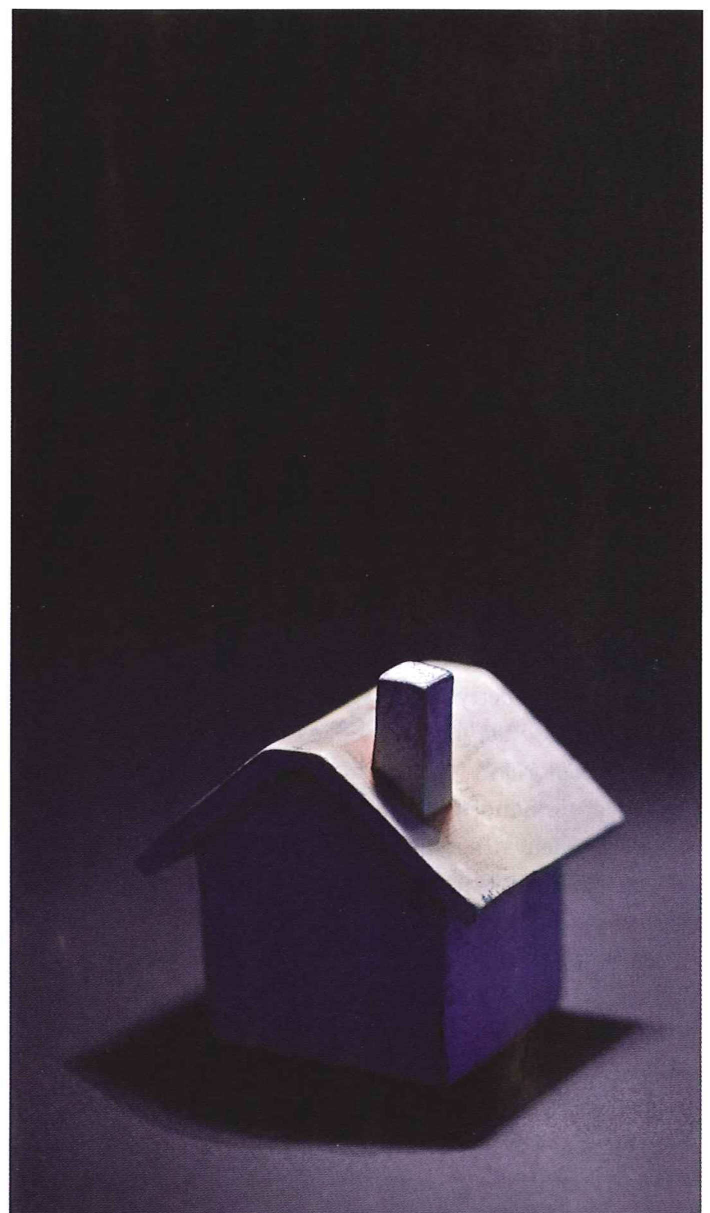
If it Sounds too Good to be True

Identifying and Avoiding Common Mortgage Fraud Scams

by Michael O'Donnell and Katherine Planer

According to a 2008 study by the Mortgage Asset Research Institute, the number of suspicious activity reports connected to mortgage fraud rose 31 percent between 2006 and 2007.[1] These scams occur right in our own backyard: As recently as June 30, 2008, the Center for Social Justice at Seton Hall University School of Law filed a class-action lawsuit on behalf of low- and moderate-income individuals deceived by a property-flipping and real estate fraud scheme inducing them to buy homes in the Newark area as investment properties.[2]



Experts maintain that the best way to combat mortgage fraud is through increased education and awareness on the part of homeowners and third parties, including real estate lawyers associated with the sale or purchase of a home.[3] This article provides a brief overview of the more common mortgage fraud scams.

There are two basic categories of mortgage fraud: fraud for property and fraud for profit. Fraud for property "entails . . . misrepresentations by the applicant solely for the purpose of purchasing a property."[4] Fraud for profit is much more complex, typically involving "multiple loans and elaborate schemes perpetrated to gain illicit profit from property sales."[5] This article addresses the latter, identifying some specific types of mortgage fraud for profit based on actual encounters of individuals who fell victim to the scams. The schemes discussed are by no means exhaustive, but merely represent some of the most innovative and popular types of scams at the moment. Finally, the article offers some tips about how those in the field can avoid unwitting involvement in mortgage fraud.

Foreclosure Rescue

The foreclosure rescue scam is one of the more increasingly popular varieties of mortgage fraud. Although the term is used to describe a number of fraudulent tactics, the more dangerous ones from a homeowner's perspective are the bailout and the bait-and-switch.

In the bailout situation, a homeowners' rescue service contacts a homeowner on the verge of foreclosure and offers to save the individual's house. These rescue services are typically run by individuals who offer to stop foreclosure instantly, and tempt desperate homeowners with promises of immediate debt relief and cash.[6]

In many situations, the representatives from the rescue service shroud themselves in a veil of legitimacy, showing up at a homeowner's doorstep and claiming to be from a well-known real estate company or mortgage brokerage firm, and presenting official-looking identification and qualifications.[7] Generally, the homeowner is then induced to sign documents, which typically include a sale agreement from the homeowner to the rescue service for nominal consideration. Sometimes the agreement is merely to refinance the mortgage, which is an undertaking the homeowner could engage in on his or her own, but instead pays the rescue service a great deal of money to perform. In many instances, despite this process, the foreclosure still proceeds, although the homeowner may be unaware of that fact.

The homeowner also executes a lease agreement permitting him or her to remain in the home, pay rent to the rescue service (often equal to the amount of the monthly mortgage payment), with an option to "buy back" the home after a set period of time, usually for an exorbitant fee the homeowner will never be able to afford.[8] The content of these documents is typically not discussed with the homeowner, and the homeowner often does not receive a copy of what he or she signed.[9] The result is that the homeowner is often unable to make rent payments, and is evicted. Even if the homeowner keeps up with the rent, he or she often cannot afford to exercise the option to reclaim the home at the agreed upon escalated purchase price, and the home is lost.[10]

Finally, even where there is no escalated price to buy back the home, or the rescue is simply to pay rent and fees while the service obtains refinancing for the homeowner, the service's efforts to refinance are minimal compared to the size of the lease payments. If refinancing does not occur, the foreclosure is complete, and the homeowner is evicted. Thus, the homeowner grossly overpays for the services with no guarantee of success.

The bait-and-switch variety of foreclosure rescue scams is the most insidious type of fraud. Here, "the homeowner does not realize that he or she is surrendering ownership of the house in exchange for a 'rescue.'"[11] The owner deeds ownership to the rescue service using a quit-claim deed, in an effort to prevent foreclosure.[12] The owner believes he or she is signing documents for a new loan to bring the mortgage up to date.[13] The homeowner is promised that he or she can buy back the home at a later time, but before the homeowner has an opportunity to repurchase, the rescue service has sold the home to another buyer.[14]

As with the bailout scam, individuals from the rescue service are careful not to explain to the homeowner exactly what he or she is signing.[15] These schemes involve fraud and deception in their most fundamental form.

Property Flipping

Property flipping need not denote something that is illegal: In some instances an individual simply purchases a home at a low cost, makes improvements on the property, and resells the home for a profit.[16] In the context of mortgage fraud, however, property flipping involves a series of sham transactions, typically between a gang of fraudsters that might include the seller, buyer, appraiser, mortgage agent, or the attorney for one or more of those parties.

For example, according to the FBI's 2007 Mortgage Fraud Report, a typical example of an illegal property-flipping scheme involves the purchase of a property for $20,000, a fraudulent appraisal of the property for $80,000 and subsequent sale of the property to a straw buyer who obtains an 80-percent loan in the amount of $64,000. The flipper receives a profit of $44,000, and the straw buyer eventually defaults on the mortgage, resulting in foreclosure, leaving the bank with a $64,000 mortgage on a $20,000 home.[17]

Another timely example of this type of fraud is evident in the allegations brought by the Seton Hall Law Center for Social Justice on behalf of a class of purchasers in the Newark area. These individuals were tricked into buying property as an *investment* that was worth far less than the value at which it was appraised by a dishonest appraiser. The flipper assured the purchasers that they would receive more than enough money to cover their monthly mortgage payments on the properties by virtue of the rent they collected off the land, but when the houses remained unfinished and could not be rented, the investors went into default on their loans and eventual foreclosure.[18] Often, however, the straw borrower is part of the fraud, even though in this instance the borrowers were unaware of the scam.

Straw buyers are individuals, either real or fictitious, working in conjunction with the original flipper, who makes a profit through the straw buyer in one of three ways.

One way is through the fraudulent appraisal and mortgage process described above.

Another common example is when the straw buyer is offered a lump sum cash amount up front by the current owner of the home in exchange for using his or her name and credit to purchase the property. Under this scheme, the owner is paid from the sale of the home, and the buyer holds the property for a period of time, failing to make payments, and eventually resulting in foreclosure on the house.[19]

The least typical example of a straw buyer involves a *bona fide* third-party purchaser to whom the straw buyer sells the flipped house, typically for a price far greater than its value.[20] While unfortunately there are some corrupt attorneys who help perpetuate the fraud on the *bona fide* purchaser by representing the straw buyer,[21] some attorneys may be caught unawares in representing the *bona fide* purchaser (BFP), but nonetheless are in a position to observe and extinguish the existing fraud.

The following story exemplifies just such an occurrence. A BFP's attorney ordered a title search prior to closing and found that there was no deed recorded into the current seller. This, in and of itself, is suspicious. The lack of a deed should have raised a red flag for the BFP's attorney. In response to the BFP's attorney's demand to see a deed, the current seller came to the closing with a deed that was a year old, but never recorded. That deed was recorded into the seller, and from the seller into the BFP on the same day. In the end, the BFP discovered that the individual who sold the property to the current seller had been dead for five years, and thus could not have legally sold the property to the current seller on the date of the one-year-old deed. This fact would have been easy for the BFP's attorney to discover if he had thoroughly reviewed the title search, because the judgment search revealed a judgment against the original seller's estate from before she purportedly sold the property to the seller.

Multiple Home Equity Lines of Credit/Manipulating the Gap

Another common fraud occurs when an owner of property applies for multiple home equity lines of credit (HELOCs) from different lenders during the same period of time, and receives multiple loans in excess of the actual equity in the home.[22] HELOCs are desirable "because the homeowner may borrow against the line of credit over a period of time using a checkbook or credit card," thus making them an "easy, fast and inexpensive means to obtain funds."[23] Although lenders conduct a title search to determine if there are any liens on the property, liens from other recently granted HELOCs applied for by the fraudsters do not show up on the search since the applications occurred simultaneously. Thus, eventually multiple HELOCs are issued for one piece of property, totaling "more than the original property purchase price, exceeding the out-of-pocket expenses incurred to secure the property."[24]

Fraudsters take advantage of home equity loans by manipulating the gap—the period of time that elapses between when the loan is filed by the lender with the county clerk's office (and thus an official record of the loan appears on the title), and when it is actually recorded publicly.[25]

In one case from North Carolina, individuals were enticed into an "investment opportunity" and promised "the receipt of eight percent of the loan proceeds at closing, no down payment, a free house in the community and/or $100,000 for each house sold on an investor-owned lot."[26] Once the investor agreed to the scheme, representatives of the fraudster sent each investor "four or five loan applications for different lenders and told them to complete each loan application."[27] The fraudster's agents sent the applications out to lenders at the same time, resulting in multiple loans being granted in the name of the borrowers "because the lenders were unaware of the contemporaneous or very recent credit extensions by other lenders."[28] Thus, the investors had multiple loans far in excess of the value of the home in their names.

Fraudulent Powers of Attorney

There are instances where an individual sells or purchases a piece of property using a fraudulent power of attorney (POA). Completing a property transaction using a power of attorney is a perfectly legitimate procedure, but an attorney should never close on a real estate transaction unless the lender has authorized the use of a POA to complete the deal. Indeed, almost all lender closing instructions direct the closing attorney not to close with a POA without lender consent. But when a POA is used on either end of a transaction, a real estate attorney should conduct some investigation to determine the validity of the POA.

In order to determine whether a POA is valid, and avoid participation in a fraudulent transaction, there are inquiries to be made. The first is determining the effective date of the POA, which in some instances can be immediate upon the POA's execution, or in some instances is a predetermined date in the future.[29] Next is to identify whether it is a durable POA, which is the only type that is still valid after the individual is incapacitated or deemed incompetent.[30]

If the POA is of the limited variety, it may not have the authority to sign off on the type of transaction at hand. Further, an individual presented with a POA as a part of a real estate transaction should inquire into whether the POA has been revoked or terminated.[31] Failure to check the POA for validation leaves parties to a transaction open to fraud, such as the type perpetrated in the flipping example above.

How Scams Can Be Avoided

Attorneys can avoid unknowingly participating in a fraudulent transaction, and falling victim to mortgage scams in their personal lives, by heightening the scrutiny they give to documents relating to real estate closings. The essential element to avoiding fraud is understanding the transaction. An attorney should be careful not to sign off on any agreement that seems even remotely unclear.

For example, in the scenario described in the property-flipping section above, involving the sale of a home by a straw person using a fraudulent deed, the attorney representing the BFP should have been immediately tipped off that something might be awry when there was no deed in the chain of title indicating the sale of the property to the current owner. Although the owner eventually produced a deed, the attorney should have investigated why this one-year-old document was so readily accessible upon request, but was never officially recorded. A thorough review of the judgment search would have unearthed the fraud. Instead, the attorney took the transaction at face value, skimmed the title commitments, and unknowingly permitted the fraudulent activity to continue.

Notices of settlement also should be filed as soon as the upcoming closing date is set. A notice of settlement is a form filed with the county clerk's office denoting the existence of an agreement "convey[ing] legal or equitable title to real estate or any interest therein or creat[ing] any lien thereon by way of a mortgage."[32] Once the notice of settlement is recorded, any liens recorded thereafter will be disregarded if the closing occurs and the deed and/or mortgage is recorded within 45 days, provided the buyer is a *bona fide* purchaser for value who took without notice of the intervening lien.[33] Filing a notice of settlement is one of the best ways to prevent scams taking advantage of the gap.

Above all, as counselors and advisors to clients, attorneys should abide by the mantra if it seems too good to be true, it probably is. Some of the most common instances of mortgage fraud involve situations where the investor, especially in property-flipping and rescue schemes, is seemingly getting something for nothing. Attorneys representing these clients in closings should carefully analyze these scenarios for any signs of fraud, to help protect both their clients and themselves. ⚖

Endnotes

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8. Example taken from Davis, *supra* note 7, at 357–58.
9. *Id. See also* John Gibeaut, Mortgage Fraud Mess, 93 *A.B.A. J.* 50, 54 (2007).
10. *See* Davis, *supra* note 7, at 359.
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12. Maryland Department of Labor, Licensing & Regulation, *Mortgage and Foreclosure Information* (June 2008), www.dllr.state.md.us/finance/mortforeinfo.shtml. [hereinafter Maryland Dept. of Labor]
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14. Maryland Dept. of Labor, *supra* note 12.
15. Tripoli & Renuart, *supra* note 11, at 8.
16. Bob Johnson, *Flipping Properties and*

the Seasoning Issue (2005), www.flippinghomes.com/articles/readarticle.aspx?artid=37 ("There are two definitions of 'flipping' when it comes to real estate. The first (and original) definition means buying a property and quickly reselling it for a profit.").
17. FBI 2007 Report, *supra* note 1.
18. Seton Hall Law Press Release, *supra* note 2.
19. *See* Fraud Problem, Straw Borrower/Buyer (2006–2007), www.fraud-problem.com/straw-borrower/.
20. *See generally* Howard Lax, Real Property Law: Recognizing Mortgage Fraud, 86 *Mich. Bar J.* 34, 36 (2007).
21. *See State v. Harris*, 861 A.2d 165, 167 (N.J. Super. Ct. App. Div. 2004) (Defendant Harris was the closing attorney for a property flipper. Harris neglected to file and record title documents and did not disclose pre-existing mortgages.).
22. Federal Bureau of Investigation, 2006 Mortgage Fraud Report (May 2007), www.fbi.gov/publications/fraud/mortgage_fraud06.htm [hereinafter FBI 2006 Report].
23. FBI 2006 Report, *supra* note 22.
24. FBI 2006 Report, *supra* note 22.
25. *See generally*, Jeanne Johnson, Beware Title Insurance Companies, Gap Period Used for Fraud on HELOC Loans (Jan. 2008), http://landrecs.com/blog/2008/01/30/beward-title-insurance-companies-gap-period-used-for-fraud-on-heloc-loans/ (describing recent indictment against individuals who allegedly "closed on multiple HELOCs in such a short period of time that the earlier lenders' security interests would not be publicly recorded at the time that later lenders closed on subsequent loans").
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