



Issue Date September 8, 2008
Audit Report Number 2008-KC-1006

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing Commissioner, H

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FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: Heartland Funding Corporation Violated the Real Estate Settlement Procedures Act and Did Not Fully Comply with HUD’s Underwriting, Quality Control, or Employee Compensation Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited Heartland Funding Corporation (Heartland Funding) because of its high 30-day delinquency rate. From January 2006 through December 2007, Heartland Funding originated 420 Federal Housing Administration (FHA) loans, valued at \$44.5 million. During this same period, 97 of the loans (23.1 percent) had been at least 30 days delinquent (past due). Our audit objectives were to determine whether Heartland Funding followed U.S. Department of Housing and Urban Development (HUD) requirements for (1) borrower eligibility and creditworthiness and property eligibility when underwriting loans, (2) implementing a quality control program, and (3) compensating its loan officers.

### **What We Found**

Heartland Funding violated the Real Estate Settlement Procedures Act (RESPA) and HUD’s requirements when processing FHA loans that involved downpayment assistance. In addition, Heartland Funding did not

follow HUD requirements when it underwrote 27 FHA loans, implemented its quality control plan, or reported staff compensation.

### **What We Recommend**

We recommend that HUD's Office of Housing take appropriate sanctions against Heartland Funding for violating RESPA. We also recommend that the Office of Housing refer Heartland Funding to HUD's Mortgagee Review Board for review and appropriate actions. In addition, we recommend that HUD require Heartland Funding to make principal reductions totaling \$83,755 on the 25 loans that used the improper downpayment assistance program.

Also, we recommend that the Office of Housing require Heartland Funding to indemnify HUD for 17 actively insured loans with unpaid principal balances totaling more than \$1.4 million; indemnify HUD for future losses on nine loans with unpaid principal balances totaling \$929,852, for which HUD has not yet sold the property; and reimburse HUD for one loan for which HUD has sold the property and incurred a loss of \$54,415. Further, we recommend that the Office of Housing verify that Heartland Funding fully implements a quality control program that complies with HUD requirements and has ceased reporting staff compensation improperly.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided the draft report to Heartland Funding on July 21, 2008, and requested a response by August 25, 2008. It provided written comments on the requested date of August 25, 2008. Heartland Funding generally disagreed with our conclusions and recommendations in findings 1 and 2; however, it generally agreed with conclusions and recommendations in finding 3.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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Heartland Funding Corporation (Heartland Funding) is a nonsupervised lender that began performing Federal Housing Administration (FHA) loan originations in September 1998. Heartland Funding maintains its main office in Springfield, Missouri, and has several branch offices in Missouri and Kentucky.

During the two-year audit period from January 1, 2006, through December 31, 2007, Heartland Funding endorsed 394 loans with original mortgage amounts totaling more than \$39 million, excluding streamline refinanced loans. Of the 394 loans, 105 became at least 30 days delinquent at some time within the first two years after endorsement, and 35 loans had ultimately incurred at least one 90-day default period.

On March 24, 2008, the U.S. Department of Housing and Urban Development (HUD) terminated the FHA origination approval agreement for Heartland Funding. The termination was based on Heartland Funding's default and claim rate of 17.86 percent during the 24-month period ending September 30, 2007. Heartland Funding's default and claim rate was 314 percent of the average lender default and claim rate for HUD's Kansas City office jurisdiction. The termination applied only to the main office in Springfield, Missouri. Heartland Funding is still allowed to originate and underwrite loans using its other branch office FHA identification numbers.

As an FHA-approved lender, Heartland Funding is required to follow 12 U.S.C. (*United States Code*) Chapter 27, Sections 2601-2617 and 24 CFR (*Code of Federal Regulations*) Part 3500, more commonly known as the Real Estate Settlement Procedures Act (RESPA). RESPA applies to transactions involving a federally related mortgage loan. RESPA is a consumer protection statute initially passed in 1974. The purposes of RESPA are to help consumers become better shoppers for real estate settlement services and to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services. HUD's Office of RESPA and Interstate Land Sales is responsible for enforcing RESPA.

In processing FHA loans, Heartland Funding used a downpayment assistance program that involved a for-profit corporation, Midwest Housing Authority (Midwest), and a nonprofit entity. Heartland Funding's owners also own Midwest. The nonprofit entity is not related to Heartland Funding. (Because this audit was of Heartland Funding and not the nonprofit entity, this report contains no conclusions regarding the activities of the nonprofit entity).

HUD's data systems showed that from January 1, 2006, through February 29, 2008, Heartland Funding obtained endorsement on 159 FHA loans using the downpayment assistance program involving the nonprofit entity, making it the primary downpayment assistance program used by Heartland Funding on FHA loans.

Our audit objectives were to determine whether the lender followed FHA requirements for (1) borrower eligibility and creditworthiness and property eligibility when underwriting loans, (2) implementing a quality control program, and (3) compensating its loan officers.

## RESULTS OF AUDIT

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### Finding 1: Heartland Funding Violated RESPA When Processing FHA Loans That Involved Downpayment Assistance

Heartland Funding failed to disclose an affiliated business arrangement with Midwest, provided instructions to title companies that mischaracterized loan transactions, and inappropriately allowed Midwest to split a portion of its fee with a nonprofit entity that performed no services in downpayment assistance (gift) transactions. This occurred because Heartland Funding's owners/managers incorrectly believed that their actions were acceptable and that HUD had approved the downpayment assistance program. As a result, Heartland Funding did not ensure that borrowers understood the loan transactions so that the borrowers had the opportunity to make informed decisions on their loans. Also, it could have engaged in practices that cost borrowers more in settlement services than allowed or reasonable and necessary.

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Heartland Funding's owners established Midwest in August 2000. Midwest's primary role was to help streamline the downpayment assistance process and close loans more quickly. A May 2001 letter of understanding between Midwest and a nonprofit entity described each party's roles and responsibilities. In addition, a subsequent May 2001 letter of agreement described the service fees that Midwest agreed to pay the nonprofit entity for its participation in the downpayment assistance program. One of Heartland Funding's owners signed the 2001 agreements on behalf of Midwest. Under the agreements, the nonprofit entity was to provide downpayment assistance funds to borrowers obtaining a loan from Heartland Funding and in return would receive 25 percent of the service fee that Midwest collected for facilitating the downpayment assistance process.

Heartland Funding's owners and staff controlled the business activities of Midwest. According to Heartland Funding's accounting staff, Midwest had no staff. A Heartland Funding owner and staff accountant processed the Midwest paperwork, made deposits to Midwest's bank accounts, and periodically issued payments from Midwest to the nonprofit entity participating in the downpayment assistance program. Further, according to the Heartland Funding accountant, Midwest did not reimburse Heartland Funding for the services that its staff provided to Midwest.



**Owners Failed to Disclose  
Affiliated Business  
Arrangement**

Heartland Funding's owners failed to disclose their affiliated business relationship with Midwest to the borrowers and others involved in the loan

transaction. According to 12 U.S.C. 2602(7), an affiliated business arrangement occurs when a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan or an associate of such person has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a settlement service and either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider. Section 2607(c) states that there is nothing that prohibits an affiliated business arrangement as long as a disclosure is made of the existence of such an arrangement to the person being referred and in connection with such referral, the person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred.

Neither HUD nor Heartland Funding loan files contained evidence that Heartland Funding or Midwest disclosed their affiliated business arrangement. In addition, we asked five borrowers participating in the Midwest/nonprofit downpayment assistance program whether they were aware that such a relationship existed between Heartland Funding and Midwest. All five borrowers stated that they were not aware of the relationship. In addition, we asked four borrowers about the downpayment assistance options offered to them and all four stated that they were not given an option of pursuing downpayment assistance from other entities or were strongly encouraged to use the certain nonprofit entity. Further, borrowers told us that they did not understand the downpayment assistance process.

### **Instructions Provided to Title Company Mischaracterized Downpayment Assistance Transactions**

Heartland Funding's loan closer provided instructions to the title company that caused it to mischaracterize the actual downpayment assistance transactions that took place. According to 24 CFR Part 3500, appendix A, the HUD-1 settlement statement is to be used as a statement of actual charges and adjustments for the parties in connection with the settlement. Also, 12 U.S.C. 2603(a) states that the settlement statement shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement.

The HUD-1 settlement statements consistently showed that the sellers paid Midwest a service fee of 3.75 to 4 percent of the sales price on all 25 of the loans reviewed that involved the Midwest/nonprofit entity downpayment assistance program. The settlement statements also showed

that the nonprofit entity donated downpayment assistance funds to the 25 borrowers, equal to 3 percent of the sales price of the home. However, no actual transfer of funds, as depicted on the settlement statements, took place. The nonprofit entity's executive director confirmed to us that it did not donate the downpayment assistance funds to the borrowers and, therefore, no funds were actually transferred from it to the borrowers.

Heartland Funding and HUD loan files contained a statement showing that at closing Heartland Funding issued its version of a paper draft in lieu of an actual transfer of funds. The closing agent instructions and disbursement authorization stated that Midwest advanced the 3 percent downpayment assistance funds to the nonprofit entity to provide to the borrower and Midwest was not providing the assistance directly to the borrower. Heartland Funding's owners told us that they considered this concurrent funding, much the same as using the proceeds from a house that a person sold as a downpayment on a house that the person is purchasing with the transactions being completed simultaneously.

After each closing, Midwest received a check from the title company as its service fee for the .75 to 1 percent difference between the seller's service fee and the borrower's 3 percent downpayment assistance. However, this payment was not disclosed on the HUD-1 settlement statements.

Further, the lack of an actual transfer of downpayment assistance funds from the nonprofit entity also violated requirements in HUD Handbook 4155.1, REV-5, paragraph 2-10c, and Mortgagee Letter 2004-28 regarding the transfer of downpayment assistance funds. Finding 2 further describes the improper transfer of funds.

**Midwest Was Inappropriately Allowed to Split Its Fee with the Nonprofit Entity**

Heartland Funding violated RESPA when it allowed Midwest (an affiliated business entity controlled by Heartland Funding) to split a portion of its fee with the nonprofit entity that performed no services in the downpayment assistance transactions. Similarly, Midwest also violated RESPA by splitting a portion of its fee with the nonprofit entity, knowing that the nonprofit entity performed no services to earn the fee.

According to 12 U.S.C. 2607(b), no person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for



services actually performed. Also, 24 CFR 3500.14(c) prohibits the splitting of fees except for actual services performed.

The letter of understanding between Midwest and the nonprofit entity stated that the nonprofit entity would help select recipients of the downpayment assistance funds, provide the funds, and aid in the administration of the program. Although the nonprofit entity received money from Midwest for its participation in the downpayment assistance program, the executive director of the nonprofit entity confirmed to us that it provided no such services or funds to the borrowers.

### **Owners Believed Their Actions Were Acceptable**

Heartland Funding's owners told us that they believed their actions were acceptable and that HUD had previously approved the downpayment assistance program that Heartland Funding had implemented with Midwest.

When we questioned the Midwest downpayment assistance program during our audit, Heartland Funding's owners insisted that HUD had approved the program during a May 2004 review. However, Heartland Funding could provide no documentation of such an approval. HUD confirmed that it conducted a review of Heartland Funding in May 2004; however, HUD records of the review do not address the Midwest downpayment assistance program.

HUD's reviewer stated that while reviewing FHA loan files he noted that one of Heartland Funding's owners signed downpayment assistance documents on behalf of Midwest. He asked the Heartland Funding owners about it and they told him that they also owned Midwest. The reviewer was concerned about a potential conflict of interest due to the common ownership of Heartland Funding and Midwest. Therefore, he discussed the potential conflict of interest with a HUD homeownership center. The reviewer subsequently informed the owners that HUD did not have concerns about the common ownership situation. However, the reviewer stated that the discussions did not involve whether the Midwest downpayment assistance program was appropriate or the way that Heartland Funding operated the program.

HUD also pointed out that Handbook 4155.1, REV-5, paragraph 2-10c, states that FHA does not approve downpayment assistance programs in the form of gifts administered by charitable organizations. Mortgage lenders are responsible for ensuring that the gift to the homebuyer from the charitable organization meets the appropriate FHA requirements and the transfer of funds is properly documented.

## **Borrowers Were Not Afforded Opportunity to Make Informed Decisions**

Heartland Funding did not ensure that borrowers understood the loan transactions so that the borrowers had the opportunity to make informed decisions regarding their loan transactions. Also, it could have engaged in practices that cost borrowers more in settlement services than allowed or reasonable and necessary.

Borrowers may have also paid more for the homes than was necessary or more than they were aware that they had agreed to pay. Several sellers stated that they had increased their list price or the initial agreed-upon sales price to cover the additional costs of the sale, after agreeing to participate in the Midwest/nonprofit downpayment assistance program and donate funds to a charitable organization on behalf of the borrower. However, borrowers told us that they were not aware that they may have incurred increased sales prices to accommodate the seller's costs of participating in the downpayment assistance program.

In addition, borrowers may have also unknowingly participated in an improper downpayment assistance program, causing HUD to overinsure the mortgages by the amount of the seller's service fee, which equaled as much as four percent of the sales price. For the 25 borrowers that participated in the improper downpayment assistance program, the sellers paid Midwest service fees totaling nearly \$84,000. Appendix D provides details on the costs paid by the seller to Midwest to participate in the downpayment assistance program.

Heartland Funding's owners told us that as of May 30, 2008, Heartland Funding had revised its policy regarding its downpayment assistance program involving Midwest and the nonprofit entity. Heartland Funding's owners stated that they will no longer use this program and any borrower who needs downpayment assistance will need to use another source.

## **Recommendations**

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgage Review Board

- 1A. Take appropriate sanctions against Heartland Funding for violating RESPA.

- 1B. Refer Heartland Funding to HUD's Mortgagee Review Board for review and appropriate actions.
- 1C. Require Heartland Funding to make a principal reduction totaling \$83,755 on the 25 loans that used the improper downpayment assistance program. See appendix D for details on the recommended reduction for each loan.
- 1D. Require Heartland Funding to adequately train its managers and staff on RESPA requirements.

## Finding 2: Heartland Funding Did Not Always Follow HUD Underwriting Requirements on 27 FHA Loans

Heartland Funding did not always follow HUD requirements while underwriting 27 FHA loans. This occurred because managers and underwriters believed that their efforts were sufficient to meet HUD requirements. As a result, HUD insured 27 loans that unnecessarily placed the FHA insurance fund at risk.

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### HUD Requirements Were Not Always Followed

Heartland Funding did not always follow HUD underwriting requirements on 27 FHA loans. FHA-approved lenders must follow HUD Handbook 4155.1, REV-5, Mortgage Credit Analysis for Mortgage Insurance, One-to-Four-Family Properties, and various HUD mortgagee letters when underwriting FHA loans. Specifically, Heartland Funding did not follow HUD underwriting requirements for verifying the transfer of downpayment assistance funds from the donor to the borrower. It also did not properly verify employment and calculate income, nor did it consider all recurring debts of borrowers when evaluating the borrowers' ability to repay the FHA-insured mortgage.

For example, in 25 of the 26 loans with improper downpayment assistance funds, Heartland Funding did not ensure that there was an actual transfer of funds from the nonprofit donor to the borrower, nor did it ensure that the funds came from an acceptable source. HUD requires lenders to determine that the downpayment assistance funds ultimately were not provided from an unacceptable source and were the donor's own funds. HUD rules further state that the donor cannot be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. HUD considers donated funds from these sources as inducements to purchase, and they must be subtracted from the sales price. HUD also requires lenders to obtain specific documents to verify receipt of the funds. For the 25 loans, Heartland Funding did not follow HUD's downpayment assistance requirements. Finding 1 contains further details on these material deficiencies.

As an example of other material deficiencies, Heartland Funding did not include all of the borrower's recurring monthly obligations in the financial ratios. HUD requires lenders to include all installment loans, revolving charge accounts, and all other continuing obligations when evaluating the borrower's debts and ability to repay the FHA loan. In two loans, Heartland Funding did not include monthly obligations that significantly

affected the borrowers' financial ratios. The borrowers provided statements from creditors to establish supplemental, nontraditional credit histories. From the nontraditional histories, Heartland Funding had evidence that the borrowers had outstanding debts requiring monthly payments, but it ignored these debts when evaluating the financial ratios and the borrowers' ability to repay the mortgage.

Appendixes C through E provide details of HUD underwriting requirements, a schedule of significant underwriting deficiencies, and detailed case studies for the 27 loans.

### **Managers and Underwriters Believed Actions Met HUD Requirements**

Heartland Funding's managers and underwriters believed that their efforts were sufficient to meet HUD requirements. Regarding downpayment assistance funds, Heartland Funding's managers told us they believed that their procedures for processing loans with downpayment assistance from a nonprofit entity, as described in finding 1, equated to an acceptable transfer of funds. In these transactions, Heartland Funding provided a statement in the loan file showing that at closing it issued its version of a paper draft in lieu of an actual transfer of funds. Heartland Funding told us that it considered this concurrent funding and that an actual (physical) transfer of funds was unnecessary.

In addition, for downpayment assistance transactions from private parties to the borrower, the underwriter told us she believed that a letter from the bank confirming that the donor had the funds available to give and a copy of a nonnegotiated cashier's check was sufficient to show a transfer of funds from the donor to the borrower. She believed that it was not necessary to obtain evidence that the funds were actually transferred from the donor to the borrower.

As for underreported liabilities, the senior underwriter told us that she had never included liabilities in financial ratios that Heartland Funding had identified through supplemental, nontraditional credit sources.

### **Loans Containing Material Deficiencies Were Submitted for FHA Insurance**

When proper lending practices are not followed, HUD lacks assurance that borrowers qualified for FHA-insured loans. The 27 loans with major underwriting deficiencies placed the insurance fund at unnecessary risk.

As of May 1, 2008, HUD's data systems showed that the 27 loans had unpaid principal balances of more than \$2.4 million. Seventeen of the loans were actively insured and had unpaid principal balances of more than \$1.4 million. HUD had paid claims on nine loans with unpaid principal balances of nearly \$1 million but had not yet sold the properties. In addition, HUD had incurred losses of more than \$54,000 on the remaining loan.

## Recommendations

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board

- 2A. Require Heartland Funding to indemnify HUD for 17 actively insured loans with unpaid principal balances of \$1,423,881. The projected loss is \$533,816 based on the FHA insurance fund average loss rate of 39 percent for fiscal year 2007 (see appendix D).
- 2B. Require Heartland Funding to indemnify HUD for future losses on nine loans with unpaid principal balances totaling \$929,852, for which HUD has not yet sold the property. The projected loss is \$351,475 based on the FHA insurance fund average loss rate of 39 percent for fiscal year 2007 (see appendix D).
- 2C. Require Heartland Funding to reimburse HUD for one loan, for which HUD has sold the property and incurred a loss of \$54,415 (see appendix D).
- 2D. Require Heartland Funding to ensure that it has adequately trained its managers and underwriters on HUD underwriting requirements, particularly with regard to downpayment assistance funds, income, and liabilities.

### Finding 3: Heartland Funding Did Not Fully Comply with HUD's Quality Control and Employee Compensation Requirements

Heartland Funding did not fully comply with HUD's quality control or employee compensation requirements. This noncompliance occurred because managers were not aware of all HUD quality control requirements and did not effectively monitor their quality control contractor. The managers elected to report compensation as contractor payments rather than employee wages to take advantage of tax rules. As a result, Heartland Funding could not ensure the accuracy, validity, and completeness of its loan originations, and HUD unnecessarily assumed an increased risk.

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#### **The Quality Control Plan Was Incomplete and Quality Control Reviews Were Not Adequate**

Heartland Funding did not fully comply with HUD's quality control requirements.

Heartland Funding's quality control plan lacked 11 required elements. For example, the plan did not require the lender to immediately refer findings of fraud or other serious violations to HUD or the Office of Inspector General (OIG); identify patterns of early defaults by location, program, loan characteristic, loan correspondent, or sponsor; and determine the method used to establish appraised values. Appendix F contains the details of the 11 missing elements.

In addition, Heartland Funding did not ensure that its quality control reviews met HUD requirements. Specifically, it did not

- Take corrective actions to reduce quality control deficiencies identified by the quality control review process.
- Ensure that the quality control reviews included all early defaults.
- Ensure that it obtained quality control reports on loans within 90 days of the loan closings. The lender did not obtain reviews within the required timeframe for six months of the audit period.
- Document on-site quality control reviews of branch offices.

- Ensure that its quality control reviews included a review of at least 10 percent of the FHA loans closed during that review period. The lender did not meet this requirement for two months of the audit period.

HUD Handbook 4060.1, REV-2, states that all FHA-approved lenders must implement and continuously have in place a quality control plan for the origination of insured mortgages as a condition of receiving and maintaining FHA approval. Further, the handbook establishes several basic elements that are required in all quality control programs. Appendix C provides the detailed HUD quality control requirements.

### **Loan Officer Compensation Was Improperly Reported**

Heartland Funding violated HUD requirements by using Internal Revenue Service Form 1099 to report loan officer compensation, which identified the staff members as independent contractors rather than Internal Revenue Service Form W-2 employees. HUD Handbook 4060.1, REV-2, paragraph 2-9(A), states that all compensation must be reported on Internal Revenue Service Form W-2.

In 2006, Heartland Funding reported earnings for 41 loan officers using Internal Revenue Service Form 1099. In 2007 and 2008, it reported earnings for 61 and 21 loan officers on Internal Revenue Service Form 1099, respectively.

### **Managers Were Unaware of All HUD Requirements and Did Not Monitor Their Contractor**

Heartland Funding managers were not aware of all HUD quality control requirements and did not effectively monitor their quality control contractor. A Heartland Funding co-owner stated that Heartland Funding relied on its quality control contractor to provide it with a quality control plan that met HUD's requirements.

As a result of our review, Heartland Funding told us that it was committed to making an extensive review of its quality control plan and it understood the need to change its in-house reviews and procedures.



### **Managers Used Internal Revenue Service Form 1099 Due to Tax Advantages**

Heartland Funding managers told us that they elected to report loan officer compensation as contractor payments rather than employee wages to take advantage of tax rules.

As a result of our review, Heartland Funding managers stated that they would begin reporting all loan officer compensation on Internal Revenue Service Form W-2 as of July 1, 2008.

### **Heartland Funding Was Unable to Ensure Proper Loan Originations**

Without a properly implemented quality control program, the lender is unable to ensure the accuracy, validity, and completeness of its loan origination operations. In addition, the lender may not identify potential deficiencies and make needed corrections in a timely manner, resulting in an increased risk to the FHA insurance fund.

As a result of Heartland Funding's improper employee compensation practices, HUD lacked assurance that it could originate loans within HUD requirements, and, therefore, HUD unnecessarily assumed an increased risk.

### **Recommendations**

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner and Chairman, Mortgagee Review Board

- 3A. Verify that Heartland Funding fully implements a quality control program that complies with HUD requirements.
- 3B. Verify that Heartland Funding has ceased reporting staff compensation using Internal Revenue Service Form 1099 and is reporting earnings using only Internal Revenue Service Form W-2.

## SCOPE AND METHODOLOGY

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Our audit period was January 1, 2006, through December 31, 2007, and was expanded as necessary to meet our audit objectives. The audit focused on the activities of Heartland Funding but was expanded as needed to include relevant business activities of Midwest, an affiliated business entity.

To accomplish our objectives, we reviewed HUD's and Heartland Funding's underwriting policies and procedures. We interviewed Heartland Funding management, HUD staff, and the executive director of the nonprofit entity. We also interviewed seven borrowers and three sellers that participated in the primary downpayment assistance program used by Heartland Funding to gain a general perspective of the program from borrowers and sellers. In addition, we reviewed Heartland Funding's quality control plan and quality control reviews, the quality control contract, loan officers' employment contract, and the contract between the nonprofit entity and the for-profit corporation used to facilitate the primary downpayment assistance program. We also researched RESPA and the Missouri Secretary of State and Internal Revenue Service Web sites.

Heartland Funding originated 420 FHA loans between January 1, 2006, and December 31, 2007. Of the 420 loans, 97 became at least 30 days delinquent during our audit period, and 35 of the 97 reached a 90-day defaulted status. We reviewed HUD and Heartland Funding loan files for the 35 defaulted loans.

When identifying underwriting deficiencies, we assessed whether the deficiencies were material and should have caused the lender to disapprove the loan. We considered any deficiencies that affected the approval and insurability of the loans as significant and recommended that HUD take appropriate action on these loans. When identifying underwriting deficiencies that we considered minor, we informed Heartland Funding of the deficiencies but have not recommended that HUD take action on these loans.

We relied on computer-processed data contained in HUD's Single Family Data Warehouse system. During the audit, we assessed the reliability of the data and found it to be adequate. We also performed sufficient tests of the data, and based on the assessments and testing, we concluded that the data are sufficiently reliable to be used in meeting our objectives.

We assigned a value to the potential savings to HUD if it implements our recommendations to require Heartland Funding to indemnify loans with material deficiencies. For those loans on which HUD has not yet incurred a loss, we applied FHA's average loss experience of 39 percent for fiscal year 2007, as provided by HUD.

- For the 17 actively insured loans that participated in the improper downpayment assistance program, we calculated the savings at \$533,816, which is the unpaid principal balance of \$1,423,881, less \$55,122 in recommended principal reductions, multiplied by the 39 percent loss rate.

- For the eight loans that participated in the improper downpayment assistance program and on which HUD has paid a claim and acquired but not yet sold the property, we calculated the savings at \$283,598, which is the unpaid principal balance of \$755,808, less \$28,633 in recommended principal reductions, multiplied by the 39 percent loss rate.
- For the one loan that did not participate in the improper downpayment assistance program but had underwriting deficiencies, we calculated the savings at \$67,877, which is the unpaid principal balance of \$174,044 multiplied by the 39 percent loss rate.

We performed audit work from January through June 2008 and conducted our audit in accordance with generally accepted government audit 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# INTERNAL CONTROLS

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Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Controls to ensure that participation in gift fund/downpayment assistance programs meets RESPA and HUD requirements.
- Controls to ensure that FHA loans meet HUD underwriting requirements.
- Controls to ensure that the lender implements a quality control program that complies with HUD requirements.
- Controls to ensure that staff compensation is reported in accordance with HUD requirements.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

## Significant Weaknesses

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

- Heartland Funding participated in an improper downpayment assistance program, contrary to RESPA and HUD requirements (findings 1 and 2).
- Heartland Funding did not have adequate controls in place to ensure that it followed HUD requirements when implementing its quality control program (finding 3).

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

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Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1C	\$83,755	
2A		\$533,816
2B		\$351,475
2C	\$54,415	

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified.

Implementation of our recommendations to require Heartland Funding to indemnify HUD for materially deficient loans will reduce the risk of loss to the FHA insurance fund. The amounts for recommendations 2A and 2B reflect that, upon sale of the mortgaged property, FHA's average loss experience is about 39 percent of the unpaid principal balance based upon statistics provided by HUD.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

<p><b>HUSCH BLACKWELL SANDERS LLP</b></p>	<p><b>Maxwell Carr-Howard</b> DIRECT 816.983.8345 · FAX 816.983.9345 · max.carr-howard@huschblackwell.com 4801 MAIN STREET, SUITE 1000 · KANSAS CITY, MO 64112 www.huschblackwell.com</p> <p>August 25, 2008</p> <p>Mr. Ronald J. Hosking Regional Inspector General for Audit U.S Department of Housing and Urban Development Office of Inspector General Region 7 Office of Audit Gateway Tower II - 5th Floor 400 State Avenue Kansas City, Kansas 66101-2406</p> <p><b>Re:</b> Formal Response to Audit of Heartland Funding Corporation</p> <p>Dear Mr. Hosking:</p> <p>I write to respond to your office's concerns as expressed in its Audit<sup>1</sup> of my clients' corporation Heartland Funding and in a telephone conference with your staff on August 12, 2008. Your office has expressed concern over the downpayment assistance program administered by a for-profit corporation, Midwest Housing Authority, also owned by Messrs. Bush and Baltzell on behalf of a charitable organization. I believe that these concerns must be viewed with an eye towards the historical development of downpayment assistance programs provided by charitable organizations.</p> <p>Moreover, it is important to note that Congress and the White House have finally and definitively spoken on such downpayment assistance programs when it passed and the President signed the Housing and Economic Recovery Act of 2008. That Act eliminated all seller-funded downpayment assistance programs—such as the one operated by Midwest—effective October 1, 2008. As a result, this discussion is truly historical; as the draft audit indicates, the Midwest program ceased on May 30, 2008 and as a result of the new law neither it nor any other seller-funded downpayment assistance program will be permitted to operate after the first of October.</p> <p>Please understand that I am not asserting that the downpayment assistance program administered by Midwest would be permitted if Heartland were to continue operations. Rather, I believe that in the regulatory environment that existed when the program was established and initially reviewed by HUD, my clients had every reason to believe that the program complied with the rules that existed and that it was identical to other programs operating at the time and indeed today.</p> <p><sup>1</sup> I have only seen the draft audit and a revision of Finding 1 and my comments are based on those documents with the assumption that the final version will not change further. I reserve the right to make further comments if the final version is revised again.</p> <p>KC-1619125-3</p>
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### Comment 1

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Comment 2

Finally, while the Audit is purportedly an audit of Heartland, it is much more a criticism of the conduct of Midwest and the not-for-profit entity [REDACTED], than it is of Heartland. Troublingly the claims that RESPA was violated are claims tied not to Heartland—which is nonetheless blamed for the violations—but to third parties not governed by RESPA. The key claim in the Audit remains that the borrowers of the audited loans faced increased purchase prices as a result of Heartland’s conduct, or at least as a result of Midwest’s conduct. But no such evidence exists, at least no such evidence was presented in the draft Audit or the revised draft Audit sent to me on August 18, 2008.

Comment 3

Comment 4

Though your auditors did take time to listen to our concerns, and provided some minor adjustments to the draft language, the basic premise remains that Heartland caused the borrowers to borrow more money than they could afford by permitting them to participate in the downpayment assistance program operated by Midwest. This allegation remains unsupported by any evidence and the allegations that HUD regulations were not followed are incorrect. the draft Audit should be withdrawn.

**NEHEMIAH AND OTHER SELLER-FINANCED DOWNPAYMENT ASSISTANCE PROGRAMS**

Comment 5

As I am sure you know, the most prominent charitable but seller-financed downpayment assistance program is the program operated by Nehemiah Corporation of America. Although HUD has made clear in recent years that it “does not ‘approve’ down payment assistance programs,” that has not always been the case. HUD Handbook 4155.1, Rev-52-10c. In 1998 Deputy Assistant Secretary Emelda Johnson expressly stated to Nehemiah that its “program complies with HUD’s regulations and guidance pertaining to the source of funds for the borrower’s down payments.” Letter of April 3 1998 from Johnson to Harris, at Tab 1. This letter, along with the not-for-profit approval by the IRS is prominently displayed on Nehemiah’s website. See [www.getdownpayment.com/pdfs/hudletter.pdf](http://www.getdownpayment.com/pdfs/hudletter.pdf).

Comment 6

Nehemiah’s downpayment assistance program is seller-financed, just like Midwest’s program. See Nehemiah Program Guidelines at Tab 2. Under its program Nehemiah provides a gift to buyers of between 1 and 6% of the final contract sales price if the seller “continues an amount equal to the gift to Nehemiah and [also] pays a processing fee.” Tab 2 at 2 ¶ 1. As is illustrated by the attached HUD-1 (borrower and seller information obscured to protect privacy) Nehemiah Gift funds [HUD-1 line 206] are directly connected to the “gift” by Nehemiah [HUD-1 line 507] which also imposes a “service fee” to Nehemiah. See HUD-1 attached at Tab 3.

In recent litigation over HUD’s effort to pass a rule prohibiting programs like Nehemiah’s, the United States District Court for the Eastern District of California described Nehemiah’s program as “seller-funded downpayment assistance.” See Order of February 29, 2008 in *Nehemiah Corporation of America v. Alphonso Jackson*, No. CIV S-07-2056 LKK/DAD (Slip Op. February 29, 2008) (hereinafter “*Nehemiah Order*”) at 1. In that litigation, Nehemiah was successful in changing a final rule that would have prohibited programs like the programs Midwest and Nehemiah operate because the Court found that “HUD was not honest with itself

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Note: We redacted the identity of the nonprofit entity to protect its privacy.



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**Comment 6**

**or the public** that it was reversing course from its prior policy” in which it had approved and permitted seller-financed downpayment assistance programs. *Nehemiah* Order at 19 (emphasis added).

Neither I nor the *Nehemiah* Court contend that HUD can’t change its rule, it should merely acknowledge that it is changing the rule from permitting seller-financed downpayment assistance programs to not permitting them. As noted above, Congress recently solved that problem for HUD by enacting a statute that prohibits such programs. But HUD should acknowledge the change in approach in its Audit of Heartland as well and judge Midwest’s downpayment assistance program under its former policy of at least tacitly approving the use of such programs to provide downpayment assistance. *Nehemiah* Order at 19.

**Comment 7**

At the time Midwest was providing the administrative support for the charitable yet seller-financed program HUD did not prohibit such programs. Indeed, Midwest simply copied the business model of Responsible Home Ownership, Inc., a for-profit company that partners with Community Housing and Development Corporation, a not-for-profit organization. As with Midwest, the for-profit company administers the program and charges a fee. The seller gives the not-for-profit a donation in an amount equal to the downpayment and the charity gives the downpayment to the buyer. See [www.responsiblehome.com](http://www.responsiblehome.com).

**Comment 7**

As you no doubt know, other similar programs operate all around the country. For example “American Family Funds, Inc., located in Mobile, Alabama, is the administrator for The Dove Foundation, a 501(c)(3) non-profit charity that provides nationwide downpayment and/or closing cost assistance to qualified American home buyers.” See [www.americanfamilyfunds.com/about.php](http://www.americanfamilyfunds.com/about.php). Like Midwest and Responsible Home, American Family Funds administers the gift program for a non-profit charity.

**Comment 7**

Now I realize the mere fact that others have the same business model as Midwest and Heartland had, does not alleviate the responsibility each of those companies have to follow applicable rules and regulations. But as the Court in *Nehemiah* noted, during the period in which Midwest operated its program, HUD has certainly “tolerated entities such as *Nehemiah*” operating seller-funded downpayment assistance programs. *Nehemiah* Order at 16. And in 1999 it abandoned an effort to prohibit seller-funded downpayment assistance programs. *Id.* (citing 64 Fed. Reg. 29,956 (Sept. 14, 1999)). “More recently, . . . HUD warmed to seller-funded DPAs. [Indeed, i]n a 2005 letter, Commissioner Montgomery defended [such programs] against calls for its ban by the GAO.” *Id.* at 16.

**Comment 8**

It is in this regulatory environment that Midwest developed the program it administered for a charitable not-for-profit organization. When challenged by a HUD Auditor in 2004 that there was a conflict of interest created by Messrs. Bush and Baltzell’s ownership of both Midwest and Heartland, Mr. Baltzell disagreed but was frank about his ownership interest. There is no question in my client’s mind that the Auditor clearly understood the entire program (that Midwest administered the program, that it charged a fee it split with the charitable

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organization, and that the seller funded the downpayment by making a gift to the charity through Midwest). After checking with his superiors, that Auditor reported that they agreed with Mr. Baltzell that there was no conflict of interest created by the business model.

In light of the historical regulatory context and the frank discussions my client had with your auditors in 2004, I do not think that the draft Audit’s characterization of the Midwest program is entirely fair. Nonetheless, I do appreciate the Audit’s acknowledgement that my clients believed that their program complied with applicable regulations.

**SPECIFIC OBJECTIONS AND RESPONSES**

**Comment 9**

The Audit purports to focus on “(1) borrower eligibility and credit worthiness and property eligibility when underwriting loans (2) implementing a quality control program, and (3) compensating its loan officers.” Draft Audit at 1. While the audit makes some valid points on the limits of the quality control program and some errors in reporting loan officer compensation on the proper IRS forms, Finding 1 points to no problems with borrower eligibility, creditworthiness, or property eligibility. Rather it merely focuses on the claimed violation of rules by a program that was identical to or similar to the program operated by Nehemiah and Responsible Home.

**Comment 10**

**Auditee’s Response on Page 2:** Without evidence that the borrowers of the loans investigated in this audit failed to meet eligibility or credit requirements, or that the property failed to meet eligibility requirements we do not believe that it is appropriate to impose any sanctions. To the extent that HUD auditors are relying on regulations that purportedly prohibit seller-financed downpayment assistance programs during the period which the federal courts have characterized this downpayment assistance as at least tacitly approved by HUD, we think this reliance is misplaced.

**Comment 11**

**Objection to Page 3:** The section discussing RESPA should acknowledge that it does not apply to Midwest which is the entity that HUD’s auditors actually assert violated the act. The act and the applicable regulations make it clear that “settlement services” do not include making or facilitating a downpayment, rather it governs the origination of a loan, providing title work, or providing services incident to the loan being issued to the borrower. See 12 U.S.C. § 2602(3); 24 C.F.R. § 3500.2. Further, it should acknowledge that while there may be some common shareholders in both Midwest and Heartland, Heartland has no authority to directly control the conduct of Midwest.

**Comment 12**

**Objection to Page 6:** The assertion that Heartland Funding failed to disclose an affiliated business arrangement is dependent, in part, on Midwest meeting the definition of an affiliated business under RESPA and its applicable regulations. An affiliated business arrangement is an arrangement that would permit one entity to “refer business incident to or a part of a real estate settlement service.” 12 U.S.C. § 2602(7). Thus, to be an affiliated business,

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**Comment 13**

both entities must provide settlement services. Heartland clearly does, as it originates loans. See 12 U.S.C. 2602(3); 24 CFR 3500.2(b)(settlement service)(1).

But Midwest’s administrative management of the not-for-profit’s downpayment assistance program does not fit either the statutory or the regulatory definition of settlement service. See 12 U.S.C. 2602(3); 24 CFR 3500.2(b)(settlement service)(1-15). Midwest does not originate loans, does not provide mortgage broker services, does not provide services related to the origination, processing or funding of any mortgage loans, it does not provide title services, it does not offer legal services, it does not provide recordation services, it does not conduct inspections, it does not conduct settlements, it does not provide mortgage insurance, it does not provide any hazard or other type of insurance, it provides no services related to real estate taxes, it provides no real estate agents or related services. *Id.*

**Comment 13**

In short, Midwest does not provide settlement services.<sup>2</sup> Therefore it cannot be an affiliated business that should have been disclosed to borrowers who were customers of Heartland. The finding that it should have disclosed its affiliation is in error as are all of the findings that flow from this error.

**Comment 13**

As Midwest is not governed by RESPA or its enacting regulations, nor is it controlled directly by Heartland, it cannot be said that it either permitted fee-splitting, or that splitting fees between Midwest and the not-for-profit is prohibited. This allegation should be struck from the Audit as well.

**Comment 14**

Finally, even if there were a basis for arguing that Midwest and Heartland were affiliated businesses under RESPA and its regulations—which they are not—no explanation is given for the conclusion that the failure to disclose the relationship limited the borrowers’ ability to make informed decisions on their loans.

**Comment 15**

The Audit makes no claim in Finding 1 that the borrowers were not qualified or that they did not need the downpayment assistance. Thus it is apparent that the only alternative open to these borrowers would be to get downpayment assistance from another entity, which would still have charged the *seller*, not the borrower, a fee. This fee would likely have been similar to or greater than the fee charged by Midwest. While disclosure is clearly not mandated by the law, even if it had been given, it does not appear that it would have impacted the borrowers’ decision in any event.

**Comments  
12-14**

**Objection to Page 7:** We reiterate our objections to page 6 here, specifically the claim that Heartland and Midwest are affiliated businesses. A plain reading of the statute and the applicable regulations belies that claim. See 12 U.S.C. 2602(3); 24 CFR 3500.2(b)(settlement service)(1-15).

**Comment 16**

<sup>2</sup> We also object to the claim that Midwest does not get reimbursements from Heartland. It does and HUD’s Audit included a review of checks from Heartland to Midwest.

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**Comment 17**

In addition, we object to the inclusion of the results of interviews with five borrowers. What these borrowers may recall about loans they received possibly years ago is hardly probative of what the majority of the borrowers knew at the time they took the loans. Be that as it may, because Heartland and Midwest do not meet the definition of affiliated businesses the disclosure was not required.

Finally, we object to the statement that borrowers were not aware that they had paid a service fee for receiving assistance. This is patently untrue. It was the seller who paid the fee not the borrower. The claim made elsewhere in the Audit that the seller increased their fees is not supported in the Audit except by conclusory allegations. This statement should be struck as the premise of the question was not even accurate.

We also object to the title on page 7 claiming that the instructions provided to title companies "mischaracterized" the downpayment assistance transactions. The specifics of the objection will be included in the section below objection to page 8 as the substance of the claim is made there.

**Comment 18**

**Objection to Page 8:** First, the purportedly inaccurate instructions were not provided by Heartland or an amorphous "loan closer" as claimed on page 7, but were provided by Midwest and the not-for-profit entity providing the downpayment assistance.

**Comment 19**

While we agree that the HUD-1 statements consistently showed that sellers paid a service fee of 3.75 to Midwest, we object to the conclusory statement that "the seller typically added 3.75 percent to the initial asking price." That statement is without support in the attachments provided to us.

**Comment 3**

Further, even if the seller increased the price of the home, that is not something within the control of Heartland and it is a term that would be negotiated between the seller and the borrower/buyer. Key to this question is, of course when the price was increased, if it was increased. Nothing in the Audit answers this question and the conclusion that Heartland is responsible for such an increase is unwarranted.

**Comment 20**

HUD's objection to the use of an escrow draft, in lieu of the actual transfer of funds is really a legal objection to the definition of the transfer of funds. This legal objection has no place in an Audit and should be stricken. Further the suggestion that HUD Handbook 4155.1 Rev.-5 paragraph 2-10(c) prohibits anything other than an "actual transfer of funds" and that the method used by Midwest was prohibited by that paragraph of the HUD Handbook is simply not accurate.

**Comment 20**

Control over how funds are transferred from one party to another occurs in millions of transactions every day without an "actual transfer" of those funds. This is a practice that is as common as writing a check or as complex as an asset transfer by Fortune 500 companies. What is common between these transactions is that the funds do not physically move from one bank

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**Comment 20**

account to another while legal control over those funds do transfer from one party to another. It is the Uniform Commercial Code that has permitted this reality for years. And it is the UCC that recognizes the transfer of funds in the type of transaction objected to by the HUD auditors. Objection or not, such transfers are legal transfers of funds.

Moreover, the claim that paragraph 2-10(c) of HUD Handbook 4155.1 Rev.-5 nonetheless requires an "actual transfer of funds"—whatever that means—is not true. Rather paragraph 2-10(c) sets out particular requirements depending on the source of the funds. If the funds are from the homebuyers' account, a cancelled check or withdrawal document must be provided; if gift funds are provided by a certified check, evidence of withdrawal from the donor's account must be provided; if a cashier's check, money order, or official check is provided by a gift donor then a withdrawal document from the donor's account must be provided. *See Id.* at 2-25.

**Comment 21**

But these examples are not the only possible means to transfer funds.<sup>3</sup> A fact made obvious by paragraph 2-10(C)'s catchall requirement that "the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds." HUD Handbook 4155.1 Rev. 5 at 2-26; *see also* Mortgagee Letter 2004-28 (reiterating that "the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the . . . gift").

**Comments  
20 and 21**

The escrow drafts meet this requirement, the legal control over the funds is transferred at the behest of the not-for-profit, from the not-for-profit's control to the borrower. There is no question that the funds left the donor's control and became the borrowers' and then became the downpayment. In that sense the transfer is even more clear than those transactions involving the physical transfer of funds.

**Comment 22**

**Objections to Pages 8-10:** Initially we repeat our objections above highlighting the fact that Midwest is not an affiliated business and does not provide settlement services under RESPA or its related regulations. *See* 12 U.S.C. 2602(3); 24 CFR 3500.2(b)(settlement service)(1-15). Thus the entire notion that Heartland permitted fee splitting by Midwest is moot as only those providing settlement services are governed by the fee splitting rule. Likewise, the implicit suggestion that it is inappropriate for Heartland's owners to have separately organized Midwest is in direct contravention of the advice Heartland received from HUD's own auditors in 2004.<sup>4</sup>

**Comment 8**

<sup>3</sup> For example, Mortgagee Letter 2004-28, the other authority cited by the auditors, recognizes that paragraph 2-10(c) does not cover all means to transfer funds and adds a requirement that wire transfers be documented in the mortgage loan application binder.

<sup>4</sup> Heartland appreciates the acknowledgement on page 9 of the Audit that in 2004 Heartland and HUD engaged in discussions about whether Midwest and Heartland could be owned by the same shareholders. However, we object to the characterization of this conversation as an inquiry by Heartland when, in fact, it was the 2004 auditor who raised the issued, describing it as a "conflict of interest." Moreover, the Audit fails to acknowledge that the 2004 auditor raised this alleged conflict of interest with his supervisors and later reported back to

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**Comment 23**

Equally important, however, is that the Audit mistakenly suggests that Heartland violated RESPA by permitting Midwest to violate the rule prohibiting fee splitting with an entity that provides no services. Even assuming that 12 U.S.C. § 2607(b) applied to an entity that did not provide settlement services—which it does not—what the auditors complain of is not prohibited by the statute. RESPA does not prohibit settlement service entities like Heartland from permitting other non-settlement service entities from splitting fees. *Id.* It simply prohibits Heartland from splitting fees with an entity or person that provides no service. *Id.* Heartland did not do this and there is no allegation that Heartland did.

**Comment 24**

The claim that Midwest split fees with an entity that did not provide services is not accurate. As is outlined above, the not-for-profit entity that Midwest provided administrative services to did, in fact, permit funds it legally controlled to be given as a downpayment. This is a service for which Midwest paid a portion of the fee it collected from the seller. These fees were really paid to the not-for-profit—something the auditors do not dispute—and made a significant impact in promoting the mission of the not-for-profit entity.

**Comments  
3, 4, and 14**

Heartland also objects to the conclusion that the borrowers paid more for their homes as a result of participation in the downpayment assistance program operated by Midwest or that the borrowers were not in a position to make an informed decision.<sup>5</sup> Again, there is no evidence of such an increase in the price of the homes in the documents provided to us nor is there any evidence that the borrowers did not have the information they needed to decide to accept the loan for which they had applied. Indeed, these borrowers, while qualifying under HUD rules, would not have been able to participate in the loan program without downpayment assistance.

**Comment 25**

As a result, it is clear that even if the program had not been offered by Midwest, the borrowers would have needed to participate in a downpayment assistance program such as the program operated by Nehemiah. If the participation in a downpayment assistance program caused an increase in the sales price of the homes in question—something that is not documented in the draft audits—the downpayment assistance presumably would have had the same effect regardless of the program that provided it. Thus, it is unfair to place the blame for this at Heartland's feet.

**Comments  
20 and 21**

Finally, for the reasons stated above in the objections to page 8, Heartland objects to the assertion that its escrow draft did not meet HUD requirements. For these same reasons, Heartland objects to the conclusion that only an "actual transfer of funds" from one bank account

**Comment 26**

Heartland that his view was not shared by his superiors who told him that the Heartland Midwest arrangement did not raise a conflict of interest.  
<sup>5</sup> Indeed, some of the very files reviewed by the auditors showed that other entities provided downpayment assistance to Heartland borrowers including Nehemiah and Neighborhood Gold. This fact belies the suggestion that borrowers had no option on what entity provided downpayment assistance and should be acknowledged by HUD.

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Comment 27

to another was necessary for legal control over the funds to be transferred from the not-for-profit entity to the borrower to use as a downpayment.

**Objections to Recommendations for Finding 1:** As Midwest is not governed by RESPA it cannot have violated RESPA nor can Heartland be blamed for its conduct. Further there is no credible evidence presented in the draft audits or their attachments that the downpayment assistance program caused an increase in the price of the homes purchased with the assistance of a loan from Heartland. For these reasons and the reasons stated above, no sanctions are appropriate and no reduction of any of the loans discussed in Finding 1 would be justified.

Comments  
20 and 21

**Objections to Finding 2:** We reiterated the objections raised above to the “actual transfer of funds.” Contrary to the assertions of the auditors, neither paragraph 2-10(c) of HUD Handbook 4155.1 Rev.-5 nor Mortgagee Letter 2004-28 impose such a requirement. Neither authority purports to cover all possible means in which gift funds might be transferred. Rather they both give examples of steps that should be taken under certain types of transfers. Then they impose a catchall requirement that “the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor’s own funds.” HUD Handbook 4155.1 Rev. 5 at 2-26; *see also* Mortgagee Letter 2004-28. The escrow draft transfers legal control of the funds under the UCC and ensures that the source of the funds is clear and the claim that either the HUD Handbook or the Mortgagee Letter 2004-28 were violated should be removed from the Audit.

Comment 27

**Objections to Recommendations for Finding 2:** As Heartland did not violate either HUD Handbook 4155.1 Rev.-5 nor Mortgagee Letter 2004-28 or RESPA (with the possible exceptions of the two loans identified missing certain recurring monthly obligations in the financial ratios) it would be inappropriate to impose sanctions for their use of the escrow drafts. Even with the issues identified in the two loans, the proposed indemnification and reimbursement is not appropriate under the circumstances.

Comment 27

**Objections to Finding 3:** We offer no objections to Finding 3 or to the Recommendations regarding Finding 3.

Thank you for taking the time to consider these objections and thanks to your staff for considering the issues we raised in our telephone conference on August 12, 2008. Taking into consideration the historical context of the now defunct seller-financed downpayment assistance programs that have been run for many years, we believe that it is inappropriate to sanction Heartland for the seller-financed downpayment assistance program offered by Midwest.

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Should you have any questions or concerns, please do not hesitate to contact me.

Sincerely,



Maxwell Carr-Howard

MCH/sm  
Enclosures

cc: Ms. Kim Randal  
Mr. Dan Tipton  
Special Agent Melissa McFadden

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D. C. 20410

OFFICE OF THE ASSISTANT SECRETARY FOR  
HOUSING FEDERAL HOUSING COMMISSIONER

APR 3 1998

Don F. Harris, Esq.  
Nehemiah Home Ownership 2000  
770 L St. Suite 750  
Sacramento, CA 95814

RE: Nehemiah Home Ownership 2000

Dear Mr. Harris:

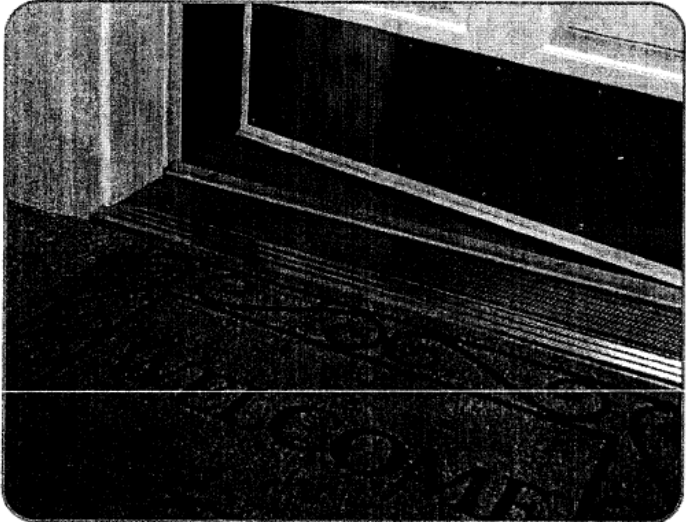
The United States Department of Housing and Urban Development ("HUD") has received and reviewed the IRS ruling that the non-profit organization which administers the Nehemiah down payment assistance program qualifies for Section 501(c)(3) status. Based upon the program specific information accompanying your submission to the IRS, we find that your program complies with HUD's regulations and guidance pertaining to the source of funds for the borrowers' down payments. Accordingly, HUD will insure eligible mortgages in which home buyers use Nehemiah's program (as set out in the submission to the IRS for Section 501 (c) (3) status) for borrower down payment assistance.

Although HUD has no immediate plans to change its policies regarding down payment assistance programs or regarding the source of borrower down payment funds, HUD reserves the right to do so in the future in accordance with applicable procedures. In the event that there are any such changes regarding the source of borrower down payment funds, the changes will become applicable to Nehemiah and all other similarly situated down payment assistance programs six months after the final promulgation and issuance of any such changes.


Sincerely,

Emelda Johnson  
Deputy Assistant Secretary  
Single Family Housing Programs

*The*  
**NEHEMIAH PROGRAM<sup>®</sup>**  
*Guidelines*



*Helping People Become Homeowners*



The Nehemiah Program<sup>®</sup>

Nehemiah Corporation of America  
424 North 7th Street, Suite 250, Sacramento, CA 95811  
877-NEHEMIAH 877-634-3642

**GETDOWNPAYMENT.COM**

*What Is The Nehemiah Program®?*

The Nehemiah Program® is the nation's largest privately funded downpayment assistance program, helping thousands of people achieve their dream of homeownership. Nehemiah Corporation of America (Nehemiah), one of the nation's largest and most respected community development corporations, administers The Nehemiah Program. The Nehemiah Program provides gift funds to qualified homebuyers who purchase participating homes using an eligible loan program, such as a Federal Housing Administration (FHA) loan. The Nehemiah Program is approved to provide gift funds by the FHA, which allows charitable organizations to provide gift funds toward downpayment and closing costs (HUD Handbook 4155.1 Rev. 4, Chg. 1).

*What Are Gift Funds?*

The Nehemiah Program® gift funds are monies offered by Nehemiah to qualified homebuyers, requiring no repayment, no silent second mortgage, and no re-capture penalties. The gift funds are offered toward the purchase of a participating home anywhere in the United States—with no income limitations and no geographical restrictions. The money given to the homebuyer is a true gift. Nehemiah charges a nominal processing fee that may be paid by the seller, lender, or homebuyer.

*Who May Request Gift Funds?*

Gift funds are requested by mortgage originators on behalf of qualified homebuyers through a registered closing agent, e.g., a settlement agent, closing attorney, escrow officer, or title company representative. Mortgage originators who choose the paperless feature option request gift funds directly from Nehemiah.

*How Are Gift Funds Requested?*

The Nehemiah Program® provides two methods for mortgage originators to request gift funds for qualified homebuyers:

**(1)\*Under the Standard Processing** method, mortgage originators complete the required documents and submit them to Nehemiah via fax through their registered closing office. The homebuyer can receive a gift amount between one percent (1%) and six percent (6%) of the final contract sales price as a percentage of the sales price or a flat gift amount. Further, the seller or homebuilder contributes an amount equal to the gift to Nehemiah and pays a processing fee.

**(2)\*Under the Online Processing Paperless** method, which provides for the fastest receipt of gift funds, mortgage originators request gift funds using our Online Processing System (OPS®) and submit their transaction to Nehemiah through our website. The homebuyer can receive a gift amount between one percent (1%) and six percent (6%) of the final contract sales price as a percentage of the sales price or a flat gift amount. The seller or homebuilder contributes an amount equal to the gift to Nehemiah. Also, the lender, seller, homebuilder, or homebuyer may pay the processing fee.

OPS is available online at <http://www.getdownpayment.com/lenders/mortgagelenders.asp>

\* We reserve the right to deny any gift request and to require additional information on any gift request.

*Who Is Eligible?*

The Nehemiah Program® offers gift funds to any qualified homebuyer, not just to first-time homebuyers. A qualified homebuyer is anyone who:

- Purchases a Nehemiah participating home to be owneroccupied (non-occupant co-borrower(s) may assist owneroccupant to qualify for mortgage).
- Uses an eligible loan program, such as an FHA loan or a conventional loan product that allows gifts from charitable organizations.

*What Is a Nehemiah Participating Home?*

A Nehemiah participating home is a home owned by a seller who has entered into a Participating Home Agreement with Nehemiah, acknowledging that the seller has made his or her home available for purchase by a homebuyer receiving gift funds. Any home on the market can be purchased using our program, provided the seller agrees to the Nehemiah participation requirements. A participating home may be an existing (resale) home or a new home offered by a homebuilder. A copy of the Participating Home Agreement can be obtained from our website at: <http://www.getdownpayment.com/lenders/download.asp>.

*What Is Recommended for the Homebuyer?*

Nehemiah recommends that homebuyers seriously consider (1) homeownership education courses and (2) home inspections.

**(1) Homeownership Education Courses:** Nehemiah strongly encourages, but does not require, all homebuyers to complete a homeownership education course. Nehemiah's Online Homeownership Education Course is available at no cost to homebuyers at: <http://www.getdownpayment.com/buyers/hec.asp>. In addition, HUD-approved counseling agencies provide homeownership education courses to homebuyers. A list of HUD-approved counseling agencies may be found online at <http://www.hud.gov/buying/index.cfm>.

**(2) Home Inspection:** Nehemiah strongly encourages, but does not require home inspections. Home inspections provide the homebuyers with an impartial evaluation and important information about the property's overall condition. An inspection may provide homebuyers with a list of items that need to be repaired or replaced. Please refer to HUD form 92564 8-99, "For Your Protection: Get a Home Inspection," for more details.

### *What Is an Eligible Loan Program?*

The Nehemiah Program® may be used in conjunction with any eligible loan program. Nehemiah reserves the right to approve the loan program. An eligible loan program has these characteristics:

- The homebuyer must qualify under a single-family, 1-4 unit loan.
- The loan must permit charitable organizations to provide gift funds to be used in conjunction with the purchase of a home.

### *What Are the Closing Agent's Responsibilities?*

To qualify as a closing agent, you must be associated with a closing office that is registered with Nehemiah. For a Closing Office Registration form, visit our website at <http://www.getdownpayment.com/lenders/closingAgents.asp> or call Customer Service toll free at (877) 634-3642.

Closing agents receive Nehemiah gift funds by wire-funds transfer through a registered closing office only. Nehemiah will not pay for any costs associated with wiring funds to Nehemiah. Such wiring costs, as well as other costs associated with the use of a closing office, must be negotiated between the homebuyer, seller, **or** lender.

Further, each of the two gift funds request methods available to mortgage originators—the Standard Process and the Online Processing System (OPS®) with a paperless feature option, has specific closing requirements, required documentation, and wiring instructions. The closing agent must receive the Nehemiah gift funds before the loan closes. Nehemiah **will not** honor gift funds requests after the loan has closed and funds have been disbursed.

### *Getting Started: It takes a Team*

The Nehemiah Program® works best when the real estate professionals working with the homebuyer to utilize the program are all informed about how the program works. Nehemiah offers training on using The Nehemiah Program through its Outreach division.

Please visit our website at <http://www.getdownpayment.com/content/training.asp?tab=2>.

Customer Service is also available through our website at <http://www.getdownpayment.com/content/contactUs.asp?tab=2> or our toll-free line, (877) 634-3642. (That's 877 Nehemiah.)

Nehemiah recommends that the mortgage originator take the lead in becoming familiar with the program and then work with homebuilders, real estate agents, and homebuyers to assist them in understanding how to use the program.

*At A Glance*

The Nehemiah Program® provides gift funds to qualified homebuyers who purchase participating homes using an eligible loan program, such as an FHA loan. Mortgage originators may request gift funds through one of the two methods shown below.

	<b>OPS® Paperless</b>	<b>Standard Process</b>
<b>Amount of Gift Funds to Homebuyer</b>	Between 1% and 6% of the final contract sales price, or a flat gift amount (not to exceed six percent (6%) of the final contract sales price)	Between 1% and 6% of the final contract sales price, or a flat gift amount (not to exceed six percent (6%) of the final contract sales price)
<b>Seller's Contribution</b>	Equal to the gift given between 1% and 6%	Equal to the gift given between 1% and 6%
<b>Processing Fee</b>	For new construction and resale property types: \$599	For new construction and resale property types: \$599
<b>Method of Request</b>	The mortgage originators request gift funds online and retain the executed documents in the borrower's loan file—they are not faxed or mailed to Nehemiah	Closing agents* must fax all required executed documents to Nehemiah  *A settlement agent, closing attorney, escrow officer, or title company representative
<b>Turnaround Time</b>	The <b>same day</b> the online request is transmitted by the mortgage originator	<b>24 hours</b> upon receipt of all required executed documents

06/07/18

**Ref to OIG Evaluation**

**Auditee Comments**

4. <input type="checkbox"/> VA    5. <input type="checkbox"/> CONV. INS.		
<b>C. NOTE:</b> This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "[POC]" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.		
D. Name and Address of Borrower	E. Name and Address of Seller	F. Name and Address of Lender
G. Property Location		I. Settlement Date
H. Settlement Agent		
Place of Settlement		

J. SUMMARY OF BORROWER'S TRANSACTION		K. SUMMARY OF SELLER'S TRANSACTION	
100. Gross Amount Due From Borrower		400. Gross Amount Due To Seller	
101. Contract Sales Price	196,400.00	401. Contract Sales Price	196,400.00
102. Personal Property		402. Personal Property	
103. Settlement Charges to Borrower (Line 1400)	3,215.45	403.	
104.		404.	
105.		405.	
<b>Adjustments For Items Paid By Seller in advance</b>		<b>Adjustments For Items Paid By Seller in advance</b>	
106. City Taxes to		406. City Taxes to	
107. County Taxes to		407. County Taxes to	
108. Assessments to		408. Assessments to	
109. HOA Dues 04/22/08 to 07/01/08	100.85	409. HOA Dues 04/22/08 to 07/01/08	100.85
110.		410.	
111.		411.	
112.		412.	
<b>120. GROSS AMOUNT DUE FROM BORROWER</b>	<b>199,716.30</b>	<b>420. GROSS AMOUNT DUE TO SELLER</b>	<b>196,500.85</b>
200. Amounts Paid By or in Behalf of Borrower		500. Reductions in Amount Due to Seller	
201. Deposit or earnest money	1,500.00	501. Excess Deposit (See Instructions)	
202. Principal Amount of New Loan(s)	193,365.00	502. Settlement Charges to Seller (Line 1400)	16,250.88
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff First Mortgage to Washington Mutual Bank/06	73,685.48
205.		505. Payoff Second Mortgage	
206. Nehemiah Gift Funds	5,892.00	506. Deposit retained by broker	1,500.00
207.		507. Gift Funds & Service Fee to Nehemiah Corporation o	6,391.00
208.		508.	
209.		509.	
<b>Adjustments For Items Unpaid By Seller</b>		<b>Adjustments For Items Unpaid By Seller</b>	
210. City Taxes 01/01/08 to 04/22/08	53.28	510. City Taxes 01/01/08 to 04/22/08	53.28
211. County Taxes 01/01/08 to 04/22/08	406.02	511. County Taxes 01/01/08 to 04/22/08	406.02
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
<b>220. TOTAL PAID BY/FOR BORROWER</b>	<b>201,216.30</b>	<b>520. TOTAL REDUCTION AMOUNT DUE SELLER</b>	<b>98,296.66</b>
300. Cash At Settlement From or To Borrower		600. Cash At Settlement To or From Seller	
301. Gross Amount Due From Borrower (Line 120)	199,716.30	601. Gross Amount Due To Seller (Line 420)	196,500.85
302. Less Amount Paid By/For Borrower (Line 220)	( 201,216.30)	602. Less Reductions Due Seller (Line 520)	( 98,296.66)
303. CASH (FROM) (TO) BORROWER	1,500.00	603. CASH (TO) (FROM) SELLER	98,296.66

## OIG Evaluation of Auditee Comments

- Comment 1** As described in the audit report, our audit period was January 1, 2006, through December 31, 2007, and was expanded as necessary to meet our audit objectives. While seller-funded downpayment assistance programs will be eliminated as of October 1, 2008, the information in the audit report remains relevant and we continue to recommend that HUD take appropriate actions.
- Comment 2** The audit report clearly states that Heartland Funding was the auditee and not Midwest or the nonprofit. Heartland Funding participated in the downpayment assistance program when originating and obtaining insurance endorsement of FHA loans. As an FHA-approved lender, Heartland Funding is required to follow HUD requirements for FHA loans. In evaluating Heartland Funding's compliance with HUD rules, we identified the improper downpayment assistance program and Heartland Funding's role in the use of the program. In order to provide HUD with sufficient information to understand how the downpayment assistance program worked and take appropriate actions, it was necessary to include certain information regarding Midwest, an affiliated business entity controlled by Heartland Funding, and the unrelated nonprofit.
- Comment 3** Our key conclusions were that Heartland Funding failed to comply with federal regulations and HUD rules when operating as an FHA-approved lender. The report does not claim that the increased sales price was the result of Heartland Funding's conduct or that of Midwest's, but was intended to notify HUD that by participating in the Midwest/nonprofit downpayment assistance program, borrowers encountered higher sales prices after the seller agreed to participate in the downpayment assistance program.
- In regard to the increased sales prices, we clarified the report to further explain that several sellers had increased their list price or the initial agreed-upon sales price to cover the additional costs of the sale, after agreeing to participate in the Midwest/nonprofit downpayment assistance program and donate funds to a charitable organization on behalf of the borrower. However, borrowers told us that they were not aware that they may have incurred increased sales prices to accommodate the seller's costs of participating in the downpayment assistance program.
- We also note that the Government Accountability Office reported that property sellers often raised the sales price of their properties to recover the contribution to the seller-funded nonprofit that provided



the downpayment assistance. In these cases, borrowers may encounter mortgages that were higher than the true market value price of the home, and may represent 100 percent or more of the property's true value. Further, a HUD consultant reported that more than 50 percent of respondents to its study in each subject group including appraisers, mortgage lenders, underwriters, seller-funded downpayment assistance providers, and real estate agents indicated that seller-funded downpayment assistance programs inflated the property sales price. Therefore, based on our interviews of sellers and the GAO and HUD studies, we believe that at least the majority of sellers for the 25 loans in question negotiated a higher sales price to cover the additional costs of participating in the Midwest/nonprofit downpayment assistance program, and in doing so caused HUD to overinsure the loans.

**Comment 4**

We did not report that Heartland Funding caused borrowers to borrow more money than they could afford by permitting them to participate in the downpayment assistance program operated by Midwest. We reported that Heartland Funding did not follow federal regulations and HUD rules when originating FHA loans that involved downpayment assistance.

In addition, we concluded that Heartland Funding did not ensure that borrowers understood the loan transactions so that the borrowers had the opportunity to make informed decisions on their loans. If the borrowers had better understood the program and the actual or potential cost to them, they may have further negotiated with the seller to reach a lower sales price, with the seller incurring the cost of the downpayment assistance rather than passing that cost to the borrower through an increased sales price. In addition, borrowers could have sought out other downpayment assistance opportunities that did not involve seller-funded assistance and/or the borrowers incurring increased sales prices and/or additional settlement costs to obtain the assistance.

**Comment 5**

According to the 1998 HUD letter to Nehemiah Corporation of America (Nehemiah), HUD reviewed an Internal Revenue Service ruling and the documents submitted to the Internal Revenue Service by Nehemiah in relation to the ruling. HUD subsequently approved Nehemiah's program as established in its application for Section 501(c)(3) status.

To be clear, we did not conclude that seller-funded downpayment assistance programs are improper. We concluded that Heartland Funding did not follow federal regulations and HUD rules when processing FHA loans using the Midwest/nonprofit seller-funded program. In particular, Heartland Funding did not follow HUD

Handbook 4155.1, REV-5, paragraph 2-10C, which states that the gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them.

**Comment 6** Our audit was of Heartland Funding, not Nehemiah. Since we did not audit Nehemiah's program, we did not make any conclusions about that program. Our conclusions and related recommendations were based on Heartland Funding's failure to abide by RESPA and HUD rules when participating in FHA loan processing activities (as further explained in Comment 5).

**Comment 7** As stated in the report, HUD/FHA does not approve downpayment assistance (gift) programs administered by charitable organizations. Mortgage lenders are responsible for ensuring that the gift to the homebuyer from the charitable organization meets the appropriate FHA requirements and the transfer of funds is properly documented. As Heartland Funding acknowledged in its response to the report, using the business model of other organizations does not mean that lenders can rely on those business models to ensure compliance with applicable federal rules and regulations.

Further, if other entities are administering a downpayment assistance program in the same manner as Heartland Funding, they may be violating federal rules and regulations as well.

**Comment 8** The HUD reviewer that performed work at Heartland Funding in 2004 was a loan specialist from HUD's Office of Single Family Housing, Quality Assurance Division, not an auditor from the Office of Inspector General.

The HUD reviewer told us that his discussions with Heartland Funding did not involve whether the Midwest/nonprofit downpayment assistance program was acceptable to HUD or the specific activities that took place when processing a loan using the assistance program. The only issue discussed was that of a potential conflict of interest. We added detail to the report to clarify this position.

**Comment 9** Part of our audit objective was to determine whether the lender followed FHA requirements regarding borrower creditworthiness when underwriting loans. A borrower's creditworthiness includes evaluating the validity of the source of funds used to close the loan. Therefore, we evaluated whether Heartland Funding followed applicable rules regarding funds used to close the 35 loans reviewed. Downpayment assistance funds are a source of funds to close loans and therefore, evaluating downpayment assistance funds and the

Midwest/nonprofit program providing those funds for 25 of the loans that we reviewed fit within our audit objectives.

**Comment 10** We conducted an audit of Heartland Funding, not an investigation of FHA borrowers.

Based on the results of our review, we maintain that Heartland Funding failed to follow federal regulations and HUD rules and it is appropriate to recommend that HUD impose appropriate sanctions for RESPA violations and to refer Heartland Funding to HUD's Mortgagee Review Board for review and appropriate actions.

**Comment 11** As explained in comment 2, Heartland Funding was the auditee and not Midwest. In evaluating Heartland Funding's compliance with applicable rules and regulations, we identified what we believe were RESPA violations by Heartland Funding. To provide HUD with sufficient information to understand our findings and take appropriate actions, it was necessary to include certain information regarding Midwest, an affiliated business entity participating in loan transactions in which Heartland Funding violated RESPA. We continue to recommend that HUD take sanctions against Heartland Funding for the RESPA violations.

**Comment 12** We maintain that Midwest was an affiliated business of Heartland Funding, as described in the report.

**Comment 13** We believe that Midwest provided settlement services in the processing of the FHA loans and is subject to RESPA requirements. For each of the loans reviewed that used the improper downpayment assistance program, Midwest signed a document stating that it was advancing the downpayment assistance funds on behalf of the nonprofit entity to facilitate the loan closing, as follows:

the nonprofit entity

As a matter of record, Mid-West Housing Authority Corp. does not donate to [redacted] but to facilitate closing of this real estate transaction is merely advancing these funds on behalf of [redacted]. These funds are committed to [redacted] under the terms of Pledge No. 6869.
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Note: We redacted the identity of the nonprofit entity to protect its privacy.

In addition, the executive director of the nonprofit entity confirmed that the nonprofit did not directly provide the downpayment assistance funds to the borrowers and that Midwest handled the services for the program as the nonprofit's administrator of the program. Midwest essentially acted as a contractor to the nonprofit and took on the roles and responsibilities of the program for the nonprofit, including settlement services. Therefore, we believe that Midwest provided

settlement services by actively participating in the origination, processing, and funding of the FHA loans; and its relationship with Heartland Funding should have been disclosed to borrowers.

**Comment 14** One of the purposes of RESPA is to help consumers become better shoppers for real estate settlement services. One way that RESPA does that is to require lenders to disclose affiliated business relationships with entities affecting a federally related mortgage loan. We did not conclude that borrowers would have made different decisions on their mortgage loans had they been made aware of the relationship between Heartland Funding and Midwest. However, we concluded that Heartland Funding did not ensure that borrowers had the required information that could have affected their decisions on their loan. Neither we nor Heartland Funding can conclude what borrowers would have done had they been aware of the relationship and fully understood the details of how the downpayment assistance program operated and was funded.

**Comment 15** Finding 1 addresses our conclusions regarding RESPA violations related to Heartland Funding's processing of FHA loans. Finding 2 addresses all material deficiencies identified regarding borrower eligibility and creditworthiness. We did not evaluate whether borrowers needed downpayment assistance to purchase the home and obtain an FHA loan. We evaluated whether Heartland Funding followed applicable rules and regulations when evaluating the funds used to close the loan (i.e. funds were from allowable sources, and properly verified and documented).

We disagree that it is apparent that the only alternative open to the borrowers was downpayment assistance from another entity, and that any other downpayment assistance would have entailed charging the seller a fee. HUD Handbook 4155.1 REV-5, explains that HUD allows downpayment assistance from multiple sources, including the borrower's relative, employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. Such donations would not necessarily involve an intermediary to process/transfer the funds; therefore, we believe that not all downpayment assistance options would have involved charging the seller a service fee.

As noted in comment 14, neither we nor Heartland Funding are in a position to conclude how full disclosure would have impacted the borrowers' decisions.

**Comment 16** As stated in the report, according to the Heartland Funding accountant, Midwest did not reimburse Heartland Funding for the services that its staff provided to Midwest. In addition, Heartland Funding did not provide the audit team, either during the audit or with its written response, any evidence that Midwest reimbursed Heartland Funding.

**Comment 17** To clarify our conclusions, we revised the statement that borrowers were not aware that they had paid a service fee for receiving the assistance and explained that borrowers were not aware that they may have incurred increased sales prices to accommodate the seller's costs of participating in the downpayment assistance program. Our intent was to point out to HUD that borrowers ultimately and unknowingly incurred the service fee when sellers increased the home price to account for the increased costs of selling their homes.

**Comment 18** We maintain that a Heartland Funding employee, the loan closer, provided instructions to the title company that mischaracterized the downpayment assistance transactions. We agree that the closing instructions state that Midwest and the nonprofit were providing the instructions, as shown below in an excerpt from a typical instructions form:

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the nonprofit entity

MID-WEST HOUSING AUTHORITY CORP. instructs the Closing Agent to credit [REDACTED] the sum of \$4254.00 from their proceeds (on HUD1 line 209\*\*)

The nonprofit entity

[REDACTED] instructs Closing Agent to credit \$4254.00 to Buyer concurrent with close of Escrow (on HUD1 line 209\*\*)

**THIS IS A GIFT, NO REPAYMENT IS REQUIRED**  
**\$1063.50 DIFFERENCE (Line 1305 LESS Line 209)** on HUD1 is to be remitted by Closing Agent to **Mid-West Housing Authority Corp.** THE HUD1 AND THE BALANCE OF THE SERVICE FEE PLUS ALL EXCESS ESCROW FUNDS PAYABLE TO MID-WEST HOUSING AUTHORITY CORP. MUST BE SENT WITHIN 24 HOURS OF CLOSING TO: MIDWEST HOUSING AUTHORITY CORP. 1442 E. PRIMROSE, SUITE 200, SPRINGFIELD, MO 65804. **Check can be delivered through Heartland Funding Corporation with the closed loan package.**

However, the loan closer physically completed the loan closing instruction forms and she or another Heartland Funding employee provided the instructions to the title company. Also, as pointed out in the report and comment 16, Heartland Funding provided no evidence to the audit team that Midwest reimbursed Heartland Funding for any services that its staff provided on behalf of Midwest.

**Comment 19** As explained in comment 3, we clarified the report to explain that several sellers had increased their home prices to cover the additional costs of the sale when agreeing to participate in the Midwest/nonprofit downpayment assistance program. And, borrowers told us that they were not aware that they may have incurred increased sales prices to accommodate the seller's increased costs of selling their home.

**Comment 20** We maintain that Heartland Funding did not ensure that there was an actual transfer of funds from the nonprofit donor to the borrower, nor did it ensure that the funds came from an acceptable source. HUD Handbook 4155.1, REV-5, paragraph 2-10C, Gift Funds (see appendix A, criterion 17), focuses on cash investments (verifiable, existing funds) needed to close the loan and how HUD requires lenders to verify and document the cash investment. The Midwest/nonprofit downpayment assistance program did not use any of the described ways to validate that an actual cash investment existed. The HUD requirement provides the rules for how lenders are to ensure that the donated funds actually exist and have been or will be transferred to the borrower from an acceptable source separate from the closing transactions depicted on the HUD-1 settlement statement. The Midwest/nonprofit program processes did not establish a real cash investment by the nonprofit.

**Comment 21** We disagree with Heartland Funding's conclusion that the control of funds through the escrow drafts effectively meets HUD's requirements, or that it adequately establishes an acceptable source of the downpayment assistance funds. As previously explained, Midwest did not physically transfer donated funds to the borrower, nor did the nonprofit entity. The only real funds changing hands in relation to the downpayment assistance process was that of the title company paying Midwest when the loan closed. The only source of funds available to the borrowers as downpayment assistance funds, according to the HUD-1 settlement statement, was the sellers' funds at the time of closing. HUD specifically states in its requirements that the seller is not an acceptable donor.

**Comment 22** As explained in comment 13, we believe that Midwest provided settlement services in the processing of the FHA loans receiving the Midwest/nonprofit downpayment assistance. Therefore, we maintain that improper fee splitting took place.

Also, we did not conclude that it was inappropriate for Heartland Funding's owners to have separately organized Midwest. We concluded only that Heartland Funding did not disclose its affiliated business relationship with Midwest, as required by RESPA. Also, as explained in comment 8, we changed the report to better explain what the HUD reviewer stated took place during the 2004 review.

**Comment 23** We disagree and continue to believe that Heartland Funding controlled the business activities of Midwest and violated RESPA when it allowed Midwest to split a portion of its fee with the nonprofit entity

that performed no services in the downpayment assistance transactions.

**Comment 24** We do not agree that the nonprofit entity performed a service that allowed it to earn a fee for its connection to the downpayment assistance program. In addition, the nonprofit's executive director confirmed that the entity provided no services for the program and relied on Midwest, as its administrator of the program, to handle the program activities.

We also disagree that the nonprofit performed a service simply by permitting Midwest to donate funds (by advancing the funds to the nonprofit via the escrow draft process in question) that Heartland Funding contends that the nonprofit legally controlled.

**Comment 25** As further explained in comment 3, the report does not claim that the increased sales price was the result of Heartland Funding's conduct or that of Midwest's. Our intent was to notify HUD that some borrowers participating in the program encountered higher sales prices than originally offered by the seller after the seller agreed to participate in the downpayment assistance program.

In addition, we disagree that borrowers' participation in other downpayment assistance programs or receipt of funds from other allowable sources would have resulted in increased sales prices. For example, sellers could have agreed to participate in a program by donating the necessary funds to the entity donating to the borrower, without raising the original sales price of the home but instead, considering the donation as a mere cost of selling their home. Also, borrowers could have received assistance from individuals other than the seller or other entities that would not have affected the selling price of the home.

**Comment 26** We did not report that borrowers had no option on what entity provided downpayment assistance. We reported what borrowers told us about their experience with Heartland Funding and the options presented for downpayment assistance.

We disagree that the named entities provided downpayment assistance to any of the 35 loans reviewed. Of the 35 loans, 25 borrowers used the Midwest/nonprofit program. For the remaining 10 loans, only two involved a nonprofit entity providing downpayment assistance and the donor identified on the HUD-1 settlement statement and gift documentation was neither of the named entities.

**Comment 27**

Based on the conclusions reached during the audit and detailed in this report, we maintain that the recommendations made to HUD are supported and appropriate.



## Appendix C

### CRITERIA

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#### **Criterion 1**

HUD Handbook 4060.1, REV-2, section 7-3, states that there are several basic elements that are required in all quality control programs that apply to both origination and servicing. Paragraph 7-3F states that all aspects of the mortgage operation, including but not limited to all branch offices or sites, FHA-approved loan correspondents, authorized agents, loan officers or originators, processors, underwriters, appraisers, closing personnel, and all FHA loan programs, must be subject to the lender's quality control reviews.

#### **Criterion 2**

HUD Handbook 4060.1, REV-2, paragraph 7-3G, states that lender offices, including traditional, nontraditional branch, and direct lending offices engaged in origination or servicing of FHA-insured loans, must be reviewed to determine that they are in compliance with HUD's requirements.

#### **Criterion 3**

HUD Handbook 4060.1, REV-2, paragraph 7-3J, states that findings of fraud or other serious violations must be immediately referred in writing (along with any available supporting documentation) to the Director of the Quality Assurance Division in the HUD homeownership center having jurisdiction. If HUD staff is suspected of involvement, refer to OIG.

#### **Criterion 4**

HUD Handbook 4060.1, REV-2, paragraph 7-5A, states that lenders should monitor the application process and must verify the identity of the loan applicant.

#### **Criterion 5**

HUD Handbook 4060.1, REV-2, paragraph 7-5C, states that lenders must identify patterns of early defaults by location, program, loan characteristic, loan correspondent, or sponsor.

#### **Criterion 6**

HUD Handbook 4060.1, REV-2, paragraph 7-6E(2), states that documents contained in the loan file should be checked for sufficiency and subjected to written reverification. Examples of items that must be reverified include but are not limited to the borrowers' employment or other income, deposits, gift letters, alternate credit sources, and other sources of funds.

### **Criterion 7**

HUD Handbook 4060.1, REV-2, paragraph 7-6E(3), states that a desk review of the property appraisal must be performed on all loans chosen for a quality control review except streamline refinances and HUD real estate owned sales. The desk review must include a review of the appraisal data, the validity of the comparables, the value conclusion, any changes made by the underwriter, and the overall quality of the appraisal. Field reviews must be performed by licensed appraisers listed on FHA's roster of appraisers.

### **Criterion 8**

HUD Handbook 4060.1, REV-2, paragraph 7-6G, states that each loan selected for a quality control review must be reviewed to determine whether conditions required to be satisfied before closing were met before closing, the seller was the owner of record or was exempt from the owner of record requirement in accordance with HUD regulations, the loan was closed and funds disbursed in accordance with the lender's underwriting and subsequent closings instructions, and the closing and legal documents are accurate and complete.

### **Criterion 9**

HUD Handbook 4060.1, REV-2, paragraph 7-7B, states that the lender must determine whether the appraised value was established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.

### **Criterion 10**

HUD Handbook 4060.1, REV-2, paragraph 7-7C, states that the lender must determine whether loan documents requiring signature (other than blanket verification releases) were signed by the borrower or employee(s) of the lender only after completion and that all corrections were initialed by the borrower or employee(s) of the lender.

### **Criterion 11**

HUD Handbook 4060.1, REV-2, paragraph 7-7P, states that the lender must determine whether the seller acquired the property at the time of or soon before closing, indicating a possible property flip.

### **Criterion 12**

HUD Handbook 4060.1, REV-2, paragraph 7-3I, states that review findings must be reported to the lender's senior management within one month of completion of the initial report. Management must take prompt action to deal appropriately with any material findings.

### **Criterion 13**

Heartland Funding's quality control plan states that for on-site branch office audits, the audit is conducted, at a minimum, once each calendar year on the premises of each branch office, unannounced. It also states that reports are prepared and provided to

senior management by the inspecting individual within Heartland Funding within 30 days following the audit.

**Criterion 14**

HUD Handbook 4060.1, REV-2, paragraph 7-6D, states that in addition to loans selected for routine quality control reviews, lenders must review all loans going into default within the first six payments. Early payment defaults are loans that become 60 days past due.

**Criterion 15**

HUD Handbook 4060.1, REV-2, paragraph 7-6A, states that loans must be reviewed within 90 days from the end of the month in which the loan closed. This requirement is intended to ensure that problems left undetected before closing are identified as early after closing as possible.

**Criterion 16**

HUD Handbook 4060.1, REV-2, paragraph 7-6C, states that a lender who originates and/or underwrites 3,500 or fewer FHA loans per year must review 10 percent of the FHA loans it originates.

**Criterion 17**

HUD Handbook 4155.1, REV-5, paragraph 2-10C, states that an outright gift of the cash investment is acceptable if the donor is the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. The gift donor may not be a person or entity with an interest in the sale of the property, such as the seller, real estate agent or broker, builder, or any entity associated with them. Gifts from these sources are considered inducements to purchase and must be subtracted from the sales price. No repayment of the gift may be expected or implied. As a rule, HUD is not concerned with how the donor obtains the gift funds provided they are not derived in any manner from a party to the sales transaction. Donors may borrow gift funds from any other acceptable source provided the mortgage borrowers are not obligors to any note to secure money borrowed to give the gift.

The lender must document the gift funds by obtaining a gift letter, signed by the donor and borrower, that specifies the dollar amount of the gift; states that no repayment is required; shows the donor's name, address, and telephone number; and states the nature of the donor's relationship to the borrower. In addition, the lender must document the transfer of funds from the donor to the borrower as follows:

1. If the gift funds are in the homebuyer's bank account, the lender must document the transfer of the funds from the donor to the homebuyer by obtaining a copy of the canceled check or other withdrawal document showing that the withdrawal is from the donor's account. The homebuyer's deposit slip and bank statement that shows the deposit are also required.

2. If the gift funds are to be provided at closing,
  - a. If the transfer of the gift funds is by certified check made on the donor's account, the lender must obtain a bank statement showing the withdrawal from the donor's account, as well as a copy of the certified check.
  - b. If the donor purchased a cashier's check, money order, official check, or any other type of bank check as a means of transferring the gift funds, the donor must provide a withdrawal document or canceled check for the amount of the gift, showing that the funds came from the donor's personal account. If the donor borrowed the gift funds and cannot provide documentation from the bank or other savings account, the donor must provide written evidence that those funds were borrowed from an acceptable source (i.e., not from a party to the transaction, including the lender). "Cash on hand" is not an acceptable source of the donor's gift funds.

Regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds ultimately were not provided from an unacceptable source and were indeed the donor's own funds. When the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source.

NOTE: FHA does not "approve" downpayment assistance programs in the form of gifts administered by charitable organizations (i.e., nonprofits). Mortgage lenders are responsible for ensuring that the gift to the homebuyer from the charitable organization meets the appropriate FHA requirements and the transfer of funds is properly documented. In addition, FHA does not allow nonprofit entities to provide gifts to homebuyers for the purpose of paying off installment loans, credit cards, collections, judgments, and similar debts.

### **Criterion 18**

Mortgagee Letter 2004-28 states that HUD Handbook 4155.1, REV-5, sets forth the documentation requirements for showing the transfer of gift funds (see paragraph 2-10C). The instructions also state that when the transfer occurs at closing, the lender remains responsible for obtaining verification that the closing agent received funds from the donor for the amount of the purported gift and that those funds came from an acceptable source. Since most transfers of downpayment funds from charities are by means of wire transfers, the lender must obtain and keep the documentation of the wire transfer in the mortgage loan application binder. While that document need not be provided in the insurance binder, it must be available for inspection by HUD when it conducts on-site reviews of lenders.

### **Criterion 19**

HUD Handbook 4155.1, REV-5, paragraph 2-11A, states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child

support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense and all other recurring charges extending 10 months or more, including payments on installment accounts, child support or separate maintenance payments, revolving accounts, alimony, etc. Debts lasting less than 10 months must be counted if the amount of the debt affects the borrower's ability to make the mortgage payment during the months immediately after loan closing. This is especially true if the borrower will have limited or no cash assets after loan closing.

#### **Criterion 20**

HUD Handbook 4155.1, REV-5, paragraph 2-11A(1), states that if a borrower has a revolving account with an outstanding balance, the monthly payments for qualifying purposes must be calculated at the greater of 5 percent of the balance or \$10 (unless the account shows a specific minimum payment).

#### **Criterion 21**

Mortgagee Letter 2005-16 states that for manually underwritten mortgages in which the direct endorsement underwriter make the credit decision, the qualifying ratios are raised to 31 percent and 43 percent. This change will allow a larger number of deserving families to purchase their first home while not increasing their risk of default. As always, if either or both ratios are exceeded on a manually underwritten mortgage, the lender must describe the compensating factors used to justify mortgage approval.

#### **Criterion 22**

HUD Handbook 4155.1, REV-5, paragraph 2-6, states that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. Income may not be used in calculating the borrower's income ratios if it comes from any source that cannot be verified, is not stable, or will not continue. This section describes acceptable types of income, procedures for calculating effective income, and requirements for establishing income stability. HUD does not impose a minimum length of time a borrower must have held a position of employment to be eligible. However, the lender must verify the borrower's employment for the most recent two full years. To analyze and document the probability of continued employment, lenders must examine the borrower's past employment record, qualifications for the position, previous training and education, and the employer's confirmation of continued employment.

#### **Criterion 23**

HUD Handbook 4155.1, REV-5, paragraph 2-7(O), states that only the amount by which the borrower's automobile allowance or expense account payments exceed actual expenditures may be considered income.

#### **Criterion 24**

HUD Handbook 4155.1, REV-5, paragraph 3-1(E), states that a verification of employment and the borrower's most recent pay stub are to be provided. "Most recent" means at time the loan application is made. If the document is not more than 120 days old when the loan closes (180 days old on new construction), it does not have to be

updated. As an alternative to obtaining a verification of employment, the lender may obtain the original pay stubs covering the most recent 30-day period, along with the original Internal Revenue Service Forms W-2 from the previous two years. The pay stubs must show the borrower's name, Social Security number, and year-to-date earnings. Any copy of the W-2 not submitted with the borrower's income tax returns are considered "original W-2s."

The lender must also verify by telephone all current employers. The loan file must include a certification from the lender that the original documents were examined and the name, title, and telephone number of the person with whom employment was verified. For all loans processed in this manner, the lender also must obtain a signed copy of Internal Revenue Service Form 4506, Request for Copy of Tax Form; Internal Revenue Service Form 8821; or a document that is appropriate for obtaining tax returns directly from the Internal Revenue Service. The lender may also use an electronic retrieval service for obtaining W-2 and other tax return information. If the employer will not give telephone confirmation of employment or if the W-2 indicates inconsistencies (e.g., Federal Insurance Contributions Act (FICA) payments not reflecting earnings), standard employment documentation must be used.

#### **Criterion 25**

HUD Handbook 4155.1, REV-5, paragraph 2-10, states that all funds for the borrower's investment in the property must be verified and documented. In addition, paragraph 2-10A states that if the amount of earnest money deposit exceeds 2 percent of the sales price or appears excessive based on the borrower's history of accumulating savings, the lender must verify with documentation the deposit amount and the source of funds. Paragraph 2-10B adds that a verification of deposit, along with the most recent bank statement, may be used to verify savings and checking accounts. If there was a large increase in an account or the account was opened recently, the lender must obtain a credible explanation of the source of those funds.

#### **Criterion 26**

HUD Handbook 4155.1, REV-5, paragraph 2-10M, states that borrowers who have saved cash at home and are able to demonstrate adequately the ability to do so are permitted to have this money included as an acceptable source of funds to close the mortgage. To include such funds in assessing the homebuyer's cash assets for closing, the money must be verified, whether deposited in a financial institution or held by the escrow/title company, and the borrower must provide satisfactory evidence of the ability to accumulate such savings. The asset verification process requires the borrower to explain in writing how such funds were accumulated and the amount of time taken to do so. The lender must determine the reasonableness of the accumulation of the funds based on the borrower's income stream, the period during which the funds were saved, the borrower's spending habits, documented expenses, and the borrower's history of using financial institutions.

## Appendix D

### SCHEDULE OF SIGNIFICANT UNDERWRITING DEFICIENCIES

FHA case number	Insurance status	Unpaid principal balance	Potential loss on active loans*	Actual loss on sale of property	Midwest service fee paid by seller/ principal reduction	Improper downpayment funds	Unsupported income/questionable employment	Unsupported assets	Underreported liabilities
291-3436225	Active	\$88,478	\$33,085		\$3,645	X			
291-3445329	Active	\$72,233	\$27,094		\$2,762	X			
291-3491171	Active	\$58,579	\$21,968		\$2,250	X			
291-3497962	Active	\$167,372	\$62,760		\$6,450	X			
291-3504173	Active	\$76,818	\$28,824		\$2,910	X			
291-3510603	Active	\$137,505	\$51,592		\$5,217	X			
291-3515216	Active	\$60,935	\$22,852		\$2,340	X			
291-3523490	Active	\$112,158	\$42,069		\$4,288	X			
291-3534543	Active	\$68,653	\$25,694		\$2,772	X			
291-3536810	Active	\$53,315	\$20,003		\$2,026	X			
292-4750043	Active	\$53,085	\$19,913		\$2,025	X			
291-3451490	Active	\$85,475	\$32,058		\$3,274	X			
291-3501879	Active	\$77,615	\$29,122		\$2,942	X			
291-3457458	Active	\$120,882	\$45,200		\$4,984	X			
183-0050764	Active	\$63,205	\$23,716		\$2,396	X			
291-3478304	Active	\$59,273	\$22,239		\$2,250	X			X
291-3514867	Active	\$68,300	\$25,627		\$2,591	X			X
<b>Subtotal</b>		<b>\$1,423,881</b>	<b>\$533,816*</b>		<b>\$55,122</b>				

FHA case number	Insurance status	Unpaid principal balance	Potential loss on active loans*	Actual loss on sale of property	Midwest service fee paid by seller/ principal reduction	Improper downpayment funds	Unsupported income/questionable employment	Unsupported assets	Underreported liabilities
291-3470693	Claims – not sold	\$69,553	\$26,094		\$2,644	X			
291-3437844	Claims – not sold	\$80,376	\$30,154		\$3,058	X			
031-3342094	Claims – not sold	\$96,245	\$36,095		\$3,694	X			
291-3473099	Claims – not sold	\$85,069	\$31,919		\$3,225	X			
291-3444897	Claims – not sold	\$74,164	\$27,827		\$2,813	X			
292-4759348	Claims – not sold	\$139,505	\$52,333		\$5,318	X			
291-3451881	Claims – not sold	\$72,621	\$27,251		\$2,747	X			
291-3438912	Claims – not sold	\$138,275	\$51,925		\$5,134	X	X		
<b>Subtotal</b>		<b>\$755,808</b>	<b>\$283,598*</b>		<b>\$28,633</b>				
291-3445667	Claims – not sold	\$174,044	\$67,877					X	
<b>Subtotal</b>		<b>\$929,852</b>	<b>\$351,475</b>						
291-3433547	Claims - sold			\$54,415		X			
<b>Totals</b>		<b>\$2,353,733</b>	<b>\$885,291</b>	<b>\$54,415</b>	<b>\$83,755</b>				

\* Estimated future losses are based on HUD's average loss rate of 39 percent of the unpaid principal balance for claims paid from the FHA insurance fund for fiscal year 2007. For the 25 loans that participated in the improper downpayment assistance program (17 active loans and 8 loans with claims paid but the property had not yet been sold), we reduced the unpaid principal balances by the sales price increases/principal reductions before applying the 39 percent loss rate.



## Appendix E

### CASE STUDIES FOR 27 QUESTIONED LOANS

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Case number: 291-3436225

Insured amount: \$89,708

Section of Housing Act: 234(c)

Status upon selection: Defaulted on 14th payment

Date of loan closing: April 12, 2006

Underwriter type: Manual

#### **Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,734 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$3,645 (4 percent of the sales price) to Midwest. However, there was no evidence of actual transfer of funds from the nonprofit entity to the borrower.

#### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3445329

Insured amount: \$73,084

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 12th payment

Date of loan closing: May 12, 2006

Underwriter type: Manual

#### **Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,210 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,762 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

#### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3491171

Insured amount: \$59,529

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: December 7, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,800 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,250 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3497962

Insured amount: \$169,342

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 1<sup>st</sup> payment

Date of loan closing: January 18, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$5,160 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$6,450 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3504173

Insured amount: \$76,991

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: February 23, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,328 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,910 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3510603

Insured amount: \$138,024

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: March 8, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$4,173 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$5,217 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3515216

Insured amount: \$61,165

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 2nd payment

Date of loan closing: April 4, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,755 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,340 (3.8 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3523490

Insured amount: \$112,582

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 4th payment

Date of loan closing: April 27, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$3,431 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$4,288 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3534543

Insured amount: \$68,756

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: June 12, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,079 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,772 (4 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3536810

Insured amount: \$53,601

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 2nd payment

Date of loan closing: June 4, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,621 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,026 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 292-4750043

Insured amount: \$53,165

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 3rd payment

Date of loan closing: May 8, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,620 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,025 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3451490

Insured amount: \$86,615

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 10th payment

Date of loan closing: June 12, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,619 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$3,274 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3501879

Insured amount: \$77,826

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: January 29, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,353 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,942 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3457458

Insured amount: \$122,674

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 15th payment

Date of loan closing: June 28, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$3,738 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$4,984 (4 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 183-0050764

Insured amount: \$63,395

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: October 12, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,917 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,396 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3478304

Insured amount: \$59,529

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 5th payment

Date of loan closing: September 29, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$1,800 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,250 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)



### **Underreported Liabilities**

The lender did not include monthly obligations of \$691 in the borrower's financial ratios. The borrower provided statements from creditors to establish a supplemental, nontraditional credit history. The lender had evidence that the borrower had two accounts with a television sales and rental company with balances of \$6,548 and \$1,300. HUD requires that at least 5 percent of the balance be used in calculating the minimum monthly payment. Therefore, the borrower had installment/revolving debt of \$327 ( $\$6,548 \times .05$ ) and \$65 ( $\$1,300 \times .05$ ) that the lender had not considered when evaluating the borrower's debts.

The lender also had evidence that the borrower had an auto loan and was making payments of \$69 per week, or \$299 per month, with an outstanding balance of approximately \$2,137. The lender did not consider this debt in the financial ratios either. Although at \$299 per month the borrower was scheduled to pay off the auto loan in about seven months, the lender should have included the \$299 monthly auto loan in the financial ratios because the debt affected the borrower's ability to make the mortgage payment immediately after loan closing. The additional debts increased the monthly debt by \$691 ( $\$327 + \$65 + \$299$ ).

Further, the borrower had no cash assets after closing. The mortgage credit analysis worksheet showed that the borrower had only \$90 in reserves, the two monthly bank statements showed less than \$2 balances at the end of each month, the borrower reported no cash assets on the application (only a small 401K), and a note in the loan file stated that the borrower had to take the entire \$278 balance from his bank account and make a deposit on the way to closing to have sufficient funds of \$279 to close the loan. This information further showed that the auto loan would have significantly affected the borrower's ability to repay the mortgage. The additional debts increased the debt-to-income (back) ratio from 32.09 percent to 76.11 percent. This well exceeded HUD's requirement of 43 percent.

### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-11A (criterion 19)

HUD Handbook 4155.1, REV-5, paragraph 2-11A(1) (criterion 20)

Mortgagee Letter 2005-16 (criterion 21)

Case number: 291-3514867

Insured amount: \$68,558

Section of Housing Act: 203(b)

Status upon selection: Defaulted on 4th payment

Date of loan closing: March 26, 2007

Underwriter type: Manual

### **Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,073 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,591 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

### **Underreported Liabilities**

The lender did not include monthly obligations of \$254 in the borrower's financial ratios. The only liability reported on the mortgage credit analysis worksheet and loan application was \$136 per month. The lender had obtained two additional statements of nontraditional credit to evaluate the borrower's credit history. One statement was from a car dealer, showing a balance of \$3,581 and a weekly payment of \$30 (or \$130 monthly, based on a yearly cost). The other credit was from a rent-to-own store with no balance listed but a history of paying \$124 per month. However, the lender did not include these liabilities in the debt ratios. If these additional liabilities had been included, the debt-to-income (back) ratio would have increased from 35.54 percent to 48.9 percent. In addition, the lender used an incorrect monthly principal and interest amount (\$428.49), which was \$50.88 less than the actual note amount (\$479.37), in computing the back ratio. If the lender had used the correct liabilities and principal and interest amounts, this would have increased the back ratio to 51.6 percent. The lender did not provide compensating factors on the mortgage credit analysis worksheet. The back ratio exceeded HUD's limit of 43 percent.

### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-11A (criterion 19)

Mortgagee Letter 2005-16 (criterion 21)

Case number: 291-3470693

Insured amount: \$69,946

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 7<sup>th</sup> payment

Date of loan closing: August 28, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,115 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,644 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3437844

Insured amount: \$80,918

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 1<sup>st</sup> payment

Date of loan closing: May 4, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,447 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$3,058 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 031-3342094

Insured amount: \$96,978

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 6<sup>th</sup> payment

Date of loan closing: March 13, 2006

Underwriter type: Automated

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,955 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$3,694 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3473099

Insured amount: \$85,325

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 5th payment

Date of loan closing: September 22, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,580 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$3,225 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3444897

Insured amount: \$74,411

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 5th payment

Date of loan closing: May 15, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,250 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,813 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 292-4759348

Insured amount: \$139,609

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 2nd payment

Date of loan closing: May 2, 2007

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$4,254 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$5,318 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3451881

Insured amount: \$72,675

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 2nd payment

Date of loan closing: June 9, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$2,198 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$2,747 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3438912

Insured amount: \$139,838

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on  
13th payment

Date of loan closing: May 18, 2006

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The HUD-1 settlement statement showed that the borrower received downpayment assistance of \$4,261 from a nonprofit entity. The settlement statement showed that the seller paid a service fee of \$5,134 (3.75 percent of the sales price) to Midwest. However, there was no evidence of actual funds transferred from the nonprofit entity to the borrower.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)  
Mortgagee Letter 2004-28 (criterion 18)

### **Unsupported Income/Questionable Employment History**

The lender did not adequately confirm the borrower's income/employment information. The lender did not obtain a verification of employment, and neither the loan application nor paystubs identified the borrower's employer, drawing into question the validity of the reported employment and income. Using the income data in the loan file, the lender also overstated the borrower's income. The lender calculated the monthly income using the borrower's gross pay, expense reimbursements, and advances. However, the lender should not have included the expense reimbursements in the borrower's income. The lender did not document sufficient information in the loan file to determine the proper monthly income, and, therefore, it was unable to show what the financial ratios should have been to determine the borrower's ability to repay the mortgage.

### **HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-6 (criterion 22)

HUD Handbook 4155.1, REV-5, paragraph 2-7O (criterion 23)

HUD Handbook 4155.1, REV-5, paragraph 3-1E (criterion 24)

Case number: 291-3445667

Insured amount: \$167,373

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 8th payment

Date of loan closing: May 10, 2006

Underwriter type: Automated

### **Unsupported Assets**

The lender did not verify assets used to close the loan. According to the sales contract and the HUD-1 settlement statement, the borrower paid a \$3,500 earnest deposit. However, there were no bank statements or verification of deposit to indicate the source of funds for the \$3,500. Also, the borrower did not provide satisfactory evidence of the borrower's ability to accumulate such savings.

Also, the lender did not verify the source of \$6,617 that the borrower paid in cash at closing. The HUD-1 settlement statement did not indicate downpayment assistance funds used on the loan, but the mortgage credit analysis worksheet indicated that the borrower had \$9,500 in assistance funds available. The lender obtained an assistance letter from a relative for \$6,000 and a copy of a cashier's check for that amount payable to the title company. The donor's bank confirmed that the donor had the funds available to give the borrower; however, there was no evidence in the loan documentation that the donor actually transferred the funds to the borrower. The lender did not obtain a withdrawal document or canceled check for the funds.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraphs 2-10 & 2-10A (criterion 25)

HUD Handbook 4155.1, REV-5, paragraph 2-10M (criterion 26)

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)

Case number: 291-3433547

Insured amount: \$77,484

Section of Housing Act: 203(b)

Status upon selection: Claim - defaulted on 2nd payment

Date of loan closing: April 10, 2006

HUD costs incurred: Loss on sale of property - \$54,415

Underwriter type: Manual

**Improper Downpayment Assistance Funds**

The lender did not adequately document that the donor transferred the downpayment assistance funds to the borrower. The lender obtained an assistance letter from a relative for \$4,800 and a copy of a cashier's check for that amount payable to the borrower. The donor's bank confirmed that the donor had the funds available to give the borrower; however, there was no evidence that the donor gave the funds to the borrower. The lender did not obtain bank statements of either the donor or the borrower, the cashier's check did not show that it was negotiated, and there was no other evidence of the transfer of funds.

**HUD Requirements – Appendix C**

HUD Handbook 4155.1, REV-5, paragraph 2-10C (criterion 17)

Mortgagee Letter 2004-28 (criterion 18)



## Appendix F

### QUALITY CONTROL PLAN MISSING ELEMENTS

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Heartland Funding's quality control plan did not contain the following 11 required elements. The plan did not require the lender to

- Review certain items at the branch offices, including whether the office provided toll-free lines or accepted collect calls from borrowers and whether personnel were employees of the lender or contract employees performing functions that FHA allows to be outsourced.
- Immediately refer findings of fraud or other serious violations in writing (along with available documentation) to HUD or to refer HUD staff suspected of involvement to OIG.
- Verify the identity of the loan applicant.
- Identify patterns of early defaults by location, program, loan characteristic, loan correspondent, or sponsor.
- Reverify other income.
- Ensure that appraisal desk reviews included a review of the appraisal data, validity of the comparables, value assigned, any changes made by the underwriter, and overall quality of the appraisal.
- Ensure that appraisal field reviews be performed by licensed appraisers listed on FHA's roster of appraisers.
- Ensure that conditions required for closing were met, the seller was the owner of record, the loan was closed and funds properly disbursed, and closing and legal documents were accurate and complete.
- Determine whether appraised values were established using reasonable comparables, reasonable adjustments, and in expectation of repairs required to meet minimum safety and soundness requirements.
- Determine whether loan documents, requiring signature, were signed by the borrower or employees of the lender only after completion and that all corrections were initialed by the borrower and/or employees of the lender, as appropriate.

- Determine whether the seller acquired the property at the time of closing or shortly before the closing, indicating a possible property flip.