UNITED STATES OF AMERICA

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

OFFICE OF THE SECRETARY

In the Matter of:	)	
	)	January 9, 2018
Vinson Mortgage Services, Inc.	)	
	)	
Respondent.	)	HUDOHA: 16-JM-0076-MR-008
	)	
	)	

For the Petitioner: K. Lee Marshall, Esq.; Barbara A. Smith, Esq.

For the Respondent: Ross A. Fisher, Esq., Barrat R. McVary, Esq., Brian A. Dupré, Esq.

ORDER ON SECRETARIAL REVIEW

On May 5, 2015, the Mortgagee Review Board ("Board") of the United States Department of Housing and Urban Development ("HUD," "Department" or "Agency") issued a Notice of Violation ("NOV"), informing Vinson Mortgage Services, Inc. ("Petitioner") that the Board was considering taking an administrative action pursuant to 12 U.S.C. § 1708 and 24 C.F.R. Part 25. The Board also informed Petitioner that it was considering imposing civil money penalties in accordance with 12 U.S.C. § 1708 and 24 C.F.R. Part 25 and the Pre-Penalty Notice as required by 24 C.F.R. § 30.70. The alleged violation was due to Petitioner's failure to timely submit acceptable audited financial statements and supplementary reports and/or timely submit required cure documents as required by HUD for Fiscal Year ("FY") 2013 via HUD's Lender Electronic Assessment Portal ("LEAP") to maintain its Federal Housing Administration ("FHA") Title II lending approval. On March 15, 2016, the Board sent Petitioner a Notice of Administrative Action ("NOAA") withdrawing Petitioner's FHA lending approval for a period of one year pursuant to 12 U.S.C. § 1708(c) and 24 C.F.R. Part 25. The Board voted to withdraw Petitioner's FHA lending approval based on the violation set forth in the NOV.

On April 8, 2016, Petitioner filed a Notice of Appeal requesting a hearing to challenge the NOAA. A hearing on the matter was conducted March 21-22, 2017, and April 26, 2017, before Chief Administrative Law Judge J. Jeremiah Mahoney ("ALJ"). On August 14, 2017, the ALJ issued an *Initial Decision and Order* ("Decision"). The ALJ held that the Board's

withdrawal of Petitioner from the FHA Title II lending program for one year was supported by substantial evidence and Petitioner was provided sufficient notice to meet due process requirements. *Decision* at 14.

On September 15, 2017, Petitioner filed a *Petition for Secretarial Review* ("Petition"). Petitioner argued that the *Decision* should be vacated or modified because the withdrawal penalty was disproportionate to the conduct alleged and the Board failed to provide adequate notice regarding the alleged violation. *Petition* at 5-10. On October 16, 2017, HUD filed a *Brief in Opposition to Petitioner's Secretarial Appeal* ("Response"). HUD disputed all of Petitioner's claims and requested that the Secretary, or his designee, affirm the ALJ's decision. *Response* at 8-14.

On appeal, the Secretary, or his designee, conducts a *de novo* review and may adopt or reject any of the ALJ's findings or conclusions of law. *See HUD v. Corey,* HUDALJ 11-M-207-FH-27, at 2, n.2 (July 16, 2012). However, the Secretary, or his designee, may only consider evidence contained in the record and must consider and include in the determination such factors as may be set forth in applicable statutes and regulations. *See* 5 U.S.C. § 557(b); 24 C.F.R. § 26.52. After considering the evidentiary record and applicable law, the Secretary, or his designee, may "affirm, modify, reduce, reverse, compromise, remand, or set aside any relief granted in the initial decision." 24 C.F.R. § 26.52(k). The Secretary, or his designee, has 30 days after receipt of the brief in opposition, if any, to issue a written determination, but he may extend the time in which a written determination is due up to an additional 60 days. 24 C.F.R. § 6.52(l). On October 18, 2017, an order was issued to both parties that extended the time in which a written decision must be issued by the Secretarial Designee from November 15, 2017, until January 16, 2018.

After review of the record, I affirm the ALJ's *Decision.* In light of the facts and based on an analysis of the applicable law, the *Petition* is **DENIED** for the reasons set forth below. Pursuant to 24 C.F.R. § 26.52, the ALJ's *Decision* is **AFFIRMED.**

APPLICABLE LAW

The National Housing Act ("Act"), Pub. L. No. 84-345, 48 Stat. (1934), 12 U.S.C. §§ 1701 *et seq.* created the Federal Housing Administration ("FHA"), which 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 "[h]ave, or be held by, a mortgagee approved by the Administrator as responsible and able to service the mortgage properly." *See* 12 U.S.C. § 1709(b)(1). Pursuant to the Act, FHA established requirements that mortgagees must satisfy to obtain, and renew on an annual basis, approval to originate FHA-insured loans. These requirements are set forth at 24 C.F.R. Part 202 and the FHA TITLE II MORTGAGEE APPROVAL HANDBOOK 4060.1, REV-2 (2006).

Under 24 C.F.R. § 202.5(g), a mortgagee must provide to the HUD Secretary a copy of its audited financial statements within 90 days of its fiscal year end and furnish such other

information as the Secretary may request. HUD-approved Title II non-supervised mortgagees[1] are subject to the HUD Uniform Financial Reporting Standards. *See* 24 C.F.R. § 5.801(a)(5). Under those standards, the mortgagee "must provide to HUD such financial information as required by HUD . . . on an annual basis . . . [and these] must be . . . [p]repared in accordance with Generally Accepted Accounting Principles ["GAAP"] as further defined by HUD in supplementary guidance." *See* 24 C.F.R. § 5.801(b)(1).

In 2010, HUD revised its regulations to increase the net worth minimum requirements for all annual mortgagee recertification packages submitted after May 20, 2013. *See Federal Housing Administration Continuation of FHA Reform; Strengthening Risk Management Through Responsible FHA-Approved Lenders*, 75 Fed. Reg. 20718, 20733 (Apr. 20, 2010). The revised net worth requirement is found in 24 C.F.R. § 202.5(n)(3)(i) and states:

> "[i]rrespective of size, . . . each approved lender or mortgagee, for participation solely under 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 TITLE II MORTGAGEE APPROVAL HANDBOOK ("Handbook") to offer guidance and clarification to mortgagees and participants in FHA's Title II program. The Handbook states that "mortgagees must meet specified net worth requirements for initial approval and to maintain approval." FHA TITLE MORTGAGEE APPROVAL HANDBOOK 4060.1, REV-2 at ch. 2-5. "An approved mortgagee must maintain at least the minimum required adjusted net worth at all times. If at any time it falls below the required minimum, the mortgagee must notify the Lender Approval and Recertification Division and submit a Corrective Action Plan. Failure to comply is grounds for administrative action by the [Board]." *Id.* at ch. 6-21. If an FHA-approved lender represents that the net worth deficiency was cured before issuance of the audit report, "HUD reviews the notes to the financial statement to determine if there has been a subsequent event that brings the mortgagee's net worth to FHA requirements." *Id.* at ch. 4-5 (B)(5)(a). However, if an FHA-approved lender purports to cure the net worth deficiency after issuance of the audit report, HUD requires that the lender provide documentation establishing a "sufficient amount of capital has been contributed to the company to correct the [net worth] deficiency." *Id.* at ch. 4-5 (B)(5)(b). Further, the Handbook specifies that "[t]he mortgagee's corrective action plan must describe the form of capital contribution, the exact date of the contribution, and the amount or value of the contribution." *Id.* Finally, the Handbook states that where an analysis of the mortgagee's electronic "submission and notes . . . reveals that the

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[1] A nonsupervised lender or mortgagee is a lending institution which has as its principal activity the lending or investing of funds in real estate mortgages, consumer installment notes, or similar advances of credit, or the purchase of consumer installment contracts, and which is not approved under any other section of this part. *See* 24 C.F.R. § 202.7(a). A non-supervised mortgagee may submit applications for mortgage insurance. *See Id.*

mortgagee's adjusted net worth does not meet FHA requirements [such violation] is grounds for administrative action by [the Board]." *Id.* at ch. 4-5 (B)(5)(c).

The Act established the Board and empowered it to take action against any mortgagee found to be engaging in activities in violation of the FHA requirements. *See* 12 U.S.C. § 1708(c)(1). When any "report, audit, investigation, or other information before the Board discloses that a basis for an administrative action against a mortgagee exists, the Board shall take one of the following administrative actions: (1) [l]etter of reprimand; (2) [p]robation; (3) [s]uspension; (4) [w]ithdrawal; and (5) [s]ettlements. *See* 12 U.S.C. § 1708(c)(3). In determining which administrative action should be taken, the Board considers, among other factors, the seriousness and extent of the violations, the degree of the mortgagee responsibility for the occurrences, and any other mitigating or aggravating factors. *See* 24 C.F.R. § 25.8.

Under 12 U.S.C. § 1708(c)(3)(D), 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." The Board shall determine the terms of such withdrawal, but the term shall be not less than 1 year [and if] the Board has determined that the violation is egregious or willful, the withdrawal shall be permanent." *Id.*

The HUD regulation at 24 C.F.R. § 25.6 provides, in relevant part, that:

> "[any] administrative action imposed under 12 U.S.C. § 1708(c) shall be based upon one or more of the following violations . . . (e)[t]he failure of a nonsupervised mortgagee to submit the required annual audit report of its financial condition prepared in accordance with instructions issued by the Secretary within 90 days of the close of the fiscal year. . .; (g) [f]ailure to comply with any agreement, certification, undertaking, or condition of approval listed on, or applicable to, . . . mortgagee's application for approval . . .; (j) [v]iolation 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 . . ."

In actions where the Board seeks to impose a withdrawal, the notice must describe the nature and duration of the administrative action, state the reasons for the action with specificity, inform the mortgagee of the right to a hearing regarding the administrative action, and the manner and time in which to request a hearing. *See* 24 C.F.R. § 25.9(b); *see also* 12 U.S.C. § 1708(c)(4).

BACKGROUND

Petitioner was founded in 2006 and has approximately 75 employees. On November 19, 2010, Petitioner applied for approval to participate in the FHA Title II loan program. At the time of its application, Petitioner agreed to comply with HUD requirements including the Act, HUD regulations, FHA handbooks, and mortgagee letters with regard to participating in the program. Gov. Ex. 28. On December 20, 2010, HUD approved Petitioner's participation in the Title II

FHA loan program. Petitioner's Exhibit 1. In that letter, HUD informed Petitioner of its obligation to submit annual audited financial statements. *See id.* Since receiving FHA approval, Petitioner has been a non-supervised mortgagee. Approximately half of Petitioner's loan volume consists of FHA loans. Petitioner's current owners, Mr. Ray "Shawn" Vinson and Mr. Kevin Vester, purchased the company in November 2014. Mr. Vinson is the President and Mr. Vester is the Chief Financial Officer.

HUD requires FHA-approved lenders to complete an annual recertification process through the LEAP system in order to maintain its FHA lender approval. As part of the process, lenders are required to submit audited financial statements. To meet HUD requirements, the audit report must show that the company had an adjusted net worth in excess of the regulatory minimum at the close of the fiscal year. Additionally, lenders are required to submit a Corrective Action Plan in response to any findings identified by the auditor in the audit report that indicate a failure to maintain adjusted net worth or other regulatory requirements.

Petitioner retained Clifton Larson Allen LLP to audit its financial statements for FY 2013 ("Original FY 2013 Audit Report"). The Original FY 2013 Audit Report, dated March 31, 2014, concluded that Petitioner was required to have a minimum adjusted net worth of $2,173,378 for FY 2013 in order to comply with regulatory requirements. Petitioner Ex. 4, p. 14. However, the Original FY 2013 Audit Report concluded that Petitioner's adjusted net worth was just $357,641 and the company "[h]ad a significant lack of sufficient capital." *See id.* at 15. The Original FY 2013 Audit Report further concluded that "[t]here [was] a shortfall of approximately $1.8 million needed in order to meet the minimum amount required using HUD guidelines." *Id.* It also noted, "[a] formal plan ha[d] not been adopted by [Petitioner] to inject the necessary capital and as of March 31, 2014, the necessary capital ha[d] not been raised by [Petitioner]." *Id.* The Original FY 2013 Audit Report did note that Petitioner was working to obtain a Small Business Administration Loan ("SBA Loan") and the proceeds of the loan would be injected into Petitioner's working capital. *Id.* at p. 36. Petitioner did not complete the documentation for the SBA Loan until November 2014.

The SBA Loan is a business loan issued by Fortune Bank that is insured by the SBA pursuant to SBA's 7(a) loan program. The language of the SBA Loan states that proceeds may be used for working capital. 13 C.F.R. § 120.120(b)(4). The SBA Loan's Note states "oral agreements . . . to forbear from enforcing payment of a debt . . . are not enforceable . . . [t]o protect you (Borrower(s)) and us (Creditor) from misunderstanding or disappointment, any agreements we reach covering such matters are contained in this writing, which is the complete and exclusive statement of the agreement between us, except as we may later agree in writing to modify it." *See* Gov. Ex. 26, attachment 5.

The SBA Loan that Petitioner obtained is comprised of several documents signed by Mr. Vester or Mr. Vinson or both as officers of Petitioner, and identifies the borrowers as Petitioner, Mr. Vester and Mr. Vinson. *See id.* The SBA Loan states that each borrower is "joint and several[ly] liable" for the loan and identifies the Grantor as Petitioner, Mr. Vester, and Mr. Vinson. *Id.*, attachment 1. In addition, the SBA Loan's Commercial Security Agreement includes, in the definition of collateral, assets for which Petitioner is the exclusive owner. *Id.*

The original principal amount of the SBA Loan was $932,000. *Id.*, attachment 2. The SBA Loan's Disbursement Request and Authorization identifies the SBA Loan as being made

"to two individuals and a Corporation." *Id.* On November 21, 2014, $906,324 was disbursed in two equal amounts of $453,162 to Mr. Vester and Mr. Vinson. *Id.*, attachment 6 and 7. On November 25, 2014, Mr. Vinson and Mr. Vester transferred the amount to an account held by Petitioner. *Id.*, attachment 8 and 9.

On March 12, 2015, Robert May, a HUD Auditor, emailed Mr. Vinson regarding the Original FY 2013 Audit Report. Gov. Ex. 31. Mr. May's email informed Mr. Vinson that the report was deficient and asked Mr. Vinson to submit (1) an independent auditor's report on the financial statements and supplemental computation of the adjusted net worth, (2) a Corrective Action Plan for the adjusted net worth noncompliance, (3) a copy of all bank statements for the months in which deposits were made to offset the adjusted net worth deficiency; and (4) a separate management written Corrective Action Plan on letterhead for each internal control finding. *Id.* Mr. May also informed Petitioner that failure to submit the requested documents could result in a referral to the Board for administrative action, including, but not limited to, civil money penalties. *Id.* On March 20, 2015, Petitioner acknowledged Mr. May's email and stated that Petitioner was working to respond to the request. Gov. Ex. 51.

Petitioner did not provide any of the documents requested. Therefore, on May 5, 2015, the Board issued a NOV alleging that Petitioner failed to timely submit acceptable audited financial statements and supplementary reports and/or timely submit required cure documents into the LEAP portal. Gov. Ex. 1. The NOV informed Petitioner that it was considering taking administrative action and that Petitioner had 30 days from receipt of the NOV to provide a written response. *See id.* The NOV further stated that the Board would consider Petitioner's response when deciding which administrative action to take, if any. *Id.*

On June 5, 2015, Mr. Vester responded to the NOV and stated that Petitioner disagreed with some of the conclusions in the Original FY 2013 Audit Report. Gov. Ex. 2. At that time, Petitioner represented that management contributed cash to increase the company's net worth. *Id.* at p. 5. In support, Petitioner attached its FY 2014 Audit Report in an attempt to show that the net worth deficiency had been resolved. *Id.* There was no mention of the SBA Loan in Petitioner's response.

Because Petitioner had not submitted all of the documents requested in the March 12, 2015 email to show compliance with FHA requirements, on December 10, 2015, Mr. Edward Muckerman, a Board Specialist, sent an email to Mr. Vester giving Petitioner one more opportunity to submit the required documents as detailed in the March 12, 2015, email. Gov. Ex. 5. On December 15, 2015, Mr. Vester responded to Mr. Muckerman's email stating that Petitioner had uploaded the requested documents into the LEAP system. Gov. Ex. 6. Among these documents was Petitioner's Corrective Action Plan that specifically stated that Petitioner's "ownership injected $453,162 as working capital and another $453,162 on November 25, 2014." *Id.* There was no mention that ownership had obtained the SBA Loan.

On March 15, 2016, the Board, through a NOAA, informed Petitioner that its FHA approval had been withdrawn for one-year because Petitioner violated HUD recertification requirements for FY 2013. Gov. Ex. 3. Specifically, the NOAA stated that Petitioner had failed to timely submit acceptable audited financial statements and supplementary reports for FY 2013. The NOAA also informed Petitioner that it could appeal the Board's decision pursuant to 24

C.F.R. § 25.10 within 30 days of the receipt of the NOAA and described the manner in which to request a hearing. *See id.*

On April 8, 2016, Petitioner filed a Notice of Appeal requesting a hearing to challenge the NOAA. Subsequently, Petitioner requested that Mueller Post audit its financial statements for FY 2013 (Second FY 2013 Audit Report). The report, dated October 4, 2016, stated that Petitioner was required to have a minimum adjusted net worth of $1,559,652 for FY 2013. Petitioner's Ex. 3. However, according to Mueller Post, Petitioner's actual adjusted net worth for FY 2013 was $410,456, which is a deficiency of $1,140,196. *See id.* The report also noted that Petitioner's [n]et worth [was] not in compliance with HUD guidelines," and that there was a "risk that HUD could remove FHA lending rights." *Id.*

Petitioner did not disclose the SBA Loan as a liability in its financial statements for the Second FY 2013 Audit Report, nor did it provide the SBA Loan documents to Mueller Post until 2017. After receiving the SBA Loan documents in 2017, the lead auditor from Mueller Post stated that the FY 2014 Audit Report did not fairly represent the SBA Loan because the report did not include a full description of the loan and did not represent that Petitioner's assets were pledged in collateral for the loan. Tr. 685:2-687:16 (testifying Notes 15 and 16 did not fairly present the SBA Loan). Furthermore, a HUD auditor agreed that a loan with joint and several liability, like the one in this case, should be treated as a liability in its entirety. *See Decision* at 9, 13 (referring to testimony of Wendell Conner, CPA and HUD regulator of auditors and audits).

DISCUSSION

I. Petitioner's Conduct Provided Sufficient Evidence to Impose the Withdrawal Penalty.

Petitioner argued that the *Decision* should be modified or set aside because the one-year withdrawal penalty is grossly disproportionate to the alleged conduct. *Petition* at 5. Petitioner argued that if the Original FY 2013 Audit Report was improper or did not meet HUD's guidelines, the error was a single act more properly sanctioned through the imposition of a fine. *Id.* at 6. The ALJ rejected this argument, holding that Petitioner's violation of net worth requirements for recertification and failure to provide audits prepared consistent with GAAP was sufficient evidence for a one-year withdrawal. *Id.* at 11-12. HUD agreed with the ALJ's determination and maintained the position that the failure to provide acceptable financial statements was a serious infraction punishable by the withdrawal of its approval to participate in the FHA Title II loan program. *Response* at 13-15. After review of applicable statutes, regulations, and the record, I agree with the ALJ's holding that Petitioner's conduct provided sufficient evidence for a one-year withdrawal of its approval to participate in the FHA Title II program.

A. Petitioner Did Not Satisfy the Minimum Net Worth Requirement.

On December 20, 2010, HUD approved Petitioner's participation in the FHA Title II program. Petitioner's Ex. 1. After receiving FHA approval, Petitioner was obligated to provide HUD with audited financial statements in order to renew approval to originate FHA-insured loans. *See* 24 C.F.R. Part 202 and FHA TITLE II MORTGAGEE APPROVAL HANDBOOK 4060.1,

REV-2 (2006). These financial statements were necessary to prove that Petitioner had the sufficient capital to be an FHA approved lender. Yet, in FY 2013, Petitioner's adjusted net worth did not meet the regulatory minimum. Based on the record, the Original FY 2013 Audit Report showed Petitioner's net worth at an estimated $1.8 million below the regulatory minimum. Gov. Ex. 32, p. [16]; Tr. 115:21-116:2. 152:15-154:4. Additionally, the Second FY 2013 Audit Report, completed in 2016 by new auditors, revealed a net worth deficiency of approximately $1.1 million. Gov. Ex. 7, p. 32. Although, Petitioner secured the SBA Loan in the amount of $906,324 to be used as a capital contribution, that amount was not enough to meet HUD's minimum net worth. Therefore, Petitioner's net worth failed to meet the regulatory requirement at the close of FY 2013.

B. Petitioner Failed to Cure the Net Worth Deficiency.

The Handbook specifically states that "[a]n approved mortgagee must maintain at least the minimum required adjusted net worth at all times." HANDBOOK at ch. 6-21. The Handbook further states, "[i]f at any time it falls below the required minimum, the mortgagee *must* notify the Lender Approval and Recertification Division and submit a Corrective Action Plan." *Id.*

In an attempt to raise capital, Petitioner's management secured an SBA Loan in 2014. Yet, the record reflects that the SBA Loan could never cure Petitioner's net worth deficiency. First, Petitioner's net worth deficiency was, depending on the audit used, at least $1.1 million and the SBA Loan was in the amount of $906,324. Thus, even with the SBA Loan, Petitioner's net worth was still insufficient to meet HUD requirements. Second, Petitioner's management failed to fully disclose the terms of the SBA Loan to its auditors and to HUD. Specifically, the loan documents identify Mr. Vinson, Mr. Vester, and Petitioner as "joint and several[ly] liable"[2] for the loan and Petitioner's assets as collateral for the loan. Therefore, as a named borrower, Petitioner was also liable for repaying the loan. Because of this fact, Petitioner's financial statements should have reflected the loan as a liability and *not* as paid in capital by the owners. Tr. 207:10-208:19.

Lastly and most troubling, Petitioner's management attempted to alter the terms of the SBA Loan. Mr. Vinson and Mr. Vester had a verbal agreement, which they later reduced to writing, to treat the SBA Loan as one in which they, not Petitioner, would be responsible for repaying. *Decision* at 12-13. This action was reflected in the FY 2014 Audit Report and the Second FY 2013 Audit Report when Petitioner's management informed the auditors that they had made a capital contribution of $906,324 (the exact amount of the SBA Loan) to the company. *See* Gov. Ex. 26 (Attachment 5). The oral agreement did not excuse Petitioner's liability because, per the terms of the loan agreement, the arrangement was invalid. In the end, no matter how Petitioner defined or represented the SBA Loan, the $906,324 amount was not sufficient to make up the net worth deficiency. Therefore, Petitioner failed to cure the net worth deficiency.

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[2] The SBA Loan's Commercial Security Agreement states "[all] obligations of the Grantor under this Agreement shall be joint and several, and all references to Grantor shall mean each and every Grantor. This means that each Grantor, signing below is responsible for all obligations in this Agreement . . ." *See* Gov. Ex. 26, attachment 1.

C. Petitioner Did Not Submit Acceptable Audited Financial Statements.

Pursuant to 24 C.F.R. § 5.801(b)(1), Petitioner was required to submit audited financial statements consistent with GAAP. GAAP requires financial statements to be a fair presentation of Petitioner's financial position. *See e.g.*, Gov. Ex. 7 (audit page 1; under "Management's Responsibility"). In this case, HUD deemed the Original FY 2013 Audit Report as unacceptable and provided Petitioner with numerous opportunities to fix the issue. But with each opportunity, Petitioner continued to materially misrepresent its financial position. For example, Petitioner submitted the FY 2014 Audit Report to show that it was operating with the sufficient net worth. However, those financial statements reflected the $906,324 (the amount of the SBA Loan) as a capital contribution, but did not specify that it was the SBA Loan. Again in 2016, Petitioner's management disclosed the loan amount as a capital contribution in its Second FY 2013 Audit Report, but did not specify that it was the SBA Loan.

Moreover, Petitioner's auditor testified that the Second FY 2013 Audit Report was unacceptable because it did not comply with GAAP. The auditor testified that Petitioner's management failed to disclose that they had named the company as a borrower in the SBA Loan documents and had pledged Petitioner's assets as collateral. Tr. 625:2-687:16. Therefore, HUD was unable to accept the 2013 financial statements and the Corrective Action Plan. Tr. 199:12-16, 199:24-200:8; 201:23-202:5; Gov. Ex. 15, ¶4-8(B)(4). Because of these misrepresentations regarding the nature of the loan, none of the audited financial statements Petitioner submitted were ever acceptable to show that it had a sufficient net worth to maintain its FHA approval.

D. Petitioner's Argument That the Sanction Would Negatively Impact Its Business Does Not Excuse the Violation.

In determining what administrative action is proper, the Board must consider (1) the seriousness and extent of the violations, (2) the degree of mortgagee responsibility for the occurrences, and (3) any other mitigating or aggravating factors. 24 C.F.R. § 25.8. Petitioner argued that the company would go out of business and that underserved communities would be impacted if its FHA approval were withdrawn.[3] *See Petition* at 6-7.

Petitioner's actions warrant the imposed penalty. First, Petitioner did not meet the net worth requirement for FY 2013. HUD made several attempts to resolved this, but Petitioner repeatedly failed to get required documents to HUD in a timely fashion. Second, Petitioner misrepresented the SBA Loan as a capital contribution rather than Petitioner's liability on both its FY 2014 Audit Report and Second FY 2013 Audit Report that were submitted to HUD. This misrepresentation caused Petitioner's financial documents to be inconsistent with GAAP. Additionally, Petitioner's net worth still remained under the required threshold even with their failed attempts to treat the Petitioner's loan as a capital contribution.

There is no dispute that the withdrawal penalty would have adverse effects on Petitioner. However, Mr. Vinson also testified that business would be "difficult" but the company "would likely survive" if Petitioner was withdrawn from the FHA Title II program. Tr. 572:15-573:2. Additionally, Mr. Vinson testified further that out of all the FHA loans Petitioner originated,

[3] In its *Petition*, Petitioner introduced new evidence to justify its position that the withdrawal penalty was grossly disproportionate to the violation. Because it was not part of the original record, any new arguments Petitioner makes in its Petition will not be considered here.

only "dozens" were originated in underserved communities. *Id.* Petitioner has not shown a hardship through these statements and they do not mitigate the egregiousness of Petitioner's continued misrepresentations as to the nature of the capital contribution. Therefore, Petitioner's regulatory violations coupled with its attempt to cover the violation through misrepresentations warrant assessing the withdrawal penalty.

II. HUD Provided Sufficient Notice and Opportunity to be Heard to Meet Due Process Requirements.

"Due process is flexible and calls for such procedural protections as the particular situation demands." *Matthews v. Eldridge*, 424 U.D. 319, 324 (1976) (quoting *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972)). The fundamental requirement of due process in any proceeding is to provide timely notice to interested parties and allow them the opportunity to be heard. *See Armstrong v. Manzo*, 380 U.S. 545, 550 (1965). Similarly, HUD requires the Board to send a NOV to a mortgagee prior to taken any action against a mortgagee. 24 C.F.R. § 25.7(a). The NOV must state the alleged violation and direct the mortgagee to respond in writing within 30 days after receipt of the notice. *Id.*

In this case, Petitioner argued that the NOV "did not indicate that the Agency was actually seeking a withdrawal penalty" and that the NOV only "indicate[d] that [HUD] was "considering imposing monetary penalties."" *Petition* at 8. Contrary to this argument, HUD maintained the position that the NOV gave sufficient notice that Petitioner's regulatory failure could result in administrative action, civil money penalties, or both. *Response* at 9-10; *see also* Gov. Ex. 1, p. 1, 2. Furthermore, HUD argued that Petitioner had actual knowledge of the alleged violation through various communications between itself and HUD. *Response* at 10. The ALJ held that HUD provided Petitioner sufficient notice of its violation and an opportunity to present its defenses to meet due process requirements. *Decision* at 10-11. After review of the record and legal authorities, I agree with the ALJ.

As required by HUD and due process, the Board provided notice to Petitioner of its violation on May 5, 2015. *See* Gov. Ex. 1. The NOV stated that Petitioner failed to timely submit acceptable audited financial statements and supplementary reports and/or failed to timely submit required cure documents into the LEAP portal. *Id.* In the first sentence, the NOV states that the Board was "considering taking an administrative action against [Petitioner] . . . pursuant to 24 C.F.R. Part 25."[4] *Id.* Next, the NOV states that the Board could impose a civil money penalty or take an administrative action. *Id.* at p. 2. The NOV further states that the Board would "make a final determination as to the appropriate action to take or penalty to seek based on the information available to the Board." *Id.* Based on the plain reading of the NOV, it is clear that Petitioner was on notice of the alleged violation and on notice that withdrawal was the type of sanction that could be imposed under the circumstances.

The record also reflects that Petitioner had knowledge as to its regulatory violations through various communications it had with HUD. Tr. 21:25-26:19, 28:9-29:18. In a March 12, 2015 email, HUD informed Petitioner that the Original FY 2013 Audit Report was deficient.

[4] 24 C.F.R. § 25.5 (a) reads: [t]he Board is authorized to take administrative actions in accordance with 12 U.S.C. 1708(c), including, but not limited to, the following: issue a letter of reprimand, probation, suspension, or withdrawal; or enter into a settlement agreement.

Gov. Ex. 31. In that communication, HUD specifically identified the net worth deficiency. Gov. Ex. 31. On March 20, 2015, Mr. Vester acknowledged the email and stated that Petitioner was working to provide the necessary information to comply with HUD. Gov. Ex. 51. On December 10, 2015, an email was sent to Mr. Vester providing Petitioner with another opportunity to cure the net worth deficiency. Gov. Ex. 5. On December 15, 2015, Mr. Vester stated that Petitioner had submitted documents into the LEAP system. Gov. Ex. 6. These communications show that Petitioner had adequate notice of its regulatory violation, including well before the NOV was issued, that was sufficient to meet due process requirements.

Furthermore, Petitioner was given the opportunity to be heard through all stages of the case. Prior to the NOV, HUD informed Petitioner of its net worth deficiency and gave Petitioner a chance to resubmit the required information. After Petitioner's failure to do so, the Board issued the NOV. As required by HUD and due process, the NOV gave Petitioner 30 days to respond in writing to HUD regarding the regulatory violation. Gov. Ex. 1, p.2. The NOV explained that Petitioner's response had to address factors listed in 24 C.F.R. §§ 25.8 and 30.80. *Id.* Additionally, the NOV stated that if Petitioner wanted to raise its ability to pay civil money penalties as an affirmative defense or argument in mitigation, that Petitioner had to provide documentation of its ability to pay. *Id.* On June 5, 2015, Petitioner provided a written response to HUD, but this response only discussed Petitioner's disagreement with the findings of the Original FY 2013 Audit Report and did not discuss its ability to pay the civil money penalty or any other mitigating factors. Gov. Ex. 2.

Subsequent to Petitioner's next attempt to submit information after a 6-month delay, the Board issued the NOAA on March 15, 2016 withdrawing Petitioner's FHA approval for one-year because the additional information still did not meet HUD requirements. Gov. Ex. 3. The NOAA specifically stated that Petitioner could appeal the withdrawal pursuant to 24 C.F.R. § 25.10 within 30 days of the receipt of the NOAA and detailed how Petitioner could request a hearing. *See id.* On April 8, 2016, Petitioner exercised its right to a hearing. *Id.* Thus, Petitioner had numerous opportunities to be heard through all stages of the case and I find that due process requirements were met.

CONCLUSION

Upon review of the entire record of this proceeding as well as applicable statutes and regulations, the *Petition* is **DENIED** for the reasons set forth above. Pursuant to 24 C.F.R. § 26.52, the ALJ's August 14, 2017, Initial Decision and Order is **AFFIRMED**.

Dated this 9th day of January, 2018

Andrew Hughes
Secretarial Designee