Real Estate Fraud

The Housing Industry's White-Collar Epidemic

An Inman News Special Report

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Introduction

Mortgage fraud is without question a losing proposition for everyone other than the perpetrators, who often walk away with the ill-gotten riches from their unpunished crimes. Fraudsters cheat the mortgage system out of millions, perhaps billions of dollars. They also place bogus documents into the public record, ruin unsuspecting dupes' credit histories, artificially inflate property values and corrupt unwitting accomplices, among a long list of their other unsavory (yet admittedly fascinating) misdeeds.

The incidence of mortgage fraud is increasing partially as a result of technologies that facilitate creation of falsified documents and electronic loan processes that afford opportunities for fraud to creep in unnoticed. Systemic disincentives for lenders to report suspicious activities and to account for fraud as such on their books combine with lax enforcement to create a criminal-friendly environment.

One way or another it all adds up to a pox on mortgage lending--a pox that's in dire need of a good strong cure. This Inman News Special Report reviews three years of stories on the illness and begins with one possible remedy.

Mortgage fraud: Real estate's white-collar epidemic

Part 1 of 5: Lenders duped out of millions while regulators stand by and watch

Monday, June 23, 2003

By Jessica Swesey

Last year, Bree Duke, a real estate agent for Metro Brokers/GMAC Real Estate in Atlanta, was a rookie scrambling to close her first sale when a lender-appointed appraiser called and asked whether she was "cool."

"Cool" was code for Duke turning her head while the lender approved a $140,000 loan on a home she knew was worth only $100,000. The appraiser and mortgage broker were conspiring to commit mortgage fraud and planned to split the extra $40,000, but they presented it to the young sales agent as a creative lending technique that would help a buyer who had poor credit.

The multi-trillion-dollar mortgage industry is a goldmine for fraudsters, and like most white-collar crimes, mortgage fraud may not be obvious to an outsider or even to honest people in the industry. Regulators and many people in the mortgage industry know fraud is rampant, but no one has come up with a viable solution to curtail these crimes.

Mortgage fraud is increasing partly because the high volume of loan originations in the past few years makes it easier for mistakes to slip by unnoticed, according to Jim Croft, executive director of the Mortgage Asset Research Institute, a group that helps financial companies manage risk from third-party contractors.

"A substantial amount of fraud is getting by, and what was put on the books a year or two ago is just now being discovered as fraudulent," Croft said.

Mortgage fraud is a complex crime typically perpetrated by a ring of professionals who know the ins and outs of the real estate process. Attorneys, closing agents, mortgage brokers, appraisers, title insurers and real estate agents can be involved in it.

And mortgage fraud is growing nationally, leaving behind a trail of foreclosed homes, dilapidated neighborhoods, destroyed personal credit histories and unreliable comparative market values in areas where inflated appraisals have been recorded. Millions of dollars are bilked out of lenders who rarely recover their losses, and borrowers eventually end up footing the bill.

Experts say mortgage fraud is becoming more sophisticated through technology that enables perpetrators to produce bogus bank statements, tax records, closing documents, appraisals and proof of employment. Technology also enables criminals to steal identities, making it easier to obtain a home loan in an unsuspecting borrower's name.

Identity theft on the rise

Federal Trade Commission adds 162,000 victims to database in 2002

Thursday, June 26, 2003

The Federal Trade Commission told Congress this week that it is working with federal, state and local law enforcers to prevent identity theft, provide victim assistance and prosecute perpetrators.

Howard Beales, the director of the FTC's Bureau of Consumer Protection, said the number of identity theft complaints has increased since the commission set up a toll-free hotline in 1999 where identity theft victims can obtain counseling.

Beales noted that in 2001, more than 117,000 complaints from identity theft victims were added to the FTC's database, the Identity Theft Data Clearinghouse. In 2002, those complaints increased by almost 162,000.

He said the dramatic increase may reflect a growing consumer awareness of identity theft. Identity theft is an important factor in housing markets because it can contribute to mortgage fraud cases.

The FTC hotline provides consumers with telephone counseling

Donna Eide, assistant U.S. attorney for the southern district of Indiana, this year helped prosecute an $8 million mortgage fraud conspiracy case in Indianapolis in which 15 conspirators were convicted.

The lead defendant, Paul Dailey, brokered more than 100 fraudulent mortgages between 1998 and 2001, according to a Department of Justice statement.

Dailey recruited several real estate appraisers who appraised properties at two or three times their true value and closing agents who prepared two sets of documents at closing. The closing agents gave the settlement papers with the true value of the home to the seller and sent the second set of closing papers with the bogus inflated value to the lender. The fraudsters then paid the seller the true value of the home and split the rest of the cash from the lender. The buyers who obtained the fraudulent loans in their names, known as "straw purchasers," were in on the scheme.

Mortgage fraud is epidemic in Indianapolis and surrounding areas, according to Eide. The southern district of Indiana launched a mortgage fraud task force comprised of the U.S. Attorney's office, Federal Bureau of Investigation, Internal Revenue Service, U.S. Secret Service, Postal Inspection Service and the Office of the Inspector General of the Department of Housing and Urban Development to crack down on these crimes.

But the damage caused by mortgage fraud can't be reversed easily.

"It's been a blight on our neighborhoods here because now we have all these boarded up houses that were the used and abused properties in mortgage fraud schemes," Eide said.

She said properties used to obtain fraudulent loans always end up in foreclosure.

"Indiana has a really high foreclosure rate—the highest in the nation. I'm beginning to think fraud is at least a contributor to that," she said.

The mortgage fraud task force identified 14 groups of conspirators currently defrauding people in the Indianapolis area, according to Eide. One mortgage fraud ring takes years to investigate because there usually are dozens of properties involved and the complexity of the mortgage process is difficult to present to juries in a simple way that makes clear exactly how the fraudsters broke the law.

Desktop publishing and scanning technology make it easy for crooks to fabricate documents and remain one step ahead of investigators and victims.

Eide said another part of the problem is that it is too easy to become a mortgage broker.

Lenders rely on mortgage brokers to be the eyes and ears of the transaction; when the broker turns out to be unscrupulous, the whole transaction becomes corrupt.

from specially trained personnel who provide general information about identity theft and help guide victims through the steps needed to resolve the problems resulting from the misuse of their identities, Beales said.

Personnel advises consumers to contact the three national consumer reporting agencies and have a fraud alert placed in their file, close accounts identity thieves have accessed, dispute unauthorized charges and report the theft to the police and get a police report.

"Counselors also advise victims having particular problems about their rights under relevant consumer credit laws, including the Fair Credit Reporting Act, the Fair Credit Billing Act, the Truth in Lending Act, and the Fair Debt Collection Practices Act," Beales said.

The FTC also has worked to provide consumers with information through its consumer education and outreach efforts.

Mortgage trickery takes on many shapes

Home loan fraud disguised as little white lies

Tuesday, June 24, 2003

Mortgage fraud can be a complex scheme involving a ring of

Lenders lose millions of dollars to mortgage fraud, but there's little incentive to uncover or report fraudulent loans because lenders carry the loss on loans that have been sold to the secondary market, according to Croft. If fraud is discovered, the lender has to compensate the company that bought or insured the loan for its loss.

Croft said a lot of lenders don't go to great lengths to spot fraud in their loans, which makes it impossible to ballpark how much money is lost to mortgage fraud each year.

Mortgage fraud: Schemers concoct fake buyers

Part 2 of 5: Crooks need legitimate names to sign for falsified home loans

Tuesday, June 24, 2003

By Jessica Swesey

It took the FBI nine years to nail 35-year-old William Lee Cranston for orchestrating a $20 million mortgage fraud ring in Southern California. This year, a judge sentenced the fraud mastermind to seven years in prison and ordered him to pay restitution. Prosecutors also convicted 19 co-conspirators, including Cranston's partner Tony Leong, five loan brokers, three bank employees, three loan representatives, two purported borrowers, an escrow officer, a real estate appraiser and a tax preparer who were connected to the phony home-buying scams.

Cranston's fraud ring enabled him to obtain loans worth more than the houses he bought, then walk away with the extra cash after he paid the home sellers. He defrauded 26 lending companies out of $3.5 million between 1990 and 1993, according to a Department of Justice statement.

Cranston paid people for the use of their names on more than 100 falsified home loan applications. The fake loan applicants are known as "straw buyers" and they may be in on the fraud conspiracy. In some cases, the ringleader pays the straw buyer for his or her name, but the person doesn't know how the name will be used. In other instances, the schemer uses deceptive sales tactics to trick the buyer into purchasing a high-cost property with little value. Sometimes the crooks simply steal the buyers' identities without their knowledge.

Mortgage fraud is a sophisticated white-collar crime that's been around for decades, but technology has made the scams easier to pull off and enabled fraud to proliferate. Perpetrators of the phony home-buying schemes are attorneys, closing agents, mortgage brokers, real estate appraisers, real estate agents and title insurers.

Cranston's straw borrower schemes relied heavily on technology to generate phony pay stubs, tax records and bank statements to create false employers for the straw buyers and to inflate their income and assets so lenders would believe they were lending money to qualified borrowers. The conspirators even made up sham employers and

professionals who bilk lenders out of millions of dollars or it can be as simple as a false statement on a home loan application.

Most smaller forms of mortgage fraud aren't worth pursuing from a lender's viewpoint, and they pass through the system unnoticed or unreported.

Experts say the most common forms of this class of mortgage fraud include:

- Friends or relatives forge income verification for the person applying for a home loan.
- Borrowers produce bogus income tax return documents using Web-based tax filing programs.
- Buyers applying for a mortgage on a second home will forge lease documents for their first home to make it look as if the new home will be their primary residence when in fact it is an investment property. Buyers do this because they can get a lower interest rate on a primary residence mortgage than they can on a second home or investment property.
- Applicants with poor credit ratings recruit a friend or relative with a good credit history to sign as a co-

investment companies and rigged toll-free telephone numbers to ring in their own offices so they could falsely verify information submitted on the fraudulent loan applications.

Steven Olson, assistant U.S. Attorney for the Central District of California and a prosecutor in the Cranston case, said Cranston and his partners kept Web pages displaying national weather conditions on hand so they could produce small talk when the lenders called and make the bogus businesses seem even more realistic.

occupant of a home, but the person has no intention of living in the house.

Borrower with a bad credit history uses social security number of a parent, child or deceased person.

Olson said some of the buyers in the Cranston fraud ring knew exactly what they were doing. Cranston typically paid these buyers about $2,000 for the use of their identities and credit histories, although the buyers had no involvement in the loan transaction and did not occupy the homes purchased.

But a lot of the borrowers didn't know they were partaking in mortgage fraud, according to Olson. These unsuspecting straw buyers weren't indicted, but their personal credit histories were ruined as a result of the mortgage scams.

"These (borrowers) didn't have a lot of sophistication in mortgage practices and weren't aware of what was happening so we didn't prosecute them," Olson said.

Olson believes more mortgage fraud cases will be uncovered when the housing market takes a turn because lenders often don't uncover fraud until the property goes into foreclosure.

Technology promotes mortgage fraud because it distances the relationship between the borrower and the lender, according to Arthur Prieston, chairman of the Prieston Group, which provides lenders with insurance against mortgage fraud, due diligence and lender training to help detect and prevent fraud.

"The more faceless the relationship, the less obligation people have or feel to tell the truth," Prieston said.

Prieston, who co-authored a definitive book about mortgage fraud for the Mortgage Bankers Association of America, said his company recently discovered a fraud ring in Brooklyn, N.Y., in which the ringleader paid people for their Social Security numbers, then used them as straw buyers in a grand flip scheme where properties were bought and resold quickly at inflated prices. The crooks used the Social Security numbers to obtain approximately $35 million in fraudulent loans on about 70 properties, defrauding lenders and wrecking the straw buyers' credit histories.

"Lenders and borrowers are victims alike, and a lot of people don't know that," Prieston said.

He said the properties used in mortgage fraud schemes are of little to no value to start. Scammers will sometimes con buyers into thinking they are purchasing a sound investment property, then leave the buyers liable to repay a loan on a dilapidated property worth much less than they paid. In some cases, buyers discovered undisclosed liens worth up to 10 times the value of the property.

Olson said a damaging aspect of Cranston's mortgage schemes was what he and his partners did after they bought the properties. They approached low-income people who couldn't qualify for a home loan and offered them a deal in which they would make monthly payments in addition to a down payment to Cranston and later he would transfer title to the property into their name.

"These people would make these payments thinking that someday they would achieve their dream of owning a home in California," Olson said.

But the lenders never transferred title to the prospective buyers because they didn't qualify for the financing and by that time the lender had figured out the loan was fraudulent.

Mortgage fraud: Crooks buy cheap, sell high

Part 3 of 5: Property flipping scams wreak havoc on neighborhoods

Wednesday, June 25, 2003

By Jessica Swesey

Boarded-up apartment buildings and dilapidated single-family houses victimized by phony home buying schemes known as property flipping line the streets of many neighborhoods in Baltimore, where the practice has been widespread since the early 1990s.

A federal grand jury indicted eight people this year connected to Baltimore property flipping schemes in which the perpetrators buy low-cost properties then use deceptive sales tactics and bogus appraisals to sell them at two or three times their value within a short time frame, often the same day. Targeted properties usually end up in foreclosure because the ultimate buyers are typically low-income residents who can't afford to pay back the loans or amateur investors who bought groups of houses with promises of large cash returns and no money down.

In one flipping scheme, 64-year-old William Schmidbauer of Perry Hill, Md., faces up to five years in prison after he pleaded guilty this spring to mortgage fraud in Baltimore. Schmidbauer's flipping ring was typical, with many of the loans insured by the Federal Housing Administration, causing the agency to lose $2.5 million.

Property flipping rings often involve dozens and even hundreds of low-cost properties and can wreck whole neighborhoods, leaving a trail of abandoned houses and tenant controlled buildings when the owners skip town. Home loan fraud is growing as technology enables schemers to easily steal a person's identity or fabricate real estate appraisals, phony closing documents and bank statements. The white-collar crime is complex and usually involves dozens of professionals who know how the real estate transaction works.

Property flipping relies on collusive relationships between mortgage brokers, real estate appraisers and settlement agents.

Inflated property appraisals are essential to most property flipping schemes, enabling crooks to buy cheap and make back two or three times their investment.

Connie Wilson, executive vice president of mortgage fraud detection software company AppIntell, said the neighborhood domino effect from property flipping begins with the faulty appraisal.

One property flip might pass by unnoticed, said Wilson, but 20 flips in one area, each carrying an appraisal for three times the home's worth, might prompt the property tax assessor's office to raise property taxes because the value of the neighborhood has artificially increased. When homeowners insurance companies notice the dollar value of the neighborhood increasing, they too will raise premiums to residents.

"This goes on for a few years, then the 20 homes go into foreclosure. So now the (homeowners) pay triple the assessed value of their homes in taxes, the homeowners insurance costs went up and now the value of the property goes down because (there are) all these foreclosed homes in the neighborhood," Wilson said.

Many of the end buyers in flipping schemes are innocent people that were tricked into buying multiple properties, according to Wilson.

"Now these people own these properties that are condemned and going into foreclosure and their credit is being destroyed," she said.

Arthur Prieston, chairman of the Prieston Group, a company that provides training in mortgage fraud detection, said no mortgage fraud prevention tool can stop property flips at their source, but making real estate settlement agents or escrow officers more responsible for speaking up when they see irregularities may be a step in the right direction.

"Settlement agents are acutely aware that these are illegal transactions," Prieston said.

In some instances the title or closing officer may not be involved in the mortgage fraud conspiracy, but they facilitate the closing of a property sale knowing the seller bought the property earlier that day or just a few weeks before at half the price. In other instances, perpetrators offer a cut of the loan proceeds to the agent.

Prieston believes certain provisions in the U.S. Patriot Act could fill this hole in the real estate transaction by making the settlement agent responsible for reporting suspicious property sales.

The U.S. Department of Housing and Urban Development this year initiated an anti-flipping rule in an attempt to crack down on lax regulation. The rule makes properties that have been bought and resold within 90 days ineligible for Federal Housing Administration-insured loans.

HUD's rule shows promise that regulators are paying attention, but it only accounts for FHA-insured loans.

Wilson said some lenders set their own time guidelines for property-flipping redflags, such as homes bought and sold within six months or a year, but mortgage crooks know this and find ways around it or keep the property for a month longer than the time parameters before reselling.

"Unfortunately, we haven't been good as an industry at pursuing fraud cases," Wilson said.

She said the chances of being prosecuted for mortgage fraud where the loss amounts to hundreds of thousands of dollars are far slimmer than the chances of being prosecuted for credit card fraud, where the loss amounts to only hundreds of dollars.

Mortgage fraud: Inflated home values determine profit

Part 4 of 5: Faulty appraisals muck up comparative market analyses

Thursday, June 26, 2003

By Jessica Swesey

A two-year investigation by the FBI and Internal Revenue Service this year uncovered real estate appraiser Melvin Girton as a player in an $8 million mortgage fraud conspiracy in Indianapolis, in which Girton appraised properties for two or three times their value.

Phony appraisals are the crux of most fraudulent home-buying scams. A mortgage broker finds a borrower with good credit to buy a home for, say, $50,000 and an appraiser who's willing to inflate the value of the property to, say, $100,000. The mortgage broker secures an 80 percent loan for the buyer, pays the seller the $50,000 asking price, then splits the extra $30,000 with the appraiser and the fake buyer.

Mortgage fraud is growing rampant nationwide and can damage comparative market values in whole neighborhoods where inflated property appraisals have occurred. The faulty appraisals determine how much cash the schemers swindle out of lenders and leave unsuspecting home buyers to pay twice the true value of their homes.

These white-collar crimes have become more sophisticated, and regulators can't keep up with savvy perpetrators who use scanners and desktop publishing to steal people's identities and create bogus closing documents, bank statements, income verification and property appraisals.

A more subtle form of appraisal fraud occurs when an appraiser inflates a home's true value by five or 10 percent to match the number the mortgage broker and real estate agent want. The result is an artificially inflated housing market that could harm Wall Street investment portfolios because the valuation of underlying mortgage securities relies on home appraisals.

Sham home-buying schemes stamp sleazy reputations on mortgage brokers and appraisers, but the appraisers caught in fraud rings usually are uneducated and inexperienced and didn't intend to participate in fraud, according to Alan Hummel, president of the Appraisal Institute, an association of real estate appraisers.

"The appraiser typically isn't even involved in the money part of the scheme. Most of the time he is just supplying an appraisal for a fee," said Hummel, who has testified as an expert in mortgage fraud cases.

The mortgage broker bullies the appraiser into cooperating and may promise future work in exchange for the appraiser's cooperation.

A General Accounting Office study of the appraisal industry's regulatory system released this year found a high percentage of mortgage fraud occurs in states where appraiser licensing is voluntary.

Regulatory agencies reported a lack of funds as the main stumbling block to carrying out their licensing and other oversight responsibilities, according to the GAO study.

"Every state has a different level of funding, so there is no consistency in how (fraud) cases are handled," Hummel said.

State licensing boards need adequate resources to ensure proper licensing, investigate fraudulent activities and discipline appraisers who engage in dicey real estate transactions, he said.

Appraisers have long been under fire for giving in to pressure from real estate agents and mortgage brokers to match the home's value closely with the seller's asking price or the sale price of the home.

The real estate industry has pushed the use of automated valuation models, known as AVMs, in place of in-person appraisers to curtail faulty work. But schemers can use computers to rig AVMs and manipulate a home's value without an appraiser visiting the property to verify its condition.

Hummel said the Appraisal Institute has a partnership with AI Direct Connection, a company that acts as a firewall between mortgage brokers and appraisers.

"(This system) allows the appraiser to report honest opinions independent of the broker," he said.

The mortgage broker hires an appraiser through the firewall system. The appraiser then values the property and enters the appraisal into the system, which verifies whether it is legitimate and delivers it to the broker. There is no direct contact between the broker and appraiser.

Faulty appraisals can cause problems outside the real estate transaction where they originated. An appraiser unknowingly could inflate an appraisal on a home when looking at neighboring properties that carry faulty values, according to Hummel.

When perpetrators engage in property flipping, in which they buy low-cost properties, then quickly resell them at two or three times their true value with little or no renovations, the faulty inflated appraisal remains with the property through multiple transactions and later makes it difficult to determine the property's true worth.

"If flipped properties are used as comparable market values, property owners using that as a basis for their appraisal are also victimized," Hummel said.

Inflated home values are key to fraudulent home-buying schemes, but mortgage fraud can occur without an appraiser's direct involvement.

Donna Eide, assistant U.S. attorney for the southern district of Indiana, said investigators have found mortgage fraud cases in which the schemers stole an appraiser's name and license number, made up their own appraisals, then forged the appraiser's signature.

"These guys are very bold and will forge any document," Eide said.

Editorial: High time to clean up mortgage fraud

Part 5 of 5: Lenders should choke crime at its source, not sweep evidence under rug

Friday, June 27, 2003

Mortgage fraud is complex, technologically sophisticated and, like many white-collar crimes, hard to spot. Sadly, too many financial institutions don't even disclose publicly when they've been defrauded. Instead they sweep these crimes under the rug and record them on their accounting books as "economic losses."

It sounds like the old ineffective "don't talk about it and it never happened" solution.

The mortgage system is rigged with disincentives for lenders to report mortgage fraud. The biggest disincentive is that the lender would be out the money that would be paid back to the secondary market investors and mortgage insurers.

But how can regulators and law enforcement officials get a handle on the mortgage fraud epidemic when the victims are so tightlipped?

It's time for lenders to step up and call mortgage fraud what it is even when it means a financial loss for them. It's in the bigger interest of the financial system that these crimes be recognized and prosecuted. Otherwise, the perpetrators will continue to walk away millions of dollars richer and lenders will continue to pass along the losses to borrowers through higher fees and stricter underwriting guidelines.

Mortgage fraud isn't a victimless crime. It leaves a trail of deteriorating neighborhoods, destroyed personal credit histories and artificially inflated home value on the public record.

Lenders aren't the only ones suffering the loss, but they certainly are in the best position to take action.

True, some lenders train their employees in early mortgage fraud detection. And true, some lenders have notified the FBI after they've realized an excruciating loss. These actions are commendable and deserve recognition, but much more is needed.

Lenders should know their mortgage brokers, real estate appraisers and closing officers. They should lobby for mandatory state licensing programs that include thorough background checks and educational requirements.

Lenders should record fraud as fraud, instead of utilizing creative accounting that only hides the problem and makes it even harder for investigators to figure out. Lenders should double- and triple-check their loans before they hit the send key, and they should know who's writing their mortgages.

It's time lenders realize they have the power to choke fraud at its source. They owe it to borrowers, investors and other lenders to at least blow the whistle when something seems awry. They owe it to themselves to stop fraud from happening again.

The victim isn't responsible for the crime. But the victim at least needs to lock the windows and doors against the criminals who lurk outside.

Mortgage fraud is spreading and the stakes are high. If lenders don't stand up and take action to stop it, regulators may soon step in and force them to do so.

Lenders probe for fraud clues

Mortgage companies get to know business associates

Monday, June 23, 2003

Mortgage fraud is rampant and regulators so far haven't been able to curb perpetrators' appetite for cash. Experts say one thing lenders can do for themselves is know the people who broker their loans.

The Mortgage Asset Research Institute offers lenders two cooperative database services—LoanWatch and the Mortgage Industry Data Exchange, known as MIDEX—that keep a history of individuals and companies that have been involved in questionable activities in the past.

LoanWatch is a screening system that scrubs mortgage applications overnight for potential fraud, multiple applications and rate locks and other irregularities. The system can also be used to determine which loan applications to audit.

The MIDEX database performs an initial background check and periodic reviews of individuals and companies with whom lenders have business. It also investigates loans that contain inconsistent information.

MIDEX contains non-public information about incidents of alleged fraud, material misrepresentation and other serious misconduct by professionals in the mortgage industry. It also contains public information about individuals and companies, which are or have been subject to certain criminal, civil, enforcement or administrative actions in the mortgage and financial services industries.

The Mortgage Bankers Association endorses both database services.

MARI is an information service provider to the mortgage and financial services industries that develops and maintains cooperative databases that assist companies in managing risk from third-party contractors.

Anti-flip service makes comeback

First Lenders Data Inc. re-launches automated service to comply with HUD regulations

Friday, June 13, 2003

First Lenders Data Inc. (FLDI) has re-launched its anti-flip and fraud protection service, "HistoryPro," to assist lenders in complying with the new HUD regulations on predatory lending caused by property "flipping."

On May 1, the Department of Housing and Urban Development printed its final rule of FR-4615 (Prohibition of Property Flipping in HUD's Single Family Mortgage Insurance Programs) in the Federal Register, setting several new guidelines for mortgage lenders, including making recently flipped properties ineligible for FHA mortgage insurance. It also allows the FHA to better manage its insurance risk by requiring additional support for a property's value when a significant increase between sales occurs. Lenders must comply with the new regulations beginning June 2, 2003.

"HistoryPro" provides sales information for both subject and surrounding sales comparables, with a summary "T score" that aims to identify a possible declining or "flip" market. The product also provides ownership information, assessments, recorded sales and property characteristics.

First Lenders Data Inc. is a technology- and customer service-focused company that provides products to the mortgage lending and real estate industries.

Fraud suite takes flight

Factual Data Corp. installs search in credit reports for Patriot Act compliance

Thursday, March 06, 2003

Factual Data Corp. today announced that all of its credit reports now include an Office of Foreign Assets Control search for "Specially Designated Nationals" and "Blocked Persons."

The company also reported that a full suite of Patriot Act compliance services is available as real time, Web-based, stand-alone services for banks and credit unions, and any entity that requires identity verification and fraud searches to block potential criminal access to lending and credit-granting resources.

OFAC, a government agency, maintains a list of individuals and/or entities that have been classified as potentially dangerous and a threat to national security. The Patriot Act requires financial institutions, securities firms and insurance companies to block or freeze property, payment of any funds transfers and transactions with anyone on this list.

The fraud suite is scaleable according to the particular needs of the client and can be as simple as social security verification and validation or as comprehensive as a full data search of up to 30 data sources for information on a particular applicant including "also known as" searches, "formerly known as" searches, address history and property data, according to Factual Data.

"The market for identity theft and fraud services is becoming a major priority for everyone in any financial trade because of government regulations as well as the huge increase in fraudulent financial activity," said Dave Vinson, chief sales officer of Factual Data Corp.

Factual Data Corp. provides a range of customized information services to businesses. The company specializes in mortgage credit reports and other mortgage-related services, consumer credit reports, employment screening, resident screening and commercial credit reports.

Fraud no skin off lenders' backs

Lenders reluctant to pursue borrowers who falsify mortgage applications

Monday, January 13, 2003

By Susan Romero

Mortgage loan fraud is a lucrative low-risk crime that can net the offender upwards of $50,000 in a single transaction and rarely results in prosecution even for those who are caught red-handed.

Only a very low percentage of identified mortgage fraud cases are pursued by lenders, according to Steve Halper, president of AppIntell, which specializes in prevention of mortgage and other types of credit fraud.

"It's a very expensive proposition to gather attorneys, gather evidence, go through the filings (and) go through the court processes," he said.

Harper said lenders typically turn a blind eye when a home buyer or homeowner fudges an income statement or other loan application document in order to qualify for a mortgage loan. Instead, he said, lenders are more likely to pursue large mortgage loan fraud rings of appraisers, mortgage brokers, real estate brokers and agents, home buyers and forgers who create elaborate criminal schemes.

Federal agents in December 1999 busted a Florida mortgage fraud ring that rang up more than $29 million in falsified mortgage loans, according to a *Reuters* report. That ring included a mortgage lender, loan officer and appraiser who used in-the-know straw buyers to flip more than 200 properties at inflated prices, according to a 45-count federal indictment that followed a 19-month investigation.

The federal and state government also take an interest in loan fraud prevention and prosecution. U.S. Rep. Paul Kanjorski (D-Pa.), to take one example, spearheaded a federal effort to address mortgage fraud after phantom financing and inflated appraisals reportedly contributed to an abnormally high number of mortgage foreclosures in his Congressional district.

It's difficult to determine how much mortgage fraud costs lenders annually because no central organization tracks these amounts. But experts say the total likely runs to hundreds of millions of dollar and they agree that prevention is key to reducing the expense.

The nation's quasi-governmental secondary market loan purchaser Fannie Mae declined to comment on loan fraud detection and prosecution or whether the advent of modern automated underwriting systems make loan fraud easier or more difficult to perpetrate.

Automated systems have streamlined mortgage loan processing and helped facilitate the flow of a record number of loan originations during the past few years. Low interest rates and strong housing demand pushed loan originations toward an estimated all-time high of $2.42 trillion in 2002, according to the Mortgage Bankers Association of America.

But the jury is still out on whether automated systems open the door to more loan fraud.

"The potential for fraud in automated underwriting systems is a matter of concern. The organizations that are sponsoring the various underwriting systems have spent a fair amount of time looking at this issue," said Jim Croft, executive director of the Mortgage Asset Research Institute.

It's too soon to determine whether the weaknesses of automated loan systems facilitate additional mortgage loan fraud. It could take three to five years before any patterns are revealed because the systems are relatively new and constantly undergo upgrades, said Croft.

The primary weakness of these systems is their dependence on the validity of data entered into the system. If the information is invalid or inaccurate, the system will return a flawed score, which determines the borrower's loan eligibility and default risk.

"If someone who's using the system feeds inappropriate income values, employment information and that sort of thing, the best automated underwriting system in the world won't necessarily be able to pick that up," said Croft, who headed Freddie Mac's underwriting division in the early 1990s.

AppIntell EVP Connie Wilson said lenders who rely "too heavily" on scores produced by automated underwriting systems could pave the way for more loan fraud if they fail to verify the integrity of the data input into the systems.

Wilson said some lenders might neglect to verify a borrower's paperwork and make sure that Social Security numbers are legitimate, bank statements and paycheck stubs match the income reported and the ZIP code matches the borrower's address. She said lenders also should check for the use of whiteout fluid, inconsistent signatures and other signs that indicate loan documents may have been altered.

"As much as we'd like to believe every borrower walking through the door is as honest as we are, unfortunately that assumption is not that great because mortgage fraud probably is the most profitable type of fraud there is," said Wilson.

Prevention on the part of lenders usually takes the form of elaborate cross checking designed to spot red flags signaling possible fraud. Lenders also place a heavy onus on mortgage brokers to be on the alert for possible fraud in loan applications they receive from borrowers and submit to lenders.

Many lenders and brokers also require borrowers to read and sign an anti-fraud statement when they submit a loan application. These statements tell borrowers that falsifying or withholding loan application data could result in denial of loan approval, liability for the lender's losses, a due-and-payable demand on an outstanding loan, foreclosure if the loan isn't immediately paid in full and criminal and civil prosecution, possibly including such charges as grand theft and forgery.

Banks sharpen risk-cutting scissors

Robbery, workplace safety, internal fraud, computer security to be studied

Monday, December 30, 2002

The American Bankers Association has created an operating risk committee to help banks reduce their losses and comply with new capital requirements.

The committee will examine areas of operational risk that involve inadequate or failed internal processes, people and systems or result from external events. The charter excludes credit risk, but includes such risks as robbery, workplace safety, internal fraud and computer security.

The top priority is development of a peer group reporting program to collect, analyze and compare banks' risk events. The program is set to begin data collection in the first quarter of 2003. The effort will give the ABA and its members three years of benchmarking data to prepare for the implementation of new requirements in 2006.

Robert Jones, director of operating risk management for FleetBoston Financial and chair of the ABA Operating Risk Committee, said good benchmarking data will lead to “best practices and good performance strategies that can benefit the entire banking industry.”

“The ABA has a proven record of confidential data collection and analysis in areas such as check fraud. Better data will help banks develop better strategies to reduce losses and will help banks develop more efficient methods for determining their capital reserves,” he said.

The committee will share successful strategies with the industry and help ABA develop programs and business cases to reduce banks' operating losses. It also will aid the association in developing and advocating legislative and regulatory policy related to operating risk.

Senior managers from Bank of America, BB&T, Comerica, First Tennessee, FleetBoston, Hibernia, Key Bank, National City, Wachovia and Zions will participate in the committee.

The ABA is the nation's largest banking trade association.

Appraiser groups team up

Sign formal agreement to pursue common legislative goals

Tuesday, December 17, 2002

The Appraisal Institute and the American Society of Appraisers have joined forces to pursue the two groups' common legislative goals.

The agreement signed earlier this month formalizes a previous informal agreement covering joint government affairs activities since February.

Under the partnership, the Appraisal Institute will monitor real property legislative and regulatory issues of interest to both organizations, contact key legislators and government agency officials regarding these issues and report to the leadership of both organizations regarding these initiatives.

Legislative issues and activities the two organizations intend to jointly pursue next year include resolving deficiencies in the regulatory structure of the appraisal profession, supporting appraiser independence for consumers in financial transactions, demonstrating opportunities for real estate appraisers to provide valuation services for business financial reporting purposes, supporting the full disclosure of appraisal fees charged to borrowers in home mortgage transactions and monitoring the Internal Revenue Service's real property valuation guidelines.

Also, the associations will focus on consumer-oriented issues involving financial privacy, mortgage fraud, predatory lending and Federal Housing Administration appraisal restructuring.

Fraud on the rise

Advantage Credit finds 23% of brokers surveyed received fraudulent loan applications

Tuesday, September 17, 2002

An informal Web survey of online consumers and mortgage brokers aimed at discovering trends in fraud activity on loan applications found that despite the rise in fraud, there are still a lot of lenders not requiring some form of fraud protection with loan package submissions.

The survey found that 23 percent of mortgage broker respondents reported having received an intentionally fraudulent loan application from a prospective borrower in the past, according to Advantage Credit.

In addition, 17 percent reported having been victims of fraud themselves, while 57 percent reported personally knowing a victim of identity theft, according to Advantage Credit.

When asked about their lenders' requirements for fraud protection, 77 percent of customer respondents reported that 0-25 percent of their lenders required that some form of fraud protection be submitted with their loan packages. Fourteen percent of respondents said that 26-50 percent of lenders required fraud protection, and 9 percent reported that 76 percent or more required fraud protection with every loan package.

Brokers and originators can take several steps to help discover falsified data on loan applications, like asking for multiple forms of identification or tax transcripts, requiring all original documents, purchasing third-party fraud protection packages or adding fraud protection scans to borrowers' credit reports, according to Advantage Credit.

Fraud protection scans check credit reports for indicators such as misused Social Security numbers and addresses that deliver to a mail receiving facility or other non-residences.

Even with rising fraud, only 17 percent of the survey respondents reported ordering fraud protection on some or all credit reports, and just 14 percent reported using other fraud protection services, according to Advantage Credit.

Advantage Credit, a wholly owned subsidiary of Advantage Plaza Inc., provides credit-reporting services to mortgage brokers and lenders.

Inman Innovator Award nominee

First American's XML Legal and Vesting Services delivers the data

Thursday, July 18, 2002

First American Real Estate Solutions' Legal and Vesting Service aims to be a fast, accurate resource that delivers a property's complete legal description directly to the customer's production process in an XML data stream.

The data includes owner vesting information with supporting tax information and details of the original purchase mortgage.

The application incorporates property information directly into forms and production data flow, verifies ownership before opening a mortgage transaction, establishes vesting and identifies parties to title, confirms property location and obtains complete legal description, uncovers potentially fraudulent mortgage transactions and orders preliminary information prior to ordering a full title report.

Users can send an XML request for a parcel's information using the owner's name, address or the assessors parcel number and retrieve a search package that can be used to populate forms or reformatted for print.

Property records are updated daily from public records resources and the XML data stream requires no software installation.

The Legal and Vesting report was nominated for an Inman Innovator Award in the most innovative transaction program category. The awards will be presented July 24 at Real Estate Connect, produced by Inman News.

'Bleeding the system'

Congressman spearheads effort to address mortgage fraud

Friday, April 26, 2002

Rep. Kanjorski (D-Pa.) has spearheaded efforts to address mortgage fraud as a result of a situation in his district where phantom financing and inflated appraisals have reportedly contributed to an abnormally high number of mortgage foreclosures.

In Monroe County, Pa., hundreds of foreclosures and bankruptcy filings in recent years have indicated a pattern of questionable real estate practices and last year, federal, state, county and local law enforcement officials launched a joint investigation into widespread real estate fraud.

As part of his campaign against real estate fraud, Kanjorski has contacted the heads of numerous companies, associations and agencies to seek their input and to enlist their assistance.

Kanjorski told members of the Appraisal Institute's Leadership Development and Advisory Council Tuesday during a luncheon address that he favors increased scrutiny of the appraiser regulatory structure, and is seeking more involvement of professional organizations such as the Appraisal Institute in the regulatory process.

Kanjorski also told the Appraisal Institute audience that he is anxious to see results from the ongoing Government Accounting Office investigation into the effectiveness of the current appraiser regulatory system, which was requested last month by Senator Paul Sarbanes, (D-Md.), and Senator Zell Miller, (D-Ga.). The system has been criticized for lax enforcement at the state and federal levels, and for encouraging inconsistent standards and requirements throughout the country. Kanjorski said he hopes the study will illustrate the problems within the current appraiser regulatory structure, because the lack of enforcement is "bleeding the system."

Don't mess with Freddie

Secondary market giant smacks naughty appraisers

Wednesday, March 13, 2002

Freddie Mac has announced the upcoming release of Home Value Calibrator, an automated quality control and credit risk management tool for mortgage lenders that aims to identify inflated property valuations that may be the result of fraud or misrepresentation.

"Inflated appraisals are a key component of many abusive lending practices," said Michael Bradley, vice president of strategic information services for Freddie Mac. "Home Value Calibrator will help honest lenders protect themselves from abuse and provide fraud and risk protection to the consumer. The borrower who buys an overpriced home may lose money when they try to sell."

Home Value Calibrator analyzes home addresses and valuations and provides a score to indicate valuation inconsistencies. It also generates a report that can be used to predict whether a loan is at high risk, moderate risk or low risk of a faulty assessment.

The product will be available in the second quarter through Freddie Mac authorized distributors and resellers.

Stop thief!

Campaign aims to educate borrowers about mortgage fraud

Tuesday, March 12, 2002

The Mortgage Bankers Association of America today unveiled "Stop Mortgage Fraud," a consumer education campaign that aims to help prevent predatory lending practices.

The nationwide consumer education campaign is part of the association’s three-pronged approach to tackling the problem of predatory lending. The other two prongs are enforcement of current laws against predatory lenders and reform and simplification of the mortgage transaction.

Stop Mortgage Fraud includes a list of borrowers’ rights during the mortgage transaction, a list of common predatory lending warning signs and information about where to report suspected predatory lending activities. Borrowers can visit the Web site or call (800) 348-3931 to find out how to file a complaint.

A Spanish version of the campaign will be available in several months.

HUD asked to oust appraisers

Appraisal groups call for removal of ‘unqualified’ FHA appraisers from roster

Thursday, January 31, 2002

Two national appraisal associations have asked the U. S. Department of Housing and Urban Development to remove hundreds of appraisers they consider to be "unqualified" from the Federal Housing Authority’s single-family housing appraiser roster.

Appraisal Institute President Thomas A. Motta and American Society of Appraiser President Michael L. Austin pointed to an internal HUD analysis indicating that 330 of the appraisers on the FHA’s roster don’t have state licenses that conform to the standards issued by the Appraiser Qualifications Board, the appraisal industry's qualifications setting body. The roster contains approximately 22,160 appraisers.

"Hundreds of unqualified appraisers have been accepted on the FHA appraiser roster and HUD should take steps to remove them," said Motta, speaking on behalf of the two associations. "To ensure the competency of the program, HUD should immediately remove the 330 appraisers not conforming to the minimum standards issued by the Appraisal Qualifications Board."

A new rule proposed by HUD would require appraisers seeking acceptance to meet minimum standards issued by the board. But the proposed rule doesn’t set forth any course of action for removing currently listed appraisers who fail to meet this standard.

In a letter to HUD, Motta and Austin said an accurate appraisal is paramount to a successful and fair mortgage transaction, particularly in light of recent mortgage fraud cases throughout the country.

The letter stated that HUD should ensure that only qualified appraisers are performing appraisals for FHA and that improving the quality and accuracy of FHA appraisals can be accomplished only through higher standards for qualification and agency specific-specific education.

HUD brings down the hammer

Loan authority pulled from Florida, California lenders for improper loan originations

Tuesday, January 15, 2002

U.S. Department of Housing and Urban Development officials permanently have withdrawn a Florida mortgage company's authority to make or acquire Federal Housing Administration-insured loans.

HUD's Mortgagee Review Board permanently withdrew FHA approval from the Foundation Funding Group of Tampa, Fla., for serious violations of FHA lending requirements. The violations included improper cash-outs when originating streamlined refinanced mortgages and improper refinancing of fixed-rate and adjustable-rate mortgages.

According to HUD, Foundation Funding also failed to implement a HUD-mandated quality control plan that requires lenders to make adequate and timely reviews to detect possible violations, including fraud.

HUD also has withdrawn FHA authority from a California mortgage company for three years.

Omega Financial Services of Whittier, Calif., used falsified documentation in originating FHA loans and failed to implement a quality control plan in compliance with HUD requirements, according to the housing agency.

"We took these enforcement actions to protect the FHA insurance fund and FHA borrowers," said HUD Federal Housing Commissioner John Weicher. "Lenders who think about breaking the rules should take notice that HUD will aggressively enforce its rules and the consequences can be severe."

The Morgagee Review Board is comprised of Weicher and six senior HUD officials.

The board also proposed a three-year withdrawal of FHA approval from three lenders in New Jersey, Tennessee and Utah for violating a number of FHA requirements, including improperly qualifying loan applicants, failing to implement a quality control plan, failing to remit up-front mortgage insurance premiums and failing to submit loans for endorsement to FHA in a timely manner.

The proposed withdrawals become effective in 30 days without any further action by HUD; however, the lenders may appeal the proposed withdrawal during the 30-day period.

Guaranteed loans' frequently fraudulent

FTC takes steps to protect consumers from unscrupulous cold callers

Thursday, October 18, 2001

The Federal Trade Commission, in cooperation with the attorneys general of North Carolina, Virginia, Wisconsin, Oklahoma, Oregon and Illinois, today announced nine FTC, state or joint FTC/state law enforcement actions and six assurances of voluntary compliance designed to protect consumers from unscrupulous cold callers and telemarketing fraud.

The FTC is launching a consumer education campaign, including a redesigned section of its Web site on telemarketing fraud, to help consumers differentiate between con artists using cold calls to defraud them and legitimate telemarketers.

"Using masterful misrepresentations, fraudulent telemarketers are making cold calls to offer worthless credit-card protection services, 'guaranteed loans,' and so-called 'protection' from identity theft," said Howard Beales, director of the FTC's Bureau of Consumer Protection. "In doing so, they are stealing billions of dollars from unwary consumers. Consumers should feel as comfortable telling a cold caller not to phone them again as they do refusing entry to a stranger at their front door."

The most recent figures available put estimates of consumer loss due to such fraud at more than $40 billion a year, according to Beales. Approximately one-third of all complaints received by the FTC in the first quarter of this year began with a telephone call to a consumer.

Abandoning the field

Are laws banning 'predatory' lending spooking subprime lenders?

Thursday, September 27, 2001

By Bridget McCrea

When Bank of America announced its withdrawal from the subprime lending market in mid-August, the lender gave a succinct reason for the pullout: subprime was a type of mortgage lending that no longer fit the company's strategic and profitability objectives.

According to Charlotte, N.C.-based Bank of America, the company's subprime division had $26.3 billion in loan volume, but lacked "consistent, attractive results," hence the company's hasty exit simultaneously from both subprime mortgage and auto leasing.

"We're committed to achieving consistent, above-average shareholder returns," said Chairman and CEO Kenneth D. Lewis, "and these actions are aimed at achieving that mission."

But dig a little deeper into the retreat and some deeper reasons may be uncovered—or at least that's what the Mortgage Bankers Association of America in Washington, D.C., seems to think.

Just six days after Bank of America's announcement, the MBA released its own spin on why the lender was pulling out of the subprime market: the increase in state laws purporting to ban so-called "predatory" lending.

According to Steve O'Connor, senior director with MBA's government affairs department, a plethora of new regulations and legislation at the state and local level is "vulcanizing the national mortgage finance system."

In the last two years, a number of major lenders have either run into trouble with or run away from the subprime market.

First Union, for instance, bought The Money Store in 1998 for $2.1 billion, then promptly closed it in 2000.

Global banking firm Citigroup Inc. and one of its acquisitions, Associates First Capital Corp., formerly the finance arm of Ford Motor Co., were sued in March by the Federal Trade Commission for alleged predatory lending. An Atlanta federal court will soon decide whether to dismiss that case or let it proceed.

Chicago-based Superior Bank, a significant player in the subprime market and ranked 21st last year among all subprime loan originators, is embroiled in its own lawsuits across the country over whether some of its lending practices were abusive.

At issue in a number of these cases, said O'Connor, is the fact that state and local policy-makers haven't distinguished between subprime lending and predatory lending.

As a result, subprime lenders are faced with the burden of new legal, business and public-relations risks if they remain in the subprime market segment.

For example, O'Connor said, a law that went into effect in North Carolina in 1999 created a different set of standards and thresholds for a so-called "high-cost" loan. These standards, he said, differ from those of the current federal statutes, known as the Homeownership Equity Protection Act of 1994.

"First the lenders have the federal law to (abide by)," said O'Connor, "then there's the North Carolina law with its own standards and thresholds."

Add in a number of ordinances in such cities as Washington, D.C., and Chicago--and another that was attempted in Philadelphia—and, O'Connor said, lenders are increasingly being forced to conform to three or more layers of rules.

"Every time a new set of rules comes up, it means new compliance costs, changes in operations and new risks of inadvertently violating a rule," said O'Connor. "Overall, these new layers make it much more difficult and costly for lenders to stay in business."

Besides, said O'Connor, while the new rules are well-intentioned, they don't get to the root of the problem; rather, the restrictions constrain consumer choice and do little to stop rogue operators that ignore existing laws.

"Fraud and deception will continue because the ones who are perpetrating it aren't paying attention to the existing rules anyway," O'Connor added. "The real problem is the laws have not been crafted well enough to distinguish between legitimate subprime lending and predatory lending."

Getting to the "root of the problem" will require a three-pronged approach that includes better enforcement of existing laws, better consumer education and a simplification of the entire mortgage process, O'Connor argued.

"The complexity of the current system is what allows predators to take advantage of vulnerable borrowers in the first place."

And if the proliferation of state and local predatory lending ordinances continues, he said, chances are good that more lenders will exit the subprime market--a trend that doesn't bode well for home buyers with less-than-perfect credit histories or real estate agents looking to help them purchase a home.

"When it becomes too costly for those lenders to maintain a market presence," said O'Connor, "getting out will simply become a rational business decision in terms of the legal, operational and reputation risks."

Gauging the total size of the subprime lending market is all but impossible because lenders define the term differently, according to Rod Alba, director of regulatory affairs for the MBA. Some lenders use a FICO score of 660 as the cutoff, but others use different measurements. Sizing up the supposedly predatory portion of the market is equally perplexing because there is little agreement on what practices should be defined as "predatory," Alba indicated.

But while some lenders are shying away from the subprime market, others are embracing it.

Countrywide of Calabasas, Calif., for example, recently hired 20-year industry veteran Debbie Rosen to head the company's wholesale B/C efforts and beefed up that division's management with four other veterans from within the company.

The moves "further (Countrywide's) commitment to reaching a dominant position in the wholesale subprime lending market," according to a company press release.

Countrywide spokesperson Rick Simon said the company had $5.2 billion in company-wide loans and more than $1.7 billion from its wholesale division for calendar year 2000 and has "enjoyed success in the wholesale subprime market for six years since forming its B/C lending group."

But even Countrywide has shied away from North Carolina, pulling its subprime lending services from the state in the summer of 2000, according to Alba. The move implies that even those lenders committed to subprime lending can be spooked by new laws and regulations in some localities.

A ban on bamboozling

California's 'predatory' lending legislation awaits governor's signature

Tuesday, September 25, 2001

By Julie Clairmont

Supporters of AB 489, the California Anti-Predatory Lending Act, say it will protect seniors from being swindled out of their homes and stop unscrupulous lenders from taking advantage of low-income people who are so anxious to buy a house they'll sign anything.

Opponents say the bill will keep some of the people it aims to protect from being able to purchase a home at all.

The supporters have the upper hand. The California Legislature passed the bill, 41-27, on Sept. 12, and Gov. Gray Davis has said he will sign it.

AB 489 applies to mortgages up to $250,000 that have an interest rate 8 percent over the yield on U.S. Treasury securities or total points and fees of more than 6 percent of the loan amount.

The bill would ban loan refinances where there is no benefit to the borrower and bar financing of credit insurance within 30 days of making a loan. The bill also prohibits "packing," or charging borrowers excessive points and fees. It makes financing points and fees in excess of 6 percent of the loan or other "unconscionable fees" illegal.

Lenders doing business in California would be required to consider more carefully a borrower's ability to repay the loan. A loan covered under the law couldn't be made to a borrower whose debt, including that loan, would exceed 55 percent of his or her gross income. The bill also limits prepayment penalties and balloon payments.

Scoff-law lenders could face a six-month suspension or revocation of their license and fines up to $2,500 for each violation.

AARP sponsored the bill and has promoted it with the tagline: "They didn't tell me I could lose my house." Consumer's Union also supports the legislation.

The Mortgage Bankers Association of America opposes the bill.

Rod Alba, MBA director of regulatory affairs, said such legislation doesn't cure predatory lending practices and makes doing business in California more confusing and expensive for lenders.

"It's simply not going to work," said Alba. "There are a thousand and one ways to create products that can be used to cheat and deceive the consumer. This is just another law that is going to be set up on the shelf, followed by honest lenders and breached by those who have been committing the fraud."

Alba said some loan products prohibited under the law could be beneficial to borrowers.

"They are financing tools that assist sub-prime consumers in need," he said. "Can they be abused? Yes. But they are also powerful tools that can help some consumers."

The bill was authored by Assemblywoman Carole Migden (D-San Francisco) and is modeled after one North Carolina recently signed into law. Similar legislation has been rejected in Maryland, Florida and several other states.

Alan LoFaso, Migden's chief of staff, said federal laws are "insufficient" in protecting consumers against predatory lending and there is every reason to expect AB 489 will be enforced.

LoFaso said the bill wouldn't harm home buyers because it prohibits only specific practices that are not in borrowers' best interest.

"The bill is very balanced," said LoFaso. "It only focuses on the most egregious loans."

MBA believes consumer education and more robust enforcement of existing laws would be preferable to more laws.

Alba said AB 489 definitely would hurt business for lenders and real estate agents.

The California Association of Realtors isn't supporting or opposing the bill.

"We feel it is balanced and really goes after only the abuses," said Alex Creel, senior vice president of government affairs for the trade group.

MBA generally opposes state and local laws and ordinances that regulate mortgage lending, said Alba.

"Mortgage lending is expensively and extensively regulated federally," he said. "When every state and every single jurisdiction within a state has different laws, (lenders) simply can't keep pace and it's very hard for them to comply."

Systemic deficiencies permit 'bad actors'

Appraisal Institute seeks Congressional investigation of industry regulatory structure

Thursday, August 16, 2001

Brian A. Glanville, president of the Appraisal Institute, has submitted testimony to a Congressional committee, calling for investigations into the real estate appraisal regulatory structure.

In testimony submitted to Sen. Paul Sarbanes (D-Md.), chairman of the Senate Committee on Banking, Housing and Urban Affairs, Glanville said deficiencies in the regulatory structure are contributing to fraudulent mortgage transactions.

"While the vast majority of appraisers perform their assignments ethically and properly, some have been party to faulty or fraudulent mortgage transactions," Glanville said. "When an appraiser is involved in a premeditated property-flipping scheme or has unwittingly been part of a fraudulent transaction, the Appraisal Institute is concerned for the victims and the economic consequences.

"We hope our testimony sheds light on a number of deficiencies within the real estate appraisal regulatory structure that allow 'bad actors' to be involved in mortgage fraud, both in the conventional mortgage market and in the government-assisted market."

Federal law requires that real estate appraisals for federally related transactions be performed by licensed or certified appraisers in accordance with national uniform standards. However, appraisal groups contend that federal agencies and Congress have weakened the law by exempting nearly 90 percent of all transactions in the residential mortgage market from requiring an appraisal by a licensed and certified appraiser.

A transaction must involve a sales price of at least $250,000 before the use of a licensed and certified appraiser is required. The threshold originally was only $15,000, according to the Appraisal Institute.

Cheaper and faster appraisals

Automated valuation models are quick, but are they accurate?

Wednesday, May 23, 2001

By Julie Clairmont

Technology and automation have eliminated many jobs over the years, and now many real estate appraisers fear they may be next.

The culprit this time?

Automated Valuation Models, or AVMs, as they are known in the real estate industry. As the name implies, AVMs don't include an in-person appraisal by a human being. Instead, the AVM is based on such data as comparable home prices and the county assessor's valuation.

Some AVMs are more sophisticated than others, yet all offer an almost instantaneous report, and often for a lower price than a traditional appraisal.

Even though AVMs have been around since the 1980s, the majority of lenders still require a physical appraisal. However, lenders are relying on AVMs more than ever before in an effort to decrease costs and because more AVMs are available in the marketplace.

Many appraisers are disturbed by what appears to be a growing dependence by lenders on what appraisers say is an often less than accurate tool.

AVMs are used more often in densely populated areas because the models are based on available data.

"A few years ago, I started getting fewer orders for appraisals on homes in big towns," said Mike Foil of Foil Appraisal in Payson, Ariz. "Most of the orders I was getting were for houses in rural areas."

"In a city tract subdivision, AVMs might actually produce a pretty decent value, but most of the country is not like that," said Foil, who has been an appraiser for more than 20 years.

Appraisers believe some lenders are using AVMs in areas where homes are too spread out for automated valuations to give a consistent picture of the market.

"They are much more appropriate in urban areas, where there are many sales statistics, otherwise it's like a crap shoot," said Jerry Brewer, chair of the National Association of Realtors' Appraisal Committee and an appraiser from Memphis, Tenn.

But some appraisers say AVMs are based on such general data that there is simply too much room for error and fraud even in populous towns.

"They don't take into account specific information such as the quality difference between builders or the condition of the property," said Foil. "Nobody even drives by the house to see if it is still standing."

AVMs had been used mostly by larger mortgage banking companies, but now are moving into the mainstream.

Many companies, such as Countrywide, have their own AVMs that are based on public records and augmented by proprietary data and enhanced with other features aimed at increasing accuracy.

"Our AVM is very lender-focused," said Greg Dennis, president of Texas-based Landsafe Appraisals, a subsidiary of Countrywide Credit.

Dennis said Landsafe relies on its own proprietary data and information from San Diego-based Dataquick, which sells property data and appraisal tools, among other services.

Dennis declined to say how often Countrywide depends on AVMs in lieu of an on-site appraisal. He said the company developed its AVM primarily for "quality control" purposes and that it is frequently used in conjunction with a physical appraisal.

Dennis doesn't see AVMs as posing any danger for the economy or consumers, as some appraisers have charged.

"I don't see AVMs replacing appraisers," he said. "I see them as a tool they can use to streamline and enhance their service."

But appraisers say AVMs are a danger to homeowners, lenders and the economy. They point out that bad appraisals were a major factor in the savings-and-loan crisis of the 1980s. Bad loans based on bad appraisals are hidden in a good economy, they say.

Freddie Mac and Fannie Mae are now funding loans for purchases without traditional appraisals being required and are using AVMs of their own design. Freddie Mac charges $200 to accept a loan without an appraisal although an appraisal could be purchased for about the same price.

Patti Boeger, a spokesperson for Freddie Mac, said the program is offered only on first mortgages on single-family homes and to borrowers who have excellent credit and who have made a downpayment of at least 20 percent of the home's purchase price.

"This is a time when lending institutions are well-capitalized, and have more in their reserves than they have ever had," said Boeger.

She said Freddie Mac doesn't disclose how many borrowers have used the program, but added it is a small number. She also said opting for no appraisal is up to the consumer.

Freddie Mac has developed its own AVM based on proprietary data. Boeger said it is frequently used by appraisers to check out comparables.

"Our whole role is to make home ownership more affordable, and we have to look at ways to use technology to do that," she said.

Complicating the debate, is the fact that the Appraisers Institute, an appraiser trade organizations, is developing its own AVM.

Foil sees this development as sleeping with the enemy.

"The AI is trying to overcome this problem by developing their own AVM, but in my opinion, they're working against us," he said. "The whole thing is designed on using data from appraisers."

Like many appraisers, Foil said AVMs have their place, but shouldn't take the place of a traditional appraisal.

"I can see them being used by curious homeowners who want to get on the Internet and see what their home is worth--with the understanding that the price could be way off," he said.

He said he also could see AVMs being used in special circumstances such as a no-cash-out refinance for a borrower with good credit.

The price is right—or is it?

Appraisers fight back against pressure to inflate property values

Thursday, May 10, 2001

By Julie Clairmont

Karen Long, an appraiser and president of Karen L. Long and Associates in Livonia, Mich., strives to make sure every appraisal ordered from her company is completed accurately and on time. She even delivers a bouquet of flowers with each report.

But that's not enough, says Long, because if the property, honestly appraised at fair market value, doesn't come in at the "right" price, the client won't call her company the next time. Instead, the client will find an appraiser who will give the property whatever value the mortgage broker or loan officer requests.

"Currently, every single client I have asks for a value," said Long. "They send an order over that says: ‘Need $60,000 or stop appraisal.’"

Like many appraisers, Long routinely finds herself in the predicament of having to choose between making a living and maintaining her principles. She chooses the latter, but says it’s been at a high and frustrating cost.

"We don’t create the market, and when we’re asked to do things that are unethical, then lose business because we won’t, it’s not right," said Long, who has been an appraiser for 15 years. "We’re supposed to be an unbiased party that protects the banking industry and the consumer."

The problems began for Long when she opened her own appraisal company three years ago.

"Before then, my boss took the heat for me," she said.

Last year, she tried taking a client to court for allegedly cheating her out of $16,000 in fees for appraisal services for loans that didn’t close, but she lost the case. Her client told her she should have known she wouldn’t get paid for those appraisals if the loans didn’t close, she said. She believes she lost that case because she was "naive."

Long says she routinely loses business to appraisers who have less experience and less education and who are willing to let lenders and brokers pressure them into overvaluing property so a loan will close.

"We have inexperienced and unlicensed loan officers ordering documents and appraisals, and they’re dictating to me what the value of the home should be," she said. "I don’t even know how it got this way."

The situation "got this way" for a variety of reasons, said Jerry Brewer, chair of the National Association of Realtors’ appraisal committee and a member of the Appraisal Institute, one of the appraisal industry’s oldest and most recognized trade organizations.

"Because we have seen relatively low interest rates for a fairly long time now, there is a lot more competition in the industry," said Brewer. "There are a lot more borrowers, and it’s a bigger pie than it used to be for lenders."

This increased activity in purchase-money mortgages, and particularly refinancing of existing mortgages, has brought a lot of new companies into the market and forced the older companies to try to maintain their competitiveness, said Brewer, who owns an appraisal company in Mississippi.

"Many brokers are taking the position that if they don’t make the loan to the consumer, the competition will," he said.

Another contributing factor is that many appraisers have only a few major clients, and if one of those clients puts pressure on the appraiser to come up with a certain value and he or she doesn’t comply, it will jeopardize his or her income, explained Brewer.

The issue is now coming to the forefront, in part because it’s related to the bigger problem of "predatory lending." Inflated appraisals are part of the many home "flipping" cases investigators and regulators deal with every year. Flipping involves selling the same real property two or three times in a short span of time at double or triple the price. It is illegal when it involves fraud, such as kickbacks, falsified documents or bogus downpayments.

Brewer and many other real estate appraisers and industry representatives expressed their concerns about mortgage brokers, lenders, and loan officers pressuring appraisers to assign specific valuations during a recent meeting sponsored by the American Society of Appraisers and NAR.

Conference planners stated that a primary goal of the meeting was to develop a consensus to support legislative, regulatory or private-sector remedial actions to protect appraisers from pressure to produce the "right" market value. Other participating organizations included the Association of Appraiser Regulatory Officials, The Appraisal Foundation, The Appraisal Institute, the Internal Revenue Service, the U.S. Department of Housing and Urban Development, AARP, Fannie Mae, Freddie Mac, the Mortgage Bankers Association of America, the American Bankers Association and the Federal Housing Administration.

No solid solutions came out of the meeting, however, only a general consensus that the problem is "getting worse," said Brewer.

That's no comfort to appraisers like Long or about 6,000 others who have signed a petition posted at AppraisersForum.com and authored by Mike Foil, an appraiser from Nevada. The petition has been sent to the Appraisal subcommittee of the Federal Financial Institutions Examination Council. The appraisers behind the effort hope action will be taken to hold lenders responsible for this kind of pressure, said Foil.

No closure or real solution is on the horizon, yet some appraisers have suggestions for how to combat the pressure. Long suggests that perhaps mortgage brokers and loan officers should be salaried, and that appraisals shouldn't be ordered by people who aren't licensed.

"There has to be some accountability," Long said.

Brewer said he doesn't see any easy answer, but warns that everyone should recall that overvaluing property was a big factor in the savings and loan debacle.

"The piper is going to get paid sooner or later when you don't have a good appraisal," said Brewer.

The Mortgage Bankers Association of America, a trade organization that represents lenders and brokers, is adopting a wait and see attitude, said Bud Carter, senior director of residential finance for MBA.

"The MBA wants to see impartial and accurate appraisals," said Carter. "We do not condone anybody trying to influence an appraiser for a preconceived value."

Carter said he isn't aware of any specific efforts by his organization to address the issue, but added that the MBA is taking part in talks and discussions on the matter, such as the recent conference sponsored by NAR and the Society of Appraisers.

Carter said the issue is much more complex than lenders or brokers pressuring appraisers.

"The problem is many parties' compensation is dependent on whether the transaction closes, so there is a lot of pressure at different points," he said.

Shady dealings

Investigators say bankrupt AppOnline had ties to a convicted felon

Wednesday, April 18, 2001

By Julie Clairmont

State and federal authorities are investigating Melville, N.Y.-based AppOnline's ties to Paul Skulsky, a convicted felon, who witnesses say ran the company from behind the scenes.

(Conclusion of a two-part series. Read part 1.)

Skulsky, who served four years in prison, was convicted in 1985 on 31 counts of tax fraud, mail fraud and racketeering in connection with cable television tax shelters in California and three other states. Skulsky's brother Jeff Skulsky was president of AppOnline.

AppOnline, which also did business as Island Mortgage Network and Reliance Mortgage Network, filed for Chapter 11 protection from creditors on July 19, 2000, one month after the New York State Banking Department suspended its mortgage broker's license. The company left hundreds of borrowers with mortgages that were never funded, some of whom were evicted from their homes as a result.

AppOnline.com had an estimated $150 million in open mortgage loans when New York banking regulators suspended the license of Island Mortgage, one of its lending arms. Banking regulators and the U.S. Attorney's office are looking into complaints and questions from more than 150 borrowers in at least 20 states, including Arizona, Florida, Delaware and Maryland.

Creditors have also accused the company of diverting more than $50 million bound for home buyers. In addition, the company is being sued by Alan M. Jacobs, the court-appointed bankruptcy trustee, for allegedly transferring assets worth more than $10 million to a trust run by the company's former president. The suit, which also names the Skulsky Family Trust, is the first such action taken by the trustee and seeks to void the transfers or recover any value earned on AppOnline's property.

Boston homeowner Lee Kulas is one of the unfortunate borrowers caught up in the mess. Kulas refinanced his home in June 2000 through Island Mortgage, and has lived to regret it. All of the checks that were to fund his $350,000 mortgage bounced, yet the mortgage was still recorded on his deed, he said.

To make matters worse, Kulas started receiving letters from the bank that bought his mortgage, demanding payments, he said.

"My attorney explained (to the bank) that the company went bankrupt, but they basically said 'we don't care,' and said they would foreclose," said Kulas.

Kulas later found out that Island Mortgage had conducted business with him after the company's license was revoked in Massachusetts. Almost a year later, he said he is frustrated with the "runaround," and would like his mortgage discharged immediately.

Several parties involved have said that Jacobs, the trustee, and his attorneys have been slow in responding to calls about the status of loans and other inquiries. And borrowers have complained that the trustee and his attorneys have given top priority to the interests of the lending institutions.

On April 15, an employee for the U.S. Department of Banking in New York said banking regulators have also had trouble hearing back from the trustee and his attorneys.

"That's part of the whole problem," said the employee, who did not wish to be identified.

Bad loan business

Bankrupt AppOnline.com accused of fraud and other misdeeds

Tuesday, April 17, 2001

By Julie Clairmont

The financial woes of borrowers who obtained mortgages through Melville, N.Y.-based AppOnline.com continue to deepen.

A U.S. Bankruptcy Court judge recently ruled that the bankruptcy trustee for AppOnline has the authority to sell about 650 mortgages that the company handled, but never properly funded.

(Part one of a two-part series. Read part 2.)

The ruling would have come as a relief to hundreds of homeowners who obtained home-purchase or refinance mortgagesthrough AppOnline, only to find out that their mortgages were recorded on their deeds, but never funded. However, the judge stopped short of mandating that the mortgages be discharged, leaving that up to the individual warehouse lenders who did business with AppOnline.

"Basically, (the judge) said she did not feel she could force them to do it," said Brad O'Neil, one of the attorneys for Alan M. Jacobs, the court-appointed bankruptcy trustee.

O'Neil said the judge is expected to approve a second sale of "a substantially larger group of mortgages" on April 20.

AppOnline did business through two lending arms, Island Mortgage Network and Reliance Mortgage. In all, the company had 57 offices across the country, and is thought to have handled almost $1 billion in mortgages in 2000.

The company's clients and creditors have accused it of accepting mortgage applications and fees from borrowers, then failing to properly advance funds to complete the transactions. At settlements, checks were issued by or on behalf of Island Mortgage or Reliance Mortgage or by title companies to the home selleror the seller's mortgage holders. However, payment had been stopped on many of those checks, and hundreds more were rejected by banks because of insufficient funds.

Some borrowers who used Island Mortgage to finance a home purchase have said they were evicted from their houses because of the unfunded mortgages. Other homeowners are still in limbo, unsure of the status of their loan or living with pressure from lenders demanding payments on a bad loan.

In many cases, these loans were funded by mortgage wholesalers, such as Household Commercial Financial Services and Imperial Warehouse Finance. The lending arms of AppOnline typically borrowedmoney from so-called "warehouse lenders" that hold on to the mortgage notes for a month or two until the loans are sold to a third party.

AppOnline and Island Mortgage Network filed for Chapter 11 bankruptcy protection from their creditors on July 19, 2000. One month earlier, the New York State Banking Department had suspended the company's mortgage broker's license, citing its failure to meet its financial responsibilities and provide adequate access to records. The company left hundreds of borrowers in the lurch, and 1,000 employees out of work and owed wages.

In September, the Maryland Commissioner of Financial Regulation followed suit, closing down AppOnline and the seven Island Mortgage branch offices that had been operating in that state.

16 charged in HUD fraud

Alleged schemes involved hundreds of houses, $70 million in 203 (k) loans

Friday, December 15, 2000

Two real-estate speculators, a mortgage banker and an appraiser are among 16 people charged with schemes to defraud a federal home ownership program by purporting to sell hundreds of houses in poor New York City neighborhoods to charitable organizations.

The alleged fraud involves more than 250 properties in New York and on Long Island that were financed with $70 million in federally insured loans in 1998 and 1999, the New York Times reported.

"The defendants engaged in a coordinated effort to subvert HUD's programs to rehabilitate distressed properties in disadvantaged neighborhoods and reaped substantial illicit profits," Robert M. Morgenthau, the Manhattan district attorney, told The Times.

HUD officials said that in New York alone, 450 houses financed under its 203(k) program were in default.

The program is supposed to be available only to owners who will occupy their homes and nonprofit organizations with a background in housing rehabilitation.

HUD's inspector general, Susan Gaffney, said that 203(k) fraud had occurred throughout the country but that the extensive illegal activity by nonprofit groups was unique to New York.

These groups, which had no experience in housing, served as fronts for the real-estate speculators and got kickbacks from the other participants, the law enforcement officials said.

HUD to freeze a "hot zone"

High loan defaults in Los Angeles area brings 90-day ban on foreclosures

Monday, September 25, 2000

Due to a high rate of loan defaults, federal Housing and Urban Development officials are expected to mandate a 90-day freeze on foreclosure proceedings against area homeowners behind on payments of government-backed mortgages, the Los Angeles Times reported today.

Defaults are most often happening among the elderly, minorities and immigrants who may have fallen victim to underhanded lending practices. Investigators believe some lenders may have bought back defaulted properties, made cosmetic repairs to them and then resold them at a higher price.

"This is going to save thousands of homeowners from fraudulent foreclosures," HUD Secretary Andrew Cuomo told The Times. "We will not allow homeowners to be victimized by unscrupulous lenders."

Cuomo is scheduled to outline the 90-day moratorium today at a HUD-sponsored forum for Los Angeles community and church leaders.

Loan defaults are happening most frequently in 21 ZIP codes in Los Angeles southward to Gardena and Long Beach, the Times reported.

In the "hot zone," HUD officials found homeowners defaulting on loans or filing foreclosure claims at a rate from 7 percent to more than 15 percent. The overall Los Angeles area has a default rate of only 3.6 percent.

The moratorium is similar to a program HUD launched in Baltimore this year. The three-month freeze is used to check out FHA-approved lenders. If there is evidence of wrongdoing, HUD will curb mortgage fees and suspend violators from making government-backed loans.

It will ask lenders of FHA-backed mortgages based on inflated appraisals to restructure the loans to reflect current values. If the company declines, HUD will terminate the loan and issue the buyer another mortgage at a fair market price.

HUD hits 'bad lenders'

Northwest, Countrywide among 77 firms sanctioned in crackdown on fraud, abuse

Tuesday, September 19, 2000

Seventy-seven U.S. mortgage lenders have been sanctioned by the U.S. Department of Housing and Urban Development as part of its compliance reviews that are required of all FHA-authorized lenders.

Of those, 15 had Federal Housing Authority lending authority stripped and four have had such sanctions recommended. Fifty-eight lenders were fined. HUD's Mortgagee Review Board issued the sanctions.

Big names included branches of Norwest Mortgage and Countrywide.

"These sanctions demonstrate clearly that we meant business when we said we had zero tolerance for fraud, waste and abuse," said HUD secretary Andrew Cuomo.

"Bad lenders beware. If you try to defraud the consumer, or HUD, or don't follow the rules, we will come after you and take action."

In fiscal year 2000, HUD issued fines of at least $3.3 million and claimed to have saved taxpayers $10.59 million in indemnified loans. HUD has saved taxpayer $38.09 million in indemnified loans and imposed about $8 million in fines since 1995.

The harshest penalties -- immediate and permanent withdrawal of authority to lend FHA-insured loans – were levied against Norwalk, Calif.-based Allstate Mortgage Co.; Fort Lauderdale, Fla.-based Charter Mortgage Corp.; East Greenwich, R.I.-based Diverse American Mortgage Co.; and Jericho, N.Y.-based Rockwell Equities Inc. Diverse American was also fined $250,000 and Rockwell Equities $11,000.

In other sanctions, HUD:

- Barred St. Petersburg, Fla.-based Apollo Mortgage and Financial Services Inc., from doing business with the federal government for one year, and the board recommended its principals be barred for the same period of time. The company was also fined $40,000.
- Island Mortgage Network, Inc., of Melville, N.Y., was suspended from making FHA loans and fined $66,000.

FHA lending authority was stripped from:

- Decatur, Ga.-based Assurety Mortgage Group Inc. for three years.
- Miami-based Financial Research Services Inc., for 10 years.
- Richardson, Texas-based GM Group, Inc., for three years.

- North Miami, Fla.-based J. P. Mortgage Co., for three years.
- Carle Place, N.Y.-based Madison Home Equities, Inc., for five years.
- San Diego-based Mical Mortgage Corp./FINET Holdings Corp., for three years, which extended a prior one-year withdrawal by two years.
- Anaheim, Calif.-based ML Pacific Investment Capital, doing business as Pacific Investment Capital, for three years.
- Roanoke-Virginia Beach, Va.-based United Southern Mortgage Corp., for three years.

HUD also issued fines to:

- Assurety Mortgage Group $45,500.
- Financial Research Services, $75,000.
- GM Group, $700,000.
- J. P. Mortgage, $75,000.
- Madison Home Equities, $71,500.
- Mical Mortgage/FINET Holdings, $500,000.
- ML Pacific Investment Capital, $40,000.
- United Southern Mortgage, $250,000.

Also, the board proposed three-year withdrawals of FHA lending authority for Hempstead, N.Y.-based Amerifirst Mortgage Corp.; Austin, Texas-based Empire Funding Corp.; Palmdale, Calif.-based Hollywood Mortgage Inc.; and Floral Park, N.Y.-based Mortgage Acceptance Corp.

HUD also fined Amerifirst Mortgage $100,000; Empire Funding, $60,500; Hollywood Mortgage, $28,600; and Mortgage Acceptance, $75,000.

Also, Calabasas, Calif.-based Countrywide Home Loans Inc., faces a proposed settlement agreement including indemnification on up to five loans involving violations of the HUD/FHA requirements and regulations. The proposal includes enhancement of its quality control plan; and the payment to HUD of $30,000.

Norwest Mortgage Inc., in Des Moines, Iowa, faces a proposed settlement agreement including payment to HUD of a civil penalty of $75,000 and payment to HUD for losses suffered, including interest, from Norwest's submission of insurance claims on 39 loans that were subject to a 1996 settlement agreement.

The Seattle branch of Norwest faces a proposed settlement including indemnification on 12 loans in which violations of HUD/FHA requirements and regulations occurred, and payment to HUD of a civil penalty of $50,000.

AppOnline goes offline

Firm and subsidiary troubled on several fronts

Tuesday, July 25, 2000

By Carl D. Holcombe

Troubles are mounting for struggling online lender AppOnline.com.

The company, and a subsidiary known as Island Mortgage Network, filed for Chapter 11 last week in U.S. Bankruptcy Court for the Eastern District of New York.

And three lenders suing Island Mortgage have alleged in filings in the bankruptcy case that the company defrauded creditors of at least $50 million.

AppOnline has already been suspended from trading on the American Stock Exchange, as of June 29, and had its lending license suspended on June 30 by the New York state banking regulators.

Company officers, including CEO Edward R. Capuano and president Jeffrey Skulsky did not return phone calls Tuesday. A phone message at company headquarters in Melville, N.Y., has said for several days that the AppOnline.com Web site was down due to a power outage.

Phone calls to the law firm of Gersten Savage & Kaplowitz, which is representing Island Mortgage and AppOnline, also were not returned.

AppOnline provides mortgage services through Island Mortgage's 58 nationwide offices.

The company acquired several "bricks-and-mortar" mortgage firms in the first half of 2000, including Western National Funding Inc. and Cyber Media Group Inc.

Its revenues jumped in first-quarter 2000 by 22 percent, to $10.7 million, but losses hit $3.752 million, according to filings with the U.S. Securities and Exchange Commission.

At the end of the quarter, AppOnline had $6.09 million in cash or cash equivalents and had built an overall deficit of $27.208 million.

Its mortgage inventory was reported to be at about $112.4 million by the first-quarter's end. AppOnline.com had an estimated $150 million in open mortgage loans as of June 30, when Island Mortgage's license was suspended, and reportedly handled about $1 billion mortgages.

The stock's last trading day -- June 29 -- ended with shares at $1.44 per share, with a market capitalization of about $64.5 million.

In the bankruptcy case, three lenders suing Island Mortgage alleged the company diverted at least $50 million away from homebuyers.

"There is substantial evidence that Island Mortgage has defrauded creditors in an amount exceeding $50 million," according to filings they made with the bankruptcy court.

Island Mortgage and AppOnline both stated in the bankruptcy filing that they intend to keep their businesses running and showed $143.7 million in liabilities and assets of $140.1 million.

The filing came after a July 13 ruling in which U.S. Magistrate Judge Michael Orenstein had the account of Island Mortgage and AppOnline attached.

He ruled that the companies intended to "frustrate the enforcement of a money judgment...and...to defraud" as they took millions of dollars for improper use, which had originally been directed to the closing of mortgages.

Island Mortgage and AppOnline had been sued by HSA Residential Mortgage Services of Texas Inc., Household Commercial Financial Services Inc. and Imperial Warehouse Finance Inc.

The fallout, though, has reached beyond just Island Mortgage.

A source at Cornerstone First Financial in Maryland, purchased in February by Island Mortgage, said paychecks have stopped coming and people are losing out on homes as Island Mortgage's loan checks to sellers have been bouncing.

"I knew something was up, but I didn't know how bad it was," said the source, a two-decade veteran of the mortgage industry, who asked for anonymity.

"They put some money up front to buy us and the rest was in stock to a few people that was to be sold a year later. Then, they took our equipment, cash and didn't pay our (building's) rent."

The landlord showed up a few days ago and locked out First Financial from its long-time offices due to failure to pay rent, giving just 45 minutes for employees to clear out what they could.

"We're still operating...but it's time to start the job search," the source said.

Besides CEO Capuano, who is a major shareholder in AppOnline, with about 9 million shares, the other major shareholder is The Skulsky Trust, with 19.251 million shares. Power over those shares belongs to Skulsky and Capuano.

Also, according to SEC filings, Island Mortgage still owes Skulsky Trust about $21.7 million. That debt was originally about $31 million, but AppOnline paid it off by giving the trust about 18.2 million shares and providing the family-owned Skulsky Trust with about 42 percent ownership in AppOnline.

Fighting flipping

Congress takes on 'complex' selling issue

Wednesday, July 05, 2000

By Allison Landa

The legal yet controversial practice of "property flipping" came under fire on Capitol Hill this week as two-days of hearings on the issue wrapped up Friday.

The investigation, led by Senate Governmental Affairs subcommittee chairwoman Susan Collins (R - Maine), is a bipartisan effort to tackle what the subcommittee's Web site calls "an incredibly complex phenomenon."

Flipping occurs when a property is repeatedly bought and sold by the same party in an attempt to boost its value. However, that value often outstrips the property's appraised worth after several sales, with subsequent buyers paying an inflated price as the result.

"The ... investigation found that flippers have purchased hundreds of rundown houses and resold them -- sometimes within hours -- to unsuspecting, unsophisticated buyers," the site reads. "Buyers pay inflated prices and high mortgage payments often result in foreclosure, abandonment, or bankruptcy."

At the hearings, subcommittee members contended that flipping has grown especially common in Baltimore, Chicago, Los Angeles, New York and southern Florida, where homes in poor urban areas are bought, given cosmetic repairs and hastily put back on the market at much higher prices.

They also claimed that poor lender oversight by Department of Housing and Urban Development has allowed the problem to persist.

Committee press secretary Brian Jones said Friday that newspaper tales of property flipping -- particularly in the Baltimore area -- initially aroused Collins' ire.

"Sen. Collins was troubled by the press accounts," he said. "She asked the staff to look into it."

What they found through that investigation was even more troubling, he said: "There has been just some horrible, horrible fraud that went on."

Collins isn't seeking any specific legal remedy and was satisfied with the hearings for now, Jones said.

"She basically wanted to bring to light the issue and make sure HUD has responded," he said. "And she thinks they have."

HUD spokesman Lee Jones said the agency is continuing to increase efforts against flipping and other predatory lending practices.

"Over the years, we have been stepping up our efforts to monitor lenders, monitor appraisers," he said. "We believe that Congress ought to move to really impose some requirements on those who are lending the money, to make sure they lend on the basis of a person's ability to pay, not a person's ability to be soaked."

A joint task force between HUD and the Treasury Department recently conducted nationwide hearings on the issue. The results of those hearings were presented to Congress a little over a week ago, Lee Jones said.

"We wanted to see how it was evidencing itself in ... communities so that we could get a better picture of predatory lending," he said.

Flipping falls under a category still largely unregulated by law. It is not specifically addressed in the Uniform Standards of Professional Appraisal Practice (USPAP), but is covered by the USPAP Ethics Rule mandating appraisers conduct fair business practices.

A 1997 investigation by the Asbury Park Press in Asbury Park, N.J., revealed widespread flipping throughout the area. That same year, three local real estate appraisers pleaded guilty to inflating values on homes to increase the amount of mortgage money that could be obtained on the properties.

Flipping victim Barbara Parker of Bridgeport, Conn., told the paper that she and her husband borrowed $104,000 to buy a home from builder David A. Miller.

Parker found the home through an ad offering home ownership for no money down, plus an affordable mortgage. An independent appraiser retained by the paper placed the home's value at $58,000, far below the Parkers' purchase price.

The couple ended up struggling to meet their mortgage payments and contending with a shoddy home sorely in need of repair.

"I cried when we first moved in here," Parker told the paper. "We were paying our bills on time, but now we're starting to slide. If that happens, we'll be in trouble."

But potential homebuyers are far from powerless -- so long as they take steps to protect themselves. In the Asbury Park Press series, real estate author Peter G. Miller offered the following tips for avoiding mortgage fraud:

- Let lenders compete for your business.
- Don't borrow as much as you can afford.
- Have your own attorney review all documents before closing on a home.

Real estate agents can also avoid involving themselves in possibly fraudulent activity, veteran Wisconsin appraiser Ossie Johnson told online business magazine Office.com. Johnson's recommendations:

- Avoid quick sales turnarounds.
- Get to know an area well, particularly when working outside usual locations.
- Do independent research on comparable properties.
- Always check listing histories on any property.

"Property flipping is distinctly different than our business as usual -- which is buying and selling property at a profit," Johnson told the magazine.
"By examining the property, seeking out your own comps, and familiarizing yourself with the surroundings, you can safeguard against overvaluations -- and against federal charges."

2 plead guilty in scam

Fraudulent L.A. mortgage brokers face prison terms

Monday, June 26, 2000

By Allison Landa

Good news awaits Irene Schuler as she struggles to recover from a recent stroke.

The two mortgage brokers who defrauded the 78-year-old Santa Clara, Calif., woman -- nearly causing her to lose her house -- will both soon have a new home of their own.

It will be state prison.

On June 22, now-defunct Tri-Star Mortgage president Edward Rostami and vice president Sharon Ann Palmer-Ross pled guilty to two felony counts of conspiracy to commit elder fraud as well as two felony counts of conspiracy to commit grand theft.

Those charges stem from dealings with Schuler as well as San Rafael, Calif. resident Ruth Mikolon. Both elderly women received phone solicitations from representatives of Woodland Hills, Calif.-based Tri-Star in early 1997, and both nearly lost their homes.

"What they had was a pretty sophisticated scheme,"said Santa Clara Deputy Dist. Atty. Paul Colin, who helped prosecute the pair. "I call him the kingpin and her the queenpin."

Schuler's husband, Douglas Wagner, died in December, 1996. She had barely begun to mourn the loss before the phone started ringing.

In call upon call, Tri-Star telemarketers pressured Schuler to take out a reverse mortgage on her home of four decades -- an agreement that would pay her $650 monthly. At first, she declined. But in March 1997, she acquiesed.

When a homeowner has free and clear possession of their house, Colin said, he or she can obtain a reverse mortgage and receive regular payments from a bank.

"Over time, the bank is essentially buying the equity in your house, and when you die, they essentially own the house," he said. "That's what the promises were to Irene and Ruth, but that's not what they're stuck with.... They signed some documents and they were lied to about those documents."

Tri-Star's deception left Schuler and Mikolon not with the reverse mortgages they'd expected, but with brand-new conventional loans for $240,000 and $212,000, respectively.

Then, Colin said, Rostami and Palmer-Ross proceeded to steal all available cash in the two women's transactions by paying themselves exorbitant fees and forging checks. And since the duo already owed an estimated $13 million in civil judgments stemming from other fraudulent transactions, they quickly found themselves in need of even more cash from Schuler.

"Rostami and Palmer-Ross then conjured up another deal, convinced her she had to sign other documents, and took out another $100,000 home-equity line," he said. "They basically sucked out the equity in the available cash."

Several hundred thousand dollars short, already stripped of their real-estate licenses and facing prosecution for alleged conspiracy to defraud a Malibu, Calif., homeowner, the two fled to Mexico in spring, 1998.

By that time, both Schuler and Mikolon were getting foreclosure notices on their homes due to unpaid mortgage premiums they knew nothing about. Before Schuler contacted authorities and filed suit in fall 1997, she found herself returning to work as a housecleaner in an attempt to pay bank fees.

Rostami and Palmer-Ross, who are romantically linked and have three children despite the fact that Rostami is already married, will serve a respective three years and 16 months in state prison. They face formal sentencing next month.

Colin said he has spoken with Schuler's daughter about the judgment, and that her daughter "expressed happiness" for her recovering mother.

In August,1999, Schuler told Inman News Features that she had a few words of her own for Rostami.

"I would tell him he's been a very bad and evil person taking advantage of old ladies," she said. "If he needs to get money, he should get a job like the rest of us."

Realtors, lenders, busted for fraud

41 allegedly obtained $110 million in fraudulent loans

Thursday, December 16, 1999

Federal prosecutors announced yesterday that 39 people have been charged in U.S. District Court in Los Angeles with obtaining more than $110 million in fraudulent home loans.

A real estate company owner and a U.S. Department of Housing and Urban Development employee were also charged with fraud last week, bringing the total to 41.

The charges were announced this morning in Los Angeles and are the first criminal cases to be filed under a new U.S. Department of Housing and Urban Development anti-fraud program funded by a $ 27-million grant from Congress.

The defendants -- real estate agents, mortgage loan brokers, real estate professionals, escrow agents, notary publics and others -- allegedly used three different scams including fraudulent loan origination, equity skimming and home improvement loan fraud to collect money on Federal Housing Administration mortgages, according to Alejandro Mayorkas, U.S. Attorney for the Central District of California.

"Blue-collar individuals were being victimized by white-collar individuals," said Larry Bush, spokesman for HUD in San Francisco.

Mayorkas said the fraudulent loans allegedly obtained by the defendants have already caused at least $25 million in losses to the government. Susan Gaffney, HUD inspector general said in a news conference the charges may be "just the tip of the iceberg."

Types of fraud involved in crackdown

Fraudulent loan origination: real estate professionals helping unqualified buyers obtain funds for FHA-insured mortgages.

Equity skimming: when an owner sells his property to a straw buyer at a price well above its actual value.

Home improvement scams: involve real estate professionals getting loans in the names of fictitious borrowers, or in the names of people unaware their identities are being used.

Flipping: involves buying property and reselling it at inflated prices based on fraudulent appraisal values. Large loans are made based on the inflated appraisals and sellers and those participating in the scam line their pockets with the extra cash.

We're not talking about people messing up their books ...they knew they were doing wrong, and they were greedy.
-Larry Bush, HUD spokesman

On top of possible criminal penalties, HUD said it will pursue possible suspension or debarment from participation in HUD programs, or civil money penalties of up to $1.1 million per year -- against individuals and businesses named in today's charges.

"We're not talking about people messing up their books (by mistake)," said Bush. "They knew they were doing wrong and they were greedy."

So far, only HUD single-family housing specialist Karen L. Christensen, 35, has pleaded guilty. Christensen admitted last week to taking $80,300 in bribes, in exchange for selling $2.1 million worth of HUD properties for about $700,000 -- about one-third of appraised value.

HUD had suspected her involvement in fraudulent activities since May 1998, but held off pursuing its own investigation at the request of the Inspector General, who wanted to prevent tipping off other suspects to the federal investigation, Bush said.

Federal authorities, including investigators and auditors from the FBI, the Internal Revenue Service, the U.S. Attorney's Office and HUD focused their investigation on Southern California, where the default rate on FHA-backed mortgages is 50 percent greater than the national average.

It was a situation which "caused a red flag to go up," said Bush.

Among the mortgage companies and real estate agencies where defendants worked while allegedly carry out fraudulent activities are Century 21, First Suburban Mortgage, Milestone Mortgage, Great American Mortgage and Magic Homes Realty.