

Special: Feature

Brokers And Agents: How You Can Identify And Avoid Mortgage Fraud

BY BRIAN S. ICENHOWER

Recent financial industry distress publicly attributed to widespread mortgage loan defaults has generated mounting pressure on federal prosecutors to increase investigations into incidents of mortgage fraud across the nation. You must be knowledgeable on this topic.

On February 6, 2004, CNN reported that the FBI warned that mortgage fraud was becoming so rampant that the resulting “epidemic” of fraud could trigger a massive financial crisis. Mortgage fraud has now become so prevalent that the United States Department of Justice and the Federal Bureau of Investigation have been forced to create an entirely new category for tracking these cases.

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According to a CBS news report, the number of FBI agents assigned to mortgage related crimes increased by 50 percent from 2007 to 2008. Prosecutors and

investigators on both the state and local levels are also feverishly organizing task forces and creating real estate fraud departments to counter this burgeoning wave of crime.



statement, for the purpose of influencing a financial institution upon a loan application, purchase agreement or other related documents. A violation of the federal mortgage fraud law (18 U.S.C. § 1014) alone is punish-

able by up to thirty years imprisonment and a one million dollar fine.

MORTGAGE FRAUD SCHEMES

The most effective way to avoid prosecution for mortgage fraud is to identify mortgage fraud schemes prior to any actual involvement. Most mortgage fraud offenses fall into one of two general categories: “fraud for housing” and “fraud for profit”. Fraud for housing often involves fraudulent acts committed by a borrower, often coached by his or her mortgage broker or real estate agent, to obtain a loan for the ultimate goal of acquiring a home. These fraudulent facts generally pertain to the falsification of facts and documents during the loan application process to enable the borrower to obtain financing that he or she would otherwise not be qualified to receive. Conversely, fraud for profit typi-

CRIME AND PUNISHMENT

The primary focus of these investigations appears to be on borrowers, investors, mortgage brokers, appraisers and real estate agents. Some of the charges levied against these perpetrators have included making false statements on loan applications, bank fraud, mail fraud, wire fraud, conspiracy to launder funds and a number of applicable state laws. However, the primary legal vehicle implemented by federal prosecutors has been section 1014 of Title 18 of the United States Code which declares mortgage fraud as a federal crime encompassing anyone who willfully overvalues any land or property, or knowingly makes any false

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cally involves a more concerted plan to abuse the entire real estate transactional process for pecuniary gain.

FRAUD FOR HOUSING **Income Fraud**

This occurs when a borrower inflates his or her amount of income to qualify for a loan or a larger loan amount. Although recent reductions in the use of “stated income” or “no-doc liar loans” has somewhat curbed income fraud, daring borrowers are increasingly generating more fraudulent documents to falsify income. Information technology and photocopy equipment have become so advanced that very convincing documentation, such as income statements, savings accounts and tax returns, can be produced on demand.

Employment Fraud

In order to justify overstated income in a loan application, borrowers will claim self-employment in a non-existent company or represent having a higher position in a company than the borrower actually holds.

Failure to Disclose Liabilities

The debt-to-income ratio is an important part of the loan underwriting criteria used to determine a borrower’s eligibility for mortgage loans. Consequently, borrowers will conceal financial obligations like newly acquired credit card debt, other mortgages, and private loans to artificially reduce their debt-to-income ratios.

Occupancy Fraud

This generally occurs when a borrower states on a loan application that he or she intends to occupy a property as a primary residence to secure a lower interest rate when the borrower actually intends to obtain the loan to acquire an investment property.

FRAUD FOR PROFIT **Equity Skimming and** **Cash-Back Schemes**

A straw buyer is typically implemented as the buyer of the property due to his or her creditworthiness and resulting

ability to obtain favorable financing. Unknowing straw buyers can be manipulated by mortgage brokers and real estate agents to purchase a property as a primary residence with the broker or agent later serving as a property manager to collect anticipated rental income. After the escrow closes and the mortgage and real estate brokers collect their com-

missions, they proceed to collect rental income and fail to make the mortgage payments.

Complex schemes can involve a knowing straw buyer, an appraiser who intentionally overstates the property’s value, a dishonest seller who intentionally inflates the selling price, and a dishonest settlement officer who makes undis-

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closed disbursements from the loan proceeds. All of these conspirators collaborate to collect portions of the proceeds of an inappropriately large loan before eventually letting it go into default.

Appraisal Fraud or Price Inflation

This fraud occurs when a dishonest appraiser intentionally overstates the value of a property or when an existing appraisal is altered to reflect a higher value. When a home is overvalued, more money can be obtained by the seller in a purchase transaction or by the borrower in a cash-out refinance.

The New Appraisal Fraud: Price Deflation

When done legitimately, a short sale occurs when a borrower who owes more than his or her property is worth sells the property below market value and the lender agrees to accept the lower repayment amount and forgive the difference.

A new hybrid of fraud has emerged where an appraiser or a real estate agent drastically devalues the property in an appraisal or broker's price opinion (BPO) so that the home will sell with ease at a price well below market value. Of course the new buyer is in collaboration with the seller, agent and appraiser, so all of the conspirators proceed to sell the home at a higher price for a big profit.

Identity Theft

Identity theft fraud occurs when a victim's identity is assumed by another to obtain a mortgage without ever intending to make any payments on the loan. The perpetrators often abscond with a portion of the loan proceeds and sometimes are daring enough to lease the property and collect some deposits and rental income before disappearing.

The Buy and Bail

This completely new scheme is per-

petrated by a homeowner who cannot sell the home because more is owed on the property than it's worth. Because no lender will provide the owner a loan for a second primary residence, the owner tells the lender that he or she plans to rent out the current home despite having no intention of doing so. Sometimes a falsified rental agreement is used to further support the falsehood. Once the second home is purchased, the owner "bails" on the original home and fails to make any further mortgage payments.

AVOIDING AND PREVENTING FRAUD

Mortgage fraud frequently emanates from groups that complete an abnormal amount of similar transactions or churn out many offers to purchase at once. These outfits may appear disorganized or unprofessional due to the large amount of transactions they are attempting to manage. It is also no coincidence that mortgage fraud has significantly increased as housing values have decreased since most fraud schemes involve a financially distressed or otherwise vulnerable seller.

It is equally important to remember that agents owe a very strict fiduciary duty to act in their clients' best interests. So before reporting a client to your local authorities, you need to speak with legal counsel or your state real estate licensing department to ensure that your proposed actions don't constitute a breach of your fiduciary duty to your client.

Real estate agents are in a unique position that enables them to identify and even prevent the occurrence of fraud by recognizing the red flags, asking appropriate questions, and giving the principals in their transactions the full picture of what consequences are associated with participating in mortgage fraud. While a lot of damage has been done in the real estate market, we can prevent more of the same from occurring in the future. ■

— Brian Icenhower

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