

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of:

A1 MORTGAGE GROUP, LLC,

Respondent.

19-AF-0168-MR-004

June 4, 2020

Appearances:

Phil Kesaris, Esq.
United States Department of Housing and Urban Development
For Petitioner

Richard Cowan,
A1 Mortgage Group, LLC
For Respondent

BEFORE: Alexander FERNÁNDEZ, Administrative Law Judge

INITIAL DECISION AND ORDER

On July 5, 2019, the Mortgagee Review Board (“Board”) of the United States Department of Housing and Urban Development (“HUD”) issued a *Notice of Withdrawal* withdrawing approval of A1 Mortgage Group, LLC (“Respondent”) as a Federal Housing Administration (“FHA”) mortgagee for one year. On July 31, 2019, Respondent requested a hearing to challenge HUD’s decision to withdraw Respondent from the FHA program.

The hearing in this matter was held on September 17, 2019, in Washington, D.C. The Court received the testimony of the following witnesses: Nicole Black, an auditor in HUD’s Office of Lender Approval and Program Compliance; Nancy Aileen Murray, Division Director and Secretary for the Mortgagee Review Board; Aaron David Horenstein, a forensic auditor for HUD’s Office of Program Enforcement within the Office of General Counsel; and Richard W. Cowan

Applicable Law and Guidance

FHA Approval of Mortgagees. The National Housing Act (“the Act”), Pub. L. No. 84-345, 48 Stat. 1246 (1934), 12 U.S.C. §§ 1701 *et seq.* created the Federal Housing Administration

and the Board, provided for the insurance of mortgages by the federal government, and established the Mutual Mortgage Insurance Fund, with which the government could guarantee qualifying mortgages. To be eligible for FHA insurance, the Act requires that all qualifying mortgages shall “[h]ave, or be held by, a mortgagee approved by the Administrator as responsible and able to service the mortgage properly.” 12 U.S.C. § 1709(b)(1). Pursuant to the Act, the FHA established requirements that mortgagees must satisfy to obtain, and to annually renew, approval to originate FHA-insured loans. These are set forth at 24 C.F.R. Part 202 and the FHA Title II Mortgagee Approval Handbook 4060.1, REV-2 (2006).

FHA’s Minimum Net Adjusted Worth Requirement. Against the backdrop of one of the most significant real estate crises in U.S. history, HUD revised its regulations to increase the net worth minimum benchmarks for all annual mortgagee recertification packages submitted after May 2013. Federal Housing Administration: Continuation of FHA Reform; Strengthening Risk Management Through Responsible FHA-Approved Lenders, 75 Fed. Reg. 20718, 20733 (Apr. 20, 2010). In its explanation of the changes to the net worth requirements, HUD stated that the requirements had not been adjusted since 1993 and that the changes were being made “to ensure that FHA-approved mortgagees are sufficiently capitalized for the financial transactions occurring, and concomitant risks present, in today’s economy.” *Id.* at 20718.

The applicable net worth requirement is set out at 24 C.F.R. § 202.5(n)(3)(i) and states that:

[i]rrespective of size, ... each approved lender or mortgagee, for participation solely under the FHA single family programs, shall have a net worth of not less than \$1 million, plus an additional net worth of one percent of the total volume in excess of \$25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. No less than 20 percent of the applicant’s or approved lender or mortgagee’s required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

HUD issued the FHA Single Family Housing Policy Handbook (“Handbook”), which includes FHA approval and eligibility requirements for both Title I lenders and Title II mortgagees. The Handbook sets forth that mortgagees must meet the FHA’s adjusted net worth requirements at all times. FHA SINGLE FAMILY HOUSING POLICY HANDBOOK 4000.1, Section I.A.3.c.vii. Therefore, HUD requires that each mortgagee annually certify that it has complied with all FHA regulations and requirements necessary to maintain approval. 24 C.F.R. § 202.5(m); HANDBOOK at § I.A.8.b. The submission of a false certification is a violation of FHA requirements, which can result in referral to the Mortgagee Review Board. HANDBOOK at § I.A.8.b.(iv).

The Authority of the Mortgagee Review Board. The Act also established the Board and empowered it to take certain actions, including a withdrawal of any mortgagee found to be engaging in activities that violate FHA requirements or nondiscrimination requirements. 12 U.S.C. § 1708(c)(1). The violation of these requirements may result in the withdrawal of the

approval of a mortgagee to participate in the single-family mortgage insurance program. Specifically, the Board is empowered to initiate the withdrawal of any mortgagee “found to be engaging in activities in violation of [FHA] requirements.” 12 U.S.C. § 1708(c)(1). The Board may issue an order withdrawing a mortgagee “if the Board has made a determination of a serious violation or repeated violations by the mortgagee.” *Id.* at § 1708(c)(3)(D). The Board shall “determine the terms of such withdrawal, but the term shall not be less than 1 year.” *Id.* The violations creating grounds for an administrative action by the Board, including a withdrawal action, are listed in 24 C.F.R. § 25.6. These violations include among other things:

(g) Failure to comply with any agreement, certification, undertaking, or condition of approval listed on, or applicable to, either a mortgagee’s application for approval or an approved mortgagee’s branch office notification;

(h) Failure of an approved mortgagee to meet or maintain the applicable net worth, liquidity or warehouse line of credit requirements of 24 CFR part 202 pertaining to net worth, liquid assets, and warehouse line of credit or other acceptable funding plan;

...

(j) Violation of the requirements of any contract or agreement with the Department, or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction;

...

(p) Business practices which do not conform to generally accepted practices of prudent mortgagees or which demonstrate irresponsibility;

...

(ff) Any other violation of the Federal Housing Administration requirements that the Board or the Secretary determines to be so serious as to justify an administrative sanction.

24 C.F.R. § 25.6(g), (h), (j), (p), and (ff)

In situations where the Board seeks to impose a withdrawal, it must issue a notice that describes the nature and duration of the administrative action, specifically states the reasons for the action, and informs the mortgagee of its right to a hearing regarding the administrative action and of the manner and time in which to request a hearing. 24 C.F.R. § 25.9(b); see also 12 U.S.C. § 1708(c)(4).

Hearing Procedures. When requested, a *de novo* hearing will be conducted by an Administrative Law Judge (ALJ). 24 C.F.R. § 25.10(b). HUD has the burden to prove the respondent’s liability and any aggravating factors by a preponderance of the evidence. 24 C.F.R. § 26.45(e). Respondent shall prove any affirmative defenses and any mitigating factors by a preponderance of the evidence. *Id.* In determining the appropriate outcome, “the court is required to consider the same regulatory requirements which the Board was bound to consider in the first instance,” and “shall issue an initial decision based only on the record.” Puller

Mortg., HUDALJ 89-112-MR, at 8 (HUDALJ Oct. 17, 1990); R&G Mortg., HUDALJ 07-052-MR, at 13 (HUDALJ Nov. 20, 2007); see also 24 C.F.R. § 26.50(a).¹

Findings of Fact

Respondent A1 Mortgage Group is a Missouri limited liability company formed in 2007 and engaged in the business of originating and selling residential mortgage loans. Respondent is approved to participate as a mortgagee in the FHA mortgage insurance program.

On September 1, 2017, Richard W. Cowan and his wife Kitako Kureyama purchased A1 Mortgage Group for six million dollars. The purchase of A1 Mortgage Group was financed with a \$3,732,000 loan from Byline Bank that was guaranteed by the U.S. Small Business Administration (“SBA”). Respondent was designated as the borrower on the Security Agreement and Note for this loan from Byline Bank. Since Mr. Cowan and Mrs. Kureyama became owners of A1 Mortgage Group, the company has expanded into Texas, grown its staff, and earned a reputation for great service. There is no evidence that audits of loans originated by Respondent reveal failure of Respondent to meet or exceed FHA requirements.

In accordance with FHA requirements, A1 Mortgage Group engaged in the services of an independent public accounting firm to conduct an audit of the financial statements of the company for the fiscal year that ended December 31, 2017, and submit its report to HUD/FHA. On March 28, 2018, the accounting firm, RubinBrown LLP, submitted its audit report on the financial statements of A1 Mortgage Group to HUD as part of the mortgagee’s annual recertification package. RubinBrown was tasked with reporting on, among other things, whether A1 Mortgage Group had complied with FHA requirements. RubinBrown reported to HUD that Respondent was in violation of the minimum adjusted net worth requirement for the fiscal year that ended December 31, 2017. In fact, RubinBrown determined that A1 Mortgage Group’s adjusted net worth for the fiscal year was negative \$2,513,401, which is an amount that was \$3,583,069 below its required minimum adjusted net worth of \$1,069,668 for that year. The net worth deficiency was attributed to the fact that A1 Mortgage was a borrower and co-obligor on the long-term debt of \$3,732,000 to Byline Bank that was established when the company was purchased in 2017. Recognizing the potential effect of this violation, RubinBrown recommended that A1 Mortgage restructure its debt and/or corporate structure in such a way that A1 Mortgage is not liable for the repayment of the purchase related debt.

On March 29, 2018, James Mangan, a corporate officer for A1 Mortgage Group, signed and submitted the following statement to HUD/FHA:

I certify that, to the best of my knowledge and after conducting a reasonable investigation, the Mortgagee does now, and did at all times throughout the Certification Period, comply with all HUD regulations and requirements necessary to maintain the Mortgagee’s FHA approval as codified in 24 C.F.R. § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between Mortgagee and HUD, except

¹ Decisions of the HUD Office of Hearings and Appeals cited herein are available at https://www.hud.gov/program_offices/hearings_appeals/oalj/cases/mrbc.

for those instances of non-compliance, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.

This certification by Mr. Mangan was false, because A1 Mortgage Group was not in compliance with all HUD requirements necessary to maintain its approval. Specifically, A1 Mortgage Group failed to maintain the minimum adjusted net worth that HUD requires of an approved mortgagee during the fiscal year that ended December 31, 2017.

Respondent attempted in good faith to correct its net worth deficiency in 2018 by transferring its loan with Byline Bank to a newly created parent company named A1 Holding Company, LLC. Respondent proposed to HUD that it would transfer all the membership interests of the A1 Mortgage Group held by its members into A1 Holding Company, which would then own 100 percent of A1 Mortgage. Respondent would also transfer the loan causing the net worth deficiency to the new LLC, which would remove Respondent as a borrower to satisfy liquidity requirements. Between October and December of 2018, Respondent complied with HUD's multiple requests for documentation relevant to its compliance with FHA's net worth requirements. Mr. Cowan, owner of A1 Mortgage Group, assumed the deficiency issue has been resolved.

Ultimately, HUD found the proposed corrective action to be unacceptable, because A1 Mortgage Group remained liable for the loan balance of approximately \$3.4 million dollars as the unconditional "guarantor" of the debt, and its assets were still pledged as collateral for the loan. On this basis and Mr. Mangan's false statement, the Mortgagee Review Board determined that administrative action was warranted. On February 25, 2019, the Board advised Respondent that it was considering taking an administrative action against the company based the two violations. Respondent responded and informed the Board that its failure to maintain the required net worth was inadvertent and that it had taken corrective action in 2018 that was presumed to have satisfied HUD's concerns.

Finding Respondent's attempt to cure its net worth deficiency to be insufficient, the Board voted to withdraw the FHA approval of the company for a period of one year based on the two violations of FHA requirements. As of the date of this *Initial Decision and Order*, Respondent has not demonstrated its compliance with FHA's net worth requirement pursuant to 24 C.F.R. § 202.5(n)(3).

Discussion

HUD claims Respondent committed two violations of FHA requirements warranting the one-year withdrawal of its approval. Respondent acknowledges its failure to meet the eligibility requirement set forth by the HUD but asks for a waiver of that requirement due to its otherwise positive financial standing and positive reputation among its clientele.

I. Respondent's Violations of FHA Requirements

The Government seeks a finding that Respondent is liable for the two violations identified in the Board's Notice of Withdrawal. Specifically, the Government alleges Respondent failed to maintain the minimum adjusted net worth during the fiscal year that ended

on December 31, 2017. In addition, the Government claims that Respondent submitted a false certification that it met regulatory requirements to maintain FHA approval, when it did not meet the adjusted net worth requirements.

As noted *supra*, HUD requires mortgagees maintain at least the minimum required adjusted net worth at all times. 24 C.F.R. §§ 202.5(n) and 202.7(b)(1); HANDBOOK 4000.1, at § I.A.3.c.vii. The applicable minimum net worth requirement is \$1 million plus an additional net worth of one percent of the total volume in excess of \$25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. 24 C.F.R. §202.5(n)(3)(i).

Respondent does not dispute HUD's calculation that Respondent was required to maintain a minimum adjusted net worth of \$1,069,668 for the fiscal year ending on December 31, 2017, to comply with FHA requirements. And, although Respondent claims that it was a mistake to have listed itself as a borrower of the original loan with Byline Bank, Respondent acknowledges that remains liable for the loan balance of approximately \$3.4 million dollars as the unconditional guarantor of the debt, and that its assets are still pledged as collateral for the loan. This arrangement resulted in Respondent's adjusted net worth for the 2017 fiscal year to be \$3,583,069 below regulatory requirements. Accordingly, the Court finds that Respondent failed to meet or exceed FHA's requirements regarding minimum adjusted net worth for fiscal year 2017.

In addition, Respondent's acknowledgement of its failure to comply with FHA's minimum adjusted net worth requirements constitutes an admission that Mr. Mangan's certification on behalf of Respondent was false. Mr. Mangan's statement certified, in essence, that Respondent complied with all FHA regulations and requirements necessary to maintain its approval during fiscal year 2017. However, the day before Mr. Mangan made that statement, the accounting firm hired by Respondent had reported that Respondent did not meet the FHA's minimum adjusted net worth requirements for fiscal year 2017. Accordingly, the Court finds that this certification by Mr. Mangan was knowingly false and in violation the requirements of FHA approved mortgagees. *See* 24 C.F.R. § 202.5(m) (requiring each lender to submit annual certification forms to HUD); HANDBOOK at § I.A.8.b.iv ("If a Mortgagee submits a false certification to FHA, the Mortgagee and its certifying Corporate Officer may be referred for criminal, civil, or administrative actions, as appropriate.")

II. Imposition of Administrative Action

HUD claims the Board's decision to impose a one-year withdrawal of Respondent's FHA approval should be upheld for Respondent's failure to maintain the required net worth during fiscal year 2017, and for providing a false certification to HUD.

An administrative action imposed under 12 U.S.C. § 1708(c) must be based upon one or more of the violations enumerated by 24 C.F.R. § 25.6. The failure of an approved mortgagee to meet or maintain the applicable net worth requirements set forth by the FHA constitutes a violation for which an administrative action may be imposed. 24 C.F.R. § 25.6(h). This minimum net worth requirement is important to FHA, because it ensures that mortgagees are sufficiently capitalized for the fiscal transactions occurring and risks present in today's economy.

See In re Vinson Mortg. Servs, Inc., HUDOHA 16-JM-0076-MR-008, at 2 (HUDOHA Aug. 14, 2017).

The main issue in this case is Respondent's failure to maintain the necessary minimum adjusted net worth required to be an FHA approved mortgagee. This is an issue that has been ongoing since September 2017, and involves an FHA requirement for approving a lender or mortgagee. See 24 C.F.R. § 202.5 (setting forth the net worth requirement for lenders and mortgagees as a requirement to receive and maintain approval by the FHA). As an FHA approval standard, the minimum adjusted net worth requirement is non-waivable. R&G Mortg. Corp., at 11 (citing 57 Fed. Reg. 31048 (July 13, 1992)). Moreover, if the violation deals with a non-waivable lender approval requirement, implementing a withdrawal action is nondiscretionary. Id.

At the hearing, Mr. Cowan testified credibly that the violation was not the result of bad faith or unscrupulous operations. On the contrary, the company itself is in a strong financial position, operates with a high level of integrity, and has a stellar reputation among its clientele. Still, the Court cannot overlook the fact that Respondent, admittedly, remains noncompliant with the minimum net worth requirement and is unable to restructure its loan to exclude the company as a guarantor. As noted *supra*, the minimum net worth requirement is an important requirement that Respondent fell short of by over three million dollars for fiscal year 2017. More importantly, there is no indication that Respondent will be able to satisfy the net worth requirement to bring itself into compliance in the near future. Therefore, the withdrawal of Respondent's FHA approval is warranted.

CONCLUSION

The Court finds that Respondent violated FHA requirements by failing to maintain the minimum adjusted net worth requirement during fiscal year 2017. This violation also resulted in Mr. Mangan's certification on behalf of Respondent to FHA to be false, which is also a violation. The Court considers the lack of bad faith on the part of Respondent, and Respondent's efforts, though futile, to bring itself into compliance with FHA requirements. See 24 C.F.R. § 25.8 (requiring the consideration of mitigating and aggravating facts when determining an administrative action under 12 U.S.C. § 1708(c)). Based upon the foregoing, the Court finds that the withdrawal of Respondent's FHA approval for one year to be appropriate. See 12 U.S.C. § 1708(c)(3)(D) (requiring that the term of a withdrawal shall not be less than one year).

Accordingly, Respondent's appeal of the Board's action withdrawing approval of Respondent as an FHA approved mortgagee for one year is **DENIED**.

So ORDERED,

ALEXANDER
FERNANDEZ

Digitally signed by: ALEXANDER FERNANDEZ
DN: CN = ALEXANDER FERNANDEZ C = US
O = U.S. Government OU = Department of
Housing and Urban Development, Office of the
Secretary
Date: 2020.06.04 12:45:05 -04'00'

Alexander Fernández
Administrative Law Judge

Notice of appeal rights. The appeal procedure is set forth in detail in 24 C.F.R. § 26.52. This order may be appealed to the Secretary of HUD by either party within 30 days after the date of this decision. The Secretary (or designee) may extend this 30-day period for good cause. If the Secretary (or designee) does not act upon the appeal within 30 days, this decision becomes final.

Service of appeal documents. Any petition for review or statement in opposition must be served upon the Secretary by mail, facsimile, or electronic means at the following:

U.S. Department of Housing and Urban Development
Attention: Secretarial Review Clerk
451 7th Street, S.W., Room 2130
Washington, DC 20410

Facsimile: (202) 708-0019

Scanned electronic document: secretarialreview@hud.gov

Copies of appeal documents. Copies of any Petition for Review or statement in opposition shall also be served on the opposing party(s), and on the HUD Office of Administrative Law Judges.

Judicial review of final decision. Judicial review of the final agency decision in this matter may be available, as appropriate, under 5 U.S.C. §702.