

January 21, 1998

Audit-Related Memorandum  
98-NY-221-1801

Memorandum For: Glenn Ruggles, Director, Single Family Division  
Buffalo Area Office

From: Alexander C. Malloy, District Inspector General for Audit  
New York/New Jersey

Subject: Real Estate Brokers/Sellers circumventing the FHA requirement regarding  
gifts to Borrowers

The Office of Inspector General performed audit work at Countrywide Home Loans Inc., Buffalo, New York, a mortgagee approved by the Federal Housing Administration (FHA) to originate FHA-insured mortgages on single family properties. Our audit work covered the period between July 1, 1995 and June 30, 1997. While performing audit work at the mortgagee, we observed that real estate brokers/sellers circumvented the intent of the HUD/FHA requirement stated below by providing funds to relatives/fiancee of Borrowers<sup>1</sup>, who, in turn, gave the same amounts of money, in the form of gifts, to Borrowers to assist them in meeting the financial requirements needed to qualify for FHA-insured mortgages. We recommend that you take immediate action against these brokers/sellers so that the practice does not continue.

HUD Handbook 4155.1 REV 4 Paragraph 2-10 provides that the donor of a gift may not be a person or entity with an interest in the sale of the property such as the seller, real estate agent or real estate broker.

Our review of 20 loans at Countrywide Home Loans Inc., disclosed four cases where Franklin Enterprises Inc., and/or Erie Development Inc., (real estate brokers/sellers)<sup>2</sup> provided funds to relatives/fiancee of Borrowers. In turn, those individuals gave the same amount of money as gifts to Borrowers, who used them to financially qualify for FHA-insured mortgages. It is important to note that three of those four mortgages are in default and that 23 percent of the 53 loans where Franklin Enterprise, Inc. and Erie Development, Inc. were the real estate brokers/sellers are in default. Because the real estate brokers/sellers provided relatives/fiancee of Borrowers with the same amount of funds that relatives/fiancee gave Borrowers in the form of gifts, we believe that the real estate brokers/sellers circumvented the FHA requirement that prohibits real estate

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<sup>1</sup> Homebuyers who applied for FHA-insured mortgages.

<sup>2</sup>The same individuals are officers in both entities.

brokers/sellers from being donors of gifts to Borrowers applying for FHA-insured mortgages. As a result, ineligible Borrowers may have qualified and received FHA-insured mortgages that are now in default.

Specific details pertaining to the four cases where the real estate brokers/sellers provided funds to relatives/fiancee of the Borrowers (hereafter referred to as Mortgagors) are as follows :

FHA Case Number: 372-2537173  
Loan Amount: \$45,335  
Settlement Date: 12/29/95  
Seller: Erie Development Inc.  
Real Estate Broker: Erie Development Inc.  
Property address: 128 Freund Street  
Buffalo, New York 14215  
Mortgage status: Default

Discussions with the Mortgagor's daughter revealed that the President of Erie Development, Inc., gave her a check for \$710. She cashed the check and gave the funds as a gift to her father ( the Mortgagor). He used the funds (\$710) to assist in meeting the financial requirements needed to qualify for a FHA-insured mortgage. According to the mortgagor's daughter, the President of Erie Development Inc., gave her the money for painting she performed prior to her father's purchase of the property. To verify the accuracy of the daughter's statement, we obtained the bank records of Erie Development Inc., and observed that a check dated December 20, 1995, for \$710 was written from the Erie Development Inc., account to the Mortgagor's daughter.

FHA Case Number: 372-2498901  
Loan Amount: \$35,238  
Settlement Date 7/20/95  
Seller: Erie Development Inc.  
Real Estate Broker: Erie Development Inc.  
Property address: 105 Roebling Street  
Buffalo, New York 14215  
Mortgage status: Current

Discussions with the Mortgagor's wife revealed that the President of Erie Development Inc. gave her thirteen 100 dollar bills. She gave the funds as a gift to her husband (the Mortgagor). He used the \$1,300 to assist in meeting the financial requirements needed to qualify for the FHA-insured mortgage. According to the Mortgagor's wife, the President of Erie Development Inc. gave her the money for work that she performed at the property prior to the sale.

FHA Case Number: 372-2480289  
Loan Amount: \$39,378

Settlement Date: 6/7/95  
Seller: Franklin Enterprise Inc.  
Real Estate Broker: Franklin Enterprise Inc.  
Property address: 361 Hewitt Avenue  
Buffalo, New York 14215  
Mortgage status: Default

The Mortgagor's fiancée provided a \$1,700 cashier's check dated May 8, 1995, as a gift to the Mortgagor. The Mortgagor used the funds to assist in meeting the financial requirements needed to qualify for the FHA-insured mortgage. Although we did not speak with the Mortgagor's fiancée, we observed a check written to the Mortgagor's fiancée, dated May 4, 1995, for \$1,700 from Franklin Enterprise Inc. In addition, we observed a check written to the mortgagor dated May 4, 1995, for \$1,003 from Franklin Enterprise Inc. On the same day the Mortgagor provided a \$1,000 money order to Franklin Enterprises Inc. which was to be available at the loan closing.

FHA Case Number: 372-2515409  
Loan Amount: \$34,330  
Settlement date: 11/30/95  
Seller: Erie Development Inc.  
Real Estate Broker: Erie Development Inc.  
Property address: 103 Grimes Avenue  
Buffalo, NY 14212  
Mortgage status: Default

The Mortgagor's wife gave a \$1,100 cashier's check dated November 17, 1995, as a gift to her husband (the Mortgagor). The Mortgagor used the proceeds to assist in meeting the financial requirements needed to qualify for a FHA-insured mortgage. Although we did not speak with the Mortgagor's wife, we observed a check written to the Mortgagor's wife dated November 15, 1995, for \$1,100 from Erie Development Inc.

We are recommend that your office take immediate action against these real estate brokers/sellers (Franklin Enterprises Inc. and Erie Development Inc.) to prevent them from circumventing FHA requirements. Also, we recommend that you attempt to recover any losses that may have occurred as a result of mortgages going into default and subsequent foreclosures.

Within 60 days please give us a status report on: (1) the corrective action taken; (2) the proposed corrective action taken and the date to be completed; or (3) why corrective action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of this review.

Should you have any questions, please call me or William H. Rooney, Assistant District Inspector General for Audit, at 212-264-8000, extension 3976.

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