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MORTGAGE LOAN FRAUD IN TEXAS

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According to the FBI, mortgage loan fraud is an epidemic that involves billions of dollars a year in losses. The Financial Institution Fraud Unit of the FBI has stepped up its investigation and prosecution of criminal loan fraud, particularly where mortgage industry professionals and insiders are involved. For the fiscal year ending September 30, 2007, the FBI received nearly 50,000 SAR's ("suspicious activity reports") of mortgage fraud. In June of 2008 the FBI determined to focus on mortgage fraud at the expense of other white-collar crimes. Everyone involved in the real estate sales process is subject to scrutiny. Prosecutions are not limited to actual mortgage and bank fraud – included are prosecutions for conspiracy, mail/wire fraud, identity theft, and money laundering.

Additionally, the 80th Texas legislature passed the Residential Mortgage Fraud Act (HB 716, effective September 1, 2007) which amended certain sections of the Finance Code, Government Code, and Penal Code. The Act created the Residential Mortgage Fraud Task Force (Government Code Sec. 402.032) that is under the direction of the attorney general and includes the consumer credit commissioner, the banking commissioner, the credit union commissioner, the commissioner of insurance, the savings and mortgage lending commissioner, the presiding officer of the Texas Real Estate Commission, and the presiding officer of the Texas Appraiser Licensing and Certification Board. The Task Force facilitates the sharing of information and resources in aid of enforcement.

There is also the issue of civil liability. Lenders are reacting. Countrywide Home Loans, Inc., the nation's largest home lender, has become active in filing civil suits against the perpetrators of mortgage fraud.

Examples of fraudulent schemes include property flipping based on false loan applications and inflated appraisals (this category does *not* include buying property at a bargain price and then selling it for fair market value for a profit – that is entirely legal); nominee loans using the name and credit of "straw buyers;" equity skimming in "subject to" transactions; phony second liens to "contractors" who never perform any work; "silent seconds" that involve concealing the loan of a down payment to a borrower, when the down payment was supposed to come from the borrower's own funds; use of fictitious or stolen identities; and foreclosure schemes that mislead homeowners into paying fees and signing a deed in to an "investor" in

order to “stop foreclosure.” Common elements to most of these schemes are inflated appraisals that create “phantom equity,” kick-backs (payments “under the table,” ie., not shown on the closing statement), and falsified loan applications.

You can be reasonably sure that loan fraud has occurred when it is clear that a lender would not have made a loan if it had known all the facts - and the lender was prevented from knowing the true facts by means of misrepresentation and concealment. Putting it another way: inducing a lender to make a loan based on false pretenses is fraud.

The FBI uses two categories: “fraud for housing,” which is a single borrower who misrepresents assets and/or liabilities in order to purchase a home; and “fraud for profit” which involves mortgage professionals of all types who act collectively to defraud a lender.

Many transactions, while not plainly illegal, fall into a gray area that is increasingly suspect. The popularity of “no money down” investment programs on TV, the internet, and advanced by seminar “gurus” has added huge numbers of people to the investment game and resulted in ever-more intricate strategies in order to get rich quick. The FBI attitude toward many of these schemes is openly disdainful.

A visit to the courthouse steps on foreclosure day is akin to watching sharks being fed at the aquarium. The problem, of course, is that it is impossible for *all* these fledgling investors to become overnight millionaires. Real success involves hard work over time. Unfortunately, the intense competition involved in the investment business can make impatient and unethical investors desperate to find tricky new ways to prey on homeowners in distress.

Legitimate investors should avoid participating in programs that sound too good to be true, either to the investor or homeowner. Investment programs that ask a homeowner to sign incomprehensible documents with weird names often involve fraud. If a deal is just too complicated for the average person to understand, it may well involve fraud. If it involves several people signing interests back and forth to one another and not recording anything, it is probably fraud.

Also, perpetrators apparently believe that giving their documents creative names will exempt them from the law. If you are encouraged to use forms with such names as Delayed Purchase Option Agreement, Option Cancellation and Release Agreement, Option to Lease Purchase Real Estate, Performance Mortgage to Secure Option, Secured Reverse Assignment Agreement, Slick Tricks to Get What I Want Without Telling Anyone What I’m Doing, and the like, they are probably fraudulent. The problem for clever con artists who dream up these documents is that courts look to substance over form, and prisons are now offering long-term housing to these “clever” folks. Juries may not always understand the technicalities of mortgage finance, but they understand fraud.

Here are some other tip-offs that you may be dealing with a mortgage loan con artist:

“This is a great investment! You’ll make great money with no effort.”
“There’s no need to talk to a lawyer. These are all standard forms.”
“Just sign this blank loan application here. We’ll do all the paperwork.”
“We put the property in your name. You’re totally secure.”
“We pay all the costs and you get half the profit! Easy money!”
“We’ll pay you a bonus at closing. You’ll have cash in your pocket and instant equity.”
“We’re going to manage and sell the property and then split all the profits with you.”
“God has sent us to you to give you abundant wealth.”

The “straw buyer” scenario is particularly common. Here’s how it works:

1. A crooked investor generally looks for two categories of homes: those owned by distressed sellers who are behind on their payments; or new-home builders who have inventory they cannot move and which is draining them because of the interest carry.
2. He recruits straw purchasers/borrowers who are willing to allow their names and credit to be used in exchange for an up-front, off-the-closing statement kick-back (often \$10,000 or more) and then buys the property in the names of the straw purchasers. The note, deed of trust, and other loan documents, including an affidavit of intent to occupy, are all signed by the straw purchasers at a title company closing.
3. A real estate broker accomplice may be involved to make this easier and eventually collect a commission from a “client” the broker never met, never obtained a buyer’s representation agreement from, and never gave an IABS to.
4. A mortgage broker accomplice submits a fraudulent loan application and supporting documents that show the straw buyer as having significantly higher net income than is actually the case.
5. An appraiser accomplice inflates the value of the property, often by \$100,000 or more.
6. The amount of the loan applied for exceeds the true market value of the house.
7. A title company may be complicit in this process in order to facilitate a smooth closing with no questions.
8. All the various accomplices and co-conspirators get paid large fees at closing, either on the closing statement for vague and unspecified charges, or off the closing statement altogether.
9. The house is placed on the market but does not sell because its value is grossly inflated.

10. The lender forecloses, taking a loss (part of which is passed on to HUD or a mortgage insurer) and ruining the credit of the straw purchaser. By then, the con artists have left the scene with profits in hand.

Looking back on this scenario, it is clear that the whole transaction was concocted so that the co-conspirators could generate large up-front fees for themselves.

Interestingly, the “straw buyers” allege that they were wronged. They even file lawsuits. It is difficult to feel sorry for them, however, since they willingly signed blank documents and gladly received an under the table pay-off at closing. They cooperated in the fraud and benefited from it.

It should be noted that some sub-prime lenders are not entirely without fault, even though they may protest the loudest. Eager to make loans and collect fees, many do not supervise the underwriting process as thoroughly as they should.

In addition to the usual civil statutes that may be violated (statutory fraud, deceptive trade practices, etc.) numerous criminal statutes may be involved:

<i>FEDERAL CRIME</i>	<i>LAW</i>	<i>PENALTY</i>
False statement on a HUD loan	18 USC 1012	1 year, fine, or both
False statement to Obtain credit	18 USC 1014	2 years, \$5,000, or both
Mail/wire fraud	18 USC 1341,1343	5 years, \$1,000, or both
Concealment	18 USC 1001	5 years, \$10,000, or both
Conspiracy	18 USC 371	5 years, \$10,000, or both
Racketeering	18 USC 1961	20 years, \$25,000, or both
Money laundering	18 USC 1956	20 years, \$25,000, or both
Aggravated identity theft	18 USC 1028	20 years, \$25,000, or both

In addition, the Residential Mortgage Fraud Act amended Texas Penal Code Section 32.32(b) to state “A person commits an offense if he intentionally or knowingly makes a material false or misleading written statement to obtain property or credit, including a mortgage loan.” If the value of the property or amount of the loan exceeds \$200,000, which is the case with the median-priced family home, then the offense is a first-degree felony punishable by 5 to 99 years

in prison and a fine of \$10,000!

Also, Sec. 343.105 of the Texas Finance Code now requires that lenders and mortgage brokers give the following notice in 14 point type to residential borrowers at closing:

WARNING: INTENTIONALLY OR KNOWINGLY MAKING A MATERIALLY FALSE OR MISLEADING WRITTEN STATEMENT TO OBTAIN PROPERTY OR CREDIT, INCLUDING A MORTGAGE LOAN, IS A VIOLATION OF SECTION 32.32, TEXAS PENAL CODE, AND DEPENDING ON THE AMOUNT OF THE LOAN OR VALUE OF THE PROPERTY, IS PUNISHABLE BY IMPRISONMENT FOR A TERM OF 2 YEARS TO 99 YEARS AND FINE NOT TO EXCEED \$10,000.

I/WE, THE UNDERSIGNED HOME LOAN APPLICANT(S), REPRESENT THAT I/WE HAVE RECEIVED, READ, AND UNDERSTAND THIS NOTICE OF PENALTIES FOR MAKING A MATERIALLY FALSE OR MISLEADING WRITTEN STATEMENT TO OBTAIN A HOME LOAN.

I/WE REPRESENT THAT ALL STATEMENTS AND REPRESENTATIONS CONTAINED IN MY/OUR WRITTEN HOME LOAN APPLICATION, INCLUDING STATEMENTS OR REPRESENTATIONS REGARDING MY/OUR IDENTITY, EMPLOYMENT, ANNUAL INCOME, AND INTENT TO OCCUPY THE RESIDENTIAL REAL PROPERTY SECURED BY THE HOME LOAN, ARE TRUE AND CORRECT AS OF THE DATE OF LOAN CLOSING.

The borrower must sign this notice. It is worth noting that “The failure of a lender, mortgage banker, or licensed mortgage broker to provide a notice complying with this section to each applicant for a home loan does not affect the validity of or enforceability of the home loan by any holder of the loan” (Finance Code Sec. 343.105d).

Sec. 402.031 of the Texas Government Code was amended to define a fraudulent act as “any act that constitutes a violation of a penal law and is part of an attempt or scheme to defraud any person.” Moreover, this section imposes an affirmative duty to report fraudulent activity to “an authorized governmental agency” if “a person determines or reasonably suspects that fraudulent activity has been committed or is about to be committed.” This would include loan officers, escrow officers, realtors, and attorneys. Compliance results in immunity for the reporting individual.

These new laws make sobering reading for anyone involved in the sale, purchase, financing, and closing of residential home transactions. Who is affected? Any person, including conspirators, with actual knowledge of the fraud can be indicted for a felony criminal offense, all the way down to the notary. Moreover, culpable mental intent can be inferred.

Much of fraud prevention is common sense. If you suspect fraud in a transaction, immediately remove yourself from involvement and report the activity. Do not sign blank documents. Check out the people you're dealing with. Ask questions. Be alert for irregularities. If the answers are overly complex or outright ridiculous, walk away from the deal. It is always a good idea to consult a real estate lawyer.

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