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Schemes to hijack the American dream

Part 2 of 5: Inside real estate's fraud crisis

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Inman News

Editor's note: In this five-part series, Inman News examines the rising tide of mortgage fraud in the U.S., giving an overview of the problem, describing how it works, explaining obstacles to fighting it and describing technologies that combat it and legislation that aims to defeat it. To read the entire five-part report, "Inside real estate's fraud crisis," with two bonus stories, subscribe to Inman News*.*

The dilapidated Detroit house had collapsed, leaving only the roof visible, riddled with holes. And, the FBI discovered, it had sold for $25,000 one day and $250,000 the next – an egregious example of one of the most common types of mortgage fraud: the property flip.

For a long time, property flips were the most common type of mortgage fraud. Now, occupancy fraud and "chunking" are making gains, experts say, with a plethora of other swindles close behind.

Residential real estate loan fraud is a national epidemic, costing communities nationwide an estimated $1 billion in 2005, compared to $429 million in 2004, according to the Federal Bureau of Investigation. In this five-part series, *Inman News* examines the rising tide of mortgage fraud in the U.S. This part focuses on the schemes fraudsters use to hijack the American dream.

Flipping isn't always illegal, if it involves nothing more than a legitimate buyer selling a house soon after buying it.

In an illegal flip, any of a number of elements can be problematic, but the key element usually is the appraisal, according to experts such as Robert Walker, an executive vice president at First American Real Estate Solutions. To qualify for a mortgage loan, there must be an appraisal justifying the amount of the loan. Since the illegal property flip involves buying a house, then quickly selling it for more than it's worth, a crooked appraisal is pivotal.

Flipping is an example of what the FBI calls fraud for profit. According to the FBI, 80 percent of mortgage fraud is fraud for profit – industry professionals committing the crime to make money, as opposed to individuals fudging applications to buy a house, which is fraud for housing.

A typical flip often involves a straw buyer – a person who agrees to lend their name and credit to the transaction but doesn't intend to actually be responsible for the property.

Fraudsters sometimes offer cash to people in exchange for using their names and credit to buy a house, according to experts such as mortgage banking attorney Rachel Dollar, who represents lenders in mortgage-fraud cases.Some fraudsters have even advertised for straw buyers on eBay. Another popular ploy: a fraudster will steal someone's identity and effect the sale in their name.

So, Frank Fraudster buys the Detroit house mentioned above for $25,000. He gets a crooked appraiser to say the house is worth $250,000 – after all, the loan officer doesn't know it's a wreck. The straw buyer buys the house for $250,000 and Fred gets the sales proceeds. Bingo. A nearly $225,000 profit for Mr. Fraudster. Fred gets his money during the closing and directly from the closing attorney, as he's the seller.

Mortgage fraud can affect entire neighborhoods, as fraudsters often concentrate in specific areas, according to the Georgia Real Estate Fraud Prevention Awareness Coalition. Deteriorated and damaged homes, squatters, drug dealing, foreclosures and worse have devastated formerly flourishing neighborhoods – not to mention the damage done to individuals whose identity was used in such schemes.

There are a million variations on the flipping theme. Because lenders are now so aware of the tactic, "now people assign sales contracts (and use other machinations) in order to keep the flip off the record," according to Dollar.

"Chunking" is another common scam, Dollar said. In this scheme, the fraudster holds a seminar on how to get rich quick, convincing attendees to become investors.

The seminar producer promises to locate properties, get tenants, pay the mortgage and then sell the property - then gets inflated appraisals on dilapidated homes, sells the homes to the investors for the artificially high value but doesn't get the promised renters. Then, according to Dollar, "the mortgage goes into foreclosure and the 'investors' are left holding the bag."

In foreclosure rescue schemes, fraudsters victimize owners of properties in foreclosure, promising to help them but usually ending up owning the properties themselves with no hope of the owners recovering them, Dollar said. The attorney said the industry is seeing "sharp increases" in this type of fraud. "We are beginning to see a rise in consumers victimized in these schemes while attempting to obtain refinancings," Dollar said.

Another scheme on the upswing: occupancy fraud, the most common type of mortgage fraud reported in the first half of 2005, according to the Prieston Group, which insures lenders against mortgage fraud. In this type of fraud, borrowers – or someone acting on behalf of borrowers – misrepresent whether they plan to live at the property.

"Stated income" is another widespread form of fraud, experts say. "Borrower can't afford the house because their debt ratios are too high. Loan officer says, 'Gee, Mr. and Mrs. Borrower, if I put you in this stated income program, we can say that you make any income you want!'" said Matt Norris, a loan officer at Gateway Mortgage Group in Columbia, Mo.

While it might seem like a loan officer is doing a client a favor by helping them qualify for a home, the officer isn't doing anybody any favors if they end up buying a house they can't support, experts say of this type of fraud.

These are some of the most common forms of mortgage fraud, but by no means all of them. As Norris said, "Mortgage fraud problems are hardly limited to the mortgage companies and lenders. Some of the schemes that have been carried out would make your head spin."

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