

Raising the Drawbridge Against FRAUD

BY
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**Lenders and servicers are taking the
battle against mortgage fraud to a new level.
The trick is finding really good armor.**

Mortgages have been around since the 12th century and, undoubtedly, so has mortgage fraud in some form or another. The events of the past couple of years have been like having dragons at the door with no shield strong enough for protection. ■ The word “mortgage” comes from the Old French word “mort,” which means “dead,” and the Old English word “gage,” which means “pledge.” A mortgage was, therefore, a “dead pledge” for land buyers in the Middle Ages. A buyer would lose the property if he didn’t make his payments. The pledge itself was considered dead once the loan was paid in full. ■ Today the basic premise remains the same, even though the process has changed. We now are dealing with a record number of “dead properties” (2.8 million foreclosed properties in 2009 alone), many of them the result of mortgage fraud. Foreclosure filings in 2009 were 21 percent higher than in 2008 and a whopping 120 percent higher than in 2007, according to RealtyTrac Inc., Irvine, California. ■ “I believe a lapse of judgment in lending standards . . . is what allowed fraud to become rampant,” says Elizabeth Roush, co-founder and vice president of Veritas Funding LLC, Murray, Utah, a correspondent lender. “Lenders were encouraged to help put as many Americans into homes as possible over the past 15 years or so. Lending standards were tremendously relaxed and, unfortunately, lenders stopped being mortgage advisers and lost sight of whether or not people could actually afford the homes they were buying. In addition to loose lending standards, buyers wanted to be in homes regardless of whether or not they could afford the payment.” ■ Industry experts agree that there is a direct link between fraud and distressed real estate markets. The funding from recent economic stimulus legislation, as well as the large number of Federal Housing Administration–insured (FHA-insured) mortgages, is

creating additional opportunities for unscrupulous people to take advantage of the industry, according to the Federal Bureau of Investigation (FBI).

Two categories of mortgage fraud

The two primary categories of mortgage fraud are fraud for housing and fraud for profit. Fraud for housing generally involves a borrower who inflates his or her income in order to afford a property. Generally, the buyer has every intention of repaying the loan even though this action is illegal.

Fraud for profit, also known as “industry insider fraud,” typically involves several people working together to defraud a buyer or a mortgage lender and gain illegal profits from selling property. The mortgage fraud problem in this country is primarily associated with fraud-for-profit schemes.

“The most common types of fraud, in our experience, relate to income—fraudulent pay stubs and W-2 forms—as well as false verification of employment and owner occupancy,” says Roush.

“Some of the newer types of fraud that we’re seeing relate to property ownership and illegal flipping practices. Investors are flooding the market buying short sales and real estate-owned [REO] property. While those purchases are perfectly legal, we’ve noticed investors trying to sell properties they don’t even own,” Roush says.

“A lot of the fraud-for-profit scenarios involve illegal property flipping, or buying something cheap, getting inflated appraisals and reselling the property quickly for a profit,” says Greg Shumate, president of Duluth, Georgia-based Brand Mortgage Group.

“New rules that prohibit loan officers from ordering appraisals have really helped to curb this type of fraud. The regulations require appraisals to be ordered independently, without any influence from the seller or Realtor®. A third party also reviews them before they go to the mortgage company. Companies are getting more accurate appraisals by removing influence from the appraisal process,” Shumate says.

Even though products and programs that allowed mortgage fraud to flourish are no longer available (stated-income and stated-asset loans; W-2 stated loans; no seasoning; and more), lenders are still seeing an increase in fraud coming from borrowers.

“We’ve been seeing borrowers misrepresenting their debts,” says Timothy Baise, president and chief executive officer of Top Flite Financial Inc., Williamston, Michigan, a mortgage lender. “We also are seeing borrowers trying to purchase multiple properties through multiple lenders in an effort to buy more properties than a traditional lender would normally allow at once.”

“Almost all the new cases we’re seeing involve borrowers not properly disclosing income,” says Vince Liguori, sales manager at Cincinnati-based Emery Financial Services, a subsidiary of Cincinnati-based Emery Federal Credit Union. “Sometimes it’s an accident, but often it involves improperly declaring rental income, or having two sets of tax returns—one for a mortgage and one for getting a larger tax rebate.”

The new look of mortgage fraud

Many of the current mortgage fraud schemes have been around for a long time, such as property flipping, builder-bailouts, seller assistance, short sales, air loans, foreclosure rescues and identity theft. Tightened lending practices due to rampant housing market fraud and the economic meltdown have resulted in the emergence of several new schemes, according to the FBI.

Reverse-mortgage fraud: A small number of unscrupulous mortgage, real estate or building professionals are using Home Equity Conversion Mortgages (HECMs) (reverse mortgages) to defraud senior citizens. The most common scams involve equity theft, foreclosure rescue and investment schemes. “We’ve seen situations where the senior citizen is a straw buyer,” says Baise. “An investor will purchase a bank-owned home, do a little rehab work, then move the elderly person into the home with a contract signed and not recorded. The senior citizen, after living in the house long enough to qualify for a reverse mortgage, turns the proceeds over to the investor, thus purchasing the house in reverse.”

Credit-enhancement fraud: This fraud takes many forms. Some examples include borrowers adding their names to the bank accounts of friends or family members in order to circumvent underwriting requirements, originators depositing money temporarily into loan applicants’ accounts, and borrowers filing amended tax returns and paying “back taxes” on unreported income to “create” a higher income.

Modified builder-bailout fraud: Two new builder-bailout schemes have emerged during the recent downturn—condominium conversion, and a practice known as “pump and pay.” Because developers can’t sell many of the apartments that were converted into condos during the housing boom, they may try to entice investors with offers of cash back at closing; paid condo association dues; and promises to find renters, collect rent and oversee management. Perpetrators typically inflate the condominiums’ value in order to get a higher sales price to cover the cost of the incentives. Pump and pay involves builders inflating the appraised value of their properties, then distributing the false equity to the perpetrator disguised as set-asides for future maintenance, insurances and tax payments on the property.

Arson fraud: Arson is being used by property owners to illegally get proceeds from a property to avoid foreclosure.

Foreclosure prevention: Perpetrators pretending to be working on behalf of a homeowner facing foreclosure instruct the homeowner to send his or her house payments to the perpetrator. Then the perpetrator files for bankruptcy on the homeowner’s behalf, without the homeowner’s knowledge. The bankruptcy petition causes the foreclosure to be postponed, and the homeowner believes all is well. The foreclosure process begins anew, however, when no one attends the bankruptcy hearing.

Loan-modification fraud: Recent Housing and Economic Recovery Act (HERA) and Emergency Economic Stabilization Act (EESA) laws mandate that lenders must work with homeowners using certain programs to keep them in their homes. This is being exploited by some perpetrators who offer foreclosure relief, then tell home-

owners they must pay an upfront fee of \$1,500 to \$5,000 to participate in the loan-modification program (this is untrue; homeowners do not need to pay an upfront fee under the modification program).

Serial property flipping: Perpetrators flip the same property numerous times.

Modified short-sale fraud: Perpetrators pay real estate agents referral fees for the names of homeowners facing foreclosure. Those homeowners are then convinced to deed their property to the perpetrator in a land trust. The homeowner is listed as the trust's beneficiary and the real estate agent is listed as the trustor. The perpetrator then negotiates a short sale with the lender and, unbeknownst to the lender or the homeowner, the real estate agent sells the property for a profit to another buyer, often as soon as the next day. **MB**

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TEST YOUR MORTGAGE FRAUD I.Q.

Questions

1. More than 50 percent of all foreclosures have occurred in what four states?
2. What are the estimated annual losses from mortgage fraud?
3. What percentage of the Federal Bureau of Investigation's (FBI's) mortgage fraud cases involves foreclosure-rescue scams?
4. What is the legal penalty for submitting a falsified loan application?
5. What is the legal penalty for conspiring to commit mortgage fraud?
6. What is the statute of limitations for bringing a mortgage fraud claim?
7. What region of the country has the most pending FBI mortgage fraud investigations?
8. How many properties does Irvine, California-based RealtyTrac Inc. project will enter foreclosure in 2010?
9. What year did the FBI warn that mortgage fraud was becoming so rampant that the resulting "epidemic" of financial crimes, if not curtailed, could become "the next S&L [savings-and-loan] crisis?"
10. What is the No. 1 white-collar crime in the United States?

Answers

1. California, Florida, Arizona, Illinois
2. \$4 billion–\$6 billion
3. 50 percent involve fraudulent mortgage modification and/or foreclosure relief
4. A maximum of 30 years in prison and up to a \$1 million fine
5. A maximum of 30 years in prison and up to a \$1 million fine
6. 10 years
7. Western United States
8. Approximately 3.9 million properties
9. 2004
10. Mortgage fraud