "Noncustomary or unreasonable fees charged" that range between $200 - $450, without any explanation as to what those fees are or why they do not align with the range listed in the body of the report.[67] However, publicly available information shows that funding fees are common place for these products. Unless OIG can provide support for its conclusion that these fees are not reasonable or customary, it should remove this finding in light of the overwhelming data suggesting that they are, in fact, reasonable and customary.

b. The Funding Fee is Permissible Under FHA Guidelines Because it is Merely a Pass Through of a Third Party Fee

The funding fee is a permissible fee charged to customers that is passed through to a service provider in accordance with FHA requirements.

Section 5.A.2.a of HUD Handbook 4155.1 discusses the settlement requirements needed to close a loan, and specifically discusses the origination fee, unallowable fees, and other closing costs. That Section provides that "[l]enders may charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage loan." The only fee that is expressly prohibited from being charged to borrowers is a tax service fee.

Section 6.A.3.a of HUD Handbook 4155.2 provides an additional discussion of permissible closing costs and other fees. Here, HUD states, as the draft report notes, that "[t]he lender may only collect fair, reasonable and customary fees and charges from the borrower for all origination services." However, HUD goes on to note that "mark-ups" are prohibited and that the cost for an item charged to the borrower must not exceed the cost "charged to the lender by the service provider."

The funding fee fits squarely within the requirements of the HUD Handbooks. The funding fee is a cost borne by the lender in connection with originating the loan that is paid to the servicer or HFA. While loanDepot could choose to absorb this cost, it is also permitted to, under the FHA guidelines, pass the fee along to the borrower so long as it does not provide an additional mark up. As noted in the Draft Reports, the funding fees that were assessed were between $200 and $525. Based on the U.S. Bank guidelines currently in effect, the fee to the lender generally in that realm, which strongly suggests that the fee charged to the borrower was simply a pass-through. Such a fee is entirely fair and, as described above, is customary as the fee is required under numerous state housing agency loan programs. Accordingly, these are not loan

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[66] *See* California Housing Finance Agency, *CalHFA FHA Loan Program*. http://www.calhfa.ca.gov/homeownership/programs/fha.pdf .

[67] The DPA Draft Report notes the same non-customary or reasonable fees, listing a range of fees from $325-575 in Appendix E.

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fees resulting in profits for loanDepot as it is only authorized to pass through the amounts actually realized by the third party

c. FHA Made a Conscious Policy Decision to Permit Lenders to Charge These Fees and, in Doing So, Also Retained For Itself the Right to Prohibit or Limit Fees Charged to Borrowers

The decision to give lenders flexibility with respect to the fees they assess to borrowers, including the ability to assess borrowers a funding fee, is the result of a thoughtful policy decision made by HUD at the height of the housing boom, when FHA was losing market share to the subprime and Alt-A industry. If OIG disagrees with HUD's decision it should take the issue up with HUD, but may not retroactively enforce its policy preferences on a lender that was complying with existing requirements.

In 2006, FHA adjusted its approach to regulating fees, and altered its guidelines to remove its prescriptive list of fees that could be collected from the borrower. This was a conscious policy decision, justified by FHA's belief that:

> [B]y no longer prescribing borrower's paid closing costs, a significant impediment to the use of its programs has been eliminated. FHA-approved mortgagees advised us that sellers sometimes balked at accepting a sales contract from a homebuyer wishing to use FHA-insured financing because it's [sic] guidelines differ from standard practice and do not consider regional variations. The unintended consequence was that the homebuyer was then forced into a less suitable and often more expensive mortgage product.[68]

Along these lines, HUD codified this policy choice, when in 2008, it revised its limitations on the amount a lender may collect from a borrower to compensate the lender for expenses incurred in originating and closing an FHA-insured loan. As support for this decision, which was accompanied by the rule revising the GFE and HUD-1 forms required under the Real Estate Settlement Procedures Act, HUD stated that "the improvements to the disclosure requirements for all loans sought to be achieved as a result of this rulemaking should make total loan charges more transparent and allow market forces to lower these charges for all borrowers, including FHA borrowers."[69]

These funding fees are an established part of the mortgage market place, and they are clearly disclosed to borrowers on the GFE and HUD-1. If the borrower feels this clearly-disclosed fee is too high, the borrower is free to find another loan product or choose to rent a property rather than buy a property. If borrowers think these fees are too high and demand for the product decreases, lenders may adjust their practices to make the product more appealling.

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[68] Mortgagee Letter 2006-04.

[69] Real Estate Settlement Procedures Act: Rule To Simplify and Improve the Process of Obtaining Mortgages and Reduce Consumer Settlement Costs, 73 Fed. Reg. 68,204, 68,227 (Nov. 17, 2008).

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This is how the market works, and this is how FHA envisioned the market working. FHA did not want borrowers to avoid their products because a prescriptive set of fees was out of line with regional practice. FHA also wants to give lenders the flexibility to set fees so that they can ensure that offering these types of products remains profitable.

It is also important to note that FHA maintained some safeguards in case there was a failure of market forces. In Section 6.A.3.a of HUD Handbook 4155.2, FHA notes that "the FHA Commissioner retains the authority to set limits on the amount of any fees that a lender may charge a borrower(s) for obtaining an FHA loan." Along these lines, Section 6.A.3.d states that the "appropriate Homeownership Center (HOC) may reject charges, based on what is reasonable and customary for the area."

Funding fees are a well-established part of this product offering and FHA is well aware that these fees are charged to borrowers. As FHA has not identified an issue with funding fees, there is no basis to challenge whether they are reasonable or customary.

d. The Discount Fees Were Properly Disclosed, Charged, and Collected as Allowable Fees

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The DPA Draft Report states that 29 loans had discount fee charges that "were not used for their intended purpose."[70] OIG (again) has provided no support for its conclusion that these fees were "not used for their intended purpose" and "misrepresented."[71] To the contrary, loanDepot charged and collected these fees consistent with the HUD Handbook and Guidelines, as discussed in sections III.A.3.a-c. This is consistent with HUD requirements as they were allowable fees that the mortgagee must factor when determining the cash required to close a mortgage transaction, and not included in the minimum downpayment assistance.[72] Similarly, such fees were customary and reasonable fees and were applied consistently with the industry's understanding of HUD Guidelines and guidance.[73] They were an established part of the mortgage market place, and they were disclosed to borrowers. Further, similar to the bond-funding and bond settlement fees, these were customary and reasonable fees charged in connection with DPA program participation. OIG's apparent issue assumes a lack of borrower choice, and suppose requirements on rate and fee structures that would be inconsistent with the guidelines and their intent. Borrowers are free to choose another loan provider if they feel this clearly-disclosed fee is too high. This is a fundamental axiom of a free market economy, which the FHA and HUD clearly understood and anticipated based on their existing guidance.[74]

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[70] *Id.*

[71] *Id.*

[72] 4155.1, 5.A.1.a; 5.A.2.c.

[73] *See, e.g.*, Mortgagee Letter 2006-04.

[74] *See supra* III.A.3.c.

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4. The Higher Interest Rate Associated With the DPA is Not a Violation of HUD Requirements[75] (Subfinding #4)

The fact that borrowers received higher interest rates and, as such, were subject to a higher monthly mortgage payment obligation does not violate HUD Requirements. As a threshold matter, this simplistic argument ignores the basic fact that, without the DPA programs, these borrowers likely would not have been able to purchase the homes at all, or under less favorable terms by their own decision-making process, which include higher cash expenditures at settlement. Moreover, the interest rates were provided in a manner consistent with HUD's recently issued HUD Housing Statement and OGC Memo.

The OGC Memo expressly states that there is no violation of FHA restrictions on premium pricing where the rates agreed upon by borrower and lender are rates available to homebuyers participating in the DPA programs.[76] Specifically, Section 203(b)(5) of the National Housing Act provides that the interest rate on an FHA insured mortgage is to be agreed upon by the borrower and the Lender. Moreover, 24 C.F.R. § 203.20 provides that the borrower and the lender are to agree upon the mortgage interest rate. The OGC Memo goes on to states that:

> There is no violation of FHA restrictions on premium pricing where the rates agreed upon by borrower and lender are generally the rates available to homebuyers participating in DPA programs. Similarly, there is also no violation of FHA restrictions on premium pricing where any apparent increased interest rate did not result in a corresponding credit to the borrower.

Stated differently, because loanDepot and the borrower entered into an agreed upon interest rate and that rate was generally the same for homebuyers participating in the DPA programs, HUD would not (and does not) take issue with the loanDepot's pricing on such loans or determine that the borrower was put into a worse position.

a. Whether the Premium Pricing Provided on the FHA Loans at Issue Resulted in Borrowers being Subject to a Higher Monthly Payment Obligations is Not a Relevant Factor in Determining loanDepot's Level of Compliance with HUD's Premium Pricing Requirements

HUD Guidelines permit mortgagees to apply premium pricing on FHA-insured mortgages.[77] Through "premium pricing," an FHA borrower can pay a slightly higher interest rate (*i.e.*, premium interest rate) in exchange for the mortgagee paying the borrower's closing

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[75] The Draft Reports found that "ineligible loans with the required premium interest rates imposed on FHA borrowers resulted in higher monthly mortgage payments, compared to those of qualified FHA borrowers who did not receive downpayment assistance." GSFA Draft Report, at 9; DPA Draft Report, at 8.

[76] *See* OGC Memo, *supra* n. 4.

[77] HUD Handbook 4000.1 – Part II, A.4.d.i.A(h); A.5.c.i.B(h).

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costs and/or prepaid expenses.[78] However, for mortgage loans that maintain a premium interest rate to be insurable by HUD, the funds derived from premium priced mortgage:

> (i) [M]ay never be used to pay any portion of the borrower's downpayment;
>
> (ii) [M]ust be disclosed [in accordance with RESPA];
>
> (iii) [M]ust be used to reduce the principal balance if the premium pricing agreement establishes a specific dollar amount for closing costs and prepaid expenses, with any remaining funds in excess of actual costs reverting to the borrower, and
>
> (iv) [May] not be used for payment of debts, collection accounts, escrow shortages or missed mortgage payments, or judgments.[79]

HUD has expressly acknowledged premium pricing programs as "*very successful and . . . acceptable.*"[80]

Because: (i) premium pricing itself relates to a scenario in which a borrower receives a higher interest rate in exchange for a lender credit to closing costs and/or prepaid expenses; and (ii) any increase to the interest rate offered will result in commensurate increase to the borrower's monthly payment obligation, suggesting that the higher payment obligation resulting from a premium interest rate is indicative of a violation is not consistent with a logical reading of HUD's premium pricing standards.

b. HUD's Tiered Pricing Rule Expressly Contemplates that there will be Variations in the Interest Rates Provided to Borrowers

As noted by other industry experts, "[b]y citing the premium pricing guidance, rather than acknowledging that FHA's governing law permits variation in rates, OIG creates a level of confusion around the existing practice and makes the claim that these programs are harming consumers."[81] Accordingly, it is helpful to understand HUD's tiered pricing rule, which allows rates to vary by as much as 200 basis points, to accommodate fluctuations in secondary market execution.

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[78] *See* Mortgagee Letter 94-7: Premium Rate Mortgages, Streamline Refinances, and Other Policy Issues (Feb. 2, 1994).

[79] 4155.1 5.A.2.i.; Mortgagee Letter 94-7.

[80] Mortgagee Letter 94-7 (emphasis added).

[81] Montgomery, Brian (former Assistant Secretary of HUD and FHA Commissioner), "Keeping the Word 'Assistance' after Downpayment", http://www.collingwoodllc.com/voiceofhousing/government/2015/08/keeping-the-word-assistance-after-downpayment/ (last visited Sept. 16, 2015).

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HUD's tiered pricing rule provides further support to the argument that variations to the interest rates provided to FHA borrowers, and any corresponding increase to borrowers' monthly payment obligations, should not be construed as an express violation of HUD Guidelines. In enacting the tiered pricing rule, HUD sought to, among other things, eliminate a mortgagee's discriminatory pricing of FHA insured mortgages in a particular area that would either discourage home purchases or place an unfair burden of costs on the borrower.[82] However, within the preamble to the final tiered pricing rule, HUD also acknowledges that "different types of mortgages involve differing levels of risk, processing expenses or other factors that differentiate them and necessitate pricing variation."[83]

The aggregate charges imposed by an FHA mortgagee are subject to the tiered pricing rule.[84] Under the tiered pricing rule, the customary lending practices of a mortgagee for its single-family insured loans must not provide for a variation in mortgage charge rates that exceed two percentage points.[85] The "mortgage charge rate" is defined as "the amount of mortgage charges for a mortgage expressed as a percentage of the initial principal amount of the mortgage."[86] "Mortgage charges" include any charges under the mortgagee's control and not collected for the benefit of third parties, including for example, "interest, discount points and origination fees."[87]

The tiered pricing requirement applies to all single-family programs, however, the rule only provides for pricing comparisons among mortgages of the same mortgage type, and not across all mortgage types.[88] A "mortgage type" includes "those mortgages that are closely parallel in important characteristics affecting pricing and charges, such as level of risk or processing expenses."[89] Thus, in determining "variation in mortgage charge rates for a mortgage type," the regulations provide that "all mortgage charge rates offered by the mortgagee within an area for the mortgage type for a designated day or other time period, including mortgage charge rates for all actual mortgage applications" are compared.[90]

Given these provisions, the tiered pricing rule not only acknowledges that there may be some variation in the pricing applied to mortgage loans, but provides parameters by which mortgages can vary interest rates and certain closing costs (i.e., mortgage charges) in a manner

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[82] Tiered Pricing, 59 Fed. Reg. 9077 (Feb. 25, 1994).

[83] *Id.* at 9082.

[84] *See* Mortgagee Letter 94-16: Tiered Pricing Final Rule (Apr. 6, 1994); 24 C.F.R. § 202.12; 59 Fed. Reg. at 9078 (Feb. 25, 1994).

[85] 24 C.F.R. § 202.12(a)(1).

[86] *Id.* § 202.12(a)(5).

[87] *Id.* § 202.12(a)(3).

[88] *See* Mortgagee Letter 94-16; 24 C.F.R. § 202.12(a)(6).

[89] 24 C.F.R. § 202.12(a)(7).

[90] *Id.* § 202.12(a)(6).

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that is acceptable to HUD, among not only different "mortgage types," but also within each individual "mortgage type."

5. loanDepot Has Sufficient Controls to Ensure FHA Compliance[91] (Subfinding #5)

While the Draft Reports indicated that there are significant defects with the Company's internal controls that are intended to ensure that (i) FHA loans originated with DPA gifts met HUD FHA requirements, and (ii) fees paid by FHA borrowers were properly disclosed, customary, and reasonable, HUD requires nothing beyond what the Company is already doing.

As noted above, loanDepot met its due diligence requirements in connection with utilizing DPA program funds, as well as assuring fees charged to borrowers were "customary and reasonable." Accordingly, the Company disagrees with OIG that its internal policies may contain "significant violations," especially as it applies to the DPA matters. Moreover, without additional insight from OIG as to the specific issues with loanDepot's internal policies, it is difficult for the Company to implement or address any specific changes to its documents.

B. <u>OIG Is Required to Defer to HUD's Interpretations and Guidance Regarding Departmental Programs</u>

Even if OIG disagrees with the Company's analysis of how HUD regulations apply, OIG must defer to HUD's interpretations and guidance relating to departmental programs. HUD has publicly declared that it approves of HFA-run DPA programs. The purpose of the Inspector General Act of 1978 (IG Act) was to address fraud and abuse in the government, not to create new regulators operating outside the normal channels of regulatory guidance. The statutory provisions vesting OIG with oversight responsibility do not vest the more far-reaching power to engage in the operational responsibilities of the agency. Congress specifically addressed this issue by affirmatively including a provision that program operating responsibilities cannot be transferred to an Inspector General.[92]

Interpretation of the rules governing DPA programs is among the program operating responsibilities of HUD. The Secretary may delegate any of his functions, powers, and duties to such officers and employees of the Department as he may designate,[93] and has delegated to the General Counsel the authority to "interpret the authority of the Secretary and to determine

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[91] *See* GSFA Draft Report, at 13; DPA Draft Report, at 12.

[92] *See* 5 U.S.C. app. 3 § 9(a)(2); *Burlington N. R. Co. v. Office of Inspector Gen., R.R. Ret. Bd.*, 983 F.2d 631, 642 (5th Cir. 1993) (An Inspector General is "responsible for combatting fraud, abuse, waste, and mismanagement in federal agencies and departments. If an Inspector General were to assume an agency's regulatory compliance function, his independence and objectiveness . . . would, in our view, be compromised.").

[93] 42 U.S.C.A. § 3535(d).

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whether the issuance of any rule, regulation, statement of policy, or standard promulgated by HUD is consistent with that authority" — not OIG.[94]

Here, OIG oversteps its authority in attempting to enforce an interpretation of a regulation that is directly at odds with guidance provided by HUD. OIG's role is to investigate waste, fraud, and abuse based not on its own interpretations, but according to HUD's interpretation and guidance.[95] Within HUD, it is OGC's role to "to provide legal opinions, advice and services with respect to all departmental programs and activities."[96] As the Fifth Circuit has noted, the limitation on Inspectors General is directly supported by the House Report accompanying the IG Act, which states:

> While Inspectors General would have direct responsibility for conducting audits and investigations relating to the efficiency and economy of program operations and the prevention and detection of fraud and abuse in such programs, *they would not have such responsibility for audits and investigations constituting an integral part of the programs involved.*[97]

Indeed, HUD Handbook 2000.3 REV-4, which describes OIG's role in relation to HUD Management, states that OIG's responsibilities "neither diminish nor include program operating responsibilities of other HUD primary organization heads. Pursuant to Section 9(a)(2) of the IG Act, program operating responsibilities may not be transferred to the Inspector General."[98] And for good reason. To allow OIG to reinterpret agency guidance on its own, in conflict with prior agency interpretations would turn the federal regulatory process on its head. As the Department of Justice has noted, restrictions on OIG's authority are:

> . . . not surprising because to vest such authority in the Inspectors General would have constituted a fundamental alteration in the departments' regulatory authority. It would have taken away the power to control the investigatory portion of a department's regulatory policy from the official designated by statute or by the Secretary and placed it in an official separate from the regulatory division of the department. As the legislative

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[94] Consolidated Delegation of Authority to the General Counsel, 76 Fed. Reg. 42,462 (July 18, 2011).

[95] *See Truckers United for Safety v. Mead*, 251 F.3d 183, 190 (D.C. Cir. 2001) ("the IG's core role [i]s preventing fraud and abuse, by conducting audits and investigations relating to agency programs and operations."); *U.S. Dep't of Hous. & Urban Dev. v. Sutton*, 68 B.R. 89, 94 (E.D. Mo. 1986) ("The Inspector General Act of 1978 conferred upon the OIG the power and the duty to investigate HUD programs for fraud and irregularities and to oversee compliance with HUD regulations by program participants.").

[96] *See* HUD.GOV, *General Counsel*, http://portal.hud.gov/hudportal/HUD?src=/program_offices/general_counsel.

[97] *Burlington*, 983 F.2d at 642 (citing H.R.Rep. No. 584, 95th Cong., 1st Sess. 12–13 (1978)).

[98] HUD Handbook 2000.3 REV-4, 1-5, http://portal.hud.gov/hudportal/documents/huddoc?id=20003c1OIGH.pdf.

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history makes clear, however, it was not the intention of Congress to make such a fundamental change in the regulatory structure of the departments and agencies of the federal government.[99]

Courts have recognized that when an agency departs from prior norms it must explain such departures in a formalized process.[100] Without these explanations or following regulatory processes designed to help guide industry participants, companies like loanDepot would be left in the untenable position of not knowing how to comply with agency rules or on which interpretations to rely.

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Courts are authorized to set aside agency actions that are "arbitrary, capricious, [or] an abuse of discretion."[101] An agency's decision is arbitrary and capricious if it is not "based on a consideration of the relevant factors"[102] A choice to enforce an interpretation regarding funding for HFA DPA programs that directly contradicts HUD guidance actively ignores relevant factors and is the epitome of arbitrary and capricious agency activity. It is for that very reason that OIG's responsibilities do not include regulatory policy and do not allow OIG to pursue its own interpretation of agency rules outside of agency guidance. Simply put, OIG cannot choose to usurp HUD's operating responsibilities by enforcing regulations in a manner that is inconsistent with HUD's own interpretations.

C. OIG's Audit Violates Government Audited Standards

Comment 4

The process by which OIG arrived at its findings in these cases is also faulty and in violation of the Government Auditing Standards (GAS), invalidating the reports as a whole. OIG relies upon an inaccurate and biased sampling methodology, and the recommendations themselves are unsound as they are unsupported, incorrect, and lack the appropriate appearance of objectivity, reflected by OIG's failure to address, let alone cite, compelling contrary authority. Finally, the report exceeds a legitimate exercise of OIG's mandate to conduct and publicly report on its oversight of HUD—not to rewrite HUD's guidance, and then retroactively apply its interpretation to lenders like loanDepot who, in good faith, relied on that legitimate agency position.

The GAS require that auditors "obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions."[103] Evidence is not "sufficient" when "(1) using it carries an unacceptably high risk that it could lead the auditor to reach an incorrect or

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[99] U.S. Department of Justice, *Inspector General Authority to Conduct Regulatory Investigations*, 60-61 (Mar. 9, 1989), http://www.justice.gov/sites/default/files/olc/opinions/1989/03/31/op-olc-v013-p0054.pdf.

[100] *Nehemiah*, 546 F. Supp. 2d at 842 ("while HUD may have set forth good reasons for the rule's adoption, it did not adequately explain why it was changing its mind.").

[101] 5 U.S.C. § 706(2)(A).

[102] *Walker River Paiute Tribe v. U.S. Dep't of Hous. & Urban Dev.*, 68 F. Supp. 3d 1202, 1209 (D. Nev. 2014) (citation omitted).

[103] GAS at § 6.56.

improper conclusion, (2) the evidence has significant limitations . . . or (3) the evidence does not provide an adequate basis for . . . supporting the findings and conclusions."[104]

With this in mind, there is no basis to support the GSFA Draft Report's conclusion that the 75 loans reviewed may be legitimately extrapolated to the remaining group of 233 loans falling within the scope of OIG's review. There is also no basis to support the DPA Draft Report's conclusion that 90 loans reviewed may be legitimately extrapolated to the remaining 674 loans falling within the scope of OIG's review. For example, the conclusion that all of the remaining 233 loans must also contain ineligible gift funds, solely because they include DPA from Golden State is based on insufficient evidence. Indeed, this "sampling" to arrive at liability determinations fundamentally changes the nature of the indemnification aspect of FHA program. Specifically, HUD has long relied on post-endorsement technical review (PETR), as opposed to statistical sampling, in requesting indemnification.[105] This process focuses on a per-loan system instead of broad-stroke sampling. If OIG believes HUD should demand any indemnification, such request should be based on the PETR methodology and not statistical sampling. In 2013, HUD, acknowledging that statistical sampling and extrapolation was not the accepted practice, sought comments on whether it should implement that methodology in its audits.[106] In that notice, HUD stated that "[a]ny changes initiated as a result of this solicitation will be prospective only."[107] To the extent OIG is abandoning loan-level review and requests for indemnification in favor of sampling extrapolation, this is a direct repudiation of well-settled methodology and a retroactive change in the review process.

Comment 13

Similarly, the Draft Reports wrongly conclude that the Company violates FHA's requirements to charge "reasonable and customary" fees for which OIG is recommending reimbursement, without regard to the evidence that many other lenders and HFAs charge identical fees. OIG's determination states that "[u]nreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business."[108] However, OIG failed to disclose the foundation of its determination, nor does it disclose any market research that was conducted to determine whether these fees are prevalent in the marketplace—customary—or whether the amounts charged were similar to those charged by other lenders—reasonable.

Comment 3

Equally concerning is OIG's failure to even mention—let alone explain its departure from—HUD's contrary position in accordance with the GAS. The GAS require that:

> Criteria represent the . . . regulations, . . . standards, specific requirements, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. . . . Criteria provide a context for evaluating evidence and understanding the findings, conclusions, and recommendations

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[104] *Id.* § 6.71(b.).

[105] *See* HUD Handbook 4155.2(C); HUD Mortgagee Letter 2013-12 at 10; 24 C.F.R. § 203.55.

[106] 78 Fed. Reg. 41,075 (July 9, 2013).

[107] *Id.*

[108] GSFA Draft Report, Appendix A, at 14; DPA Draft Report, Appendix A, at 13.

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included in the report. Auditors should use criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter."[109]

Additionally, the GAS require that, "[w]hen reporting on the results of their work, auditors should disclose significant facts relevant to the objectives of their work and known to them which, if not disclosed, could mislead knowledgeable users [or] misrepresent the results."[110] Thus, the failure of OIG to disclose HUD's positions violates the GAS' mandate that "[a]uditors should use criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter,"[111], and because the lack of disclosure could mislead users and misrepresents results.

D. The Audit and Report Violate Due Process and Finalizing the Faulty Report will be an Arbitrary and Capricious Agency Action

The factual, legal, and process issues raise not only valid points of disagreement about the Draft Reports themselves, but also fundamental due process concerns. These concerns relate to both notice of the interpretation of the issue, and appropriate opportunity to respond—concerns heightened by OIG's stated intent to publish this report, notwithstanding the inaccuracies contained in it or the intra-agency disagreement that remains unresolved. It defies logic that OIG persists in issuing an audit report on a practice that HUD itself has said is acceptable. HUD is the author of the Handbook and guidance at issue and is the appropriate authority to explain its acceptable application.

Constitutional due process requirements for governmental action require, at a minimum, both appropriate notice and a meaningful opportunity to be heard before the government may determine facts or pronounce judgment.[112] For the reasons detailed in this response, notice already is lacking given OIG's new interpretation of HUD's program, which HUD itself has already rejected. To the extent OIG believes there is a legal flaw in HUD's interpretation, the appropriate and just outcome is for the agency to resolve the dispute and advise lenders going forward. To retroactively apply a new standard based on a novel interpretation rejected by the agency that wrote the rules is simply wrong. loanDepot should not be expected to remediate in connection with loans previously issued utilizing DPA in light of FHA's consistent and continued support of such programs, unless and until FHA takes some action to indicate it no longer agrees with loans utilizing these programs.

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[109] GAS at § 6.37.

[110] *Id.* at 7.17.

[111] *Id.* at 6.37

[112] *See Mathews v. Eldridge*, 424 U.S. 319, 348 (1976) ("The essence of due process is the requirement that a person or entity in jeopardy of serious loss (be given) notice of the case against him and opportunity to meet it.") (internal quotations omitted).

Comment 8

Indeed, an agency "must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed not casually ignored."[113] The reasoned analysis is required because "there is a presumption that an agency's current course of behavior best carries out Congress' policies; accordingly, deviation from that course warrants explanation."[114] "Conceptually, this requirement can be viewed as containing two components: first, whether HUD's change was supported by reasoned analysis, and second, whether HUD was honest with itself and the public that it was changing its policy."[115] OIG's approach fails here on two critical fronts: First, OIG is not the agency that interprets, adopts or changes the rules, thus it is in no position to revise prior policies at all. Second, even if it were, it has not provided any reasoned analysis as to an adoption of its recommendations. To the contrary, it has ignored contrary authority issued by HUD itself in reaching its flawed result.

Comment 5

Similarly, without due consideration, OIG failed to provide loanDepot a meaningful opportunity to respond, forcing a rushed response without reason or consideration in an apparent hurry to publish predetermined conclusions without regard to the content of any forthcoming response. Courts are authorized to set aside agency actions that are "arbitrary, capricious, [or] an abuse of discretion."[116] An agency's decision is arbitrary and capricious if it is not "based on a consideration of the relevant factors."[117] Federal agencies violate Constitutionally-required due process when they render defamatory and economically injurious public findings without providing adequate notice and an opportunity to be heard.[118] These actions reflect an arbitrary and capricious government action in violation of law.[119]

E. OIG's Recommended Actions Are Unfounded

Comment 14

Like its findings, OIG's recommendations are baseless. There is no legal or factual support for the recommendation that HUD consider indemnification, let alone civil penalties or administrative action when, in fact, by HUD's own account, loanDepot has complied with gift and DPA requirements. To require indemnification, or worse, assess civil penalties, is both inappropriate and unsupported.

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[113] *Nw. Envtl. Def. Ctr.*, 477 F.3d 668, 687 (9th Cir. 2007) (internal quotations omitted).

[114] *Nehemiah*, 546 F. Supp. 2d at 840.

[115] *Id.* at 841.

[116] 5 U.S.C. § 706(2)(A).

[117] *Walker River Paiute Tribe*, 68 F. Supp. 3d at 1209 (citation omitted).

[118] *See, e.g., Old Dominion Dairy v. Sec'y of Def.*, 631 F.2d 953, 962-66 (D.C. Cir. 1980); *accord Wisconsin v. Constantineau*, 400 U.S. 433, 437 (1971) ("Where a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential.").

[119] *See, e.g., Doe v. Tenenbaum*, 900 F. Supp. 2d 572, 575 (D. Md. 2012) (enjoining agency's publication of materially inaccurate report about manufacturer's product because the decision to publish the report was "arbitrary and capricious"), *rev'd on other grounds sub nom. Doe v. Pub. Citizen*, 749 F.3d 246 (4th Cir. 2014).

Comment 14

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To avail itself of the remedies sought—namely civil and administrative remedies under the FCA and the Program Fraud Civil Remedies Act (PFCRA), 31 U.S.C. §§ 3801-3812 and civil money penalties under 24 C.F.R. § 30.35—Program Enforcement would be required to show that a claim, written statement, or certification that was made, presented, or submitted to HUD was false, fictitious, or fraudulent as a result of allowing HFA and government-administered DPA funds, and that loanDepot knew or should have known of the falsity of the claim, statement, or certification.[120] It can show neither.

Indeed, even assuming that Program Enforcement could show that a false, fictitious, or fraudulent claim, written statement, or certification was made, presented, or submitted to HUD, Program Enforcement could not possibly show that loanDepot acted with the requisite scienter. To establish a claim under the FCA, the PFCRA, or 24 C.F.R. § 30.35, OIG must show that loanDepot knew or should have known of the falsity of the claim, written statement, or certification, or that loanDepot acted with deliberate ignorance or reckless disregard of the truth or falsity.[121] However, loanDepot reasonably relied upon HUD's own guidance and interpretation of the Guidelines in permitting HFA and government-administered DPA programs.[122]

Likewise, there is no basis to require indemnification on the loans. The simple fact is loanDepot complied with HUD's own Guidelines, as supported by HUD. Moreover, OIG lacks any authority to demand consumer remediation, nor can it direct HUD to require it. The authority of OIG derives exclusively from the IG Act, which establishes Inspectors General (IG) at enumerated federal agencies and defines and limits the authority of those IGs.[123] The audit authority of an IG under the IG Act is limited to conducting audits of the "programs and operations" of the specific "establishment[s]" listed in the Act, including HUD.[124] The authority of OIG to publish reports is similarly limited to reports "concerning fraud or other serious problems, abuses, and deficiencies *relating to the administration of programs and operations administered or financed by such establishment.*"[125] In carrying out those responsibilities, the IG

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[120] *See* FCA, 31 U.S.C. § 3729(a)(1)(A)-(B) (requiring proof of a "false or fraudulent claim"); PFCRA, 31 U.S.C. § 3802(a)(1)-(2) (requiring proof of a "false, fictitious, or fraudulent" claim or written statement); 12 U.S.C. §§ 1735f-14(b)(1)(D), (F), and (b)(2)(A), (B), as incorporated by 24 C.F.R. § 30.35 (requiring proof of "false" information or certification).

[121] *See* FCA, 31 U.S.C. §§ 3729(a)(1)(A)-(B) and 3729(b)(1)(A) (requiring proof that the person acted with "actual knowledge" or acted in "deliberate ignorance" or "reckless disregard" of the truth or falsity of the information); PFCRA, 31 U.S.C. §§ 3802(a)(1)-(2) and 3801(a)(5) (requiring proof that the person had "actual knowledge" or acted in "deliberate ignorance" or "reckless disregard" of the truth or falsity of the information); 12 U.S.C. §§ 1735f-14(b)(1)(D), (F) and (b)(2)(A), (B), and 1735f-14(g), as incorporated by 24 C.F.R. §30.35 (requiring proof that the person had "actual knowledge or should have known" of the acts).

[122] *See* OGC Memo, *supra* n. 4.

[123] 5 U.S.C. App. §§ 2(1), 12(2).

[124] *Id*; 5 U.S.C. App. § 4(a)(1).

[125] 5 U.S.C. App. § 4(a)(5) (emphasis added).

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Act also requires that OIG "comply with standards established by the Comptroller General of the United States for audits of Federal establishments, organizations, programs, activities, and functions."[126] Accordingly, the audit authority of OIG is limited to audits of the operations and activities of HUD. In fact, OIG has no supervisory or enforcement authority for any of the statutes that the GSFA Draft Report indicates were the basis for the review.[127]

IV. Conclusion

For the reasons set forth within this submission, loanDepot disagrees with the findings because the Draft Reports include demonstrably incorrect factual findings and erroneous legal standards. Specifically, DPA programs meet HUD Handbook and Guidelines regarding eligible gifts, premium pricing requirements, and gift fund documentation. Further, the circular funding mechanism addressed by OIG does not invalidate DPA programs on its face. Moreover, fees charged in connection with these programs meet HUD's requirements for "customary and reasonable" fees. Finally, borrowers that received DPA may ultimately pay more with respect to their loan, but not in a manner that runs afoul of HUD requirements.

Comment 6
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The recommendations themselves are unsound factually and legally as they are unable to state an appropriate cause of action and OIG lacks jurisdiction to compel requested relief. In addition, the process by which OIG arrived at its findings in this case is flawed. OIG's audit process violated various requirements of the GAS.

We trust that the information contained in this submission will allow OIG to reconsider their proposed findings and withdraw the faulty reports. To the extent that it does not, we reiterate our request that loanDepot be afforded additional opportunity to discuss the issuance of the Draft Reports.

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[126] *Id.* § 4(b)(1)(A).

[127] *See Consumer Financial Protection Bureau v. Morgan Drexen, Inc.*, SACV 13-1267-JLS, 2014 WL 250604 at 12-13 (C.D. Cal. Jan. 10, 2014) (CFPB has exclusive authority to promulgate regulations under certain consumer protection statutes).

EXHIBITS

A. Statement of Ed Golding, July 20, 2015

B. Office of General Counsel Memorandum, August 11, 2015

C. loanDepot Letter to OIG, September 10, 2015

D. Email from P. MacDonald to T. Schulze, September 16, 2015

E. Letter from National Association of Local Housing Finance Agency, April 19, 2004

Exhibit A

FROM THE DESK OF ED GOLDING

July 20, 2015

FHA's Position on Down Payment Assistance Programs

In light of a recent audit by HUD's Office of Inspector General, I want to take this opportunity to reaffirm FHA's support of certain down payment assistance programs, like those run by State Housing Finance Agencies. These programs help creditworthy families buy their first homes in communities across the country – responsibly expanding access to credit.

The intent of our rules regarding down payment assistance is clear and allows HFAs the discretion necessary to fund these programs appropriately. HUD is taking active steps to completely resolve the issues raised in the audit and to provide proper clarity and guidance to the market.

Here is a link to the audit: https://www.hudoig.gov/sites/default/files/documents/2015-LA-1005.pdf

HUD.gov/FHA

HUD Press Releases

Exhibit B

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

AUG 11 2015

MEMORANDUM FOR: Edward L. Golding, Principal Deputy Assistant Secretary for Housing, H

FROM: Helen Kanovsky, General Counsel, C

SUBJECT: Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs.

You have advised that the audit of NOVA Financial & Investment Corporation by the U.S. Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) has created concerns about the propriety of certain Downpayment Assistance (DPA) programs being operated by various governmental entities, including Housing Finance Agencies. Specifically, you requested guidance concerning whether a governmental entity's use of FHA mortgages with arguably higher than market interest rates in its DPA program represents "premium pricing" as defined by Federal Housing Administration (FHA) requirements. Additionally, you asked whether a practice of raising funds in this manner by governmental entities to provide DPA is permissible under FHA requirements.

First, FHA's Interpretative Rule, Docket No. FR-5679-N-01, published on December 5, 2012 and Mortgagee Letter 2013-14, published on May 9, 2013 superseded previous FHA guidance in regards to governmental entities DPA programs. Second, neither the Interpretative Rule nor the Mortgagee Letter placed restrictions on how a governmental entity may fund its DPA programs. Finally, the use of funds derived from the sale of mortgages with higher than market interest rates does not constitute premium pricing as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities.

Permissible Source of Funds for Downpayment Assistance Programs

Governmental entities are a permissible source of funds for a borrower's Minimum Cash Investment. FHA's interpretation of section 203(b)(9)(C) of the National Housing Act provides that FHA is not prohibited from insuring mortgages originated as part of a governmental entities DPA programs when the entity directly provides funds toward the required Minimum Cash Investment. This interpretive rule placed no restrictions on how governmental entities acquired the funds used for their respective DPA programs. In fact, the interpretive rule specifically mentioned and recognized various ways governmental entities currently raise funds for their respective DPA programs – such as public funds, tax revenue, taxable and tax exempt general obligation bonds, and housing bonds. Further, the interpretative rule did not prohibit nor preclude governmental entities from raising funds through other means such as the sale of mortgages on the secondary market.

Subsequent to the interpretive rule, FHA issued Mortgagee Letter 2013-14, which provided additional guidance to mortgagees on how to document the funds used for DPA provided as well as guidance on secondary financing by a Federal, State, or local governments or their agencies or

instrumentalities. This Mortgagee Letter did not place any restrictions or prohibitions on how a governmental entity could raise funds to fund its DPA program.

FHA's determination not to place restrictions or prohibitions on how a governmental entity raises funds to support its DPA programs through either the Interpretive Rule or the Mortgagee Letter is in keeping with FHA's previous guidance. FHA's Handbook 4155.1.5. B.4.b concerning the source of funds for a gift specifically states that "FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction." Further, as the Interpretative Rule and the Mortgagee Letter are the later enacted, they supersede any previous guidance that arguably may conflict. FHA does not place restrictions or prohibitions on how a governmental entity elects to raise funds to support its DPA program and governmental entities may directly provide funds for a borrower's Minimum Cash Investment.

Premium Pricing

Section 203(b)(5) of the National Housing Act provides that the interest rate on an FHA insured mortgage is to be agreed upon by the borrower and the lender. Regulation 24 C.F.R. §203.20 similarly provides that the borrower and the lender are to agree upon the mortgage interest rate. FHA does not regulate interest rates and cannot regulate interest rates.

FHA's current guidance does not prohibit premium pricing. FHA guidance does, however, restrict how a credit to the borrower, as a result of premium pricing, may be used. FHA permits the credit to be applied towards a borrower's closing costs or other prepaid items, but does not permit the credit to be used towards the borrower's downpayment. If the resulting credit exceeds the amount of actual closing costs or prepaid items, HUD requires the lender to reduce the principal balance of the mortgage.

There is no violation of FHA restrictions on premium pricing where the rates agreed upon by borrower and lender are generally the rates available to homebuyers participating in DPA programs. Similarly, there is also no violation of FHA restrictions on premium pricing where any apparent increased interest rate did not result in a corresponding credit to the borrower.

NOVA Audit

Based on the above legal analysis, we do not see any basis to challenge the legality of NOVA's DPA programs. Because the practices engaged in by NOVA do not represent premium pricing as defined by FHA requirements, and because FHA does not restrict the source of the funds used for the DPA provided by governmental entities, we cannot support the OIG's conclusion that NOVA violated FHA requirements concerning premium pricing or the provision of gifts. Please let me know if you have any further questions concerning this matter.

Exhibit C

Buckley Sandler LLP

Michelle L. Rogers
Partner
1250 24th Street NW, Suite 700
Washington, DC 20037
t 202.349.8013
mrogers@buckleysandler.com

September 10, 2015

VIA EMAIL AND OVERNIGHT MAIL

Tanya E. Schulze, Regional Inspector General for Audit
Vincent Mussetter, Assistant Regional Inspector General for Audit
HUD-OIG Office of Audit
611 West 6th Street, Suite 1160
Los Angeles, CA 90017

Martin D. Herrera, Assistant Regional Inspector General for Audit
HUD-OIG Office of Audit
One North Central Avenue, Suite 600
Phoenix, AZ 85004

Re: loanDepot – GSFA Draft Audit Report

Dear Ms. Schulze and Mssrs. Herrera and Mussetter:

On behalf of loanDepot, LLC (the "Company"), this letter requests an extension of time to respond to the Discussion Draft Audit Report ("GSFA Draft Report") provided to the Company on September 3, 2015.

The Company has been given a mere nine business days – until September 17, 2015 – to submit formal comments to the 23-page report that HUD's Office of Inspector General ("OIG") took five months to develop and issue. Given the seriousness of the findings – which include seeking more than $20 million in indemnifications and recommending potential fines and penalties – the Company requests a two-week extension, until October 1, 2015, to submit its response.[1]

We fail to understand OIG's refusal to grant an extension to time to respond to the report, reflecting what appears to be a rush to finalize a report that is both factually and legally flawed. Indeed, this not only raises concern about the manner and degree to which the Company's response will be considered, but it is particularly troubling given materials recently issued by both HUD's Office of Housing and HUD's Office of General Counsel ("OGC"), both of which contradict and, in fact, expressly reject the conclusions in the

[1] The Company also anticipates receiving a second draft audit report in the coming days. While the Company believes it would be more efficient for all parties to respond to both reports at the same time, and therefore originally requested an extension through October 17, 2015, OIG has denied that request. Thus, the Company is seeking this extension for the GSFA Draft Report and anticipates seeking a similar extension when it receives the subsequent report, depending on the substance and size of that draft.

GSFA Draft Report. Specifically, on July 20, Ed Golding, Principal Deputy Assistant Secretary of the Office of Housing, released a statement "reaffirm[ing] FHA's support of certain down payment assistance programs, like those run by State Housing Finance Agencies," going on to say that "the intent of [the] rules regarding down payment assistance is clear and allows HFAs the discretion necessary to fund these programs appropriately."[2] Just weeks later, OGC released a memorandum ("OGC Memo") expressly endorsing the legality of Down Payment Assistance ("DPA") programs and rejecting the arguments HUD-OIG makes in the GSFA Draft Report.[3] In its opinion, OGC counseled that "the use of funds derived from the sale of mortgages with higher than market interest rates does not constitute premium pricing as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities." The GSFA Draft Report fails to mention either document.

Finally, denying the Company a meaningful opportunity to respond to the findings of the GSFA Draft Report is not only concerning given the weakness of OIG's position, it also violates basic due process requirements. In the context of governmental action, due process requires, at a minimum, both appropriate notice and a meaningful opportunity to be heard before the government may determine facts or pronounce judgment. Notice already is lacking given OIG's new interpretation of HUD's program, which HUD itself has already rejected. Denying loanDepot a sufficient opportunity to respond would be a further violation of basic constitutional due process requirements, and would be an arbitrary and capricious agency action in violation of law.[4]

* * *

We are hopeful that HUD will reconsider the requested extension, given the above. If you have any questions in the meantime, please do not hesitate to contact me. We look forward to your response.

Sincerely,

Michelle L. Rogers

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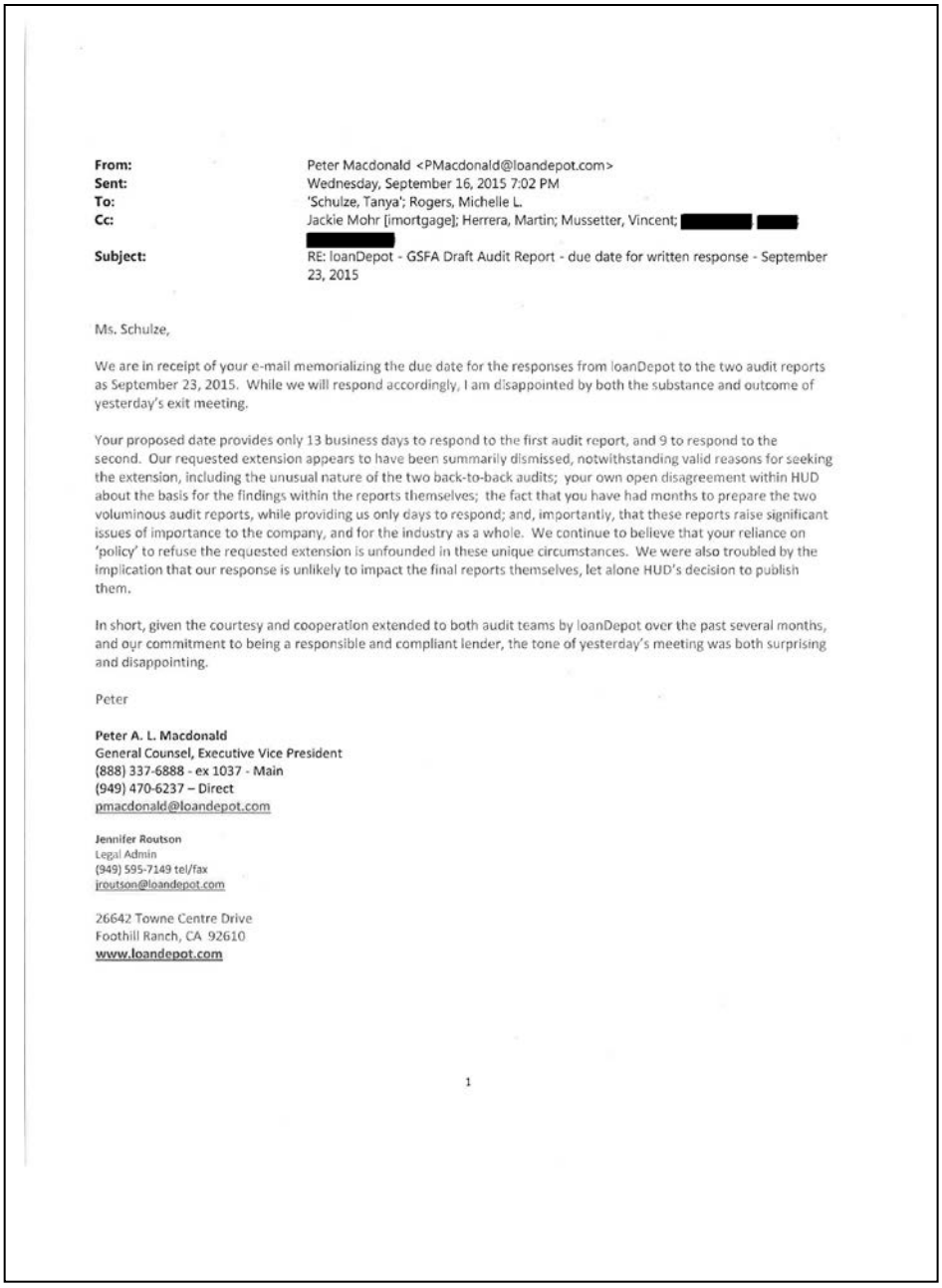
[2] Ed Golding Statement, July 20, 2015, *available at* http://www.calhfa.ca.gov/HUDOpinionEdGolding07-20-15.pdf.
[3] A copy of the memorandum is attached for your reference, and is available at http://portal.hud.gov/hudportal/documents/huddoc?id=prmssrcefndsgoventdpa.pdf.
[4] Similarly, despite OIG's apparent eagerness to finalize and issue a report, as the Company will also address in greater detail in its response, making such findings public not only will risk unfounded reputational harm to the Company, but would also be arbitrary and capricious and a due process violation.

cc: Edward L. Golding, Principal Deputy Assistant Secretary for Housing
Dane M. Narode, Associate General Counsel for Program Enforcement
Kathleen A. Zadareky, Deputy Assistant Secretary for Single Family Housing
Joy L. Hadley, Director, Office of Lender Activities and Program Compliance
Justin D. Burch, Director, Quality Assurance Division
Jeremy Kirkland, Counsel to the Inspector General
Peter Macdonald, General Counsel, loanDepot

Exhibit D



From: Peter Macdonald <PMacdonald@loandepot.com>
Sent: Wednesday, September 16, 2015 7:02 PM
To: 'Schulze, Tanya'; Rogers, Michelle L.
Cc: Jackie Mohr [imortgage]; Herrera, Martin; Mussetter, Vincent; [redacted]
Subject: RE: loanDepot - GSFA Draft Audit Report - due date for written response - September 23, 2015

Ms. Schulze,

We are in receipt of your e-mail memorializing the due date for the responses from loanDepot to the two audit reports as September 23, 2015. While we will respond accordingly, I am disappointed by both the substance and outcome of yesterday's exit meeting.

Your proposed date provides only 13 business days to respond to the first audit report, and 9 to respond to the second. Our requested extension appears to have been summarily dismissed, notwithstanding valid reasons for seeking the extension, including the unusual nature of the two back-to-back audits; your own open disagreement within HUD about the basis for the findings within the reports themselves; the fact that you have had months to prepare the two voluminous audit reports, while providing us only days to respond; and, importantly, that these reports raise significant issues of importance to the company, and for the industry as a whole. We continue to believe that your reliance on 'policy' to refuse the requested extension is unfounded in these unique circumstances. We were also troubled by the implication that our response is unlikely to impact the final reports themselves, let alone HUD's decision to publish them.

In short, given the courtesy and cooperation extended to both audit teams by loanDepot over the past several months, and our commitment to being a responsible and compliant lender, the tone of yesterday's meeting was both surprising and disappointing.

Peter

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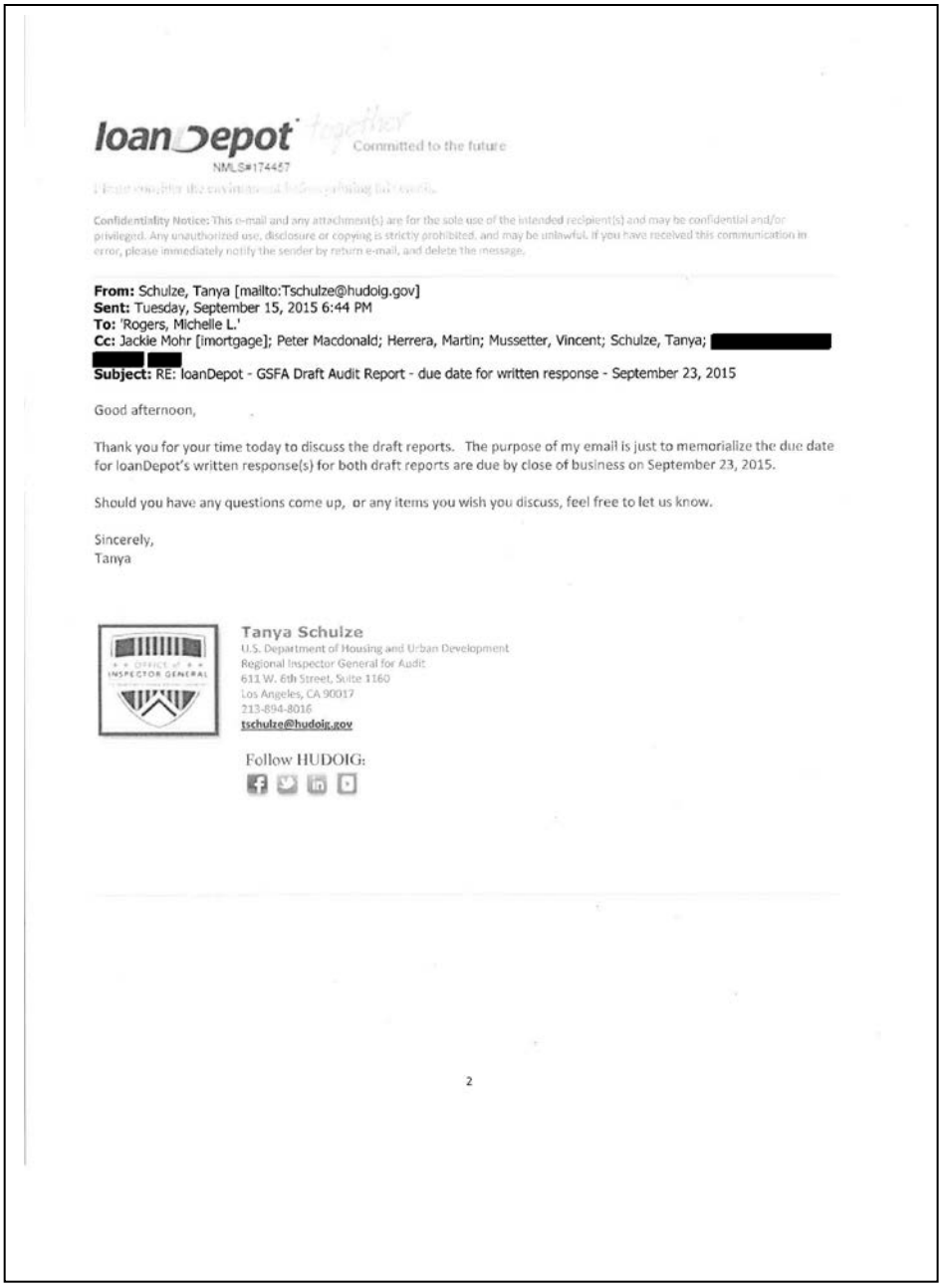
* Names redacted for privacy reasons



loanDepot together
Committed to the future
NMLS#174457

From: Schulze, Tanya [mailto:Tschulze@hudoig.gov]
Sent: Tuesday, September 15, 2015 6:44 PM
To: 'Rogers, Michelle L.'
Cc: Jackie Mohr [imortgage]; Peter Macdonald; Herrera, Martin; Mussetter, Vincent; Schulze, Tanya; [redacted]
Subject: RE: loanDepot - GSFA Draft Audit Report - due date for written response - September 23, 2015

Good afternoon,

Thank you for your time today to discuss the draft reports. The purpose of my email is just to memorialize the due date for loanDepot's written response(s) for both draft reports are due by close of business on September 23, 2015.

Should you have any questions come up, or any items you wish you discuss, feel free to let us know.

Sincerely,
Tanya

Tanya Schulze
U.S. Department of Housing and Urban Development
Regional Inspector General for Audit
611 W. 6th Street, Suite 1160
Los Angeles, CA 90017
213-894-8016
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Follow HUDOIG:

2

* Names redacted for privacy reasons

Exhibit E

NALHFA
National Association of Local Housing Finance Agencies

2025 M Street, N.W., Suite 800
Washington, DC 20036-3309
Phone: (202) 367-1197
Fax: (202) 367-2197
www.nalhfa.org

April 19, 2004

John Coonts
Deputy Assistant Secretary
Office of Single Family Housing
U.S. Department of Housing and
Urban Development
Room 9282
451 7th Seventh St., SW
Washington, DC 20410

Dear Mr. Coonts:

It has come to my attention that your Office is considering reaching a conclusion that tax-exempt mortgage revenue bonds using a premium bond structure, where the bond premium is used to make downpayment assistance in the form of an outright grant (or gift), would not qualify for FHA mortgage insurance. On behalf of the members of the National Association of Local Housing Finance Agencies (NALHFA), I and all of the industry participants with whom I've spoken are extremely concerned about such a potential conclusion.

The use of premium bonds to create downpayment assistance grants dates at least from 1993, and has been employed by numerous local and state housing issuers across the country. According to one NALHFA member, it is by far the most common type of single family structure in the marketplace today. Hundreds of bond issues, with total principal amount of probably more than a billion dollars, are issued and outstanding under this structure. Moreover, there are bond issues being priced as I write and lending programs across the country currently making loans under this structure.

My reading of Section 2-10(C) of the FHA Single Family underwriting handbook indicates that an outright gift of the cash investment is acceptable if the donor is a government agency or a public entity that has a program to provide homeownership assistance to low-and moderate-income homebuyers, the gift funding is not from the seller of the property, and no repayment of the gift is expected or implied. This is exactly how these programs are structured; for example, if the homebuyer sells or refinances the mortgage loan, no repayment of the gift is required and the homebuyer retains the entire gift. It is true that

the mortgage loan rate is higher due to the premium bond rate but this rate applies only to the mortgage loan and there is no requirement to repay the grant directly or indirectly. It is my further understanding that this structure is so universally utilized that, based on the handbook, there are no approvals needed unless the issuer is structuring the program to require a second mortgage to recover the assistance.

Should you reach this conclusion, it would cause a huge disruption in the bond market with untold consequences. I strongly urge you to reconsider your position, and provide instead a written affirmation that mortgages funded from the proceeds of a premium bond structure meeting the requirements of Section 2-10(C) qualify for FHA mortgage insurance.

Thank you for your favorable consideration of NALHFA's views.

Sincerely,

John C. Murphy
Executive Director

OIG Evaluation of Auditee Comments

Comment 1 OIG disagrees with loanDepot's conclusion that the audit report reached incorrect findings, based on flawed analyses, or that it conducted its due diligence when originating FHA loans with downpayment assistance. The report findings were based on a thorough analysis of available loan documents, agreements, and interviews. A determination was made, based on the plain writing of HUD requirements, that loans originated by loanDepot containing downpayment assistance gifts provided by the GSFA were not eligible for FHA mortgage insurance. loanDepot was obligated as the lender to conduct its due diligence to ensure that planned downpayment assistance gifts met the requirements described in HUD Handbook 4155.1.

- OIG disagrees with loanDepot's assertion that the audit report relies on an incorrect definition of premium pricing. OIG relied on the plain language writing of the requirements on premium pricing. HUD Handbook 4155.1 5.A.2.i does define premium pricing and does not specify that the premium pricing be initiated through the lender; it simply states that a premium priced mortgage may never be used to pay any portion of the borrower's downpayment. In this manner, OIG is not reinterpreting the requirement, only applying it as it is written.

- As discussed in the audit report, OIG determined that premium pricing did exist when the borrower was given a premium interest rate in exchange for downpayment assistance. The funds derived from a premium priced mortgage may never be used to pay any portion of the borrower's downpayment (HUD Handbook 4155.1 5.A.2.i). Where premium pricing is used to pay any portion of the borrower's downpayment, the loan would be ineligible even where the source of the downpayment is considered acceptable to HUD, such as a housing finance agency. Premium pricing is only permitted by HUD to allow lenders to pay a borrower's closing costs, and/or prepaid items. In this case, the premium pricing was solely to enable the sale of the increased market value bundled loans (mortgage backed securities) to recapture the downpayment assistance and the programs' operating costs and to fund future downpayment assistance. This is an ineligible use.

- In order for funds to be considered a gift, there must be no expected or implied repayment of the funds to the donor by the borrower (HUD Handbook 4155.1 5.B.4.a). To receive downpayment assistance, borrowers had to agree to mortgage interest rates (premium rates) that were above the prevailing market rate of interest for FHA mortgages without downpayment assistance. The borrowers will pay back a substantial portion of the downpayment assistance "gift" through higher mortgage payments over the life of the loan and the required premium interest rate enabled housing finance agency reimbursement upon the

subsequent bundled mortgage backed security sale. Therefore, repayment was expected and/or implied. In its response, loanDepot cites HUD's legal opinion (exhibit B of their response) as evidence the gifts met HUD requirements. However, the legal opinion failed to address HUD's requirements on what constitutes a gift.

- loanDepot argues the interest rate is based on various factors, including borrower risk and HUD's tiered pricing rule. While OIG agrees a mortgage interest rates involve various factors, and do fluctuate, we disagree borrower risk explains the higher interest rates in this circumstance. The premium rates in the loans identified in the audit report were the direct result of borrower participation in the Golden State downpayment assistance program, as loanDepot did not determine the rates in question; they were determined by the Golden State. loanDepot is incorrect in asserting that borrowers could forego the downpayment assistance to obtain a lower rate. As admitted by loanDepot, borrowers receiving downpayment assistance would not otherwise qualify for an FHA loan. Therefore, borrowers did not have the option to forego the downpayment assistance to obtain a rate closer to the market rate. loanDepot's statements on tiered pricing do not indicate that a lender can bypass requirements on premium pricing and gift funds. The audit report does not state that the premium pricing is in violation of HUD requirements simply because there is a variance in the interest rate. In this case, premium pricing is in violation of HUD requirements as it is used to pay for a borrower's downpayment assistance.

Comment 2 Like loanDepot, OIG recognizes housing finance agencies provide homeownership opportunities to low and moderate income families. However, OIG disagrees with the assertion that the audit report is not consistent with, reinterprets and contradicts clear and binding HUD guidance related to housing finance agencies and downpayment assistance programs. OIG does not disagree with Interpretative Rule Docket No. FR-5679-N-01 and Mortgagee Letter 2013-14 that housing finance agencies, as instrumentalities of State or local governments, may provide downpayment assistance. The audit report did not dispute housing finance agencies are an acceptable source of funds. However, FHA loans that contain downpayment assistance from a housing finance agency must meet all HUD requirements, including those on premium pricing and the definition of gift funds.

Neither HUD's interpretive ruling nor its related Mortgagee Letter 2013-14 contemplate the use of premium pricing by a lender to reimburse the housing finance agency. The Housing and Economic Recovery Act of 2008 amended Section 203(b)(9)(C) of the National Housing Act to preclude the abuse of the program where a seller (or other interested or related party) funded the homebuyer's cash investment after the closing by reimbursing third-party entities, including, specifically, private non-profit charities. Similarly, it would be

contrary to the intended purpose of the Housing and Economic Recovery Act to allow a local governmental entity to do the very same thing.

Comment 3 OIG disagrees with loanDepot's assertion that the bond-funding fee and bond settlement fee are legitimate fees imposed as part of the downpayment assistance programs, including the Golden State program. In its analysis, loanDepot incorrectly compares the fees of the FHA loans in the audit report to other loans with downpayment assistance. The fees must be reasonable and customary for FHA loans, independent of other programs used by the lender; the fact that the loans contain downpayment assistance is not relevant. HUD Handbook 4155.2 6.A.3.d states that the appropriate HUD Homeownership Center may reject charges, based on what is reasonable. The Santa Ana HUD Homeownership Center issued a referral of a separate lender to OIG on April 18, 2014. In that referral, HUD determined that bond commitment fees and transfer fees were not usual and customary. Similarly, OIG determined the bond funding fees charged to FHA borrowers were not reasonable or customary, see appendix E of the audit report. Although loanDepot states that the combined fees ranged from $200 to $450 in its response, the fees actually ranged from $150 to $300, however, totals in appendix E table were higher as some loans contained more than one ineligible fee. A footnote was added to the audit report for clarification.

Comment 4 OIG strongly disagrees with loanDepot when it states OIG cannot disagree with HUD, the audit process and audit report violate Government Audit Standards and has omitted relevant facts. The audit report details OIG's review of loanDepot, not of HUD or its policies. As such, OIG determined the audit report was not the proper forum to discuss HUD's disagreement or legal opinion. The audit was conducted in accordance with generally accepted government auditing standards and was written based on facts, documentation, analyses, and interviews of loanDepot and Golden State employees. OIG has also had numerous discussions with HUD regarding the issues raised in the audit report. Up to this point, OIG has not been provided compelling evidence to change the substance of the audit report. Where HUD disagrees with OIG's findings, there is a clear and specific audit resolution process. OIG cannot control HUD's premature publication of a letter and a legal opinion (see exhibits A and B of loanDepot's response) that publicly disagrees with OIG's findings before any audit resolution has taken place. The letter from HUD, dated July 20, 2015, does not provide specific guidance. Rather, it only reaffirms the position that housing finance agencies can provide downpayment assistance; a position OIG has never disputed. OIG also believes HUD's legal opinion does not fully address the downpayment assistance issue related to gifts.

OIG also disagrees with loanDepot's assertion that OIG exceeds its mandated authority. The Inspector General Act of 1978 does not state that OIG cannot disagree with and must adhere to all HUD interpretations. Doing so would severely limit and minimize OIG's independence and duty to the United States Congress and other key stakeholders. The Act was created to provide Inspector

General's the authority to conduct and supervise audits relating to the programs and operations of HUD. This authority also includes providing leadership and coordination and recommending policies for activities designed (A) to promote economy, efficiency, and effectiveness in the administration of, and (B) to prevent and detect fraud and abuse in such programs and operations. To that end, OIG is well within its authority to make recommendations to HUD based on the findings as detailed in the audit report, including recommendations for indemnification and a review for potential civil and/or administrative remedies.

Comment 5 OIG disagrees with loanDepot's statement that it was not provided due process and was not given adequate time to review and respond to the audit report. It is OIG's standard practice to provide auditees 10 to 15 days to respond to a discussion draft audit report. Extensions are granted at the discretion of the Regional Audit Manager; however, loanDepot did not provide a compelling reason for a significant extension. loanDepot was aware of the downpayment assistance issues identified in the audit report well before they were required to provide comments on September 23, 2015. As early as July 17, 2015, loanDepot became aware of an OIG audit report, 2015-LA-1005 issued July 9, 2015, that had a similar finding related to housing finance agency downpayment assistance programs. That audit report discussed premium pricing, the definition of gift funds, and housing finance agency funding structures. In addition, OIG provided a finding outline to loanDepot on August 11, 2015 that contained language similar to what appears in the audit report. The discussion draft report was provided to loanDepot on September 3, 2015 with a due date to comment of September 17, 2015. loanDepot was therefore aware of the issues for over two months before the due date for comments. loanDepot initially requested an extension of 4 weeks, or until October 17, 2015. During the exit conference, loanDepot reduced their request to two weeks, or October 1, 2015. OIG provided an extension from September 17, 2015 to September 23, 2015; an increase from 15 to 21 days.

Comment 6 loanDepot requested that OIG withhold publication of the audit report based on the seriousness of the findings and reasoning set forth in its response. OIG has determined not to withhold publication of the audit report as the response provided by loanDepot did not contain sufficient mitigating factors or supporting documents that would significantly change the facts of the findings. OIG included loanDepot's response in its entirety in appendix B of the audit report, including exhibits.

Comment 7 loanDepot argues that the audit does not support monetary penalties. OIG disagrees with this assessment. The audit report is supported by facts and documented evidence. The recommendations, including indemnification, are appropriate given the material nature of the finding that FHA loans were not eligible for mortgage insurance. Although loanDepot is correct with regard to the amount of claims, the monetary values associated with the recommendations stem from material deficiencies and as such, OIG has responsibly illustrated the potential risk to the FHA Single Family Mortgage Insurance program.

Comment 8 OIG disagrees with loanDepot's statement that OIG is rewriting HUD guidance and applies a retroactive enforcement process. OIG used the plain language of HUD requirements on premium pricing and gift funds to make audit conclusions. These requirements were in effect at the time the loans in question were originated. The report's recommendations are not enforcement, but recommendations to HUD to take appropriate corrective action on loan deficiencies that occurred and minimize future risk. See comments 2 and 4.

Comment 9 loanDepot's statement that borrowers do not have any obligation to repay the downpayment assistance funds to the housing finance agency is not correct. The borrowers will pay back the downpayment assistance "gift", in whole or in part, through higher mortgage payments over the life of the loan and the required premium interest rate which enabled housing finance agency reimbursement upon the subsequent bundled mortgage backed security sale. Therefore, repayment was expected and/or implied. Further, loanDepot admits that the downpayment assistance programs are funded in whole or in part from the capital markets through the sale of mortgage backed securities that are backed by the program loans. The premium interest rate is the instrument that allows the program to be funded and structured as is. The premium interest rate, allows the housing finance agencies to sell bundled mortgage backed securities at a higher price. See comment 1.

Comment 10 loanDepot states it located supporting documents to evidence gift funds were documented appropriately, however, that supporting documentation was not provided to OIG. Therefore, loanDepot should provide the supporting documents to HUD for review during audit resolution.

Comment 11 The discussion of secondary financing and discount fees are not part of this audit report. Refer to audit report 2015-LA-1009 for OIG's response.

Comment 12 OIG disagrees with loanDepot's characterization of a 2004 letter to HUD from the National Association of Local Housing Finance Agencies (included as exhibit E in its response). The letter in no way indicated support from HUD and only discussed mortgage revenue bonds, not mortgage backed securities that are discussed in the audit report. Absent from the letter is any type of guidance, approval, or regulations from HUD specifically indicating that premium pricing in relation to downpayment assistance is acceptable. In fact, the letter begins by stating that HUD has had concerns about this type of program, which also included a premium rate, dating back to at least 2004.

Comment 13 OIG disagrees with loanDepot's assertion that OIG's statistical sample is not sufficient when making audit projections and conclusions. OIG is an independent audit and investigative agency and as such has the authority to determine the most appropriate method to review FHA loans, including utilizing a statistical sample. Audits conducted by OIG can be very different than those conducted by HUD;

comparing the two is not relevant. OIG has no obligation to use the methodologies used by HUD when selecting samples to review FHA loans. Statistical sampling is a valid approach and was conducted in accordance with generally accepted government auditing standards. As stated in the audit report, OIG selected a stratified, systematic, statistical sample of 75 loans to determine whether loanDepot originated FHA loans containing Golden State downpayment assistance gifts in accordance with HUD FHA requirements. The sample was designed to detect ineligible loans and estimate the total number of loans and the associated dollar amount of loans with the same deficiencies in the audit universe. In addition, the sample projected the dollar amount of loans affected in a 1-year period following the audit universe timeframe, along with the dollar amount predicted if a review of the 233 remaining loan records in the audit universe was conducted. See comment 4.

With regard to recommendation 1C, the audit report recommends indemnification for those loans that are determined to contain ineligible downpayment assistance; rendering the loans ineligible for FHA mortgage insurance. The recommendation asks HUD to review the 233 loans to make that determination.

Comment 14 OIG disagrees with loanDepot's statement that the recommendations are unfounded. OIG's recommendations are fully supported by documents, analyses, and interviews. As stated earlier, the audit recommendations are not enforcement. The recommendations are addressed to HUD and must go through a well-established audit resolution process. With regard to recommendation 1A, it asks HUD's Associate General Counsel for Program Enforcement to review the facts as stated in OIG's report to make a determination whether civil and/or administrative remedies should be pursued. See comments 1 and 8.

Appendix C

Criteria

HUD Handbook 4155.1

Paragraph 2.A.2.a. Maximum Mortgage Amount for a Purchase
In order for FHA to insure this maximum loan amount, the borrower must make a required investment of at least 3.5% of the lesser of the appraised value or the sales price of the property.

Paragraph 2.A.2.c. Closing Costs as Required Investment
Closing costs (non-recurring closing costs, pre-paid expenses, and discount points) may *not* be used to help meet the borrower's minimum required investment.

Paragraph 5.A.1.a. Lender Responsibility for Estimating Settlement Requirements
For each transaction, the lender must provide the initial Good Faith Estimate, all revised Good Faith Estimates and a final HUD-1 *Settlement Statement*, consistent with the Real Estate Settlement Procedures Act, to determine the cash required to close the mortgage transaction.

In addition to the minimum downpayment requirement described in HUD Handbook 4155.1 5.B.1.a, additional borrower expenses must be included in the total amount of cash that the borrower must provide at mortgage settlement. Such additional expenses include, but are not limited to closing costs, such as those customary and reasonable costs necessary to close the mortgage loan, discount points, and premium pricing on FHA-insured mortgages.

Paragraph 5.A.2.a. Origination Fee, Unallowable Fees, and Other Closing Costs
Lenders may charge and collect from borrowers those customary and reasonable costs necessary to close the mortgage loan. Borrowers may not pay a tax service fee.

Paragraph 5.A.2.i. Premium Pricing on FHA-Insured Mortgages
The funds derived from a premium priced mortgage may *never* be used to pay any portion of the borrower's downpayment and *must* be disclosed on the GFE [good faith estimate] and HUD-1 Settlement Statement.

Paragraph 5.B.1.a. Closing Cost and Minimum Cash Investment Requirements
Under most FHA programs, the borrower is required to make a minimum downpayment into the transaction of at least 3.5% of the lesser of the appraised value of the property or the sales price.

Paragraph 5.B.4.a. Description of Gift Funds
In order for funds to be considered a gift, there must be no expected or implied repayment of the funds to the donor by the borrower.

Paragraph 5.B.5.b. Documenting the Transfer of Gift Funds
The lender must document the transfer of the gift funds from the donor to the borrower.

Paragraph 5.B.4.d. Lender Responsibility for Verifying the Acceptability of Gift Fund Sources
Regardless of when gift funds are made available to a borrower, the lender *must* be able to determine that the gift funds were *not* provided by an unacceptable source, and were the donor's own funds.

HUD Handbook 4155.2

Paragraph 6.A.3.a. Collecting Customary and Reasonable Fees
The lender may only collect fair, reasonable, and customary fees and charges from the borrower for all origination services. FHA will monitor to ensure that borrowers are not overcharged. Furthermore, the FHA Commissioner retains the authority to set limits on the amount of any fees that a lender may charge a borrower(s) for obtaining an FHA loan.

Paragraph 6.A.3.d. Rejecting Charges and Fees
The appropriate Homeownership Center may reject charges, based on what is reasonable and customary for the area.

12 U.S.C. 1709(b)(9)(C)
In no case shall the funds required by subparagraph (A) consist, in whole or in part, of funds provided by any of the following parties before, during, or after closing of the property sale: (i) The seller or any other person or entity that financially benefits from the transaction. (ii) Any third party or entity that is reimbursed, directly or indirectly, by any of the parties described in clause (i).

24 CFR Part 203, Docket No. FR-5679-N-01
The Housing and Economic Recovery Act of 2008 amended Section 203(b) to include a new subparagraph (9)(C), which specifies prohibited sources for a mortgagor's minimum investment. Section 203(b)(9)(C) of the NHA states:

> Prohibited Sources. In no case shall the funds required by subparagraph (A) consist, in whole or in part, of funds provided by any of the following parties before, during, or after closing of the property sale:
>
> (i) The seller or any other person or entity that financially benefits from the transaction.
>
> (ii) Any third party or entity that is reimbursed, directly or indirectly, by any of the parties described in clause (i).

Mortgage Letter 2013-14
This Mortgagee Letter sets forth the documentation mortgagees must provide to demonstrate eligibility for FHA mortgage insurance of loans when a Federal, State, or local government, its agency or instrumentality directly provides the borrower's required Minimum Cash Investment in accordance with the principles set forth in the December 5, 2012 Interpretive Rule ("Interpretive Rule"), Docket No. FR-5679-N-01.

Appendix D

Summary of Loans With Ineligible Downpayment Assistance

FHA loan information				Items not documented properly		Funds derived from premium-priced mortgage not disclosed	
Case number	Original mortgage amount	Status [23]	Unpaid loan balance	Gift letter	Gift transfer	HUD-1	Good faith estimate
043-9219971	$ 174,775	R	$ 172,809	-	-	X	X
043-9321851	230,743	A	225,958	X	-	X	X
043-9327979	167,902	R	165,369	X	-	X	X
043-9397600	164,957	A	162,628	-	-	X	X
043-9429912	204,232	A	201,616	-	-	X	X
043-9490484	194,904	A	193,350	-	-	X	X
043-9496079	197,849	T	196,801	-	-	X	X
045-7994654	233,433	A	226,780	-	X	X	X
045-8002078	193,649	A	188,699	-	-	X	X
045-8017644	124,913	A	121,818	-	-	X	X
045-8061211	214,051	A	208,208	-	-	X	X
045-8061496	132,063	A	128,612	-	-	X	X
045-8067250	245,422	A	238,427	-	-	X	X
045-8068471	241,544	A	234,660	-	-	X	X
045-8075017	115,371	A	112,575	-	-	X	X
045-8080119	93,279	A	90,895	-	X	X	X
045-8082112	127,645	A	124,655	-	-	X	X
045-8086192	176,739	R	172,824	-	-	X	X
045-8088158	257,744	T	-	-	-	X	X
045-8090621	263,289	A	257,256	-	-	X	X
045-8090802	179,685	A	175,355	-	-	X	X
045-8094471	181,649	A	177,812	X	-	X	X
045-8097280	204,723	A	200,000	-	-	X	X
045-8103929	116,068	A	113,661	X	-	X	X
045-8106399	132,456	R	130,062	X	-	X	X
045-8112710	223,349	A	219,015	-	-	X	X
045-8120492	150,228	A	147,313	-	-	X	X

[23] A = active, R = refinanced, T = terminated

FHA loan information				Items not documented properly		Funds derived from premium-priced mortgage not disclosed	
Case number	Original mortgage amount	Status [23]	Unpaid loan balance	Gift letter	Gift transfer	HUD-1	Good faith estimate
045-8123430	106,043	A	104,031	X	-	X	X
045-8130398	150,228	R	148,107	X	-	X	X
045-8134217	211,105	A	207,289	-	-	X	X
045-8143776	166,920	A	163,903	-	-	X	X
045-8146579	162,011	A	158,882	-	-	X	X
045-8148216	137,464	A	135,161	X	-	X	X
045-8148931	170,847	A	167,985	-	-	X	X
045-8153347	276,744	A	271,681	-	-	X	X
045-8156705	270,558	R	267,445	-	-	X	X
045-8162253	152,192	A	149,844	-	-	X	X
045-8170727	76,587	A	75,405	-	-	X	X
045-8174403	152,192	R	150,044	-	-	X	X
045-8174931	117,826	A	116,163	-	-	X	X
045-8177142	195,395	A	192,637	-	-	X	X
045-8186295	240,562	A	236,851	-	-	X	X
045-8195579	159,458	A	157,416	-	-	X	X
045-8197065	201,286	A	198,708	-	-	X	X
045-8199746	111,935	A	110,368	-	-	X	X
045-8206269	219,117	A	216,835	-	-	X	X
045-8216010	163,975	A	162,089	-	-	X	X
045-8221771	171,338	A	169,589	-	-	X	X
045-8221887	189,405	A	187,291	-	-	X	X
045-8223460	186,558	A	184,654	-	-	X	X
045-8230093	196,278	A	194,136	-	-	X	X
045-8231546	201,286	A	198,939	-	-	X	X
045-8234378	255,290	A	252,689	-	-	X	X
045-8237707	162,011	A	160,719	-	-	X	X
045-8242526	156,120	A	154,665	-	-	X	X
045-8251216	206,196	A	204,552	-	-	X	X
045-8254127	107,025	A	106,171	-	-	X	X
045-8265171	139,428	A	138,417	-	-	X	X
045-8279821	104,080	A	103,325	-	-	X	X
048-7769413	230,743	A	224,713	-	-	X	X

FHA loan information				Items not documented properly		Funds derived from premium-priced mortgage not disclosed	
Case number	Original mortgage amount	Status [23]	Unpaid loan balance	Gift letter	Gift transfer	HUD-1	Good faith estimate
048-7941417	162,501	A	159,564	-	-	X	X
048-7949768	299,475	R	295,247	-	-	X	X
048-8034545	228,779	A	225,849	-	-	X	X
048-8042558	139,918	A	138,126	-	-	X	X
048-8096947	296,530	R	293,766	X	-	X	X
197-6707636	176,739	A	173,545	-	-	X	X
197-6720684	147,283	R	145,204	-	-	X	X
197-6734517	235,653	R	232,635	-	-	X	X
197-6738907	220,924	A	216,882	-	-	X	X
197-6739668	206,196	R	203,824	-	-	X	X
197-6773805	147,283	A	145,011	-	-	X	X
197-6790922	149,737	A	147,427	X	-	X	X
197-6822482	151,603	A	149,859	-	-	X	X
331-1631642	159,065	A	155,553	-	-	X	X
332-5861808	78,551	A	76,886	-	-	X	X
Ineligible loans [24]	**$ 11,498,367**	**-**	**$ 11,061,603**	**9**	**1**	**62**	**62**
Minimum required investment met [25]	**$ 1,534,195**	**-**	**$ 1,506,314**	**1**	**1**	**10**	**10**
Loans without ineligible Golden State gifts [26]	**$ 458,540**	**-**	**$ 449,321**	**-**	**-**	**3**	**3**
Totals	**$ 13,491,102**	**-**	**$ 13,017,238**	**10**	**2**	**75**	**75**

[24] These loans include one terminated loan (highlighted in red) that contained ineligible Golden State downpayment assistance.
[25] The 10 loans (highlighted in blue) contained ineligible Golden State downpayment assistance; however, the loans had enough funds to meet the minimum cash investment without the downpayment assistance.
[26] Loans without ineligible Golden State downpayment assistance are highlighted in green.

Appendix E

Summary of Loans With Fees That Were Not Customary or Reasonable

Recommendation 1D		
FHA case number	**Interest rate lock extension**	**Noncustomary or unreasonable fees charged[27]**
043-9397600	$ -	$ 450
043-9429912	-	300
043-9490484	-	300
043-9496079	-	300
045-8002078	726	-
045-8090621	-	250
045-8143776	-	200
045-8146579	-	200
045-8148216	-	350
045-8148931	-	200
045-8153347	-	200
045-8156705	-	350
045-8162253	-	350
045-8170727	-	300
045-8174403	-	450
045-8174931	-	200
045-8177142	-	300
045-8186295	-	300
045-8195579	-	300
045-8197065	-	300
045-8199746	-	300
045-8206269	-	300
045-8216010	-	300
045-8221771	-	300
045-8221887	-	300
045-8223460	-	300
045-8230093	-	300
045-8231546	-	300

[27] Page 8 of the audit report cites noncustomary or unreasonable fees ranging from $150 to $300. The totals in the table are combined and range from $200 to $450 due to loans sometimes containing more than one ineligible fee.

Recommendation 1D		
FHA case number	**Interest rate lock extension**	**Noncustomary or unreasonable fees charged[27]**
045-8234378	-	300
045-8237707	-	450
045-8242526	-	300
045-8251216	-	300
045-8254127	-	300
045-8265171	-	300
045-8279821	-	300
048-7949768	-	200
048-8034545	-	300
048-8042558	-	300
048-8096947	-	300
197-6720684	-	200
197-6734517	-	200
197-6739668	-	350
197-6773805	-	300
197-6790922	-	300
197-6822482	-	300
Subtotals	**$ 726**	**$ 13,000**
Total	**$ 13,726**	