




OFFICE OF INSPECTOR GENERAL
Federal Housing Finance Agency

400 7th Street, S.W., Washington DC 20024

TO: Edward J. DeMarco, Director

FROM: Steve A. Linick, Inspector General 

SUBJECT: Systemic Implication Report: Weakness in Enterprises' Uniform Residential Loan Application (Freddie Mac Form 65/Fannie Mae Form 1003)

DATE: November 15, 2012

Attached is a Systemic Implication Report (SIR) prepared by the FHFA-OIG Office of Investigations identifying a possible risk in the existing mortgage loan application relied upon by Fannie Mae and Freddie Mac. As discussed in the Report, it appears that the existing application does not ask the borrower whether the borrower has submitted simultaneous or contemporaneous loan applications on the same property. We recommend that FHFA assess whether the existing application should be amended to include a question addressed to this risk.

I would appreciate it if the Agency could respond to our recommendation by November 30, 2012. Please feel free to contact me if you have any questions or concerns.

Cc: Bruce Crandlemire, Advisor to the Director



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TO: Steve A. Linick, Inspector General
Peter C Emerzian
FROM: Peter Emerzian, Deputy Inspector General, Office of Investigations
SUBJECT: Weakness in Enterprises' Uniform Residential Loan Application (Freddie Mac Form 65/Fannie Mae Form 1003)
DATE: November 15, 2012

We identified a potential weakness in the disclosure of liabilities on a Uniform Residential Loan Application (Freddie Mac Form 65/Fannie Mae Form 1003) through information gathered during an ongoing criminal investigation. We recommend that FHFA assess whether action should be taken to amend this document in order to strengthen fraud controls and enhance underwriting processes.

Background

The FHFA-OIG Office of Investigations is conducting an ongoing criminal investigation pertaining to a significant mortgage fraud scheme. The subjects of the investigation engaged in a fraudulent property flipping scheme that involved purchasing neglected properties at low prices and performing limited cosmetic improvements. The subjects then prepared fraudulent appraisals that were submitted to unwitting investors and lenders to secure financing for sales that often exceeded 100% of the flipper's cost. Subsequent to settlement, the investors frequently uncovered that the properties were not in livable condition and could not be rented. Consequently, they defaulted on their mortgages, the majority of which had been sold by the lenders to Fannie Mae or Freddie Mac.

Using deceptive marketing tactics and enticing them with the requirement of a small down payment of about \$2,000 per home, the property flipper sought out unsophisticated investors with limited net worth to purchase rental properties. The investors were led to believe that such a small down payment was made possible through housing rehabilitation program incentives. It was also their understanding that as part of this supposed program they would not have to pay any additional cash at settlement. In reality, the property flipper paid these amounts with a bank check at settlement and disguised the transaction as if the bank checks were provided by the investors.

To secure financing, the property flipper referred the investors to a corrupt mortgage broker. Although the broker knew that the investors would likely qualify for the purchase of only one or two properties, the mortgage broker typically told them that they were qualified to purchase up to ten.

Once the investors agreed to purchase multiple properties, the mortgage broker secured multiple loans from separate lenders by exploiting an apparent weakness in the loan application process. The mortgage broker simultaneously submitted multiple loan applications for each individual property to separate lenders for approval without disclosing the existence of the other pending loan applications.

Analysis

During the course of the investigation, underwriters have acknowledged that the loan applications submitted to their respective lending institutions did not disclose the existence of the other loan applications submitted simultaneously to other lending institutions. They agreed that had they known of these other loan applications they would have required detailed information to evaluate the additional risk. The witnesses said that the details of the pending loan applications could have been disclosed in the loan application – specifically under the Assets and Liabilities; Monthly Income and Combined Housing Expense Information; or the schedule of Real Estate Owned sections. It appears, however, that there is no clear instruction on the loan application to disclose simultaneous or contemporaneous loan applications. A review of the current loan application relied upon by the GSEs (Revised June 2009) reveals that a borrower is not asked whether they have loan applications outstanding at the time of submission, nor is there any similar question under Section VIII, Declarations. Further, there is no such question in the Fannie Mae Desktop Underwriter system, which is used to pre-qualify a borrower.

Fannie Mae personnel advised that in the past they have attempted to amend the loan application so that there was such a question, but have been unsuccessful to date.

Conclusion

The subjects of this criminal investigation may have exploited a weakness in the loan application process that allowed them to secure the financing of multiple loans in furtherance of a large mortgage fraud scheme.

Recommendation

It is recommended that FHFA assess whether action should be taken to amend the current loan application to include a specific question pertaining to the existence of all pending loan applications. Such an amendment may prevent fraud and facilitate criminal prosecutions when warranted.