ARIZONA DEPARTMENT OF FINANCIAL INSTITUTIONS

Felecia A. Rotellini
Superintendent of Financial Institutions

Janet Napolitano
Governor

October 15, 2007

Russell R. Rea, Esq.
Jennings, Strouss & Salmon, PLC
The Collier Center, 11th Floor
201 E. Washington Street
Phoenix, AZ 85004-2385

Reference: Docket No. 07F-BD065-BNK – Freedom Financial & Mortgage Services Corporation and Timothy A. Russell, President

Dear Mr. Rea:

I have completed my review of the record in the matter of Freedom Financial & Mortgage Services Corporation and Timothy A. Russell, President. Enclosed is my Final Decision and Order.

Please be advised that, pursuant to A.R.S. § 41-1092.09(A)(1), this decision shall be final unless written motion for rehearing is submitted no later than thirty (30) days after service of this decision. The motion for rehearing or review must specify the particular grounds upon which it is based. In the alternative, the parties may seek judicial review of this decision pursuant to A.R.S. § 41-1092.08(H).

Please contact Assistant Attorney General Erin O. Gallagher at 542-8935 with any questions.

Sincerely,

Felecia Rotellini

Felecia A. Rotellini
Superintendent

FAR:jb

Enclosure
cc: Erin O. Gallagher, Assistant Attorney General

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ARIZONA DEPARTMENT OF FINANCIAL INSTITUTIONS

In the Matter of the Mortgage Banker License of: **FREEDOM FINANCIAL & MORTGAGE SERVICES CORPORATION AND TIMOTHY A. RUSSELL** 6063 East Hermosa Vista Drive Mesa, AZ 85215 Respondents.	No. 07F-BD065-BNK **SUPERINTENDENT'S FINAL DECISION AND ORDER**

The Superintendent of Financial Institutions (the "Superintendent") having reviewed the record in this matter, including the transcripts of the August 14, and August 22, 2007 administrative hearing, and the Administrative Law Judge's recommended decision attached and incorporated herein by this reference, accepts the Administrative Law Judge's Findings of Fact and Conclusions of Law and accepts, modifies and rejects the recommended Order as follows.

FINDINGS OF FACT

The Superintendent adopts the Administrative Law Judge's Findings of Fact Paragraphs 1 through 164.

CONCLUSIONS OF LAW

The Superintendent adopts the Administrative Law Judge's Conclusions of Law Paragraphs 1 through 22.

RECOMMENDED ORDER

The Superintendent adopts, modifies, and rejects the Administrative Law Judge's Recommended Order as follows:

1) Modify Paragraph 1 to affirm rather than re-issue the March 7, 2007 Cease and Desist Order; 2) Adopt Paragraph 1 to impose the $25,000 civil money penalty as originally set forth in the March 7, 2007 Cease and Desist Order; 3) Adopt Paragraph 2 to revoke Respondents' license; 4) Reject Paragraphs 2 and 3 regarding the recommended decision's revocation of Respondents' license for only a period of two years and 4) Reject Paragraph 3 in its entirety and the imposition of a disciplinary probation period.

. . .

Reasoning for Modifications to the Recommended Order:

There is no need to re-issue the March 7, 2007 Cease and Desist order since grounds exist for revocation of Respondents' license. The Department has established by a preponderance of the evidence 1) multiple and repeat violations of the statutes governing the Respondents' conduct; 2) sufficient grounds exist to revoke Respondents' license under A.R.S. § 6-945(A)(2) and (7); and 3) the civil money penalty in the amount of $25,000 is appropriate. Conclusions of Law, Paragraphs 9, 13, 17, 18, 20, 21, 22.

The Department has further established that Respondents' persistent violations show a cavalier attitude toward state regulation. Conclusions of Law, Paragraph 20.

ORDER

IT IS ORDERED that the Respondents' license is hereby revoked. The civil money penalty of $25,000 is affirmed and due and payable upon service of this Final Decision and Order.

NOTICE

The parties are advised that, pursuant to A.R.S. § 41-1092.09, this Order shall be final unless Respondents submit a written motion for rehearing no later than thirty (30) days after service of this decision. The motion for rehearing or review must specify the particular grounds upon which it is based as set forth in A.A.C. R20-4-1219. A copy shall be served upon all other parties to the hearing, including the Attorney General, if the Attorney General is not the party filing the claim of error. In the alternative, the parties may seek judicial review of this decision pursuant to A.R.S. § 41-1092.08(H).

DATED this 15th day of October, 2007.

Felecia Rotellini
Superintendent of Financial Institutions

ORIGINAL filed this 15th day of October, 2007, in the office of:

Felecia Rotellini
Superintendent of Financial Institutions

Arizona Department of Financial Institutions
ATTN: June Beckwith
2910 North 44th Street, Suite 310
Phoenix, Arizona 85018

COPY of the foregoing mailed/hand delivered
This same date to:

Diane Mihalsky, Administrative Law Judge
Office of Administrative Hearings
1400 West Washington, Suite 101
Phoenix, AZ 85007

Erin O. Gallagher, Assistant Attorney General
Office of the Attorney General
1275 West Washington
Phoenix, AZ 85007

Robert Charlton
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Timothy A. Russell
Statutory Agent for:
Freedom Financial & Mortgage Services Corporation
6063 East Hermosa Vista Drive
Mesa, AZ 85215

Timothy A. Russell, President
Freedom Financial & Mortgage Services Corporation
6063 East Hermosa Vista Drive
Mesa, AZ 85215

AND COPY MAILED SAME DATE by
Certified Mail, Return Receipt Requested, to:

Russell R. Rea
Attorney at Law
Jennings, Strouss & Salmon P.L.C.
201 E. Washington Street, 11th Floor
Phoenix, AZ 85004-2385

Attorney for Respondents

By: June Beckwith

IN THE OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of:	No. 07F-BD065-BNK
FREEDOM FINANCIAL & MORTGAGE SERVICES CORPORATION and **TIMOTHY A. RUSSELL, President** 6063 East Hermosa Vista Drive Mesa, AZ 85215 Respondents.	**ADMINISTRATIVE LAW JUDGE DECISION**

HEARING DATES: June 25, 2007 at 9:00 a.m.; August 14, 2007 at 9:00 a.m.; and August 22, 2007 at 1:30 p.m.

APPEARANCES: The Arizona Department of Financial Institutions ("the Department") appeared through Erin O. Gallagher, Esq., Assistant Attorney General; Respondents Freedom Financial & Mortgage Services Corporation ("Freedom Financial") and Timothy A. Russell, President, appeared through Russell R. Rea, Esq., Jennings, Strouss & Salmon, PLC.

ADMINISTRATIVE LAW JUDGE: Diane Mihalsky

BACKGROUND AND PROCEDURE

1. Respondent Freedom Financial is an Arizona corporation authorized to transact business in Arizona as a mortgage banker, license number BK 0907383, within the meaning of A.R.S. §§ 6-941(5).

2. Freedom Financial does not fund mortgage loans but, instead, acts as a mortgage broker. Freedom obtains information on income and assets from borrowers who wish to purchase real property in Arizona and uses that information to negotiate loan offers from potential lenders to finance the borrowers' purchases.

3. Respondent Timothy A. Russell is the President and one hundred percent (100%) owner of Freedom Financial and is authorized to transact business in Arizona as a mortgage banker within the meaning of A.R.S. § 6-941(5), as outlined in A.R.S. § 6-943(F).

4. Freedom Financial and Mr. Russell are not exempt from licensure as mortgage bankers within the meaning of A.R.S. §§ 6-942 and 6-941(5).

5. On May 1, 2006, the Department received an anonymous complaint from a person who claimed to be employed at Freedom Financial about alleged irregularities in five specific loans.[1] The anonymous complainant generally alleged that other unspecified irregularities existed in Freedom Financial's loans and practices.

6. On August 29, 2006, the Department's Senior Examiner Joan S. Doran went to Freedom Financial's office to audit its records of advertising, personnel, loans made to consumers, internal financial status, and other matters regulated by statute.

7. According to her report,[2] Ms. Doran met with Mr. Russell on October 18, 2006 and concluded her examination on November 30, 2006. She identified numerous statutory or regulatory violations or irregularities from Freedom Financial's records

8. Ms. Doran did not find any irregularities or statutory or regulatory violations in the five loans specified on the anonymous complaint.

9. During Ms. Doran's examination of Freedom Financial's records, she noted numerous loan applications having been made by Richard and Jane Fletcher during a short period of time, which applications showed conflicting monthly income figures and other information. Although Ms. Doran "skimmed" the records of the Fletcher transactions, she did not analyze the transactions and, instead, took the records to the Department's Investigator Clyde Granderson.

10. Ms. Doran also found two loan applications by Freedom Financial's employees Rick Duell and Steve Archer that contained what she considered to be questionable information. She also referred these applications to Mr. Granderson.

11. On March 7, 2007, the Department issued an Order to Cease and Desist; Notice of Opportunity for Hearing; Consent to Entry of Order ("the cease and desist order"), which was drafted and signed by the Department's Assistant Superintendent Robert D. Charlton, based on the results of Ms. Doran's examination.

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[1] *See* Respondents' Ex. A.
[2] *See* Department Ex. 1.

12. The March 7, 2007 cease and desist order required Respondents to cease and desist the statutory and regulatory violations immediately and imposed a $25,000.00 civil penalty.

13. On March 29, 2007, Mr. Russell on behalf of Freedom Financial appealed and requested an informal settlement conference on the cease and desist order.[3]

14. On April 7, 2007, Mr. Russell on behalf of Freedom Financial responded to the Department's cease and desist order, admitting many of the violations charged in the order but alleging that all of the violations had been remedied.[4] Mr. Russell attached to his response seven exhibits.

15. On April 13, 2007, the Department issued a Notice of Hearing, which set an administrative hearing on May 16, 2007 on the statutory and regulatory violations charged in the cease and desist order. The Department also charged several other violations, including that Respondents submitted loan applications that violated A.R.S. § 6-947(L) and had failed to maintain the net worth required by A.R.S. § 6-943(C).

16. On May 4, 2007, the Office of Administrative Hearings received Respondents' answer, which admitted some of the charged violations, denied others, and stated that Respondents' lacked sufficient information or belief to admit or deny others.

17. On May 4, 2007, the Office of Administrative Hearings received Respondents' unopposed motion to continue to allow them to investigate the factual allegations in the Department's notice of hearing that had not been contained in the cease and desist order and to allow the parties to participate in an informal settlement conference.

18. On May 7, 2007, the Administrative Law Judge continued the hearing to June 25, 2007, a date for which both parties' attorneys had confirmed their own and their clients' availability, and informed the parties that, "[a]bsent extraordinary circumstances, no further continuances will be granted."

19. On June 21, 2007, the Office of Administrative Hearings received Freedom Financial and Mr. Russell's second request for continuance, because the Department allegedly had not negotiated in good faith at the requested settlement conference but, instead, and used the conference to conduct discovery and that, as a result, Respondents

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[3] *See* the Department's Ex. 3.
[4] *See* Respondents' Ex. S.

had not been able to have subpoenas issued or perform other necessary discovery. In addition, Mr. Russell's 15-year-old daughter was participating in the 2007 World Championship Paint Horse Show in Fort Worth, Texas, and the event conflicted with the scheduled hearing.

20. On June 22, 2007, the Administrative Law Judge denied the motion to continue.

21. A hearing was commenced on June 25, 2007. Because the parties did not conclude presentation of their evidence, a further hearing was held on August 14, 2007 and a second further hearing on August 22, 2007. The Department presented the testimony of Ms. Doran, Mrs. Fletcher, and Mr. Granderson and had admitted into evidence 37 exhibits. Respondents presented the testimony of Mr. Russell and had admitted into evidence 19 exhibits.

THE PARTIES' STIPULATIONS WITH RESPECT TO THE NOTICE OF HEARING

22. At the beginning of the hearing, Respondents admitted the factual predicates for the statutory violations charged in the cease and desist order, in relevant part as follows:

a. Respondents violated A.R.S. § 6-944(A) by transferring or assigning their mortgage banker license, specifically by allowing unlicensed, out-of-state mortgage companies to originate mortgage loans using Freedom Financial's name and mortgage license for a fee at least 16 times during the calendar years 2005 and 2006;

b. Respondents violated A.R.S. §§ 6-943(N) and 6-946(E) by

   (i) Failing to use their proper name and license number and failing to include the required disclosures within regulated advertising in at least 11 advertisements and/or solicitations and

   (ii) Failing to correct this violation from their last examination;

c. Respondents violated A.R.S. § 6-943(O) and A.A.C. R20-4-102(20) by failing to conduct the minimum elements of reasonable employee investigations before hiring employees specifically by

(i) Failing to obtain a completed and dated "I9" (Employment Eligibility Verification Form) before hiring two employees;

(ii) Failing to consult with the applicant's most recent or next most recent employer before hiring 13 employees;

(iii) Failing to inquire regarding an applicant's qualifications and competence before hiring 25 employees;

(iv) Failing to obtain a credit report before hiring 12 employees;

(v) Failing to conduct further investigation of one employee with a derogatory credit report; and

(vi) Failing to correct this violation from the last examination.

d. Violated A.R.S. § 6-947(B) and A.A.C. R20-4-102 by contracting with or paying compensation to unlicensed, independent contractors, specifically by:

(i) Paying compensation in the total amount of $128,289.44 to 18 unlicensed, independent contractors for marketing, mortgage leads and telemarketing services on 36 separate occasions;

(ii) Accepting free advertising from an escrow agent/title company;

(iii) Purchasing gift cards in the amount of $1,822.00 for referral fees to borrowers;

(iv) Paying reimbursement in the total amount of $35,550.00 to two employees without any back-up documentation;

(v) Paying reimbursements in the amount of $22,567.30 to employee owned companies for inappropriate expenses; and

(vi) Failing to correct these violations from their last examination.

e. Violated A.R.S. § 6-946(A) and A.A.C. R20-4-1806(B) by failing to maintain complete and correct records, specifically by being unable to supply invoices and/or other back-up documentation to substantiate payments to 7 vendors and/or employee reimbursement.

f. Violated A.R.S. § 6-947(A) and A.A.C. R20-4-1808 by allowing borrowers to sign regulated documents containing blank spaces, specifically,

   (i) Twenty-one preliminary truth in lending disclosures were signed in blank;

   (ii) Sixteen rate lock election disclosures were signed in blank; and

   (iii) One good faith estimate was signed in blank.

g. Violated A.R.S. § 6-946(E) and A.A.C. R20-4-1806(B)(6) by failing to comply with the disclosure requirements of Title I of the Consumer Credit Protection Act (15 U.S.C. §§ 1601 through 1666j), the Real Estate Settlement Procedures Act (12 U.S.C. §§ 2601 through 2617), and the regulations promulgated thereunder, specifically,

   (i) Failing to disclose application fees of $500.00 within good faith estimates to 2 borrowers;

   (ii) Failing to disclose yield spread premiums within the good faith estimates to 6 borrowers; and

   (iii) The origination fees as disclosed in the good faith estimates to 3 borrowers were significantly lower than the origination fees paid by those borrowers upon final settlement.

h. Violated A.R.S. § 6-946(C) by failing to use proper appraisal disclosures, specifically,

   (i) Using unlawful appraisal disclosures that limit a borrower to 90 days in which the borrower may request a copy of an appraisal for which the borrower has paid; and

(ii) Failing to correct this violation from their last examination.[5]

Because Respondents did not agree to pay the $25,000.00 civil penalty assessed in the cease and desist order, the Department may consider the above admitted violations in determining what, if any, penalty to assess.

23. The Department also may consider the license history, including the admitted violations, as factors in aggravation of the penalty if it determines that Respondents committed additional statutory violations, as alleged in the notice of hearing.

24. The Department at the beginning of the hearing withdrew the allegations in the notice of hearing that Respondents had submitted deceptive loans containing at least 3 questionable appraisals,[6] had procured at least one suspicious CPA letter resulting in a potentially fraudulent loan,[7] and had facilitated a refinance of a property with an unknown address.[8]

25. Respondents admitted that, on April 3, 2007, they submitted their annual Report on Audited Financial Statements for the year ending December 31, 2006 and that Respondents' total equity as stated on the Balance Sheet was $47,608, approximately $53,392 short of the net worth required by A.R.S. § 6-943(C).[9]

26. Respondents disputed, however, that these circumstances established that they had failed to maintain a net worth of one hundred thousand dollars, in violation of A.R.S. § 6-943(C).

27. The Department also alleged that Respondent's had made a false promise or misrepresentation or concealed an essential or material fact in the course of the mortgage banker business in applications submitted on behalf of the Fletchers and two applications submitted by Freedom Financial's employees Rick Duell and Steve Archer.

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[5] These factual predicates are based upon the facts alleged in Factual Allegations ¶ 4 and all subparts and the law cited in Law ¶ 2, a-h in the Notice of Hearing.
[6] Notice of Hearing factual allegation ¶ 7, p. 6, ll. 25-26.
[7] Notice of Hearing factual allegation ¶ 7, p. 7, l. 1.
[8] Notice of Hearing factual allegation ¶ 7, p. 7, ll. 2-3.
[9] Notice of hearing factual allegation ¶ 8.

THE FLETCHER APPLICATIONS

Mrs. Fletcher's Testimony

28. Mr. Fletcher had retired from his job at Lockheed Martin as a tool and die maker. At all times relevant to this complaint, he received a monthly pension in the amount of $1,492.00. In 2004 and 2005, according to his 1099 forms, he received an annual total of $17, 905.20 from his pension.[10]

29. On the applications at issue, Mr. Fletcher stated that the market value of his retirement account was $27,996.[11]

30. Mrs. Fletcher does not have a college degree. Before 2003, Mrs. Fletcher worked for a doctor in California preparing bills to insurance companies. In 2001, she had taken and failed the examination to become a licensed real estate salesperson in California.

31. Between May and August of 2003, Mrs. Fletcher took classes to become a licensed real estate salesperson in California. On August 21, 2003, she was licensed as a real estate salesperson by the California Department of Real Estate.[12]

32. Between August 2003 and July 2006, Mrs. Fletcher earned commissions as the real estate salesperson on the sale of approximately 12 residential properties in California. Eight of these residential properties were sold in 2004.

33. According to her 1099 forms from her former employer Hartwig Realty in Lancaster, California, Mrs. Fletcher earned $17,813.78 in commissions in 2004 and $27,618.21 in commissions in 2005 from her activities as a real estate salesperson.[13]

34. Mrs. Fletcher testified that she earned less in 2004 because she was spending time in Arizona, investigating real estate investment opportunities.

35. Mr. and Mrs. Fletcher owned their residence on 10715 Ross Rd. in Littlerock, California, which Mr. Fletcher had purchased before they were married. The market value of this residence in the fall of 2005 was $420,000 and Mr. and Mrs. Fletcher were liable for a $1,000/month payment for the $138,457.00 mortgage on the residence.[14]

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[10] *See* the Department's Ex. 34.
[11] *See, e.g.,* the Department's Ex. 26 at FF-04054.
[12] *See* Respondents' Ex. C.
[13] *See* the Department's Ex. 34.
[14] *See, e.g.,* Department's Ex. 24.

36. Between 2001 and 2003, Mr. and Mrs. Fletcher also purchased three rental properties in California, as follows:

36.1 A residential property at 40810 13th St. in Palmdale, California. The market value of this property in the fall of 2005 was $380,000 and Mr. and Mrs. Fletcher were liable for a $1,428/month payment for the $182,000 mortgage on the property. Mr. and Mrs. Fletcher also received $1,428/month in rent for the property.[15] At the time of the hearing in this matter, Ms. Fletcher testified that she received $1,900/month for rent on the property on 13th Street.

36.2 A residential property at 16635 Jubilee Trail in Lake Los Angeles, California. In January 2005, the Fletchers had estimated this property to be worth $250,000, were liable for an $874/month payment for the $135,000 mortgage on the property, and received $1,300/month in rent.[16] Mrs. Fletcher testified that she and her husband purchased the Jubilee Trail property for approximately $85,000 and, sometime in 2005, sold the property for a profit of approximately $58,000 over its purchase price. Mrs. Fletcher believes that she did a 1031 exchange for her profits for the purchase of 4-plexes on 38th St. in Phoenix in January 2005.

36.3 A residential property at 1636 E. Ave. Q-11 in Palmdale, California. In January 2005, the Fletchers had estimated this property to be worth $217,000, were liable for a $935/month payment for the $140,000 mortgage, and received $1,300/month in rent.[17] Mrs. Fletcher testified that she had purchased the property for $105,000 and sold it in 2005 for between $30,000 and $50,000 more than its purchase price. She believes that she also used the profit in a 1031 exchange to purchase the 4-plexes on 38th St. in Phoenix.

37. In 2004-2005, Mr. and Mrs. Fletcher also had two IRA accounts at Sun America, having balances of approximately $170,000 and $39,277.[18]

38. Mrs. Fletcher testified that, at the end of 2004, she and her husband decided to purchase properties in Arizona and started looking at the website "Loopnet." Mr. and

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[15] *Id.*
[16] *See* Department's Ex. 28.
[17] *See id.*
[18] *See, e.g.,* Department's Ex. 26 at FF-04054.

Mrs. Fletcher met Arizona real estate agents Lisa Egan and Mark Archer of Powerhouse Realty in Scottsdale through "Loopnet."

39. Mr. and Mrs. Fletcher drove to Arizona to look at properties but the properties they initially saw were not what they wanted. Mr. and Mrs. Fletcher were not interested in relocating to Arizona. They were looking for multi-family residential investment property.

40. In early 2005, Mr. and Mrs. Fletcher decided to purchase six four-plex residential properties on N. 38th St., between E. Thomas and E. Indian School Roads, in Phoenix. The six buildings on contiguous parcels contained 24 rental units. Mr. and Mrs. Fletcher agreed to pay $286,620 for each of the 6 4-plexes on 38th St. in Phoenix.

41. Ms. Egan and Mr. Archer referred them to Rick Duell at Freedom Financial to obtain financing.

42. Mrs. Fletcher testified that she and her husband provided Mr. Duell with the 1099 forms, tax returns, bank statements, leases for the single family residential rental properties in California, and information for the 401K accounts that she and her husband owned at Sun America. Mr. Duell filled out the initial application forms at Freedom Financial and mailed the applications to Mr. and Mrs. Fletcher in California. Mrs. Fletcher testified that she assumed that all of the loan applications were "full document" residential loan applications, because she had provided all the documents to Mr. Duell's partner Bill Cada.

43. The loan application for the property at 2919 N. 38th St. identified Mr. Fletcher as a self-employed investor and Mrs. Fletcher as a homemaker. Mr. Fletcher's base employment income was list as $3,600/month, plus $589/month in rental income. The four properties in California were identified as assets.[19]

44. Mrs. Fletcher testified that her husband is retired. He is not an investor. She is a real estate agent, not a homemaker.

45. Mr. and Mrs. Fletcher's signatures dated January 19, 2005, beneath the paragraph entitled "Acknowledgement and Agreement," which provided:

> Each of the undersigned specifically represents to Lender and to Lender's actual or potential agents, brokers, processors, attorneys, insurers, servicers, successors and assigns and

[19] Department's Ex. 28.

> agrees and acknowledges that: (1) the information provided in this application is true and correct as of the date set forth opposite my signature and that any intentional or negligent misrepresentation of this information contained in this application may result in civil liability, including monetary damages, to any person who may suffer any loss due to reliance upon any misrepresentation that I have made on this application, and/or in criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Sec. 1001, et seq. . . .

Mrs. Fletcher testified that neither of these signatures belonged to her and her husband.[20]

46. Rick Duell's and Freedom Financial's names were printed as the interviewer on the loan for the property at 2919 N. 38th St. Another employee of Freedom Financial signed the application as Freedom Financial's interviewer on January 17, 2005.

47. The loan application for the property at 2921 N. 38th St. identified Mr. Fletcher as "retired/pension" and Mrs. Fletcher as a homemaker. Mr. Fletcher's base employment income was list as $3,600/month, plus $409/month in rental income. The four properties in California were identified as assets.[21]

48. Freedom Financial's Mr. Duell signed the loan application for the four-plex at 2921 N. 38th St. Mr. and Mrs. Fletcher signed the application, under the same paragraph quoted above at Finding of Fact No. 44, on January 19, 2005.

49. Mrs. Fletcher admitted on cross-examination that the stated value of $1,152,000 for the California real estate may have been accurate on the loan applications for the properties on 38th St. She also admitted that she and her husband may have had $115,405 in savings, though she did not think that number was correct. She does not take issue with the value of the real estate or other assets in the loan applications.

50. The loans were funded and, in January 2005, Mr. and Mrs. Fletcher purchased each of the six four-plexes in N. 38th St. in Phoenix for $286,620 with financing obtained through Mr. Duell at Freedom Financial, including first and second mortgages for each of the six properties.[22]

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[20] *Id.* at FF-01555.
[21] Department's Ex. 28.
[22] *See, e.g.,*. Department's Ex. 28, 32.

51. Between January and August 2005, according to Mrs. Fletcher, Mr. Fletcher performed "hundreds" of repairs and improvements on the six properties on 38th St. in Phoenix.

52. In August 2005, Mr. and Mrs. Fletcher sold the six four-plexes on 38th St. in Phoenix for nearly $360,000 each, making a $73,000 profit on each sale. In the fall of 2005, Mr. and Mrs. Fletcher had $531,000 in a 1031 exchange account.[23]

53. Mr. and Mrs. Fletcher decided to purchase additional property in Arizona. They contacted Lisa Egan and Mark Archer about possible new investments. Ms. Egan and Mr. Archer showed them 14 four-plexes located on 14 contiguous parcels on Crown, Williams, and Hill Streets in Mesa.

54. The 14 parcels were part of a larger development called the Greenwood Apartments. Mrs. Fletcher testified that the individual buildings in the Greenwood Apartments were mostly owned by different people when she and her husband decided to purchase the 14 parcels, with Mike Wolf as the listing agent. But, when she and her husband actually purchased the properties, there was only one seller, Jeff Flores. Mrs. Fletcher testified she understood that Mr. Flores had purchased all the properties that comprised the Greenwood Apartments and immediately "flipped" 14 of them to the Fletchers. Mrs. Fletcher testified that she knew that Mr. Flores was trying to sell the other parcels that he had purchased but did not know whether he had been successful.

55. Mrs. Fletcher testified that Mr. Flores had provided income statements and rent rolls for the Mesa properties.

56. Mrs. Fletcher testified that she knew when she and her husband agreed to purchase the 14 four-plexes in Mesa that they had a negative cash flow. But Ms. Egan and Mr. Archer assured her that, at most, she and her husband would only have to make three monthly payments before they would be able to "flip" the properties at a profit.

57. Mrs. Fletcher testified that she and her husband again asked Mr. Duell at Freedom Financial to fill out loan applications for them to purchase the fourteen properties in Mesa. Some of the loan applications were only in her husband's name;

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[23] The record does not explain the difference between Mrs. Fletcher's testimony about the profit from the 6 4-plexes and the amount in the 1031 account after the sale. It appears that some of the profits from the sale of the two properties in California may have been placed in the 1031 account.

some were in both their names. Mrs. Fletcher testified that she never told Mr. Duell to make any of the applications only in her husband's name.

58. Only Mr. Fletcher's name is on the loan application for the four-plex at 418 N. Hill in Mesa. His occupation is listed as "investor." His monthly income is listed as $27,333.00, far more than his $1,492 Lockheed Martin pension, with a negative net rental income of $10,104, for a total net income of $17,228.89. Mr. Fletcher signed below the paragraph quoted at Finding of Fact No. 44.[24]

59. The assets on the loan application for the property at 418 N. Hill in Mesa include $531,000 in the 1031 exchange and a $3,500 cash deposit toward purchase price. Mr. and Mrs. Fletcher's residence on Ross Road and the rental property on 13th St. in Palmdale are listed as assets.[25]

60. On the loan applications for the property located at 509 S. Williams in Mesa, both Mr. and Mrs. Fletcher's names are on the loan application. His occupation is listed as "investor" and hers is listed as "real estate agent." His monthly income is listed as $10,666.00 and her monthly income is listed as $10,333.00, for a total of $20,999.00 per month. Mr. and Mrs. Fletcher both signed below the paragraph quoted at Finding of Fact No. 44 on December 1, 2005.[26]

61. A second loan application for the property at 509 S. Williams in Mesa was filled out only in Mr. Fletcher's name. His monthly income was again listed as $10,666.00.[27] Mrs. Fletcher testified that she had no idea why there were two sets of loan applications.

62. The assets listed on the application for the property at 509 S. Williams were the $3,600 cash deposit, the $27,996 value of Mr. Fletcher's Lockheed Martin pension, and the $531,000 in the 1031 exchange account. The properties included the Fletcher's residence in Littlerock, California, the rental in Palmdale, California (net monthly rental income $448), and the property at 449 S. Williams (net monthly rental negative $710).

63. A loan application for the property at 449 S. Williams in Mesa was filled out in both Mr. and Mrs. Fletcher's names. Mr. Fletcher's occupation was listed as "investor"

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[24] Department Ex. 24, FF-00033-35.
[25] *Id.* at FF-00034-35.
[26] Department Ex. 25, FF-04275-77.
[27] Department Ex. 25, FF-04403-04.

and Mrs. Fletcher's occupation was listed as "real estate agent." Mr. Fletcher's monthly income was listed as $10,666 and Mrs. Fletcher's monthly income was listed as $10,333, for a total monthly income of $20,999. Mr. and Mrs. Fletcher both signed the loan application on December 1, 2005 under the paragraph quoted at Finding of Fact No. 44.[28]

64. The loan application for the property at 449 S. Williams in Mesa showed as assets the $27,996 value of Mr. Fletcher's pension, $531,000 in the 1031 exchange account, $170,000 and $39,277 in the Sun America IRAs, and $3,500 as a cash deposit. The properties owned included the residence in Littlerock, California the rental in Palmdale, California (net monthly rental income $448) and the 4-plexes at 408 S. Williams (net monthly rental income negative $635) and 509 S. Williams in Mesa (net monthly rental income negative $635).

65. Mrs. Fletcher identified a second loan application for the property at 449 S. Williams in Mesa. Neither Mrs. Fletcher's nor her husband's incomes were stated. Mrs. Fletcher testified that the signatures on the loan application were not hers or her husband's.[29]

66. Mrs. Fletcher testified that the monthly income of $10,666 for her husband and $10,333 for her on a third loan application for the property at 449 S. Williams in Mesa was also incorrect. The signatures did not belong to her or her husband, although Rick Duell's signature appeared on behalf of Freedom Financial.[30]

67. Mrs. Fletcher testified that similar misstatements of her and husband's occupations and incomes appeared in the loan applications for the property at 1605 E. Crown St. in Mesa. The signatures on the application were not hers or her husband's.[31] But Rick Duell signed the application on behalf of Freedom Financial.

68. The assets listed for the property at 1605 E. Crown St. included the Fletcher's residence, the Palmdale rental, and pending purchases on the 4 plexes at 1606 E. Crown St. (net rental income negative $1,193), 1614 E. Crown St. (net rental income negative $1,193), and 1615 E. Crown St. (net rental income negative $1,193).

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[28] Department Ex. 26, FF-04053-55.
[29] *Id.*, FF-04200-02.
[30] *Id.*, FF-04207-09.
[31] Department Ex. 27, FF-03471.

69. Similar misstatements of Mr. and Mrs. Fletcher's incomes and occupation appear on the loan applications for the properties at 1615 E. Crown St.,[32] the property at 434 N. Hill,[33] the property at 408 N. Williams,[34] and the property at 406 N. Hill.[35] Mrs. Fletcher testified that it was not hers or her husband's signatures on the loan application for the properties at 408 N. Williams.[36] Mrs. Fletcher testified that the assets and property holdings generally were accurate. Some of the applications were unsigned, but Mrs. Fletcher testified that she and her husband received a loan for all the properties.[37]

70. Mr. Duell signed most of the applications on behalf of Freedom Financial.

71. Mrs. Fletcher testified that her income and her husband's income on all of the applications that the Department had admitted into evidence were incorrect. She testified that she had provided accurate information on income to Mr. Duell. Mrs. Fletcher admitted signing most of the loan applications, but denied having read them before signing. Mr. Duell had mailed the loan applications to her, but somehow the mail ended up in the trash and it rained. She had to use her hair dryer to dry the documents out. Mrs. Fletcher did not read the loan applications before signing them at the title company because she had so many documents to sign. Everyone was making fun of her about how long it took her to sign. She still hasn't read most of the documents.

72. Mrs. Fletcher testified that she and her husband have updated the paint and carpeting in some of the properties. To avoid the expense of a management company, she and her husband have renovated a storage unit into a one-bedroom apartment and have moved in.

73. The settlement statements or HUD-1 forms that the Department had admitted into evidence show loan origination fees to Freedom Financial in the amounts of $3,187.50,[38] $1,487.00,[39] $1,487.00,[40] $2,975.00,[41] $2,006.00,[42] $2975.00,[43] $3,187.50,[44] $1,487.00,[45] $2,006.00,[46] and $3,187.50.[47]

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[32] Department Ex. 29.
[33] Department Ex. 30.
[34] Department Ex. 31.
[35] Department Ex. 33.
[36] Department Ex. 31 at FF-01293.
[37] Department Ex. 32 at FF-02112.
[38] Department's Ex. 24 at FF-00006.
[39] Department's Ex. 25 at FF-04241.
[40] Department's Ex. 26 at FF-04042.

74. Mrs. Fletcher admitted that all the settlement statements for the Mesa 4-plexes showed a $3,572 assignment from funds received from the seller to Peter Eggebrecht, her brother, who is a mechanic in New Mexico.[48] Ms. Fletcher testified that Ms. Egan had instructed her to assign funds to "someone she trusted" to be able to get money for upgrades to the properties. Mrs. Fletcher identified Ms. Egan's handwriting on a Buyer's Inspection Notice and Seller's Response for the Mesa properties, which provided that "[i]n lieu of all repairs, seller agrees to contribute $3,572.00 . . . through an irrevocable assignment of funds made payable to a person or entity of the buyers choice."[49] Mrs. Fletcher admitted that she and/or her husband had signed to acknowledge the assignment.

75. Mrs. Fletcher admitted that the total assignment to her brother for upgrades was more than $70,000 for the fourteen properties. She testified that she had asked Ms. Egan why the monies could not be held out in escrow and Ms. Egan had said, "Lenders don't like to see money going back and forth between buyers and sellers."

76. Mrs. Fletcher testified that she thought that Mr. Duell knew about the assignment because he was involved in the transactions, but admitted that she had mentioned the assignment to him.

77. Mrs. Fletcher admitted that she had met with Mr. Granderson and Ms. Ives of the Department in May 2007. She and her husband had $531,700 in the 1031 account from the sale of the properties on 38th St. She had to reinvest this money in Arizona real estate or face negative tax consequences.

78. Mrs. Fletcher admitted that she and/or her husband had signed a "Borrower's Certification and Authorization," in which she acknowledged that all the information of the

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[41] Department's Ex. 27 at FF-03331.
[42] Department's Ex. 28 at FF-01330.
[43] Department's Ex. 29 at FF-05194.
[44] Department's Ex. 30 at FF-04462.
[45] Department's Ex. 31 at FF-01156.
[46] Department's Ex. 32 at FF-02027.
[47] Department's Ex. 33 at FF-060922.
[48] *See, e.g.*, Department's Ex. 26 at FF-04042.
[49] Respondents' Ex. B.

loan application was true and complete and that Freedom Financial reserved the right "to change the mortgage loan review processes to a full documentation program."[50]

79. Mrs. Fletcher admitted that Freedom Financial did not solicit her and her husband's business. No one at Freedom Financial, including Mr. Duell, knew about the payments to her brother Bill Eggebrecht.

80. Mrs. Fletcher testified that, at the time of hearing, the value of her primary residence on Ross Road in Littlerock, California was approximately $500,000. She still owned the rental property on 13th St. in Palmdale, California and received $1,900/month in rent.

81. Mrs. Fletcher testified that she rented the 24 units in the 4-plexes on 38th St. until she and her husband sold them in August 2005. The rents ranged from $550/month for a 2-bedroom unit to $450 or $475/month for a 1-bedroom unit.

82. Mrs. Fletcher testified that the fourteen 4-plexes contained 54 rental units, a storage room, and an office. Fewer than 50% of the 14 parcels in the Greenwood Apartments had been rented since she had her husband purchased them. When she purchased the units in 2005, she had received $524/month for the units that were rented. In February 2006, she had raised the rent in some units to $584/month and others to $624/month. At the time of the hearing, she was still receiving rents for unsold properties. The properties still had a high vacancy rate.

83. Mrs. Fletcher testified that she and her husband managed to sell the 4-plex at 408 N. Williams in July 2006 for $419,000, which she testified was at a loss. Mrs. Fletcher testified that she and her husband still own 13 of the 4-plexes in Mesa, but all are in default and are scheduled for trustee's foreclosure sales.

84. Mrs. Fletcher testified that she and her husband tried to sell the remaining 13 4-plexes at the Greenwood apartments. They listed the properties three times with three different real estate agents. All of the agents told them that they had paid too much for the properties. In April 2007, Mr. and Mrs. Fletcher filed complaints to the Arizona Real Estate Department against Ms. Egan and Mr. Archer.

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[50] Respondents' Ex. E.

85. Mrs. Fletcher did not make any complaints against Rick Duell or Freedom Financial to the Arizona Department of Financial Institutions.

86. Mrs. Fletcher testified that, in August 2006, after she thought that the listing had expired on the 13 remaining 4-plexes in Mesa, she received a call from Jeff Flores, who had sold her the properties. Mr. Flores told her that his real estate agent, Mike Wolf, had a buyer for all the properties. Mr. and Mrs. Fletcher did a "wrap" through Mr. Wolf and Linda at Remax to sell the properties to a Mr. Johnson. At that time, they were three months behind on mortgage and utility payments. They would not make any money on the sale but Mr. Johnson would pay closing costs, real estate agent commissions, late fees, and interest and would bring the mortgage and utility payments current. Mr. Johnson took over the obligation in September 2006. Under the agreement, Mr. Johnson had 8 months to sell and refinance the properties. Mrs. Fletcher testified that she was not "dumping" the properties; she and her husband were just trying to avoid being where they find themselves now. Mr. Johnson was not able to sell the properties and, at the time of the hearing, the Fletchers were again facing foreclosure and the destruction of their credit.

87. Mrs. Fletcher admitted on cross-examination that she and her husband had assumed the risk that they would not be able to sell the Mesa 4-plexes quickly for a profit. Respondents had not advised them to buy the properties.

88. Mrs. Fletcher testified that the sales closed on the 14 4-plexes in Mesa in November and December 2005.

89. Mrs. Fletcher admitted that she signed under the avowal that the information in the applications was true and correct and that lenders had a right to rely on this information.

90. Mrs. Fletcher testified that she only disputed the income stated on the applications. She did not dispute the assets or liabilities listed.

91. Mrs. Fletcher testified that she met with Mr. Granderson in May 2007 for 1½ or 2 hours. She offered to testify at the hearing. He did not promise her anything in return for information, cooperation, or testimony.

Mr. Granderson's Testimony

92. Mr. Granderson has been employed by the Department since November 2006. He primarily investigates mortgage fraud.

93. Mr. Granderson testified that, as a field auditor, he audited large mortgage companies with respect to what underwriters had done.

94. Before Mr. Granderson started working for the Department, he was a federal auditor for 24 years and managed a staff in the federal HUD office in San Francisco.

95. Mr. Granderson testified that he returned from a weekend and found a box of loan files in his office, including 20 or so with the same investors, the Fletchers. A lot of the files were closing at near the same time. He looked at the files to see how the applicants qualified for all the loans.

96. Mr. Granderson testified that he noted several irregularities in the loan applications, including inconsistent employments and income. On some applications, Mr. Fletcher was working at or retired from Lockheed Martin as a tool and die maker. On others he was an investor. Mr. Fletcher's income varied from $3,600/month plus $500 in rental income to $27,000/month plus negative rental income. Mrs. Fletcher was identified as a homemaker on some applications and as a real estate agent on others. Her monthly income varied from nothing to more than $10,000.

97. Mr. Granderson testified that all the irregular loan applications were completed by the same lender and loan officer.

98. Mr. Granderson testified that the applications made no sense. If the loans were closing near the same time, the same applicant's income figures should not vary so widely. Mr. Granderson testified that he questioned where the information on the applications was coming from.

99. Mr. Granderson testified that, years ago, mortgage applications would be hand-written by the applicant. The current practice is that the lender, in this case Freedom Financial, creates a printed or type-written application based on information provided by the applicant.

100. Mr. Granderson testified that the name of the seller in the appraisal did not match the name of the seller on the HUD-1 form. He wondered how the seller could sell what he did not own. Mr. Granderson assumed that there was a double escrow involved.

101. Mr. Granderson contacted the Fletchers. At a meeting in April 2006, he asked them about their incomes. He learned that Mr. Fletcher received a pension of $1,492/month. Mrs. Fletcher earned approximately $20,000/year as a real estate agent, or about $1,600/month.

102. Mr. Granderson testified that the loan applications were for stated income loans. For a stated income loan, the borrower doesn't have to provide full documentation, such as a W-2 or pay stub, to substantiate the claimed income. The lender usually contacts the employer to verify employment. If the applicant were retired, the lender would verify that the applicant received a pension. An income stated application does not look any different from a full documentation application.

103. Mr. Granderson testified that Mrs. Fletcher told him that she thought she was applying for a full documentation loan and said that she had provided Mr. Duell and Freedom Financial with copies of her tax forms and other documents.

104. Mr. Granderson testified that the base employment income on the forms is the amount that the applicant earns from an employer. If the applicant is retired, the pension he receives is considered "other income." Mr. Fletcher's $1,492 pension is not on any of the loan applications.

105. Mr. Granderson testified that none of the applications showed Mrs. Fletcher's true income of approximately $1,600/month. Because real estate agents are paid on commission, her income should be under "commission," not "base employment income."

106. Mr. Granderson testified that the loan application has another line for "net rental income." Rental income is not part of base employment income.

107. Mr. Granderson testified that a person's income could change in a short time. But you would expect to see some explanation in the file. On these applications, the stated income appears based solely on what was needed to get the loan.

108. Mr. Granderson's assistant Susie Ives contacted some of the lenders who had funded the loans, including Credit Suisse, Greenpoint, and Stonecreek. For income stated loan applications, most broker agreements prohibit false statements.

109. Mr. Granderson pointed out the Wholesale Client Agreement between Freedom Financial and Credit Suisse, which required Freedom Financial to agree that no

fraudulent information would be on the applications that it submitted and that Freedom Financial would use its best efforts to ensure that applications did not contain "untrue, erroneous, or misleading" information.[51] Mr. Russell had signed the agreement on behalf of Freedom Financial. Mr. Granderson testified that he believed that the Fletchers' loan applications contained misrepresentations of their base employment incomes.

110. Mr. Granderson testified that, according to the HUD-1 forms, Credit Suisse had funded the loans for the properties at 433 N. Hill, 434 N. Hill, and 418 N. Hill, for which the applications contained misrepresentations as to the Fletchers' incomes.[52] Mr. Duell had signed all three applications on behalf of Freedom Financial.

111. Mr. Granderson pointed to the Wholesale Mortgage Broker Agreement between Freedom Financial and Stonecreek Funding, which required Freedom Financial to warrant that it did not know anything about the condition of the property and the borrower's circumstances that might cause the loan to become delinquent.[53]

112. Mr. Granderson testified that, according to the HUD-1 form, Stonecreek had eventually funded the loan for both mortgages on the properties at 509 S. Williams and 449 S. Williams.[54] In his opinion, the loan applications contained misrepresentations about the Fletchers' income. Mr. Duell had signed the loan applications on behalf of Freedom Financial.

113. Mr. Granderson testified that none of the applications correctly stated the Fletchers' income. The Department does not consider the Fletchers' assets to be part of their income. In addition, previously funded loans should have been disclosed and were not on many subsequent applications. The omission constitutes a misrepresentation because a lender would want to know not only an applicant's income but his debts and encumbrances.

114. The Department also had admitted into evidence an e-mail from Tammy Meyer at Aegis Mortgage to Susie Ives about its policies for an income stated loan, in relevant part as follows:

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[51] Department Ex. 36 at 4, ¶ 4.5.
[52] Department Ex. 30 and 24.
[53] Department Ex. 37 at 3, ¶ 5.1.
[54] Department Ex. 25, 26.

> Our goal is to simplify both underwriting policy and processing documentation. However, prudent underwriting policy will not be abandoned. The reduction in documentation does not eliminate the necessity to closely review and evaluate all information available in the file to determine the reasonableness of he borrower's ability to repay the mortgage debt.
>
> Reasonableness will be based on the borrower's employment history, income source and past credit experience which must be commensurate with the loan request. For example, information on the credit report should corroborate information on the application. Borrower's income source must be from a source likely to generate sufficient income to repay the debt. Material inconsistencies must be investigated. Loan requests from an applicant with atypical characteristics require full income and asset documentation . . . .

115. Mr. Granderson testified that Aegis eventually funded the mortgages for the properties at 1615 E. Crown and 1616 E. Crown. The loan applications for the properties contained misrepresentations about the Fletcher's income. Mr. Duell signed the applications on behalf of Freedom Financial.

116. Mr. Granderson testified that the application for the property at 1516 E. Crown also showed two pending purchases of other rentals. This information should have been on other applications. The property at 418 N. Hill was not listed, but should have been because the transaction closed earlier.

117. Mr. Granderson pointed out that, on one application signed October 5, 2005, Mr. Fletcher's income was $10,666/month and Mrs. Fletcher's income was $10,333/month.[55] On another application signed the same date, Mr. Fletcher's income was $12,666/month and Mrs. Fletcher's income was $11,333/month. Mr. Duell signed both applications. It was not possible for a person to have a different income on the same date.

118. Mr. Granderson asked Mrs. Fletcher about the disbursements to Peter Eggebrecht from the seller's funds. There should have been documents in Freedom Financial's file to explain the disbursement because a lender would want to make sure that there were no undisclosed disbursements. Mrs. Fletcher explained that he was her

[55] Ex. 30 at FF-04673.

brother and the money was given to pay the mortgage and for repairs. She had been told that it could not be done in these transactions. Mr. Granderson testified that the disbursement for repairs should have been in the appraisal, but wasn't.

119. Mr. Granderson testified that the base employment income is understood in the industry to be the amount shown on a 1099 or W-2 form, the same as a full document loan. Although Mr. Granderson has reviewed underwriters' work, he has never worked as an underwriter. Mr. Granderson admitted that Stonecreek's underwriting guidelines provided that, for stated income loans, underwriters should use their "good judgment and third-party sources" to determine reasonable income levels.[56]

120. The Stonecreek underwriting guidelines also provide that "[v]erification of employment is required in all cases" and that "[i]f multiple sources of income are present they must be identified on the 1003 and verified as such."

121. Mr. Granderson did not ask the lenders who had funded the Fletchers' loans whether they believed the loan applications contained misrepresentations. He did not tell any of the lenders that the loan applications contained misrepresentations. But he testified that whoever funded the loans based on the misrepresentations had been defrauded.

122. Mr. Granderson testified that the $140,000 in savings and $11,000 in checking that the Fletchers claimed on one application was not income. But it could be used to pay mortgages. Similarly, the approximately $139,000 in the Sun America IRAs was not income but could be withdrawn.

123. Mr. Granderson testified that the Fletchers also received some income from rentals. Before they were sold, they had received rental income from the 4-plexes on 38th St.

124. Mr. Granderson admitted that the money in the 1031 account could be deferred income that would become taxable if the Fletchers did not follow the rules. But the money had shown up on the HUD-1 statements as the down payment on the purchase of the Mesa 4-plexes in October, November, and December of 2005, not as income. Although a 1031 account could provide income, in this case it did not.

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[56] Department Ex. 38 at 7.

125. Mr. Granderson testified that he believes the Fletchers were real estate investors. Freedom Financial had a right to rely upon the information they provided.

126. Mr. Granderson noted that some of the Fletcher applications show rental income. Others showed a negative rental income from multiple properties.

127. Mr. Granderson testified that he believed that the Fletchers had committed mortgage fraud by signing the applications that misrepresented their incomes. He knew of no representation made to the Fletchers that they would not be reported if they cooperated with the Department.

128. Mr. Granderson admitted that there was no law against dual escrows. But, if the purchase price for the property had been increased, it should have been reported on the appraisal.

129. Mr. Granderson admitted that a lender can prepare the final application based on information provided by the underwriter or broker. Some of the applications appeared to be in different type and were not signed by Mr. Duell.

Mr. Russell's Testimony

130. Mr. Russell is 42 years old. He the widowed single father of a 15-year-old daughter.

131. Mr. Russell testified that he has a little bit of college. Most of his education came from "the school of hard knocks." He started in the mortgage industry as a loan officer 14 years ago, then became an underwriter and, finally, district manager. All of his prior experience is in the lending side of the industry.

132. Mr. Russell started Freedom Financial in 2002. As a mortgage broker, Freedom Financial takes information from contact with consumers and then processes it to lenders. Freedom Financial is involved in originating loans in Arizona, California, Tennessee, Colorado, and Minnesota. It has 150 employees in Arizona and 4 employees in the other states.

133. Mr. Russell testified that consumers usually initially contact Freedom Financial by telephone and say what they need in a brief interview. Freedom Financial then goes to the lenders and makes recommendations to the consumers about the programs that would best suit their needs. Freedom Financial works with lenders to

determine what information is required and, once the loan is pre-approved, works with the lender to facilitate the loan.

134. Mr. Russell testified that the income on a stated income application is the applicant's capacity for an income that is reasonable. The source of the income figure may be historic wages or a CPA report or other letters. Lenders look at income that is reasonable for what the person does. Lenders also may request verification, such as internet research on what a reasonable income is for a certain type of employment or industry. Lenders also may request validation that an applicant actually performs the work claimed. For example, a pizza delivery person's claim of a $5,000/month income is not reasonable.

135. Mr. Russell testified that lenders also may consider an applicant's assets to substantiate his ability to repay the loan. Lenders' primary concern is the applicant's capacity to repay the loan.

136. Mr. Russell testified that Freedom Financial's loan fees are one-half the industry average. Freedom Financial cares about consumers. It has not been involved in any litigious activity except the matter at issue. Every other complaint has been resolved to the consumer's satisfaction.

137. Mr. Russell testified that he has taken steps to resolve all of the issues identified in the cease and desist order. The Department has never provided any rules or regulations regarding supervision of loan officers.

138. Mr. Russell testified that he has never knowingly failed to comply with a licensing statute. With respect to ethical issues, the climate in the industry has changed. The best year in the industry that he ever saw in terms of the availability of funding was 2005. Anyone who wanted money could get it based in appreciation in the real estate market. Lenders did everything they could to facilitate consumer demand.

139. Mr. Russell testified that the market began to change at the end of 2005, when the real estate market started cooling and more property became available. The market became much more of a buyers' market. Wall Street reacted with the start of a downhill run. As a result, more than 50 lenders went out of business, including Aegis, Stonecreek, ABC, and Express Capital, all of whom had funded loans for the Fletchers.

They did not go out of business based on the Fletcher loans but based on what was happening in the real estate market and the mortgage industry.

140. Mr. Russell acknowledged that he has a fiduciary responsibility to lenders. Freedom Financial must communicate all pertinent facts to lenders. This involves due diligence: an underwriter must verify and validate information. Borrowers provide initial information, which may or may not be complete. Based on the general outline of the information that borrowers provide, lenders decide whether the borrowers are credit-worthy.

141. Mr. Russell testified that Mr. Duell as a loan officer had contacted lenders and told them how many properties that the Fletchers were purchasing and, based on this and other information, 10 or 15 lenders had responded, "We can do the deal; this is what we need."

142. Mr. Russell testified that he had contacted the lenders involved in the Fletcher transactions after the Department had charged Freedom Financial with misrepresentation on the Fletcher applications. All four of the lenders contacted had said that they did not believe any misrepresentations had been made and said that Mr. Duell had been forthright in providing information. Freedom Financial had accurately informed the lenders of the pertinent facts and put the facts in a format that was acceptable to the lenders. Freedom Financial still does business with all the lenders involved who are still in business.

143. Mr. Russell testified that, if the lenders believed that the applications contained misrepresentations, they could demand that Freedom Financial buy back the loans. None of the lenders have demanded a buy back.

144. Mr. Russell testified that, at the time the Fletcher applications were submitted, the guidelines about what lenders would consider as income were much looser. The transactions involving the Fletchers were among the most technical and high risk in the industry.

145. Mr. Russell testified that the 1031 funds were not in play in early 2005, but the IRAs, savings and checking accounts, and rental income were. Based on these liquid assets, the $3,600/month income on some of the applications was not just appropriate, it

was validated. The Department is treating the Fletchers' income stated applications as a full documentation application, which is not the standard or practice in the industry.

146. Mr. Russell testified that the $10,666 income showed on applications from the fall of 2005, which considered Mr. Fletcher's asset information, including the 1031 information, and divided by 24 for a 2-year income flow. Using this method of calculation, a $30,000/month income would not have been unreasonable. Mr. Duell had understated the Fletcher's incomes.

147. Mr. Russell testified that Credit Suisse had prepared two of the applications that showed Mr. Fletcher's monthly income as more than $27,000. Mr. Duell did not sign these applications and the numbers at the top and typeface indicated that Credit Suisse had prepared the applications based on the information that Freedom Financial had provided.[57]

THE DUELL AND ARCHER APPLICATIONS

Mr. Granderson's Testimony

148. Mr. Granderson looked at the personnel files for Mr. Duell and Steve Archer.

149. The settlement statement for the property at 3313 N. 68th Street in Scottsdale showed Mr. Duell as the borrower.[58] On this stated income loan application, Mr. Duell had indicated that he was employed as a senior vice president by Freedom Financial and that his base employment income was $24,966/month.

150. Mr. Granderson testified that Mr. Duell's 2006 W-2 form from Freedom Financial showed that he earned $93,597, which is less than $8,000/month. Mr. Duell's statement on the application that he earned three times this income is a misrepresentation. An outside source could have supplemented his income from Freedom Financial, but Mr. Granderson did not find that Duell worked anywhere else.

151. Mr. Granderson testified that he had contacted Greenpoint Mortgage, which had funded Mr. Duell's loan, for its requirements. He learned that the loan was a refinance of an existing loan to take $72,000 out of the property. For a refinance,

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[57] Department Ex. 24 at FF-0036, 51-54, Ex. 30 at FF-004490 to 94, Ex. 29 at FF-060950-53, 68-71.
[58] Department Ex. 21.

Greenpoint required a debt to income ratio of 40% for an investment property.[59] Mr. Duell needed a high income to qualify for the loan. His stated income appears to have been a misrepresentation calculated to secure the loan.

152. Mr. Granderson testified that, according to the HUD-1 settlement statement for the property at 3219 E. Cottonwood Lane in Phoenix, Steven R. Archer was the borrower.[60] The loan application was stated income because no other documents were contained in the file. Mr. Archer indicated that he had been employed by Freedom Financial for 10 months as a loan officer. He stated his base employment income was $8,100/month.

153. Mr. Granderson obtained Mr. Archer's W-2 form from Freedom Financial for 2006. He earned $30,563 for the ten months he worked there, approximately $3,000/month. His stated income of $8,100/month was a misrepresentation.

154. Mr. Granderson admitted on cross-examination that, for a stated income loan, the borrower states an income and the underwriter determines whether the income is reasonable given the borrower's occupation or employment and employment history. The lender determines the borrower's ability to repay the loan based on his stated income.

155. Mr. Granderson admitted that lenders have the right to deny or investigate loan applications based on a borrower's stated income. Both loans were funded; World Savings funded Mr. Archer's loan and Aegis funded Mr. Duell's loan.

156. Mr. Granderson testified that Mr. Duell's loan application showed some rental income. He was not aware of any other employment held by Mr. Duell. If he were self-employed at another job, he should have shown the additional income as "other income."

Mr. Russell's Testimony

157. Mr. Russell testified that a loan officer has unlimited income potential. He just has to get out of bed in the morning. A salesperson has to believe that he will make $1 million/year to be effective.

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[59] Department Ex. 41 at 12.
[60] Department Ex. 23.

158. Mr. Russell testified that lenders scrutinize loan applications from brokers' employees. If there is a problem with the application, lenders will turn it down. No lender turned down Mr. Duell's or Steve Archer's applications.

159. Mr. Russell testified that Mr. Duell is Freedom Financial's top salesman. Except for this complaint, Rick Duell has worked for Freedom Financial for 6 or 7 years without incident.

160. Mr. Russell testified that Mr. Duell's and Mr. Archer's W-2s were irrelevant. Mr. Duell made significantly more money in prior years. He also had $70,000 in unreimbursed income. Mr. Duell also worked as a stock trader and as a hair dresser. Mr. Russell testified that he thought that the incomes that Mr. Duell and Mr. Archer stated were reasonable because the lender thought they were reasonable.

FAILURE TO MAINTAIN NET WORTH OF $100,000

161. Mr. Russell testified that, in 2006, Freedom Financial had maintained its books based on a cash basis of equity. Because Freedom Financial was required to have an accountant calculate equity based on an accrual basis, it had this calculation performed at the first of the year.

162. Mr. Russell testified that his understanding was that Freedom Financial had to maintain a net worth of at least $150,000 on a cash basis. But, in 2006, he had deposited money to start a new marketing campaign. A firm in Texas with whom Freedom Financial had been doing business, which owed Freedom Financial $140,000, had filed for bankruptcy. Mr. Russell testified that he took money from other sources to pay his employees.

163. Mr. Russell testified that he hired a new accountant and company controller. Although he cannot ever get rid of a cash basis accounting, during the calendar year he now has Freedom Financial's equity checked on an accrual basis at least four times. So it will never again enter a new year without the statutorily mandated net worth.

164. Mr. Russell testified that the Department's investigation had been brutal on him, his family, and his employees. The Department had assumed that he was guilty based on what some one else did. Mr. Russell denied having done anything deliberate or malicious.

CONCLUSIONS OF LAW

1. The Department has the authority and duty to regulate all persons engaged in the mortgage banker business and with the enforcement of statutes, rules, and regulations relating to mortgage bankers; this matter lies within the Department's jurisdiction.[61]

2. The Department bears the burden of proof and must establish Respondent's statutory violations by a preponderance of the evidence.[62] "A preponderance of the evidence is such proof as convinces the trier of fact that the contention is more probably true than not."[63] A preponderance of the evidence is "[t]he greater weight of the evidence, not necessarily established by the greater number of witnesses testifying to a fact but by evidence that has the most convincing force; superior evidentiary weight that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other."[64]

A.R.S. § 6-947(L)

3. A.R.S. § 6-947(L) includes among prohibited acts that "[a] mortgage banker shall not make a false promise or misrepresentation or conceal an essential or material fact in the course of the mortgage banker business."

4. The Fletcher applications and the Duell and Archer applications that were admitted into evidence all showed "base employment income" that was many times the actual income shown on the borrowers' W-2 or 1099 forms. No commissions or other income was shown. Some of the Fletcher applications from early 2005 showed a modest net rental income; most of the later applications showed no positive net rental income at all.

5. The Fletcher applications from October, November, and December 2005 that showed other properties purchased during this same time frame showed a negative net rental income. Although the $531,000 in the 1031 account was shown as an asset on some of the applications, according the Mrs. Fletcher's and Mr. Granderson's

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[61] A.R.S. §§ 6-941 *et seq.*
[62] *See* A.R.S. § 41-1092.07(G)(2); A.A.C. R2-19-119; *see also Vazanno v. Superior Court*, 74 Ariz. 369, 372, 249 P.2d 837 (1952).
[63] Morris K. Udall, ARIZONA LAW OF EVIDENCE § 5 (1960).
[64] BLACK'S LAW DICTIONARY at page 1220 (8th ed. 1999).

testimony, other applications, and the HUD-1 statements, the monies in that account had been used as a down payment for the Mesa properties, as required by the tax code to avoid a substantial taxable event. The 1031 account was not available to make the mortgage payment on the Mesa properties.

6. Respondents argued that all the lenders were interested in was potential income and verified assets. Obligations and liabilities need not be considered. If a borrower had verified assets, her actual income was irrelevant. The various categories of income and mortgage liabilities could be ignored. Since neither the Fletchers nor any of the lenders had complained or demanded a buy back, Respondents argued that Mr. Russell's testimony about his understanding of the requirements for an income stated loan reflected industry practice and standards, which in turn defined what would constitute a misrepresentation under A.R.S. § 6-947(L).

7. On this record, it does appear that the Fletchers and the lenders may have been complicit in Freedom Financial's practice of collapsing all the income, asset, and other information into a single category called "base employment income." It does not appear that any of them considered that mortgage obligations for other properties or negative net rental income could reduce the estimated income available to pay the mortgages on the property financed. Rather, a "base employment income" was assigned based on what was needed to fund the loan, rather than any objectively reasonable figure that considered actual or even a reasonable net income.

8. The Fletchers, the lenders, and Freedom Financial seemed to have been operating under the shared but objectively unreasonable assumption that the borrowers' actual ability to pay did not much matter since, in any event, the properties would be "flipped" in a short time for a profit, regardless of the price paid or the negative cash flow of rental income properties. All that mattered was an income amount that would support the loan application. This approach to real estate investment and mortgage banking appears to be nothing more than a Ponzi scheme, devoid of meaningful standards or principles.

9. The Department therefore has borne its burden to establish that Freedom Financial misrepresented the Fletchers' income on the applications at issue, in violation of A.R.S. § 6-947(L).

10. "The purpose of the [Department] is to promote the public welfare by protecting the financial assets of the citizens of this state by administering this state's statutes that relate to financial institutions and enterprises."[65] Because the Department's mandate is to protect the public and the financial assets of all the citizens of Arizona, the Fletchers' and the lenders' complicity in Freedom Financial's misrepresentation does not obviate the violation.

11. But the industry practice and the lenders' and borrowers' possible complicity in the misrepresentations should be considered in mitigation of the penalty.

12. Mr. Russell testified that Mr. Duell had other sources of income and was owed unreimbursed expenses. These alleged additional income sources were not referenced anywhere in the application and, therefore, could not have been considered by a lender in determining whether to make the loan and should not be considered by the Department in determining whether a violation occurred. Mr. Russell's testimony that both Mr. Duell and Mr. Archer had potential to earn significantly more at Freedom Financial than they earned in 2006 is nothing more than speculation.

13. The Department therefore has borne its burden to establish that Freedom Financial misrepresented Mr. Duell's and Mr. Archer's base employment income on the loan applications admitted into evidence, in violation of A.R.S. § 6-947(L).

VIOLATION OF A.R.S. § 6-943(C)(2)

14. A.R.S. § 6-943(C)(5) requires that, to qualify for a mortgage banker license or license renewal, a person or entity must "[a]t all times have and maintain a net worth of not less than one hundred thousand dollars." A.R.S. § 6-946(B) requires that "[e]very mortgage banker shall observe generally accepted accounting practices."

15. Respondents admitted that their audited financial statement for the year ending December 31, 2006 showed a total equity of $47,608, approximately $53,392 short of the net worth required by A.R.S. § 6-943(C)(5).

16. Mr. Russell's professed confusion about whether Respondent could maintain the required equity under a cash accrual basis ignores the plain language of

[65] Laws 1994, Ch. 30, § 3.

A.R.S. § 6-946(B). His testimony that Freedom Financial's net worth dipped below the statutory requirement only because of its loyalty to its employees is irrelevant.

17. The Department has borne its burden to establish that Respondents violated A.R.S. § 6-943(C)(2) by allowing Freedom Financial's net worth to fall below $100,000, as of December 31, 2006.

STATUTORY VIOLATIONS IN CEASE AND DESIST ORDER

18. Respondents admitted the statutory violations in the Department's cease and desist order, including that they had failed to correct four of the violations from their last examination.

19. Respondents argued that the civil penalty assessed was excessive, especially in light of the lack of merit in the Department's charged violations of A.R.S. § 6-947(L). That argument is addressed above.

20. The violations charged in the cease and desist order were numerous and serious. Respondents' persistent violations show a cavalier attitude toward state regulation.

21. The Department has borne its burden to establish that the civil penalties assessed in the cease and desist order are appropriate in light of the number, severity, and persistence of the violations that Respondents admitted.

22. Department has also established cause to suspend or revoke the Respondents' license under A.R.S. § 6-945(A)(2)[66] and (7)[67] in the misrepresentation of base employment income on the numerous Fletcher applications and the Duell and Archer applications, especially in light of their poor licensing history.

RECOMMENDED ORDER

Based on the foregoing, the Administrative Law Judge recommends that the Department issue an order against Respondents Freedom Financial and Mr. Russell's mortgage banker License No. BK 0907383 that includes the following terms:

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[66] This statutory subsection includes among the grounds for suspension or revocation of a mortgage broker license that the licensee "[h]as shown that he is not a person of honesty, truthfulness and good character."

[67] This statutory subsection includes among the grounds for suspension or revocation of a mortgage broker license that the licensee "[h]as violated any applicable law, rule or order."

(1) Reissue the March 7, 2007 Cease and Desist Order in its entirety, including the findings of statutory violations and the imposition of a $25,000.00 civil penalty under A.R.S. § 6-132; and

(2) On the effective date of the Department's final order in this matter, revoke Respondents' license for a period of two years, but

(3) Stay the revocation of the license for two years, during which time Respondents shall be on disciplinary probation. As terms of probation, (a) Respondents shall within sixty (60) days to pay the $25,000.00 civil penalty and (b) Respondents shall obey all applicable laws and regulations. Violation by the Respondents of A.R.S. §§ 6-947(L), 6-943(C)(5), or any of the statutes or regulations charged in the Cease and Desist Order and admitted at hearing shall result in the summary revocation of Respondents' mortgage banker license.

If the Director of the Office of Administrative Hearings certifies this Administrative Law Judge Decision, the effective date of the order will be forty days from the date of certification.

Done this day, September 7, 2007.

Diane Mihalsky
Administrative Law Judge

Original transmitted by mail this
11 day of September, 2007, to:

Arizona Department of Financial Institutions
Felecia Rotellini, Director
ATTN: June Beckwith
2910 North 44th Street, Suite 310
Phoenix, AZ 85018

By _____