



(U) 2010 Mortgage Fraud Report Year in Review

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Directorate of Intelligence
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Prepared by

Financial Crimes
Intelligence Unit

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(U) Scope Note

(U) The purpose of this study is to provide insight into the breadth and depth of mortgage fraud crimes perpetrated against the United States and its citizens during 2010. This report updates the 2009 Mortgage Fraud Report and addresses current mortgage fraud projections, issues, and the identification of mortgage fraud “hot spots.” The objective of this study is to provide FBI program managers and the general public with relevant data to better understand the threat posed by mortgage fraud. The report was requested by the Financial Crimes Section, Criminal Investigative Division (CID), and prepared by the Financial Crimes Intelligence Unit (FCIU), Directorate of Intelligence (DI).

(U) This report is based on FBI; federal, state, and local law enforcement; mortgage industry; and open-source reporting. Information was also provided by other government agencies, including the U.S. Department of Housing and Urban Development-Office of Inspector General (HUD-OIG), the Federal Housing Administration (FHA), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN). Industry reporting was obtained from LexisNexis, Mortgage Asset Research Institute (MARI), RealtyTrac, Inc., Mortgage Bankers Association (MBA), Interthinx, and CoreLogic. Some industry reporting was acquired through open sources.

(U) While the FBI has high confidence in all of these sources, some inconsistencies relative to the cataloging of statistics by some organizations are noted. For example, suspicious activity reports (SARs) are cataloged according to the year in which they are submitted, but the information contained within them may describe activity that occurred in previous months or years. The geographic specificity of industry reporting varies, as some companies report at the ZIP code level and others by city, region, or state. Many of the statistics provided by the external sources, including FinCEN, FHA, and HUD-OIG, are captured by fiscal year (FY); however, this report focuses on the calendar year findings as reported by mortgage industry and economic data sources. Additionally, there are also variances in the reporting of fraud depending on who the victim is (either a financial institution or a homeowner). While these discrepancies have minimal impact on the overall findings stated in this report, we have noted specific instances in the text where they may affect conclusions.

(U) See Appendix A for additional information for these sources.

(U) Geospatial maps were provided by the Crime Analysis Research and Development Unit, Criminal Justice Information Services Division.

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(U) Key Findings

- (U) Mortgage fraud continued at elevated levels in 2010, consistent with levels seen in 2009. Mortgage fraud schemes are particularly resilient, and they readily adapt to economic changes and modifications in lending practices.
- (U) Mortgage fraud perpetrators include licensed/registered and non-licensed/registered mortgage brokers, lenders, appraisers, underwriters, accountants, real estate agents, settlement attorneys, land developers, investors, builders, bank account representatives, and trust account representatives.
- (U) Total dollar losses directly attributed to mortgage fraud are unknown.
- (U) A continued decrease in loan originations from 2009 to 2010 (and expected through 2012), high levels of unemployment and housing inventory, lower housing prices, and an increase in defaults and foreclosures dominated the housing market in 2010. RealtyTrac reported 2.9 million foreclosures in 2010, representing a 2 percent increase in foreclosures since 2009 and a 23 percent increase since 2008.
- (U) Analysis of available law enforcement and industry data indicates the top states for known or suspected mortgage fraud activity during 2010 were California, Florida, New York, Illinois, Nevada, Arizona, Michigan, Texas, Georgia, Maryland, and New Jersey; reflecting the same demographic market affected by mortgage fraud in 2009.
- (U) Prevalent mortgage fraud schemes reported by law enforcement and industry in FY 2010 included loan origination, foreclosure rescue, real estate investment, equity skimming, short sale, illegal property flipping, title/escrow/settlement, commercial loan, and builder bailout schemes. Home equity line of credit (HELOC), reverse mortgage fraud, and fraud involving loan modifications are still a concern for law enforcement and industry.
- (U) With elevated levels of mortgage fraud, the FBI has continued to dedicate significant resources to the threat. In June 2010, the Department of Justice (DOJ), to include the FBI, announced a mortgage fraud takedown referred to as Operation Stolen Dreams. The takedown targeted mortgage fraudsters throughout the country and was the largest collective enforcement effort ever brought to bear in combating mortgage fraud.
- (U) The current and continuing depressed housing market will likely remain an attractive environment for mortgage fraud perpetrators who will continue to seek new methods to circumvent loopholes and gaps in the mortgage lending market. These methods will likely remain effective in the near term, as the housing market is anticipated to remain stagnant through 2011.

(U) Introduction

(U) Mortgage fraud remained elevated in 2010 despite modest improvements in various economic sectors and increased vigilance by financial institutions to mitigate it. Although recent economic indicators report improvements in various sectors, overall indicators associated with mortgage fraud—such as foreclosures, housing prices, contracting financial markets, and tighter lending practices by financial institutions—indicate that the housing market is still in distress and providing ample opportunities for fraud. National unemployment remains high, and housing inventory is at the same level it was in 2008 in the midst of the housing crisis.¹ Mortgage delinquency rates and new foreclosures continued to increase in prime and subprime markets.

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(U) Mortgage Fraud

Mortgage fraud is a material misstatement, misrepresentation, or omission relied on by an underwriter or lender to fund, purchase, or insure a loan. This type of fraud is usually defined as loan origination fraud. Mortgage fraud also includes schemes targeting consumers, such as foreclosure rescue, short sale, and loan modification.

(U) Mortgage Fraud Perpetrators

(U) Mortgage fraud enables perpetrators to earn high profits through illicit activity that poses a relative low risk for discovery. Mortgage fraud perpetrators include licensed/registered and non-licensed/registered mortgage brokers, lenders, appraisers, underwriters, accountants, real estate agents, settlement attorneys, land developers, investors, builders, bank account representatives, and trust account representatives. There have been numerous instances in which various organized criminal groups were involved in mortgage fraud activity. Asian, Balkan, Armenian, La Cosa Nostra,² Russian, and Eurasian³ organized crime groups have been linked to various mortgage fraud schemes, such as short sale fraud and loan origination schemes.

(U) Mortgage fraud perpetrators using their experience in the banking and mortgage-related industries—including construction, finance, appraisal, brokerage, sales, law, and business—exploit vulnerabilities in the mortgage and banking sectors to conduct multifaceted mortgage fraud schemes. Mortgage fraud perpetrators have a high level of access to financial documents, systems, mortgage origination software, notary seals, and professional licensure information necessary to commit mortgage fraud and have demonstrated their ability to adapt to changes in legislation and mortgage lending regulations to modify existing schemes or create new ones.

(U) Mortgage fraud perpetrators target victims from across a demographic range, with perpetrators identifying common characteristics such as ethnicity, nationality, age, and socioeconomic variables, to include occupation, education, and income. They recruit people who have access to tools that enable them to falsify bank statements, produce deposit verifications on bank letterhead, originate loans by falsifying income levels, engage in the illegal transfer of property, produce fraudulent tax return documents, and engage in various other forms of fraudulent activities. Mortgage fraud perpetrators have been known to recruit ethnic community members as co-conspirators and victims to participate in mortgage loan origination fraud.

(U) Financial Impact of Mortgage Fraud^a*(U) Losses*

(U) Total dollar losses attributed to mortgage fraud are unknown; however, law enforcement and mortgage industry participants have attempted to quantify them in recent years. According to CoreLogic (*see Appendix A for source description*) more than \$10 billion in loans originated with fraudulent application data in 2010 (*see Figure 1*).⁴

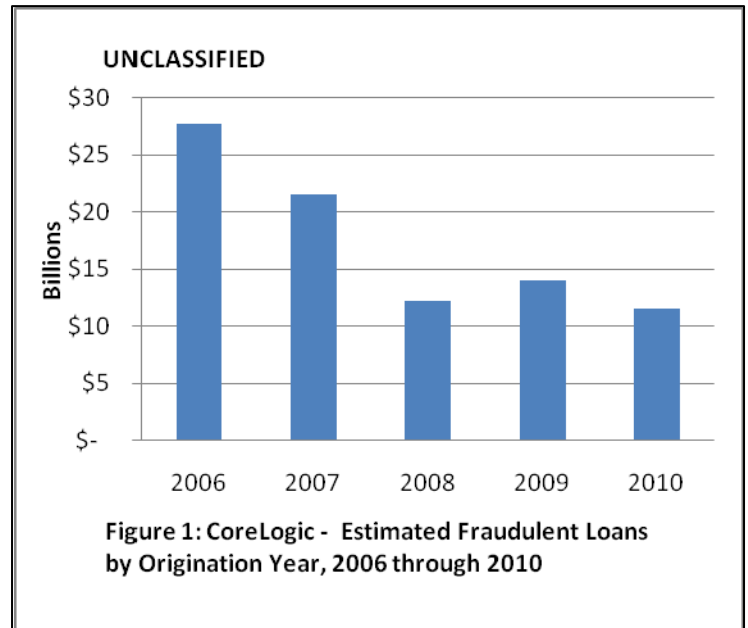
(U) Economic & Mortgage Market Conditions

(U) Mortgage fraud both impacts and is impacted by various economic conditions such as mortgage loan originations; unemployment; mortgage loan delinquencies, defaults, and foreclosures; negative equity; loan modifications; housing prices and inventory; real estate sales; housing construction; and bank failures. As of December 2010, activity in the housing market remained very weak as new construction and permits declined, demand for housing remained depressed, home sales declined, and home prices decreased.

- (U) According to the Federal Reserve Board, as of December 2010, real estate markets remained weak, sales declined, obtaining credit was reported as a constraint on demand for homes, existing home inventories remained at high levels, and home prices generally declined across most Federal Reserve Districts.⁵
- (U) The National League of Cities reported that the fiscal condition of U.S. cities continued to weaken in 2010 as cities were confronted by the economic downturn.⁶
- (U) A study by the Federal Reserve Bank of Philadelphia reported that low-income households still struggle to access credit.⁷ Organizations providing services to these households have seen an increase in demand for their services while trying to meet those demands with cuts in funding. The top three factors contributing to a lack of access to credit include lack of financial knowledge, underwriting standards/credit ratings, and lack of cash flow.

(U) Mortgage Loan Originations

(U) According to the MBA, mortgage loan originations for one to four units exceeded \$1.6 trillion in 2010; however, this is a decrease from 2009, which reported \$2 trillion in originations.^{8,9}



^a (U) The discovery of mortgage fraud via the mortgage industry loan review processes, quality control measures, regulatory and industry referrals, and consumer complaints lags behind economic indicators—often up to two years or more, with the impacts felt far beyond these years.

(U) Unemployment

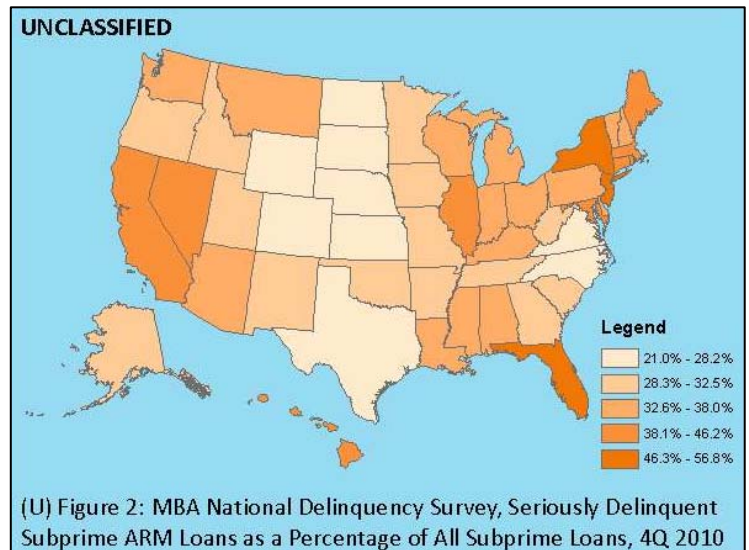
(U) Unemployment is a factor that is expected to influence the number of foreclosures in the years to come.¹⁰ The unemployment rate as of December 2010 was 9.4 percent, an improvement from 9.9 percent as of December 2009.¹¹ The Federal Reserve Board indicates that the jobless rate is anticipated to remain elevated at the end of 2012.¹² According to the most recent report by the National Foreclosure Mitigation Counseling program established by Congress, 58 percent of homeowners receiving foreclosure counseling listed unemployment as the main reason for default.¹³

(U) Mortgage Loan Delinquencies, Defaults, & Foreclosures

(U) Delinquencies

(U) In addition to unemployment, mortgage loan delinquencies, defaults, and foreclosures are also contributing factors to an increasing pool of homeowners vulnerable to mortgage fraud. The MBA National Delinquency Survey (NDS)^b reported 43.6 million first-lien mortgages on one- to four-unit residential properties in 2010.

- (U) According to the MBA NDS, 8.2 percent (or 3.6 million) of all residential mortgage loans (seasonally adjusted) in 2010 were past due, excluding those already in the foreclosure process.¹⁴ In 2010, 8.8 percent of mortgage loans were seriously delinquent (more than 90 days past due per MBA NDS, to include those in the process of foreclosure).¹⁵ The NDS continues to report an increase in foreclosure rates for all loan types (prime, subprime, FHA, and Veteran’s Administration (VA)) from 2008 to 2010. States with the highest overall delinquency rates were Mississippi (13.3 percent), Nevada (12 percent), and Georgia (11.9 percent).
- (U) The number of commercial mortgage loan delinquencies increased 79 percent in 2010, from 4.9 percent in December 2009 to 8.79 percent in December 2010.¹⁶ Nevada (28.2 percent) and Alabama (16 percent) have the highest delinquency rates in the United States.
- (U) The MBA NDS 2010 data indicate that while the seriously delinquent rate for subprime loans was 28.5 percent in 2010, the rate was 38.9 for subprime Adjustable Rate Mortgages (ARMs). States with the most seriously delinquent subprime ARMs in 2010 were Florida (56.8 percent), New Jersey (52.7 percent), New York (51 percent), Nevada (46.2 percent), and Hawaii (43.3 percent) (see Figure 2).



^b (U) The MBA NDS is estimated to cover 88 percent of the outstanding first-lien mortgages in the mortgage market.

(U) Defaults

(U) Fitch rating agency anticipates a re-default rate on loan modifications between 60 and 70 percent for subprime and Alt-A loans, and 50 to 60 percent for prime loans.¹⁷ Defects in servicer foreclosure procedures have stalled the process throughout the country thereby lengthening the process further. Fitch states that it will take four years to remove the backlog of properties and return the market to balance.¹⁸

(U) Foreclosures

(U) According to RealtyTrac, a record 2.9 million homes received foreclosure filings in 2010 (up from 2.8 million in 2009) as the problem became more widespread due to high unemployment.¹⁹ The number of foreclosures continues to outpace the number of loan modifications (*see Figure 3*).²⁰

- (U) The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) report that completed foreclosures in the fourth quarter of 2010 decreased by nearly 50 percent and newly initiated foreclosures decreased by almost 8 percent as a result of the moratorium on foreclosure actions by the largest mortgage service providers brought on by the robo-signing issue.²¹
- (U) According to the MBA, foreclosure inventory is highly concentrated geographically, with more than 50 percent of foreclosed properties located in five states: Florida, California, Illinois, New York, and New Jersey.²²

(U) Negative Equity/Underwater Mortgages

(U) According to CoreLogic, homeowners in negative equity positions add to the number of homeowners vulnerable to short sale fraud schemes. CoreLogic reported that negative equity was concentrated in five states at the close of 2010. Nevada had the highest percentage of mortgages with negative equity at 65 percent, followed by Arizona (51 percent), Florida (47 percent), Michigan (36 percent), and California (32 percent).²³

- (U) CoreLogic reporting indicates that 11.1 million, or 23.1 percent, of all residential properties with a mortgage were in negative equity (\$750 billion) at the end of the fourth quarter 2010, up from 10.8 million, or 22.5 percent, in the previous quarter.²⁴

(U) Loan Modifications

(U) Historic increases in delinquencies and foreclosures continue to burden the mortgage servicing system.²⁵ According to the Home Affordable Modification Program (HAMP), of the 2.9 million eligible delinquent loans (60 or more days delinquent as reported by servicers through December 2010, but excluding FHA and VA loans), only 521,630 have been granted permanent modifications, while 1.5 million are in trial modifications.²⁶

(U) The OCC/OTS reported that 25.5 percent of loan modifications were re-defaulting in 2010, falling 60 or more days past due nine months after modification.²⁷

(U) While their position in rankings may change slightly, the top 10 states reporting active trial and permanent mortgage loan modifications in 2009 were also the top 10 states in 2010 and through March 2011 (see Figure 3).²⁸

- (U) Interthinx reports that property owners are fraudulently decreasing their income and property values to get their debt reduced for their loan modifications.²⁹ They are fabricating hardships and filing false tax returns to this end. Also, individuals who first perpetrated fraud in loan origination are now attempting to defraud *again* during their loan modification.
- (U) Freddie Mac reports that 2010 loan modification fraud trends include strategic defaults, which are accompanied by false statements about income, assets, or the homeowner's inability to pay.³⁰ Loan modification perpetrators are misrepresenting occupancy and income (by stating it is lower), altering pay stubs, and seeking modifications without an actual financial hardship.³¹
- (U) HUD reported 2010 loan modification scams in the form of principal reduction scams, rent-to-own-leaseback, bankruptcy fraud, and false reconveyance.³² In addition, HUD reported that fraudsters are trolling unemployment offices, churches, and public foreclosure rescue fairs targeting vulnerable homeowners.

(U) *Housing Prices & Inventory*

(U) Housing prices continued to weaken and trends in sales continued to decrease in 2010 (see Figure 4). The economic downturn has resulted in home prices 1.6 percent lower than a year ago, slightly worse than industry predictions of 1.5 percent.³³ Metropolitan Statistical Areas of Detroit, Atlanta, Cleveland, and Las Vegas each have home prices below their 2000 levels.

(U) Housing inventory was reported to be at levels witnessed in 2008 during the financial crisis. Home values are expected to fall in 2011.

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|--------------|---|---|---|
| State | Total Active Trial and Permanent Mortgage Loan Modifications as of 31 Dec. 2009 | Total Active Trial and Permanent Mortgage Loan Modifications as of 31 Dec. 2010 | Total Active Trial and Permanent Mortgage Loan Modifications as of March 2011 |
| CA | 172,288 | 158,021 | 172,728 |
| FL | 105,108 | 80,732 | 87,060 |
| IL | 44,942 | 36,246 | 38,915 |
| AZ | 43,126 | 31,947 | 33,083 |
| NY | 38,282 | 30,435 | 32,988 |
| GA | 33,774 | 24,563 | 26,483 |
| MI | 29,103 | 22,481 | 23,817 |
| NJ | 28,517 | 21,782 | 23,348 |
| MD | 28,117 | 21,702 | 23,118 |
| TX | 28,577 | 17,757 | 19,075 |

(U) Figure 3: Top 10 States Reporting Active Trial and Permanent Mortgage Loan Modifications, 2009 to March 2011. Source: U.S. Treasury Making Home Affordable Program: Servicer Performance Reports, 31 December 2009 through March 2011.

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|-----------------|--------------------|--------------------|
| City | % Change 2009-2010 | % Change 2004-2010 |
| U.S. | -1.4 | -18.5 |
| Phoenix, AZ | -8.3 | -32.3 |
| Atlanta, GA | -7.9 | -19.0 |
| Portland, OR | -7.8 | 2.4 |
| Chicago, IL | -7.4 | -20.8 |
| Detroit, MI | -6.4 | -44.9 |
| Seattle, WA | -6.0 | 0.1 |
| Tampa, FL | -5.9 | -24.9 |
| Minneapolis, MN | -5.1 | -26.9 |
| Las Vegas, NV | -4.7 | -52.1 |
| Charlotte, NC | -4.3 | -1.3 |

(U) Figure 4: Top 10 Cities by Percent Change in Home Prices, through December 2010. Source: S & P/Case-Shiller Home Price Index & FiServe Data

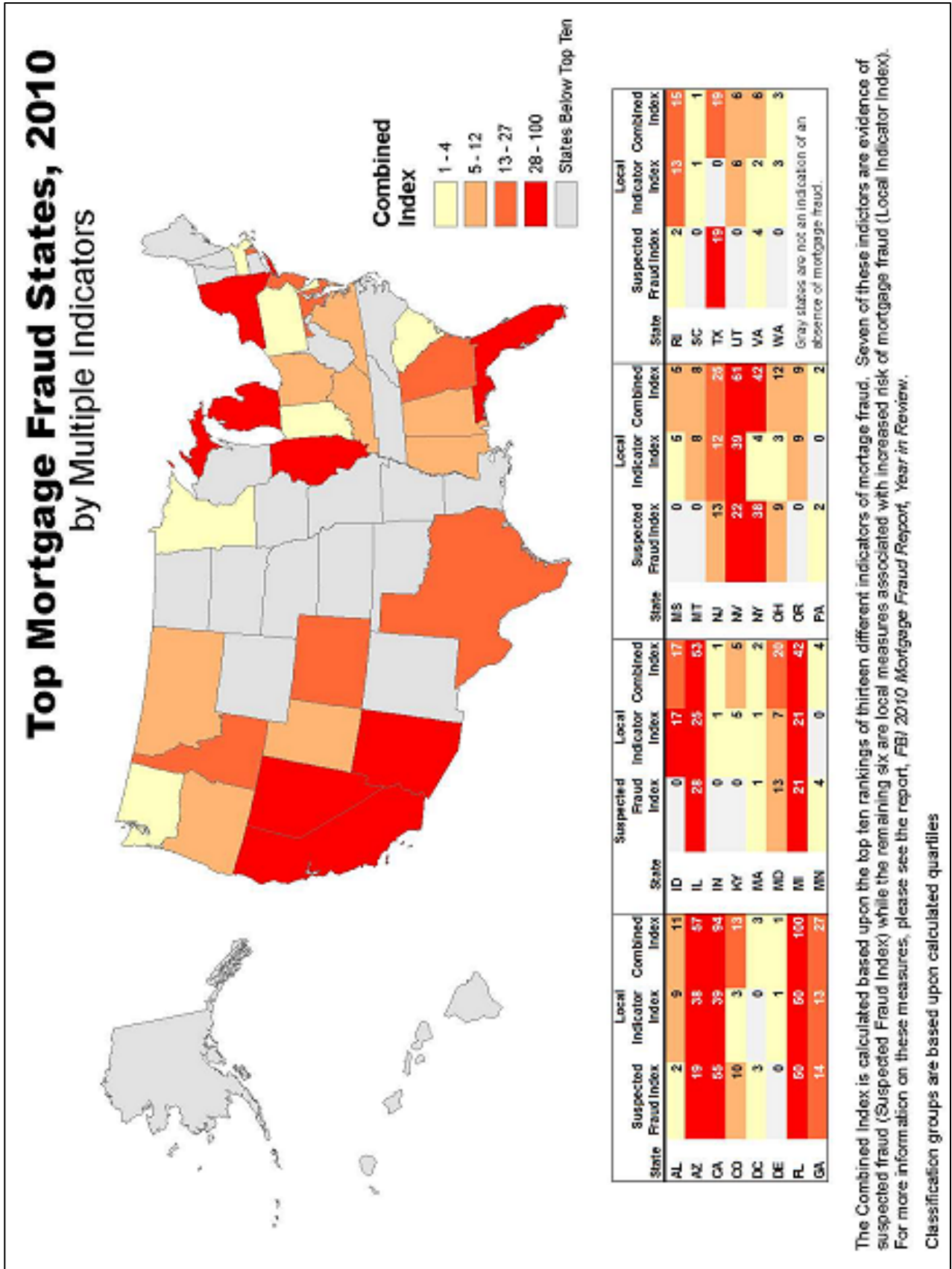
(U) According to the National Association of Realtors, pending home sales decreased 6 percent from 2009 to 2010, and existing home sales decreased 5.7 percent for the same period.³⁴

(U) Top Geographical Areas for Mortgage Fraud

(U) Methodology

(U) Data from law enforcement and industry sources were compared and mapped to determine those areas of the country most affected by mortgage fraud during 2010. This was accomplished by compiling the state rankings by each data source, collating by state, and then mapping the information.

(U) Combining information from states reporting fraud with those reporting significant vulnerability for fraud indicate the top states in 2010 were Florida, California, Arizona, Nevada, Illinois, Michigan, New York, Georgia, New Jersey, and Maryland (*see Figure 5 on page 11*).



(U) Figure 5: Top Mortgage Fraud States, 2010

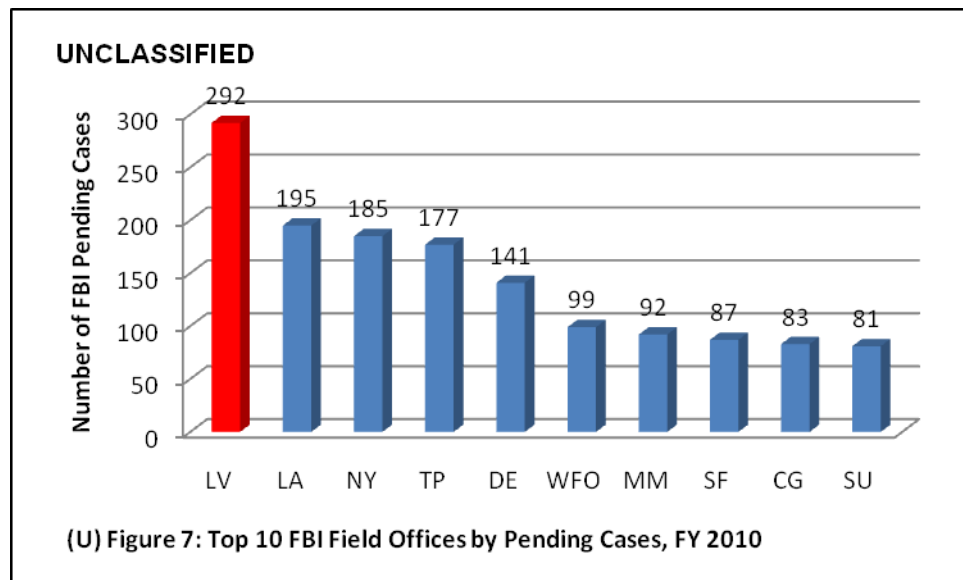
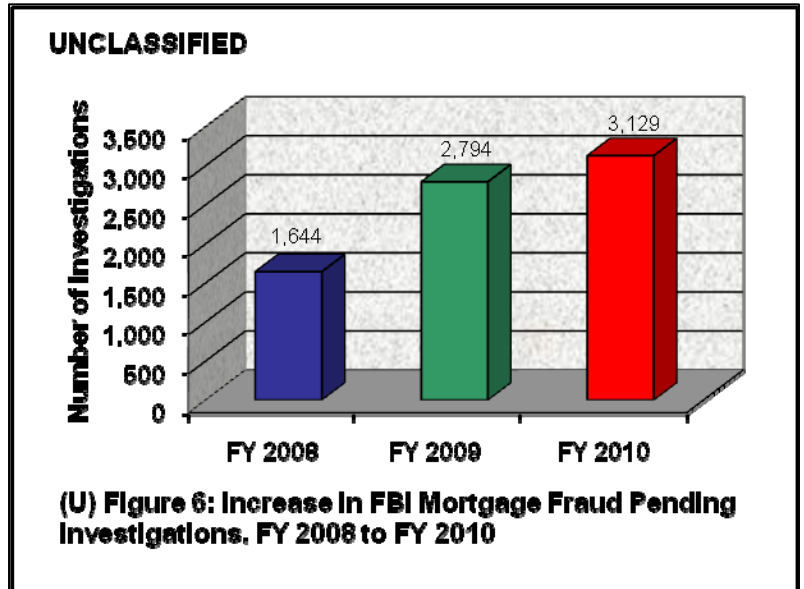
(U) Detailed Look at Fraud Indicators by Source Entity

(U) Various data sources, to include the FBI, HUD-OIG, FinCEN, MARI, Interthinx, Fannie Mae, Radian Guaranty, CoreLogic, the U.S. Census, and the U.S. Department of Labor were used in this report to identify geographic fraud trends. This report also takes a more detailed look at information reported by law enforcement and industry to identify additional fraud patterns and trends.

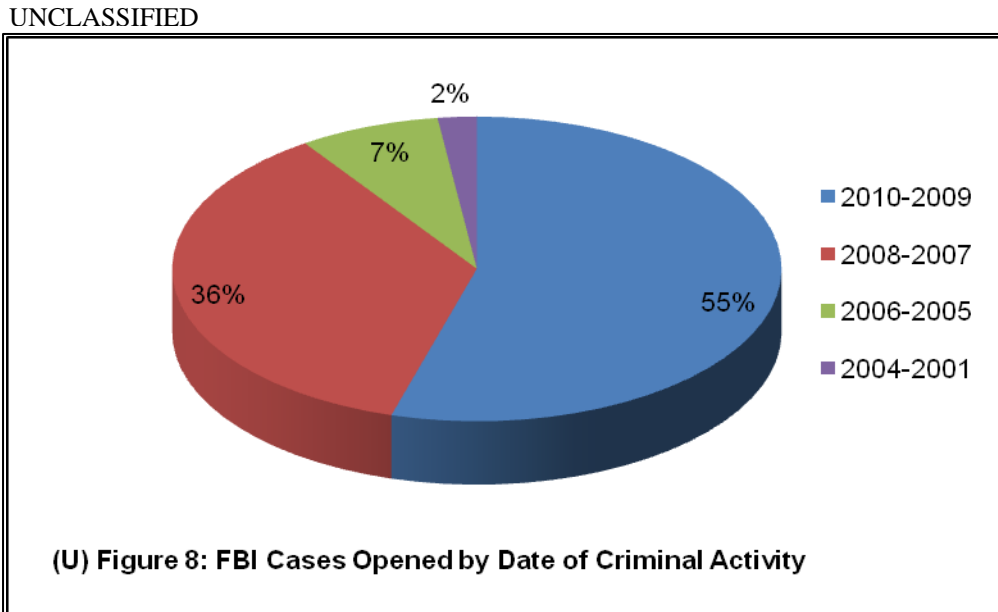
(U) FBI

(U) FBI mortgage fraud pending investigations totaled 3,129 in FY 2010, a 12 percent increase from FY 2009 and a 90 percent increase from FY 2008 (see Figure 6). According to FBI data, 71 percent (2,222) of all pending FBI mortgage fraud investigations during FY 2010 (3,129) involved dollar losses totaling more than \$1 million.

(U) FBI field divisions that ranked in the top 10 for pending investigations during FY 2010 were Las Vegas, Los Angeles, New York, Tampa, Detroit, Washington Field, Miami, San Francisco, Chicago, and Salt Lake City, respectively (see Figure 7).

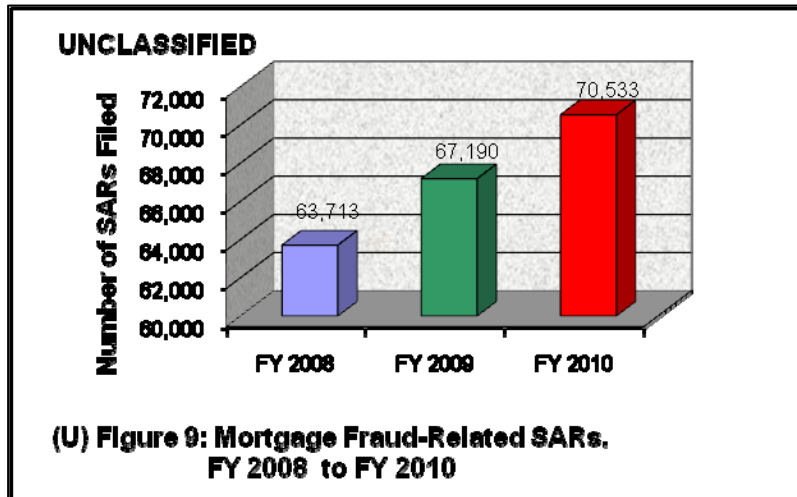


(U) The FBI assesses that the majority of mortgage fraud cases opened in FY 2010 involved criminal activity that occurred in either 2009 or 2010 (see Figure 8).



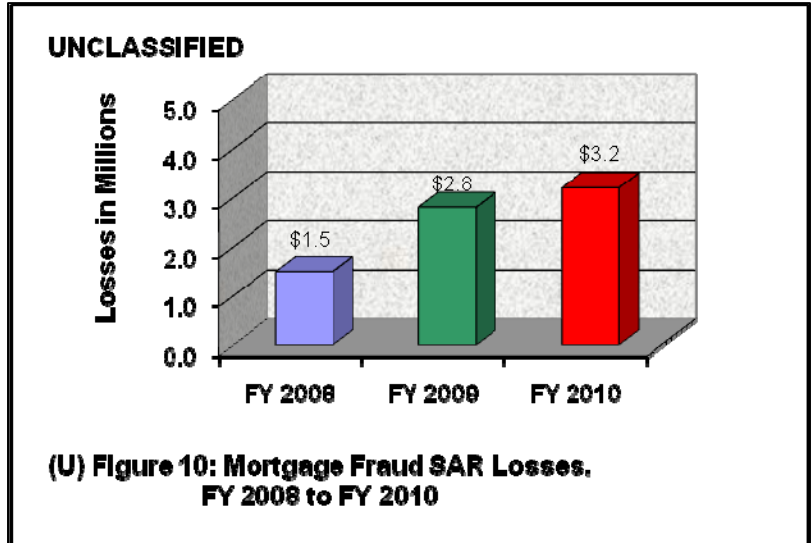
(U) *Financial Institution Reporting of Suspicious Mortgage Fraud Related Activity Increases - FinCEN*

(U) SARs filed by financial institutions indicate that there were 70,533 mortgage fraud-related SARs filed with FinCEN in FY 2010—a 5 percent increase from FY 2009 and an 11 percent increase from FY 2008 filings (see Figure 9).^c

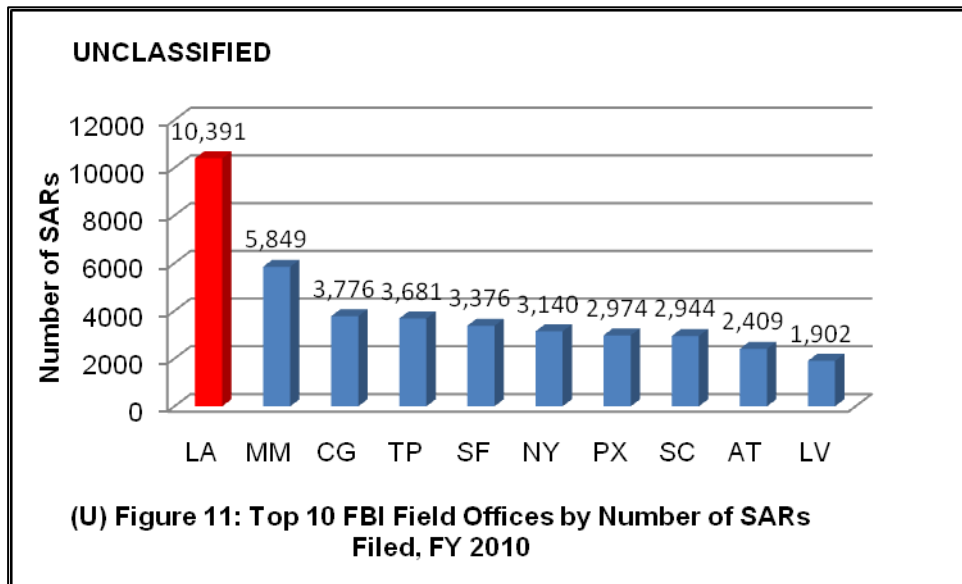


^c (U) Mortgage Loan Fraud (MLF) SAR time lag versus fraud reporting for calendar year 2009: SAR filers reported suspicious activities that were more than a year old in 77 percent of MLF SARs; fourth quarter mortgage loan fraud SAR filings indicated that 65 percent of reported activities occurred more than two years prior to the filing compared with 43 percent in the fourth quarter of 2008. Source: FinCEN, April 2010.

(U) SARs reported in FY 2010 revealed \$3.2 billion in losses, a 16 percent increase from FY 2009 and a 117 percent increase from FY 2008 (see Figure 10). Only 25 percent of SARs in FY 2010 reported a loss, compared with 22 percent reporting a loss (\$2.8 billion) in FY 2009 and also compared with 11 percent reporting a loss (\$1.5 billion) in FY 2008.

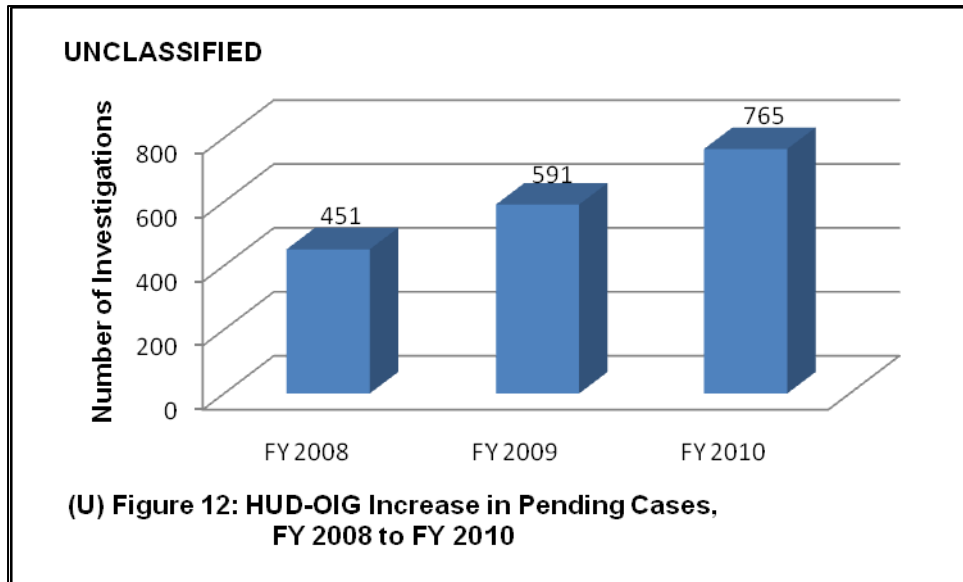


(U) The Los Angeles, Miami, Chicago, Tampa, San Francisco, New York, Phoenix, Sacramento, Atlanta, and Las Vegas FBI Field Offices reported the largest number of SARs filed in FY 2010 (see Figure 11). Eight of the top 10 (Los Angeles, Miami, Tampa, San Francisco, Chicago, Sacramento, New York, and Atlanta) were consistently ranked in the top 10 for the last three years.



(U) U.S. Department of Housing and Urban Development-Office of Inspector General

(U) In FY 2010, HUD-OIG had 765 pending single-family residential loan investigations, a 29 percent increase from the 591 pending during FY 2009.³⁵ This also represented a 70 percent increase from the 451 pending during FY 2008 (see Figure 12 on page 15). Fraud schemes reported by HUD in ongoing investigations include flopping, reverse mortgages, builder bailout schemes, short sales, and robo-signing.³⁶



(U) According to HUD, the preventloanscams.org website has received more than 11,416 complaints as of December 31, 2010, with associated losses of more than \$23 million.³⁷

(U) *LexisNexis - Mortgage Asset Research Institute*

(U) During 2010, Florida, New York, California, New Jersey, Maryland, Michigan, Virginia, Ohio, Colorado, and Illinois were MARI's top 10 states for reports of mortgage fraud across all originations.³⁸ While half of the states in the top 10 are located in the Northeast, Florida has continued to rank first in fraud reporting since 2006, and its fraud rate was more than three times the expected amount of reported mortgage fraud for its origination volume in 2010.³⁹ Additionally, MARI reports that 27 percent of *all* reported loans with fraud investigated (post-funding) in 2010 were for Florida properties.

(U) MARI reports that misrepresentation on loan applications and verifications of deposit along with appraisal and valuation issues, presented the most egregious problems in 2010 originations.⁴⁰

(U) *Interthinx*

(U) The top 10 states for possible fraudulent activity based on 2010 loan application submissions to Interthinx were Nevada, Arizona, California, Michigan, Florida, Colorado, Minnesota, Georgia, Rhode Island, and Massachusetts.⁴¹ According to Interthinx's 2010 Annual Mortgage Fraud Risk Report, the states with the highest overall levels of mortgage fraud risk correlate closely to the states with the highest levels of foreclosure activity and underwater borrowers. Additionally, they report a strong correlation between mortgage fraud risk and foreclosure activity that is consistent with fraud schemes such as flopping and foreclosure-rescue-related schemes.

(U) *Fannie Mae*

(U) Fannie Mae's top 10 mortgage fraud states based on significant misrepresentations discovered by the loan review process through the end of December 2010 were California, New York, Florida, Illinois, Texas, New Jersey, Arizona, Georgia, Alabama, and Michigan.

(U) According to Fannie Mae, short sale, foreclosure rescue, and real estate owned (REO) sales fraud continue to thrive as a result of the opportunities created by defaulting markets. For example, Fannie Mae is investigating fraud schemes perpetrated by real estate agents who manipulate Multiple Listing Services (MLS) data to bolster sagging sales prices. Fannie Mae continues to investigate REO flipping involving real estate agents who withhold competitive offers on REO properties so that they can control the acquisition and subsequent flip.

(U) In 2010 Fannie Mae reported the occurrence of loan origination fraud in the form of affinity fraud, reverse mortgages, condo conversion, and multi-family fraud schemes and stated that Fannie Mae is witnessing a shift in loan origination fraud from the Southeast to the Northeast.⁴² Servicing fraud reported by Fannie Mae includes short sale fraud, fraud involving REOs, and loan modifications. Current reverse mortgage fraud schemes reported by Fannie Mae include the use of asset misrepresentation, occupancy fraud, and identity theft. Condo conversions currently represent 14 percent of Fannie Mae's mortgage fraud investigations. Fraudsters are using payment abatements to delay defaults, inflated property values, and failure to disclose debt. In a majority of these schemes, the fraudsters made 15-18 payments before defaulting. Fraud involving multi-family properties includes valuation fraud, in which fraudsters misrepresent the condition of the rehabilitated units or factor in incomplete renovations—perpetrators divert funds to their own companies but do not complete the renovations. Perpetrators are also falsifying occupancy rates on their rent rolls and flipping properties to non-arms-length purchasers.

(U) CoreLogic

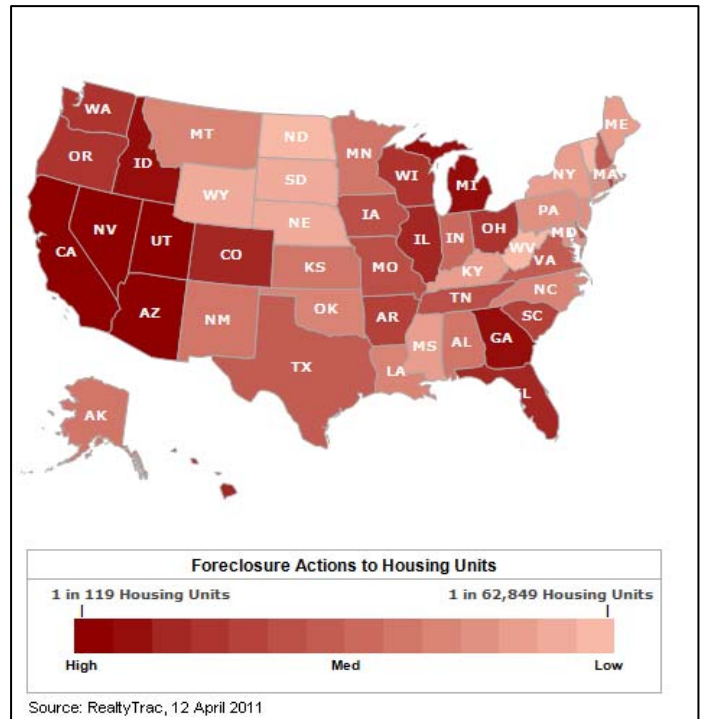
(U) CoreLogic reported a 20 percent increase in mortgage fraud and approximately \$12 billion in originated fraud loan amounts in 2010 (which is flat due to declining origination volumes).⁴³ While the majority of fraud reported by lenders involves income misrepresentation, there has been an 8 percent decrease in this fraud type from 2009 to 2010,⁴⁴ while there were increased occurrences of occupancy, employment, and undisclosed debt for the same period.

(U) CoreLogic also reports that mortgage fraud is becoming increasingly well-hidden and that lenders are reporting increases in hidden frauds such as short sale fraud, REO flipping fraud, and closing agent embezzlement. They are also seeing an increased frequency of flipping and straw buyer schemes in FHA loans.

(U) RealtyTrac

(U) According to RealtyTrac, a record 2.9 million homes received foreclosure filings in 2010 (up from 2.8 million in 2009) as the problem became more widespread due to high unemployment (see Figure 13).⁴⁵ As in previous years, California, Florida, Nevada, and Arizona top the list of states with the highest rates of foreclosure.

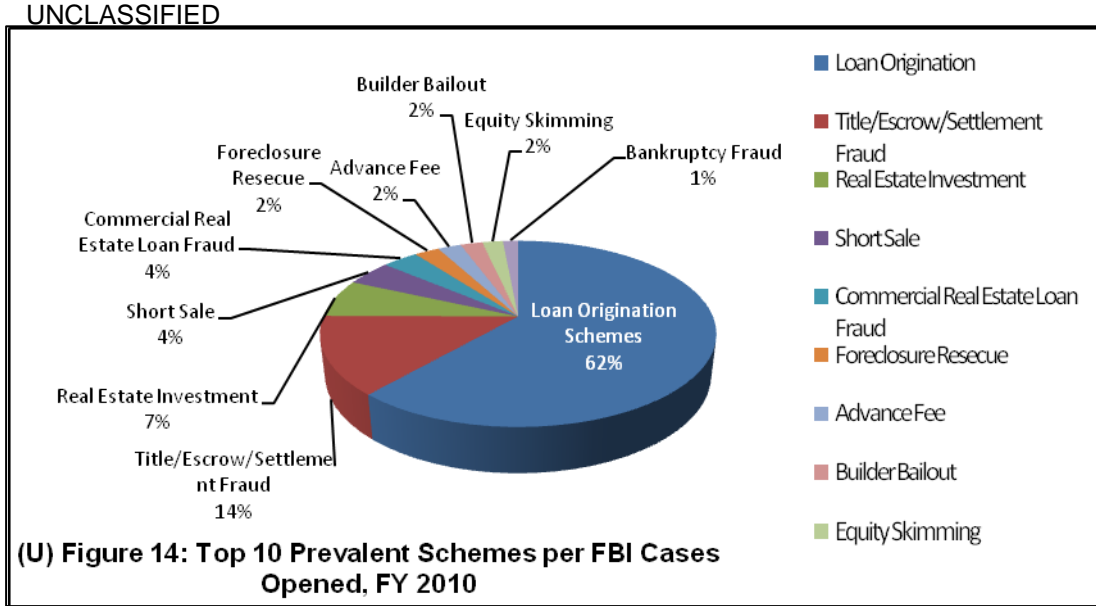
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(U) Figure 13: Measure of Foreclosure Actions to Housing Units as of April 2011

(U) Current Schemes & Techniques

(U) An analysis of FBI reporting revealed that the most prevalent mortgage fraud schemes identified in FY 2010 included loan origination schemes (to include property flipping), followed by settlement-related schemes (to include kickbacks), real estate investment schemes, short sale schemes, commercial real estate loan frauds, foreclosure rescue schemes, advance fee schemes, builder bailout schemes, equity skimming schemes, and bankruptcy fraud (see Figure 14).



(U) Loan Origination Schemes

(U) Mortgage loan origination fraud is divided into two categories: fraud for property/housing and fraud for profit. Fraud for property/housing entails misrepresentations by the applicant for the purpose of purchasing a property for a primary residence. This scheme usually involves a single loan. Although applicants may embellish income and conceal debt, their intent is to repay the loan. Fraud for profit, however, often involves multiple loans and elaborate schemes perpetrated to gain illicit proceeds from property sales. Gross misrepresentations concerning appraisals and loan documents are common in fraud for profit schemes, and participants are frequently paid for their participation.

(U) Loan origination fraud schemes remain a constant fraud scheme. These schemes involve falsifying a borrower’s financial information—such as income, assets, liabilities, employment, rent, and occupancy status—to qualify the buyer, who otherwise would be ineligible, for a mortgage loan. This is done by supplying fictitious bank statements, W-2 forms, and tax return documents to the borrower’s favor. Perpetrators may also employ the use of stolen identities. Specific schemes used to falsify information include asset rental, backwards application, and credit enhancement schemes.

(U) Freddie Mac is reporting that the loan origination frauds they are witnessing include false documents, property flips with phantom rehabilitation, fictitious assets, and fabricated payroll documents.⁴⁶ Fraudsters are also using phantom rehabilitations to increase the property values.

However, Freddie Mac has been interviewing borrowers and their neighbors to determine if the rehabilitations are actually occurring. Also, Freddie Mac is reporting that fraudsters continue to use transactional “lenders” such as the “dough for a day” businesses that “loan” potential borrowers money so that underwriters will see they have assets when conducting their “proof of funds” due diligence risk assessment on the loan application.

(U) Backwards Application Scheme

(U) In a backwards application scheme, the mortgage fraud perpetrator fabricates the unqualified borrower’s income and assets to meet the loan’s minimum application requirements. Incomes are inflated or falsified, assets are created, credit reports are altered, and previous residences are altered to qualify the borrower for the loan.

(U) Fraudulently Inflated Appraisals

(U) Mortgage fraud perpetrators fraudulently inflate property appraisals during the mortgage loan origination process to generate false equity that they will later abscond. Perpetrators will either falsify the appraisal document or employ a rogue appraiser as a conspirator in the scheme who will create and attest to the inflated value of the property. Fraudulent appraisals often include overstated comparable properties to increase the value of the subject property.

(U) Illegal Property Flipping

(U) Illegal property flipping is a complex fraud that involves the purchase and subsequent resale of property at greatly inflated prices. The key to this scheme is the fraudulent appraisal, which occurs prior to selling the property. The artificially inflated property value enables the purchaser to obtain a greater loan than would otherwise be possible. Subsequently, a buyer purchases the property at the inflated rate. The difference between what the perpetrator paid for the property and the final purchase price of the home is the perpetrator’s profit.

(U) Traditionally, any exchange of property occurring twice on the same day is considered highly suspect for illegal property flipping and often is accompanied by back-to-back closings where there is a purchase contract and a sales contract that are both presented to the same title company. FBI combined intelligence and case reporting for FY 2010 indicates that property flipping is occurring in 47 out of 56 field office territories. The fraud continues to involve the use of fraudulent bank statements, W-2s, and pay stubs; the use of straw buyer investors to purchase distressed properties for alleged rehabilitation; perpetrators receiving cash-back at closing; and the failure to make the first mortgage payment. This type of fraud often results in foreclosure. FBI information indicates the top 10 states reporting same-day property flips (as recorded by county clerk’s offices throughout the United States) in 2010 were Florida, Ohio, Georgia, Minnesota, Hawaii, Michigan, Tennessee, New York, Maryland, and Washington.

(U) Among other industry sources reporting significant property flipping, Interthinx reports that it is still prevalent and trending upward.⁴⁷ Current property flipping schemes reported by Interthinx involve fraud against servicers; piggybacking on bank accounts to qualify for mortgages; and forgeries. HUD reporting indicates the use of limited liability companies (LLCs) to perpetrate fraudulent property flipping.⁴⁸

(U) Title/Escrow/Settlement Fraud/Non-Satisfaction of Mortgage

(U) A review of FBI cases opened in 2010 indicates that 38 percent of FBI field offices are reporting some form of title/escrow/settlement fraud. The majority of these frauds involve the diversion or embezzlement of funds for uses other than those specified in the lender's closing instructions. Associated schemes include the failure to satisfy/pay off mortgage loans after closings for refinances; the reconveyance or transfer of property without the homeowner's knowledge or consent; the failure to record closing documents such as property deeds; the recording of deeds without title insurance but charging the homeowner and absconding with the money; the use of settlement funds intended to pay subcontractors by general contractors to pay debts on previous projects; the use of dry closings; the delayed recording of loans; the filing of fraudulent liens to receive cash at closing; and the distribution of settlement funds among co-conspirators.

(U) According to a review of FBI investigations opened in FY 2010, title agents and settlement attorneys in at least 21 investigations in 14 field office territories are involved in non-satisfaction of mortgage schemes. They are engaged in misappropriating and embezzling more than \$27 million in settlement funds for their own personal use rather than using those escrowed funds to satisfy/pay off mortgages as directed per lender instructions provided at closing. Perpetrators diverted escrow monies intended for lenders to themselves or to entities that they controlled. In addition to embezzling escrow funds, perpetrators are also falsifying deeds, recording deeds without title insurance, and failing to record deeds and taxes.

(U) Real Estate Investment Schemes

(U) In a real estate investment scheme, mortgage fraud perpetrators persuade investors or borrowers to purchase investment properties generally at fraudulently inflated values. Borrowers are persuaded to purchase rental properties or land under the guise of quick appreciation. Victim borrowers pay artificially inflated prices for these investment properties and, as a result, experience a personal financial loss when the true value is later discovered. Analysis of FBI cases opened in FY 2010 revealed that 43 percent of FBI field offices are reporting this activity with losses exceeding \$76 million.

(U) Short Sale Schemes

(U) A real estate short sale is a type of pre-foreclosure sale in which the lender agrees to sell a property for less than the mortgage owed. Short sale fraud consists of false statements made to loan servicers or lenders that take the form of buyer or seller affirmations of no hidden relationships or agreements in place to resell the property, typically for a period of 90 days. One of the most common forms of a short sale scheme occurs when the subject is alleged to be purchasing foreclosed properties via short sale, but not submitting the "best offer" to the lender and subsequently selling the property in a dual closing the same day or within a short time frame for a significant profit. Reverse staging and comparable shopping techniques are currently being used by fraud perpetrators in the commission of short sale frauds. The fraud primarily occurs in areas of the country that are experiencing high rates of foreclosure or homeowner distress.

(U) Industry participants are reporting that short sale fraud schemes continue to be an increasing threat to the mortgage industry. A recent CoreLogic study indicated that short sale volume has

tripled from 2009 to 2010.⁴⁹ In June 2010, Freddie Mac reported that short sale transactions were up 700 percent compared to 2008.

(U) Industry sources report that in the process of committing short sale fraud, fraudsters are manipulating the Broker Price Opinions (BPOs) and MLS; engaging in non-arms-length transactions;⁵⁰ using LLCs to hide their involvement in short sale transactions;⁵¹ failing to record short sale deeds of trust; using back-to-back and multiple real estate agent closings; selling properties to an LLC or trust months before the sale;⁵² selling the property to a family member or other party the fraudsters control and deeding the property back to themselves; engaging in escrow thefts, simultaneous double sales to Fannie Mae and Freddie Mac, and failing to pay off the original loan in a refinance transaction; property flopping;⁵³ bribing brokers and appraisers; refusing to allow the broker or appraiser access to the property unless the fraudster is present; providing their own comparables to the appraiser; taking unflattering photographs of the property and pointing out defects in the property to the appraiser;⁵⁴ providing false estimates of repair, rebuttal of appraisal, and selection of poor comparable properties;⁵⁵ and facilitating the partnership of attorneys with non-attorneys to split fees acquired during short sale negotiations.⁵⁶

(U) Commercial Real Estate Loan Fraud

(U) Commercial real estate loan fraud continues to mirror fraud in the residential mortgage loan market. Law enforcement investigations indicate that perpetrators such as real estate agents, attorneys, appraisers, loan officers, builders, developers, straw buyer investors, title companies, and others are engaged in same-day property flips; the falsification of financial documents, performance data, invoices, tax returns, and zoning letters during origination; the diversion of loan proceeds to personal use; the misrepresentation of assets and employment; the use of inflated appraisals; and money laundering.

(U) FBI reporting indicates that some commercial real estate-driven bank failures may expose insider and accounting fraud in regional and community banks.⁵⁷ According to FBI analysis, these frauds are emerging in addition to the residential mortgage frauds still being found in roughly half of all bank failures investigated by the FBI.⁵⁸ FBI case information and open source financial reporting indicates some executives and loan officers may resort to issuing fraudulent loans, dishonest accounting, or other criminal activity to disguise the poor financial conditions of their institutions. A review of banks that failed due to overexposure to commercial real estate debt during the boom years revealed that a small percentage showed fraudulent commercial real estate activity, attempts to hide bank financial conditions, and insider loan schemes through which executives and other insiders benefited by controlling lending decisions.

(U) The Congressional Oversight Panel examined commercial real estate losses and financial stability in February 2010 and found that poor-performing loans and defaults would affect banks into 2011 and beyond.⁵⁹ Some banks are also extending the terms of some poor-performing commercial real estate loans, pushing the potential loan default dates past 2011.⁶⁰

(U) Foreclosure Rescue

(U) Foreclosure rescue schemes are often used in association with advance fee/loan modification program schemes. The perpetrators convince homeowners that they can save their homes from foreclosure through deed transfers and the payment of up-front fees. This “foreclosure rescue”

often involves a manipulated deed process that results in the preparation of forged deeds. In extreme instances, perpetrators may sell the home or secure a second loan without the homeowners' knowledge, stripping the property's equity for personal enrichment. For example, the perpetrator transfers the property to his name via quit claim deed and promises to make mortgage payments while allowing the former home owner to remain in the home paying rent. The perpetrator profits from the scheme by re-mortgaging the property or pocketing fees paid by desperate homeowners. Often, the original mortgage is not paid off by the perpetrator and foreclosure is only delayed.

(U) Financial industry reporting indicates that foreclosure rescue schemes remain a current threat.⁶¹ Analysis of FBI intelligence reporting indicates that foreclosure rescue schemes were the sixth-highest reported mortgage fraud scheme in FY 2010. According to FBI case analysis, mortgage fraud foreclosure rescue investigations comprised two percent of all mortgage fraud cases opened in FY 2010.

(U) Advance Fee Schemes

(U) Mortgage fraud perpetrators such as rogue loan modification companies, foreclosure rescue operators, and debt elimination companies use advance fee schemes, which involve victims paying up-front fees for services that are never rendered, to acquire thousands of dollars from victim homeowners, and straw buyers.

(U) Builder Bailout Schemes

(U) Builders are employing builder bailout schemes to offset losses and circumvent excessive debt and potential bankruptcy as home sales suffer from escalating foreclosures, rising inventory, and declining demand. Builder bailout schemes are common in any distressed real estate market and typically consist of builders offering excessive incentives to buyers, which are not disclosed on the mortgage loan documents. In a common scenario, the builder has difficulty selling the property and offers an incentive of a mortgage with no down payment. For example, a builder wishes to sell a property for \$200,000. He inflates the value of the property to \$240,000 and finds a buyer. The lender funds a mortgage loan of \$200,000 believing that \$40,000 was paid to the builder, thus creating home equity. However, the lender is actually funding 100 percent of the home's value. The builder acquires \$200,000 from the sale of the home, pays off his building costs, forgives the buyer's \$40,000 down payment, and keeps any profits.

(U) Equity Skimming Schemes

(U) Equity skimming schemes occur when mortgage fraud perpetrators drain all of the equity out of a property. For example, perpetrators charge inflated fees to "help" homeowners profit by refinancing their homes multiple times and thus skimming the equity from their property. A perpetrator will also help a homeowner establish a home equity line on a property. The perpetrator then encourages the homeowner to access these funds for investment in various scams.

(U) Debt Elimination/Reduction Schemes

(U) FBI reporting indicates a continued effort by Sovereign Citizen domestic extremists throughout the United States to perpetrate and train others in the use of debt elimination schemes. Victims pay advance fees to perpetrators espousing themselves as “sovereign citizens” or “tax deniers” who promise to train them in methods to reduce or eliminate their debts. While they also target credit card debt, they are primarily targeting mortgages and commercial loans, unsecured debts, and automobile loans. They are involved in coaching people on how to file fraudulent liens, proof of claim, entitlement orders, and other documents to prevent foreclosure and forfeiture of property.

(U) Legislative Issues*(U) Dodd-Frank Act*

(U) The Dodd Frank Act (DFA) was created to address various issues that occurred during the financial crisis. According to MBA, the DFA will establish the Consumer Financial Protection Bureau (CFPB) and set strict standards and regulations for processing mortgage loans.⁶² To protect consumers from fraud, the CFPB will: (1) regulate strict guidelines for appraisers and licensing to appraisal management companies; (2) oversee and have total responsibility for consumer financial protection laws;^d (3) add more layers to disclosures, licensing, and process regulation with loan originators, reverse mortgages, mortgage companies, and advertising practices; and (4) harmonize the TILA and RESPA disclosure.^{63,64}

(U) The new act will prohibit the use of BPOs as the primary benchmark for the value of a property being purchased.⁶⁵ Additionally, the CFPB will oversee consumer protection laws, including TILA and RESPA.⁶⁶ The DFA will require lenders to be accountable for the cost it provides to borrowers during the loan application process.⁶⁷ The legislation will modernize the real estate appraisal regulation by enforcing actions against states and appraisers that do not abide by the new regulation.⁶⁸ Also, there will be a new appraisal standard board and appraisers should follow the new regulations.⁶⁹ The DFA is set to better regulate consumer protection laws and help reform Fannie Mae and Freddie Mac.⁷⁰

(U) Federal Trade Commission’s (FTC) Mortgage Assistance Relief Services (MARS) Rule

(U) The FTC rule on MARS prohibits charging advance fees for loan modification services, but states that attorneys are the exception to the rule and are therefore permitted to charge an advance fee provided some stipulations are met.⁷¹

(U) According to the FTC’s MARS, a company cannot charge an up-front fee for a loan modification until it provides the homeowner a written offer for the modification or other relief from their lender and the homeowner accepts the offer.⁷² The company must also provide the homeowner with a document from its lender showing the changes to the homeowner’s loan if the homeowner decides to move forward with the modification. In addition, the company must clearly disclose the total fee charged for its services. MARS also requires that companies spell out

^d (U) Including Real Estate Settlement Procedure Act (RESPA), Truth in Lending Act (TILA), Home Ownership and Equity Protection Act (HOEPA), and Home Mortgage Disclosure Act (HMDA).

important information in their advertisements and telemarketing calls, such as disclaimers and consequences for securing their services.

(U) The Secure and Fair Enforcement Act

(U) The Secure and Fair Enforcement (SAFE) for Mortgage Licensing Act—enacted in July 2008— required states to have a licensing and registration system in place for all loan originators by July 31, 2010, to reduce mortgage fraud and enhance consumer protection.

(U) FBI Response

(U) With elevated levels of mortgage fraud, the FBI has continued to dedicate significant resources to the threat. In June 2010, the DOJ, to include the FBI, announced a mortgage fraud takedown referred to as Operation Stolen Dreams. The takedown targeted mortgage fraudsters throughout the country and was the largest collective enforcement effort ever brought to bear in combating mortgage fraud. Operation Stolen Dreams involved 1,215 criminal defendants and included 485 arrests, 673 informations and indictments, and 336 convictions. The defendants were allegedly responsible for more than \$2.3 billion in losses.

(U) The FBI continues to enhance liaison partnerships within the mortgage industry and law enforcement. As part of the effort to address mortgage fraud, the FBI continues to support 25 mortgage fraud task forces and 67 working groups. The FBI also participates in the DOJ National Mortgage Fraud and National Bank Fraud Working Groups, as well as the Financial Fraud Enforcement Task Force (FFETF). The FFETF's mission is to enhance the government's effectiveness in sharing information to help prevent and combat financial fraud.

(U) The FBI continues to foster relationships with representatives of the mortgage industry to promote mortgage fraud awareness and share intelligence. FBI personnel routinely participate in various mortgage industry conferences and seminars, including those sponsored by the MBA. Collaborative educational efforts are ongoing to raise public awareness of mortgage fraud schemes through the publication of the annual Mortgage Fraud Report and the Financial Crimes Report to the Public, and through the dissemination of information jointly or between various industry and consumer organizations. Analytic products are routinely distributed to a wide audience, including public and private sector industry partners, the intelligence community, and other federal, state, and local law enforcement partners.

(U) The FBI employs sophisticated investigative techniques, such as undercover operations and wiretaps, which result in the collection of valuable evidence and provide an opportunity to apprehend criminals in the commission of their crimes. This ultimately reduces the losses to individuals and financial institutions. The FBI has also instituted several intelligence initiatives to support mortgage fraud investigations and has improved law enforcement and industry relationships. The FBI has established methodology to proactively identify potential mortgage fraud targets using tactical analysis coupled with advanced statistical correlations and computer technologies.

(U) Outlook

(U) In a thriving economy, loan originations for both new purchases and refinances are plentiful. Schemes which thrive in such an economy include loan origination fraud, property flips, and equity conversion schemes. In a sluggish economy, delinquency and foreclosure rates soar, and loan originations slow dramatically. In this economy, the most prevalent schemes are those which target distressed homeowners, including foreclosure rescue, loan modification, and short sales.

(U) The FBI assesses that the current and continuing depressed housing market will likely remain an attractive environment for mortgage fraud perpetrators who will continue to seek new methods to circumvent loopholes and gaps in the mortgage lending market. These methods will likely remain effective in the near term, as the housing market is anticipated to remain stagnant through 2011. Market participants are expected to continue employing and modifying old schemes and are likely to increasingly adopt new schemes in response to tighter lending practices.

(U) Appendix - Sources

(U) **CoreLogic** – CoreLogic is the nation’s largest provider of advanced property and ownership information, analytics, and solutions. The company’s database covers more than 3,000 counties, representing 97 percent of U.S. real estate transactions. CoreLogic obtains property records, tax assessments, property characteristics, and parcel maps from tax assessors and county recorder offices across the nation and combines this data with flood, demographic, crime, site inspection, neighborhood, document image, and other information from proprietary sources.

(U) **Fannie Mae** – Fannie Mae is the nation’s largest mortgage investor. To aid in mortgage fraud prevention and detection, the company publishes mortgage fraud statistics and mortgage fraud news articles and provides recorded training modules and fraud reference tools on their eFannieMae.com website.

(U) **FinCEN** – Established by the U.S. Treasury Department, the Financial Crimes Enforcement Network’s mission is to enhance U.S. national security, deter and detect criminal activity, and safeguard financial systems from abuse by promoting transparency in the U.S. and international financial systems. In accordance with the Bank Secrecy Act, SARs filed by various financial entities are collected and managed by FinCEN and used in this report.

(U) **Interthinx** – Interthinx, Inc. is a provider of risk mitigation and regulatory compliance tools for the financial services industry. The Interthinx Fraud Risk Indices consist of the Mortgage Fraud Risk Index and the Property Valuation, Identity, Occupancy, and Employment/Income Indices, which measure the risk of these specific types of fraudulent activity. The Interthinx Fraud Risk Report represents an in-depth analysis of residential mortgage fraud risk throughout the United States as indicated by the Interthinx Fraud Risk Indices.

(U) **LexisNexis Mortgage Asset Research Institute** – MARI maintains the Mortgage Industry Data Exchange (MIDEX) database, which contains information submitted by mortgage lenders, agencies, and insurers describing incidents of alleged fraud and material misrepresentations. MARI releases a report highlighting the geographical distribution of mortgage fraud based on these submissions. MARI ranks the states based on the MARI Fraud Index (MFI), which is an indication of the amount of mortgage fraud discovered through MIDEX.

(U) **Mortgage Bankers Association** – The Mortgage Bankers Association is the national association representing the real estate finance industry. The MBA is a good source of information for regulatory, legislative, market, and industry data.

(U) **RealtyTrac** – RealtyTrac is the leading real estate marketplace for foreclosure properties and publishes the country’s largest and most comprehensive foreclosure database with more than 1.5 million default, auction, and bank-owned homes from across the country.

(U) **U.S. Department of Housing and Urban Development-Office of Inspector General** – HUD-OIG is charged with detecting and preventing waste, fraud, and abuse in relation to various HUD programs, such as single- and multi-family housing. As part of this mission, HUD-OIG investigates mortgage fraud-related waste, fraud, and abuse of HUD programs and operations.

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