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BANKERS ADVISORY

October 15, 2010

New Trends in Mortgage Fraud

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The current economic and housing market situation has expanded the types of mortgage fraud perpetrated against homeowners, lenders, and borrowers. Tightening credit guidelines, strict appraisal standards, and the soft housing market have lead to increasingly creative methods to commit fraud. Fraud is also spreading to the northeastern United States, with the New York City-Northern New Jersey-Long Island area ranked highest nationally for all types of mortgage fraud in 2009, the last year data is available (Twelfth Periodic Mortgage Fraud Case Report, Mortgage Asset Research Institute, Denise James & Jennifer Butts, April 2010). Falsification on the loan application remains the most common type of fraud (Mortgage Fraud Case Report), however, the increasing number of distressed properties on the market and homeowners requiring loan modifications has expanded the nature and types of scams targeting troubled homeowners and properties. This article will describe the changing landscape of mortgage fraud as it pertains to current market and lending conditions.

1. <u>Fraudulent REO and Short Sale Flipping</u>

REO and short sale flipping scams are increasing as foreclosed and distressed properties continue to impact the real estate market. Short sale flipping fraud involves investors or real estate agents concealing the true identity of a buyer in a short sale transaction, purchasing the property for significantly less than fair market value, and then immediately reselling the property for a large profit at an artificially inflated price ("Mortgage Fraud Overview," Fannie Mae, May 2007). CoreLogic estimates that one in every fifty-three short sales is a fraudulent flip and that this type of fraud costs $310 million dollars annually ("Fighting Fraud with Frank," National Mortgage News, Frank McKenna, 9/8/2010). REO flips involve investors purchasing bank-owned or foreclosed properties at deflated prices and

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reselling them for a large profit, often by using a straw buyer who is compensated for participating ("Mortgage Fraud Overview" & "Fighting Fraud with Frank"). CoreLogic estimates that fraudulent REO flips cost lenders approximately $61,000 in loan value for every case ("Fighting Fraud with Frank"). As REO and distressed properties remain on the market, these types of scams will increase and continue to impact lenders, real estate agents, and buyers as well as manipulate property values in communities.

2. Origination and Closing Process Fraud

Fraud or misrepresentation in the application process represents 59% of all reported mortgage fraud in 2009, the last year from which data is available (Mortgage Fraud Case Report). Misrepresentations on tax returns and financial statements were higher in 2008 and 2009; New York reported 37% of frauds involved tax return and financial statement misrepresentation in 2009 (Mortgage Fraud Case Report). Ironically, the tightening credit standards have led to increases in origination fraud as borrowers' income and liabilities are closely scrutinized. Borrowers hide debts and other liabilities in order to meet the required debt to income ratios under lenders' credit guidelines ("Fighting Fraud with Frank"). Asset inflation or fabrication is also on the rise because borrowers with high amounts of liquid assets are given less underwriting scrutiny as they are a lower risk for the lender due to their high amounts of reserves ("Fighting Fraud with Frank"). Borrowers with lower incomes may misrepresent or completely fabricate bank or investment accounts in order to qualify for a loan. As credit standards continue to tighten, this type of fraud will increase and grow in complexity in order to exploit the process.

Fraud is also occurring in the closing process, due in part to the focus on loan origination and modification ("Fighting Fraud with Frank"). The FBI has begun focusing on title and settlement agents as they are often co-conspirators in a fraud scheme ("Fighting Fraud with Frank"). Many title agents are underpaid and not well-trained or supervised as they conduct settlements, and frequently fraudulent closings will have as few as two people present ("Fraud Probes Delayed by 2005-08 Backlog," National Mortgage News, Brad Finkelstein, 09/27/10). The most common closing process fraud involves embezzlement of the proceeds for the agent's own gain ("Fighting Fraud with Frank"). Lenders are often not extensively involved in the closing process so these scams require less effort and sophistication on the part of the fraudster.

3. Loan Modification and Distressed Homeowner Scams

As the numbers of troubled homeowners continue to increase, so will loan modification and homeowner rescue scams. These scams involve an individual misrepresenting their affiliation with a lender, "fee for service" operations, and bait and switch or quitclaim deed traps. The most common type of homeowner rescue scam involves the fraudster directly contacting a distressed homeowner and promising to negotiate a loan modification with the lender on the borrower's behalf ("Fraud Schemes and Modification Scams," Penny A. Paplanus, CMB, Cognitive Options Group, LLC). Often the fraudster will lie about their affiliation with a lender or nonprofit counseling service and advise the homeowner to deal directly with them, either by making the mortgage payments directly to the fraudster or requiring an upfront fee before anything is executed on the borrower's behalf ("Fraud Schemes and Modification Scams"). In both these instances the fraudster will simply take the money and disappear, leaving the homeowner further in default with the lender ("Fraud Schemes and Modification Scams").

A far more sinister scam is the bait and switch. In that situation, the homeowner is tricked into giving up the property while still losing thousands of dollars or remaining liable for the debt. The most common scheme results in the fraudster convincing the homeowner to sign a quitclaim deed over to the fraudster. The scam artist assures the homeowner that he or she may remain in the home while paying the scammer rent until the homeowner's financial situation improves ("Mortgage Fraud: Tick, Tick, Boom!" National Mortgage News, Brian King, 09/20/10). The fraudster then records the deed, becomes the owner of record, sells the property for a profit, and the homeowners are evicted ("Mortgage Fraud: Tick, Tick, Boom!"). A variation of this scheme involves the fraudster using the quitclaim deed to obtain a second mortgage on the property and retaining the proceeds for his or her own gain ("Fraud Schemes and Modification Scams"). There is almost no legal recourse for the victims of this scam because they signed a quitclaim deed over and no longer own the property. Also, the victim will remain liable for the debt as transferring a deed does not extinguish the liability on the unpaid mortgage ("Fraud Schemes and Modification Scams").

The Loan Modification Scam Prevention Network has created a website, www.preventloanscams.org, to identify and track individuals and companies engaging in loan modification fraud ("New Web Site Aims to Track Fraud in Loan Modifications," HeraldTribune.com, Aaron Kessler, 03/22/10). HUD, the Department of Justice, U.S. Treasury, FBI, Fannie Mae, Freddie Mac, and various advocacy groups are partnering in the Loan Modification Scam Prevention Network ("New Web Site Aims to Track Fraud in Loan Modifications"). Homeowners can report fraudsters and file complaints online and HUD has asked approved housing counselors to report scams to the website as well ("New Web Site Aims to Track Fraud in Loan Modifications"). The Loan Modification Scam Prevention Network seeks to track trends and identify fraudsters earlier with this website in an effort to prevent this growing area of mortgage fraud ("New Web Site Aims to Track Fraud in Loan Modifications").

4. Fraud and Negligence in the Foreclosure Process

Speaker Nancy Pelosi has started an investigation into foreclosure fraud after it was revealed that JP Morgan Chase, Ally Financial, and Bank of America had processing irregularities in their foreclosure proceedings ("Foreclosure Fraud Investigation: Nancy Pelosi Calls for Mortgage Fraud Inquiry," Examiner.com, 10/5/10). Foreclosure proceedings are halted in 23 states while Attorneys General investigate the processes ("Foreclosure Fraud Investigation: Nancy Pelosi Calls for Mortgage Fraud Inquiry"). The Office of the Comptroller of the Currency has also ordered Bank of America, HSBC, Citigroup, PNC, JP Morgan Chase, Wells Fargo, and U.S. Bancorp to review foreclosure processes ("OCC Orders Top Servicers to Check Their Foreclosure Practices," National Mortgage News, 10/1/10). Ally, Bank of America, and Chase all discovered employees signing documents or approving affidavits with little or no personal knowledge of each case, so-called "robo-signers" ("JP Morgan Chase Freezes Foreclosure Cases," Palm Beach Post, Kimberly Miller, 09/29/10). Courts have accepted suspect documentation in foreclosure proceedings due to the vast numbers of foreclosures occurring since the 2008 market correction, especially with unrepresented borrowers or manufactured defaults ("JP Morgan Chase Freezes Foreclosure Cases"). Bank of America, Wells Fargo, and Chase combined hold $5.2 trillion in housing receivables and control 54% of the market share ("OCC Orders Top Servicers to Check Their Foreclosure Practices"). Fitch Ratings will downgrade a bank's rating if the internal foreclosure processes are deficient or fraudulent ("JP Morgan Chase Freezes Foreclosure Cases").

5. Conclusion

Mortgage fraud impacts lenders, buyers, real estate agents, sellers, and communities as a whole. It can falsely inflate property values and raise property taxes or leave large amounts of properties vacant and prey to criminal activity ("Mortgage Fraud Overview"). Credit guidelines can tighten and lenders can raise fees and interest rates in order to combat fraudulent activity and recover from the losses ("Mortgage Fraud Overview"). The recent market correction and sluggish recovery are breeding grounds for new and more sophisticated types of fraud and ever increasing victims to target. Lenders, politicians, real estate agents, appraisers, and borrowers must partner in combating and avoiding fraud in order to preserve the American Dream for future generations.