



U.S. DEPARTMENT OF  
HOUSING AND URBAN DEVELOPMENT  
OFFICE OF INSPECTOR GENERAL

September 28, 2017

**MEMORANDUM NO:**  
2017-LA-1803

## *Memorandum*

TO: Gisele G. Roget  
Deputy Assistant Secretary for Single Family Housing, HU

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

//SIGNED//

FROM: Tanya E. Schulze  
Regional Inspector General for Audit, Los Angeles Region, 9DGA

SUBJECT: RMS & Associates, Las Vegas, NV, Improperly Originated FHA-Insured Loans  
With Restrictive Covenants

### **INTRODUCTION**

We audited RMS & Associates' Federal Housing Administration (FHA) loan origination because it was one of the top lenders that originated FHA-insured loans with downpayment assistance from the City of Las Vegas. A previous U.S. Department of Housing and Urban Development, Office of Inspector General (HUD OIG), audit (Evergreen Home Loans, 2016-LA-1011) found that Evergreen originated FHA-insured loans in connection with the City of Las Vegas' downpayment assistance program that contained prohibited legal restrictions on conveyance.

The objective of our audit was to determine whether RMS improperly originated FHA loans for properties with restrictive covenants.

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

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

## **METHODOLOGY AND SCOPE**

We performed our fieldwork at our Las Vegas, NV, and San Francisco, CA, field offices from May through August 2017. Our audit generally covered loans with closing dates from July 2010 through May 2015.

To accomplish our objective, we reviewed

- Applicable Code of Federal Regulations and HUD program requirements.
- Reports and information from HUD's Neighborhood Watch system.<sup>1</sup>
- RMS' FHA-insured loan documents, including downpayment assistance closing documents.
- RMS' policies and procedures for reviewing closing documentation.

During a previous audit of another lender, we determined that closing documents associated with the City of Las Vegas' Neighborhood Stabilization Program (NSP) downpayment assistance program contained prohibited legal restrictions on conveyance. We obtained a listing of all NSP downpayment assistance loans awarded by the City. Using HUD's Single Family Data Warehouse,<sup>2</sup> we identified which downpayment assistance loans were associated with FHA loans and originated by RMS. We determined that RMS originated 50 FHA-insured loans that received NSP downpayment assistance. Of the 50 loans, 49 were active FHA loans at the time of the audit. The outstanding mortgage balance for the 49 loans was more than \$4.9 million. We obtained and reviewed the closing documents for all 49 active loans. The results of our audit are limited to the 49 loans reviewed and cannot be projected to all FHA-insured loans originated by RMS.

We conducted the audit in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information system controls of RMS. We did not follow standards in these areas because our primary objective was to determine whether closing documents related to downpayment assistance signed by borrowers contained prohibited legal restrictions on conveyance. To meet our objective, it was not necessary to fully comply with the standards, nor did our approach negatively affect our review results.

## **BACKGROUND**

FHA provides mortgage insurance on single-family home loans made by FHA-approved lenders. Since its creation in 1934, it has insured more than 41 million properties, making it the largest mortgage insurer in the world. FHA's mortgage insurance protects lenders against losses resulting from homeowners defaulting on their mortgage loans. This decreases the lender's risk because FHA will pay a claim to the lender should a default occur. However, loans must meet certain requirements established by FHA to qualify for this insurance.

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<sup>1</sup> Neighborhood Watch is a system that aids HUD-FHA staff in monitoring lender progress and performance. The system also aids lenders and the public in self-policing the industry.

<sup>2</sup> The Single Family Data Warehouse is an extensive collection of database tables organized and dedicated to support analysis of single-family housing data.

RMS & Associates is a nonsupervised direct endorsement lender.<sup>3</sup> Its home office is located at 3585 East Flamingo Road, Suite 103, Las Vegas, NV. RMS was approved by FHA in May 1997.

The HUD OIG audit of Evergreen Home Loans (audit report 2016-LA-1011) identified loans that received home-buyer downpayment assistance from the City of Las Vegas. The audit concluded that the agreements used to secure those loans subjected the borrower to contractual liability other than the repayment of assistance provided, which violated HUD regulations.

## **RESULTS OF REVIEW**

RMS improperly originated FHA loans for 49 properties that contained prohibited restrictive covenants. This condition occurred because RMS did not have adequate policies and procedures in place to identify the prohibited restrictive covenants. As a result, RMS placed the FHA fund at unnecessary risk for potential losses of more than \$2.4 million.<sup>4</sup> In addition, HUD paid partial claims on 2 of the 49 active loans, resulting in actual losses of \$26,242.

### **RMS Originated Loans That Contained Prohibited Legal Restrictions on Conveyance**

RMS improperly originated FHA loans for 49 properties that contained prohibited restrictive covenants. HUD's policy of free assumability with no restrictions states that a mortgage is not eligible for insurance if the mortgaged property is subject to legal restrictions on conveyance.<sup>5</sup> However, legal restrictions are acceptable if they are part of an eligible government or nonprofit program as long as the restrictions do not subject the borrower to contractual liability other than requiring repayment of downpayment assistance received. In addition, the borrower must be allowed to recover the sum of the original purchase price, the borrower's reasonable cost of sale, and the reasonable cost of improvements made by the borrower.<sup>6</sup> The borrowers of these 49 loans received downpayment assistance from NSP through the City of Las Vegas. In exchange for the downpayment assistance, the borrowers agreed to a repayment clause that required repayment to the City of an amount equal to the current market value of the property, less any portion of the value attributable to expenditures of non-NSP funds for acquiring or improvements to the property. The repayment clause did not allow the borrower to recover the reasonable cost of sale as required. Under these circumstances, the borrower could repay more than the assistance received.

As a result, the 49 RMS loans contained legal restrictions on conveyance that violated HUD's policy of free assumability; thus, all 49 loans were ineligible for FHA insurance. The total unpaid mortgage balance of these 49 loans with restrictive covenants was more than \$4.9 million, with an estimated loss to HUD of more than \$2.4 million. Of the 49 active loans, HUD paid partial claims on 2 loans totaling \$26,242.<sup>7</sup> The following table identifies the active FHA-insured loans that contained prohibited restrictive covenants.

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<sup>3</sup> A nonsupervised direct endorsement lender is one that has as its principal activity the lending or investing of funds in real estate mortgages and is permitted by HUD to underwrite single-family mortgages without FHA's prior review and submit them directly for FHA insurance endorsement.

<sup>4</sup> The estimated potential loss amount is based on a 49 percent loss rate from HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition as of June 2017.

<sup>5</sup> 24 CFR (Code of Federal Regulations) 203.41(b)

<sup>6</sup> 24 CFR 203.41(d)(1)(i)

<sup>7</sup> FHA loan numbers 332-5174647 and 332-5372733

**FHA loans with prohibited restrictive covenants**

FHA case no.	Mortgage balance	Estimated loss to HUD (49%) <sup>8</sup>
332-5255547	\$78,336	\$38,385
332-5318551	91,684	44,925
332-5395888	88,463	43,347
332-5641223	83,746	41,035
332-5502632	57,792	28,318
332-5547697	79,951	39,176
332-5383844	47,000	23,030
332-5687087	107,203	52,529
332-5370892	134,478	65,894
332-5324688	114,009	55,865
332-5463551	84,186	41,251
332-5389167	51,454	25,212
332-5509857	100,775	49,380
332-5697245	96,763	47,414
332-5706399	123,615	60,571
332-5641830	70,008	34,304
332-5260019	73,704	36,115
332-5578800	73,568	36,048
332-5848882	158,278	77,556
332-5402444	94,530	46,320
332-5617303	101,473	49,722
332-5835452	142,487	69,819
332-5370925	143,787	70,455
332-5568225	95,815	46,949
332-5789805	193,706	94,916
332-5252216	82,415	40,383

<sup>8</sup> The estimated loss to HUD is the mortgage balance multiplied by the 49 percent loss rate from HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition as of June 2017.

FHA case no.	Mortgage balance	Estimated loss to HUD (49%) <sup>8</sup>
332-6089653	205,455	100,673
332-5436142	75,483	36,987
332-5236820	83,275	40,805
332-5420129	91,977	45,069
332-5324399	63,967	31,344
332-5732484	96,676	47,371
332-5409856	104,472	51,191
332-5762802	151,242	74,109
332-5522608	91,644	44,906
332-5385708	116,927	57,294
332-5454100	69,893	34,248
332-5174647	128,806	63,115
332-5232018	84,071	41,195
332-5324629	66,954	32,807
332-6020752	216,006	105,843
332-5372733	114,928	56,315
332-5173612	90,590	44,389
332-5237333	87,333	42,793
332-5797443	124,890	61,196
332-5396644	101,290	49,632
332-5503151	96,391	47,232
332-5587089	61,534	30,152
332-5768329	74,733	36,619
<b>Totals</b>	<b>4,967,763</b>	<b>2,434,204</b>

### Conclusion

RMS improperly originated FHA loans for 49 properties that contained prohibited restrictive covenants. We reviewed RMS' closing policies and procedures and determined that they did not contain enough detail to ensure that RMS identified prohibited restrictive covenants. As a result, HUD paid partial claims totaling \$26,242, and RMS placed the FHA fund at unnecessary risk for potential losses of more than \$2.4 million.

## **RECOMMENDATIONS**

We recommend that the Deputy Assistant Secretary for Single Family Housing Require RMS to

- 1A. Work with HUD to nullify the restrictions on conveyance that violate HUD policy or indemnify HUD. This action will protect HUD against future losses of \$2,434,204 for the 49 loans.
- 1B. Repay HUD \$26,242 for partial claims paid on two FHA loans that contained prohibited restrictive covenants.
- 1C. Develop and implement policies and procedures to identify prohibited restrictions on conveyance to ensure that it does not originate FHA loans with prohibited restrictive covenants.
- 1D. Provide training to its employees regarding HUD's requirements related to prohibited restrictions on conveyance.

We also recommend that the Associate Counsel for the Office of Program Enforcement

- 1E. Determine legal sufficiency and if legally sufficient, pursue civil and administrative remedies, civil money penalties, or both against RMS, its principals, or both for incorrectly certifying to the eligibility for FHA mortgage insurance or that due diligence was exercised during the origination of FHA loans.

## Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1A		\$2,434,204
1B	\$26,242	
<b>Totals</b>	<b>26,242</b>	<b>2,434,204</b>

- 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 policies or regulations. In this case, ineligible costs of \$26,242 relate to partial claims paid by HUD on two FHA loans that were not eligible for FHA insurance due to prohibited restrictive covenants.
- 2/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligations of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. If HUD implements our recommendations to indemnify 49 loans not originated in accordance with FHA requirements, it will reduce FHA's risk of loss to the insurance fund. Recommendation 1A represents the estimated loss to HUD for the 49 loans containing prohibited restrictive covenants. It is based on HUD's calculation that FHA loses on average 49 percent of the claim amount when it sells a foreclosed-upon property. The 49 percent loss rate is based on HUD's Single Family Acquired Asset Management System's "case management profit and loss by acquisition" computation for fiscal year 2017.

## Appendix B

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

#### Comment 1

#### Comment 2

**RMS**  
Residential Mortgage Services

September 22, 2017

[REDACTED]

U.S. Department of Housing and Urban Development  
Office of Inspector General  
302 East Carson Avenue, Suite 400  
Las Vegas, NV 89101


Re: RMS & Associates ("RMS"), Las Vegas, NV

Dear [REDACTED]:

Thank you for personally meeting with me in your office on May 18, 2017 to discuss this matter, and thank you for visiting our office on August 7, 2017 to further discuss this matter and also to meet our company President and to meet our Closing Manager. Also, thank you for coordinating the initial and exit teleconferences as well. We are in receipt of the draft audit report dated September 8, 2017 identifying our written response ought to be presented as an electronic copy on or before September 22, 2017. Please accept this letter as our official response, as many aspects of the draft report are not factually correct.

We understand HUD-NSP and HUD-FHA are in disagreement and therefore HUD-OIG has stepped in to perform audits and gather information allowing for a resolution. The HUD Exchange website identifies ... "Congress established the Neighborhood Stabilization Program ("HUD-NSP") for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. Through the purchase and redevelopment of foreclosed and abandoned homes and residential properties, the goal of the program is being realized." Within that legislation, HUD-NSP shall provide Homeownership Downpayment Assistance ("DPA monies") to qualified buyers of certain foreclosed and abandoned homes.

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(702) 796-3453 · 1-800-510-3453 · Fax (702) 320-5800  
NMLS# 168397



\*names redacted for privacy purposes



## Ref to OIG Evaluation

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### Comment 3

Thank you for disclosing that HUD-NSP never actually reviewed the legal documents that were put forth on its behalf by its counter-party municipality, City of Las Vegas ("City"). We understand from your telephonic and in-person disclosures to RMS that HUD-NSP gave complete autonomy to the City to administer these DPA monies on behalf of HUD-NSP and you reiterated to RMS several times that HUD-NSP literally never even reviewed the legal documents containing the problematic repayment clause being contemplated in the draft audit report.

### Comment 4

Respectfully, RMS requests HUD-OIG to consider the oversight requirements and responsibilities of HUD-NSP as required by The Neighborhood Stabilization Program Monitoring Guide for Local Governments ("Guide"). The Guide contains specific oversight procedures for which HUD-NSP must perform of its counter-party municipalities regarding the Homeownership Assistance Documentation associated with the property sale. RMS is unable to reconcile how HUD-NSP can be on record, and have your support, as never reviewing the legal documents that were put forth on its behalf in connection with the Homeownership Assistance Documentation when the Guide required HUD-NSP to have done so.

### Comment 5

RMS agrees with HUD-FHA that HUD-FHA shouldn't be put at risk of potential financial exposure for insurance claims due to an apparent lack of oversight by HUD-NSP in connection with the agency relationship HUD-NSP created with the City. It is unfortunate HUD-NSP chose not to comply with the Guide in this regard, allowing the City full reign to create legal documents that mandate the borrower utilize HUD-FHA financing and yet also contain an interesting unique repayment clause for the first five years of the loan for which theoretically could result in the borrower repaying an amount greater than the DPA monies the borrower received from HUD-NSP. The clause is written in a manner such that it is impossible to calculate whether there will even be an amount to be repaid within those first five years because the factor of the calculation depends upon future events yet to occur. RMS agrees that beginning in year six, the repayment clause is unequivocally in compliance with Title 24: Housing and Urban Development - Code of Federal Regulations ("CFR").

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Comment 6

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To be sure, HUD-NSP through its counter-party municipality literally mandated that FHA financing being utilized by each of these borrowers. HUD-NSP through its counter-party municipality required the borrower to execute a legal security instrument entitled "Deed of Trust Securing Neighborhood Stabilization Program Funds (FHA LOAN)". Please note "FHA LOAN" is literally in bold capital letters and notated in parenthesis for emphasis within the actual name of the legal security instrument. There can be no misunderstanding that these borrowers must obtain a "FHA LOAN" in order to receive these DPA monies from HUD-NSP.

Comment 6

As such, HUD-NSP through its counter-party municipality required that each of these borrowers must in fact utilize FHA financing and must sign this legal document, being bound by the specific repayment clause being contemplated herein, in order to receive these DPA monies from HUD-NSP.

Comment 6

RMS understands HUD-FHA later identified that HUD-NSP was incorrect to mandate these borrowers utilize HUD-FHA financing as the first five years of the repayment clause could theoretically conflict with the repayment clause rules as per the CFR. And yet the repayment clause is in fact in compliance with the CFR rules related thereto beginning in year six.

Comment 7

RMS acknowledges almost all of these fifty loans are now in year six or beyond and are therefore compliant with the CFR rules in connection with the repayment clause. In fact, within the upcoming months, the five year clause will expire in connection with all fifty of these loans in which all fifty loans will literally be in compliance with the CFR rules related to the repayment clause.

Comment 7

Thank you for personally informing me in our meeting held in your office on May 18, 2017 that your expectation and understanding from working on the other lender audits of this exact repayment clause issue is that HUD-OIG will recommend RMS only needs to indemnify the loans in which the five year repayment clause hadn't yet expired, at which time I expressed relief and together we discussed that almost all of these fifty loans are already in year six or beyond and there haven't been any claims whatsoever in connection with these fifty loans. In connection therewith, we were confused how the situation seemingly changed during our next meeting that was held in our office on August 7, 2017, in which you informed that RMS will now need to indemnify all fifty of the loans even if the five year repayment clause had already expired.

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The draft report put forth by HUD-OIG dated September 8, 2017 identifies HUD-OIG conducted an audit of RMS in accordance with Generally Accepted Government Auditing Standards ("GAGAS"). The draft audit report also contains an unsupported conclusion referencing an "Estimated Loss to HUD: 49%" for which no basis within GAGAS exists. RMS acknowledges GAGAS provides a framework of standards to calculate the extent of any potential financial claims exposure to HUD-FHA as a result of these fifty borrowers being mandated by HUD-NSP through its counter-party municipality to utilize HUD-FHA financing in order to receive these DPA monies from HUD-NSP.

Please accept the following loan-level analysis of the fifty loans being contemplated herein, to include the mortgage insurance premiums received by HUD-FHA to date through September 2017, along with a calculation made in accordance with GAGAS to address any potential "Estimated Loss/Gain to HUD".

FHA Case Number	Up-Front Mortgage Insurance Premiums Received	Annual Mortgage Insurance Premiums Received Through September 2017	Total Insurance Premiums Received
332-5173612	2,272.50	8,523.99	10,796.49
332-5174647	3,233.12	3,719.45	6,952.57
332-5236820	2,097.00	2,232.60	4,329.60
332-5232018	2,100.76	3,283.50	5,384.26
332-5237333	2,187.81	3,555.10	5,742.91
332-5255547	2,278.13	2,324.04	4,602.17
332-5252216	2,055.38	4,561.96	6,617.34
332-5260019	1,842.75	1,965.36	3,808.11
332-5318551	1,402.15	951.02	2,353.17
332-5324688			

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	1,272.00	6,575.23	7,847.23
332-5324399	818.25	3,203.28	4,021.53
332-5324629	747.00	3,050.04	3,797.04
332-5370925	1,592.25	9,434.18	11,026.43
332-5370892	1,496.00	8,477.60	9,973.60
332-5372733	1,708.61	1,281.60	2,990.21
332-5385708	1,472.25	9,987.04	11,459.29
332-5389167	570.00	3,135.00	3,705.00
332-5383844	700.00	422.82	1,122.82
332-5395888	980.00	5,389.80	6,369.80
332-5402444	1,045.25	5,748.60	6,793.85
332-5396644	1,120.00	8,932.29	10,052.29
332-5420129	1,020.00	5,610.00	6,630.00
332-5436142	839.00	4,614.60	5,453.60
332-5409856	1,530.01	2,677.50	4,207.51
332-5454100	771.90	8,654.49	9,426.39
332-5463551	930.00	6,223.25	7,153.25
332-5502632	820.25	1,469.74	2,289.99
332-5503151	1,061.00	8,461.62	9,522.62
332-5509857	1,424.00	830.76	2,254.76
332-5522608	1,004.90	8,382.92	9,387.82
332-5547697	1,118.43	2,003.80	3,122.23
332-5578800	1,401.66	5,339.52	6,741.18
332-5568225	1,857.63	6,965.91	8,823.54

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332-5587089	1,174.93	4,028.40	5,203.33
332-5617303	1,933.61	7,136.20	9,069.81
332-5641223	1,595.86	5,699.40	7,295.26
332-5641830	1,349.30	4,578.24	5,927.54
332-5687087	2,026.50	6,996.54	9,023.04
332-5697245	1,822.15	6,182.22	8,004.37
332-5706399	2,364.25	8,021.61	10,385.86
332-5732484	1,813.49	5,596.02	7,409.51
332-5762802	2,870.88	8,858.88	11,729.76
332-5768329	1,667.91	1,834.80	3,502.71
332-5789805	3,630.81	10,851.24	14,482.05
332-5797443	2,347.36	7,243.20	9,590.56
332-5812792	3,039.75	9,084.84	12,124.59
332-5835452	2,668.23	7,951.80	10,620.03
332-5848882	2,938.43	8,069.28	11,007.71
332-6020752	3,882.43	4,606.02	8,488.45
332-6089653	3,741.62	4,179.96	7,921.58
Total	87,637.50	268,907.26	356,544.76

Comment 11

Please note the draft audit report identifies there have been zero actual claims in connection with these fifty loans, and yet RMS confirmed via FHA Connection that there were two "partial" claims in connection with two borrowers who each lost their job and qualified for loan modification assistance from HUD-FHA. The audit report identifies HUD paid partial claims totaling \$26,242 in connection with the two loan modification assistance matters.

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Thus, RMS confirmed these fifty loans so far have resulted in insurance premiums received by HUD-FHA in the amount \$356,544.76. RMS understands HUD-FHA paid partial claims in connection with loan modification assistance totaling \$26,242. RMS therefore acknowledges these fifty loans have in fact resulted in HUD-FHA currently in receipt of net positive premiums realized in excess of claims in the amount of \$330,302.76 (i.e.  $356,544.76 - 26,242 = 330,302.76$ ).

Regarding the calculation made in accordance with GAGAS to address any potential "Estimated Loss to HUD", RMS identifies it shall be calculated as follows:

50 (i.e. Fifty): Total Population of all Loans

0 (i.e. Zero): Actual Claims

2 (i.e. Two): Partial Claims

Two partial claims contained within the total population are as follows:

FHA Case Number	Loan Amount	Total Insurance Premiums Received	Total Paid Claims by HUD	Total Paid Claims by HUD, Net of Premiums Received
332-5174647	\$ 146,927	\$ 6,952.57		
332-5372733	<u>172,569</u>	<u>2,990.21</u>		
Total	\$ 319,496	\$ 9,942.78	\$ 26,242	\$ 16,299.22

\$ 319,496: Total aggregate loan amounts within entire population for which claims were paid

\$ 16,299.22: Net claims paid by HUD in connection with the entire population of loans

5.10%: Net claims, expressed as a percentage, for extrapolation to the entire population

\$ 4,967,763: Total aggregate amount of the entire population of loans

\$ 253,432.48: Estimated Loss to HUD in accordance with GAGAS

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RMS identifies the Estimated Loss to HUD for this entire population of loans, in accordance with GAGAS, is deemed to be \$253,432.48, and NOT the mysterious unsupported amount of \$2.4 million dollars as purported in the draft audit report.

Comment 10

Of importance, RMS identifies HUD-FHA has already realized cash inflows from mortgage insurance premiums related to these fifty loans in the amount \$356,544.76, far surpassing any such potential estimated loss to HUD in accordance with GAGAS.

Comment 12

Also, of interest, FHA Connection confirms HUD-FHA will recoup in full the loan modification assistance partial claims monies in the amount of \$26,242 as the principal loan balances of both loans have been increased by \$26,242 in aggregate.

Comment 13

Next, RMS would like to address several key aspects of the Housing and Economic Recovery Act of 2008 ("Act"), in which Congress established the Neighborhood Stabilization Program.

'NSP Laws and Federal Register Notices' is the authorizing legislation for NSP as enacted by Congress. Specifically, the Act identifies there will be "alternative requirements" and "waivers of regulations" for the purpose of assisting in the redevelopment of abandoned and foreclosed homes under the Neighborhood Stabilization Program.

Comment 13

RMS identifies the authorizing legislation explicitly acknowledges the Act conflicts with and overrides Title 24 CFR in connection with the administering of the Neighborhood Stabilization Program.

RMS respectfully requests HUD-OIG to consider the repayment clause rules that normally apply as put forth by Title 24 CFR are deemed to be waived for purposes of administering the Neighborhood Stabilization Program, with the Act providing specific alternative requirements for the five-year period following the date of enactment of the Act.

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RMS identifies the City appears to have in fact administered the Neighborhood Stabilization Program as required by the Act, as it specifically relates to the first five years of the repayment clause. RMS identifies the Act requires as follows: "5-YEAR REINVESTMENT PERIOD.— During the 5-year period following the date of enactment of this Act, any revenue generated from the sale, rental, redevelopment, rehabilitation, or any other eligible use that is in excess of the cost to acquire and redevelop (including reasonable development fees) or rehabilitate an abandoned or foreclosed upon home or residential property shall be provided to and used by the State or unit of general local government in accordance with, and in furtherance of, the intent and provisions of this section."

RMS also identifies the extraordinary measures being taken by Congress during the crisis-era as the housing market was collapsing. The Act references the emergency nature of this legislation and the desire for speed and expedited program implementation as the basis for explicitly waiving Title 24 CFR regulations with such "alternative requirements".

Further, during the crisis-era years for which this emergency legislation was enacted, property values were declining at an alarming rate. To suggest within the draft audit report that these borrowers may have to repay an amount greater than the amount of DPA monies obtained from HUD-NSP during those first five years would literally require the property value to have increased during those first five years. The housing market was obviously not increasing during these years, in fact property values were declining at such an alarming rate that Congress had to enact this emergency legislation, to include waiving Title 24 CFR regulations. Therefore, the first five years of the repayment clause being contemplated herein would actually result in the these borrowers not having to repay any DPA monies whatsoever, as the property values were declining. And, RMS agrees that beginning in year six, the repayment clause is unequivocally in compliance with Title 24 CFR as well as the Act itself.

As noted within the Recommendations section of the draft audit report, RMS will certainly work with HUD and all other counter-parties to nullify any such restrictions that do not comply with HUD guidelines.

As noted within the Recommendations section of the draft audit report, RMS respectfully requests HUD recognize GAGAS provides no basis whatsoever for the unsupported hypothesis that these fifty loans could somehow result in \$2.4 million dollars of future losses to HUD and therefore remove any such reference related thereto.

Comment 13

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Comment 12

As noted within the Recommendations section of the draft audit report, RMS respectfully requests HUD remove the recommendation that RMS ought to repay HUD \$26,242 for partial claims as this exact amount has already been added to the principal loan balances of the two subject loans that received the loan modification assistance. Otherwise, HUD will literally be receiving the monies twice, once from RMS and again from the borrower through the principal loan payments. Also, RMS identifies the insurance premiums HUD collected in connection with these two subject loans hasn't been considered in any such recommendation for RMS to repay HUD. As such, upon accounting for the premiums HUD already collected in connection these two loans in the amount of \$ 9,942.78, than the make-whole claim RMS ought to repay HUD, if HUD hadn't already increased the borrowers loan balances, would be \$ 16,299.22 (i.e. 26,242 – 9,942.78 = 16,299.22).

Comment 15

As noted within the Recommendation section of the draft audit report, RMS thanks you for personally acknowledging during our telephonic exit teleconference on Thursday September 14, 2017, that our policies and procedures to identify prohibited restrictions on conveyance are in fact detailed and satisfactory and therefore HUD-OIG may consider removing any such recommendation suggesting otherwise. RMS has proper policies and procedures and training in place and our trained closing personnel followed those policies and procedures in connection with these fifty loans. RMS identifies the Act supersedes Title 24 CFR and specifically the repayment clause rules for the first five years from the date of enactment of the Act have explicit requirements.

Comment 16

As noted within the Recommendation section of the draft audit report, RMS respectfully requests HUD-OIG remove Recommendation 1E in its entirety as the contents of this response letter provide new facts and information rendering such recommendation unnecessary.

Comment 13

In recap, it appears HUD-FHA believes Title 24 CFR governs the repayment clause rules in connection with these fifty loans. It appears HUD-NSP and its counter-party municipality acknowledge the Act explicitly conflicts with, and overrides, Title 24 CFR rules related thereto and provides alternative requirements and waivers to such Title 24 CFR rules. It appears these fifty loans have resulted in substantial financial gains to HUD-FHA as the insurance premiums far exceed any estimated loss calculated in accordance with GAGAS.

Comment 17

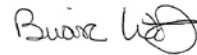
September 22, 2017

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In closing, RMS wishes to express gratitude for the opportunity to participate in the resolution of this matter. RMS has been an approved FHA Mortgagee for over twenty years and the quality of our loan performance and our extremely low Compare Ratios can be verified by our Neighborhood Watch statistics. RMS has worked closely with HUD-FHA over the years and we are honored to be an approved FHA Mortgagee in good standing. Thanks again for the opportunity to participate in the resolution of this matter.

Sincerely,

RMS & Associates



Brian Wetzel, CPA

Chief Compliance Officer

cc: Wayne K. Wasano, President – RMS & Associates

## **OIG EVALUATION OF AUDITEE COMMENTS**

- Comment 1     We appreciate your cooperation throughout the audit process. We disagree that aspects of the audit report are not factually correct. We will address RMS' comments in this response.
- Comment 2     RMS is correct that we performed other audits regarding restrictive covenants. However, we disagree that HUD's FHA program and HUD's NSP are in disagreement. Although FHA and NSP have different requirements, the home-buyer assistance agreements did not meet the requirements for either program. The audit of the City of Las Vegas NSP found that the home-buyer assistance program agreements did not meet HUD requirements.
- Comment 3     We disagree that HUD gives complete autonomy to the City to administer its NSP downpayment assistance funds. The unified NSP1 and NSP3 notice, dated October 19, 2010, states that the City is required to comply with HUD regulations found at 24 CFR Part 570, subpart I for states, and part 570 subparts A, C, D, J, K, and O for CDBG entitlement communities. HUD will also consider any grantee that adopts 24 CFR 92.252 (a), (c), (e) and (f), and 92.254. However, HUD did not provide template language to the City for its NSP downpayment agreements with its borrowers. Regardless of whether HUD reviewed the NSP downpayment agreements, it is the responsibility of the FHA lender to ensure that its loans meet all FHA requirements.
- Comment 4     Our audit objective was to determine whether RMS improperly originated FHA loans for properties with restrictive covenants. This was an external audit of an FHA lender, not an internal audit of HUD. RMS originated loans that did not meet FHA requirements. It is the FHA lender's responsibility to ensure that it meets all FHA requirements. RMS will work with HUD during the audit resolution process to resolve the audit recommendations.
- Comment 5     HUD's monitoring of NSP was not part of this audit. We disagree that there was a "mandate" to use FHA financing for the downpayment assistance program. The City's downpayment assistance program was not exclusive to FHA loans. As an FHA lender, RMS had the responsibility to ensure that its FHA-insured loans met FHA requirements. We agree that the amount of potential liability incurred by the borrower is based on future events and cannot be quantified until the repayment clause is executed. RMS will work with HUD during the audit resolution process regarding the implementation of specific recommendations, including loans that are in year 6 of the agreements or beyond.
- Comment 6     The City did not mandate the use of FHA financing for these borrowers. The City also had conventional loans as part of its program. The document labeled "FHA Loan" was created by the City. However, the City had another version of the document labeled "Conventional Loan." Neither HUD nor the City mandated the borrower to obtain an FHA-insured loan. As an FHA lender, RMS had the responsibility to ensure that its loans met FHA requirements.

- Comment 7 The meeting held at our office on May 18, 2017 occurred at the beginning of the audit. At that time, we had not come to any conclusions as to how we were going to report on our findings. As the audit progressed, we developed our finding and recommendations. We reported the findings of this audit the same way we reported them on similar audits. We agree that most of the 50 loans have repayment agreements in year 6 or beyond. However, we disagree that the loans are now compliant. The loans were not originated in accordance with HUD requirements and thus not eligible for FHA insurance regardless of the current age of the loan. Because the loan was not originated in accordance with FHA requirements, we recommended that RMS remove the restrictions on conveyance or indemnify the loans. RMS can work with HUD during the audit resolution process to remove the restrictions on conveyance or indemnify the 50 loans.
- Comment 8 As noted in the Methodology and Scope section of the report, we conducted the audit in accordance with generally accepted government auditing standards, except that we did not consider the internal controls or information system controls of RMS.
- Comment 9 The 49 percent figure represents the estimated loss severity rate, supported by HUD's Single Family Acquired Asset Management System's case management profit and loss by acquisition as of June 30, 2017. This rate is applied against the unpaid principal balance of loans reviewed during the audit. This figure is based on HUD's own data on its average loss experience based on its return on properties sold through its real estate-owned inventory. We routinely use these data and this methodology to estimate the potential loss to HUD on our FHA-related audit reports and comply with any applicable generally accepted government auditing standards. In this audit, we use this figure to estimate the amount of funds to be put to better use if our audit recommendations are implemented.
- Comment 10 We acknowledge RMS' analysis of the 50 loans. However, this does not change our methodology or audit recommendations. These loans contained prohibited restrictive covenants at the time of insurance and were, therefore, not eligible for insurance. The amount of mortgage insurance premiums paid is not relevant to the funds to be put to better use calculation.
- Comment 11 We agree that there have been 0 full claims and 2 partial claims for the 50 loans. However, this does not impact our conclusions and recommendations. These loans contained restrictive covenants and were, therefore, not eligible for insurance.
- Comment 12 RMS can submit supporting documentation to HUD during the audit resolution process. However, the amount of the partial claims on two loans does not impact our overall conclusions in the report.
- Comment 13 We acknowledge that waivers may be provided under certain circumstances. However, we are not aware of any waivers granted for the issues identified in the

audit report. RMS will work with HUD during the audit resolution process to address the audit recommendations.

- Comment 14 We acknowledge the housing market conditions at the time of the creation of NSP. However, the creation of NSP did not waive or change FHA requirements related to restrictive covenants, including the requirements at 24 CFR 203.41.
- Comment 15 We disagree that RMS has proper policies and procedures in place. Although we agree that the policies and procedures are detailed, they fail to instruct its employees to look for language that would violate 24 CFR 203.41. We still recommend that HUD require RMS to revise its policies and procedures and train its employees on the new policies and procedures to ensure that it identifies prohibited legal restrictions on conveyance.
- Comment 16 We disagree that the information provided in RMS' response render recommendation 1E unnecessary. RMS originated loans that violated FHA requirements. Recommendation 1E is addressed to HUD's Office of Program Enforcement, and it will make the determination regarding civil and administrative remedies based on the facts in this audit report. As a result, the recommendation will remain in the report. RMS will work with HUD's Office of Single Family Housing and Office of Program Enforcement during the audit resolution process to address the audit recommendations.
- Comment 17 We appreciate RMS' cooperation throughout the audit process. RMS will work with HUD during the audit resolution process to resolve the audit recommendations.