



# CHICAGO TITLE INSURANCE COMPANY

<b>TOPIC:</b> <u>Mortgage Fraud and Identity Theft</u>
--

**By: J. Donald Cole**

**FNTG family of title companies including Chicago Title Insurance Company**

Mortgage fraud is a growing problem and has gotten the attention of the lending community, title insurers and even the FBI. Four years ago fraud was not even in the top ten causes and costs of claims for the title insurance industry. Today it is the leading cause and the most expensive. The claims arise under numerous types:

1. *Conspiracy;*
2. *Breach Of Contract;*
3. *Intentional Misrepresentation And Concealment;*
4. *Negligent Misrepresentation;*
5. *Negligence;*
6. *Breach Of Fiduciary Duty;*
7. *Violation Of Rico Statutes (Including Wire And Mail Fraud);*

These claims are very expensive and usually result in a full loss to the lender. This makes it a very costly item for the title insurer. The Company has claims involving only two sets of transactions in which the claimants are demanding in excess of \$8,000,000 actual damages, plus exemplary damages.

The fraud takes many forms. The basic categories are:

- Straw-Buyers
- Identity Fraud
- Property Flips or Double Escrows
- Builder Bailouts
- Mechanics' Lien Fraud
- Appraisal Fraud

The following will take these common forms and explain how the fraud is perpetrated. The first is the use of straw-buyers.

## **Straw Buyers**

In this form there is no "real" buyer/borrower. In many of these situations the borrower is paid to purchase the property for a third party. This is because in many cases the straw-buyers' credit is normally sufficient to qualify for the loan while the third party cannot qualify. In other cases even the straw-buyer also could not qualify so there is "phantom income/employment" to create a qualified borrower.

Often the straw-buyer buys the property with a high loan to value ratio new loan. This cashes the seller out. The third party who actually takes the property will not make any payments on the loan. In really aggressive scams they may make a few initial payments while accumulating rental funds from a tenant they have placed in the property. The straw-buyer may not be aware that third party will not make payments and not realize that his/her credit will be affected adversely. However they usually find out they have been duped when they are contacted by a collection agency.

There are some keys to discovering a straw-buyer scheme. The following lists some of the more common red flags to avoid being taken in by this fraud:

- Down payment check is drawn on an account that differs from that shown on the loan application
- Names are added to purchase contract
- HUD-1 indicates transfers or payments to brokers or third parties
- Quit Claim Deed is used either right before or soon after closing
- The sale is to a relative or related party
- There is little or no credit for borrower
- There is usually lack of substantiated down payment through the closing
- There may be no real estate agent

The other good protection against fraud is making sure that the parties executing the documents are who they claim to be. The easiest ways to accomplish this is through excellent notary practices.

The first step is to confirm that the notary has a current and legitimate notary commission. The second is to require proof that the notary has the required notary bond in place. In the state of North Carolina there is no required notary bond. However, the notary is *personally* liable for negligence or fraud in the performance of the duties as a Notary Public. It is a Class 1 misdemeanor for a notary to sign an acknowledgement when the principal does not in fact appear before them. It is a Class 1 felony if they do so with the intent to commit a fraud.

The notary must be sure that it meets the basic requirements of the acknowledgement. These are the personal appearance of the party, on given date, and whose identity is proven by either personal knowledge or satisfactory evidence by either a federal or state government identification. A notary should always maintain and use a notary log or journal. They should also keep this journal and their seal locked in a safe place. Many frauds have been accomplished with the use of a “borrowed” notary seal.

### **Flips or Double Escrows**

The most common recent real estate fraud and largest real estate scam in terms of the extent of damage it can cause are illegal flips. They can either be a single transactions or a series of transactions. In order for flips to occur, especially on a large scale there must be two components; inflated appraisal and a closer who “looks the other way” or may participate in the

scam. The intended victim is the lender so therefore the true nature of the transaction is normally hidden from the ultimate lender. The elements that make up the flip are:

- Purchase at or below market value
- Inflated appraisal
- Second sales contract (flip) at the inflated value
- Loan based upon inflated value
- May or may not be simultaneous closings

There are some basic things that real estate professionals can do to combat these scams.

1. Use the title commitment to make a flip disclosure
2. Use escrow flip disclosure forms
3. Make certain the new lender signs approval of flip
4. Make sure all monies deposited are disclosed properly
5. Read your lenders instructions

The following is actual language in a lender's instructions dealing with potential flip transactions affecting their collateral.

**“STRICT COMPLIANCE WITH THESE INSTRUCTIONS IS REQUIRED.**

#### **Sales Contract**

2. **The Seller(s) on the sales contract and the Seller(s) on the Commitment must be identical. Any deviation will require WRITTEN approval prior to request for disbursement.**
4. **Earnest money credited on the HUD-1 Settlement Statement & earnest money reflected on the Sales Contract must not vary. Any discrepancies will require PRIOR approval from the disbursing office.**
5. **No cash allowances may be provided for borrower on the Sales Contract and no cash allowance may be credited to Borrower n the HUD-1 settlement statement.**

#### **Title Policy/Title Commitment/Restrictions/Endorsements**

**If you have information that this is a simultaneous transaction, contact Lender's office immediately. Written approval to proceed with the loan closing must be received to continue.**

#### **Property Requirements – Underwriting/Closing Requirements**

**Borrowers occupying property – NO SECONDARY FINANCING WITHOUT PRIOR APPROVAL FROM LENDER ...”**

As is obvious from the above, it is crucial to read and comply with the lender's instructions to avoid liability to the lender for an undisclosed flip transaction.

### **Builder Bailout**

Second only to large flip scams in terms of the extent of damage it can cause are builder bailouts. Often in these scams the basic elements are the entire development is made up of partially built homes that are sold to straw buyers, based on falsified financial information and based on inflated appraisals. The proceeds of these sales are used to bail builders out of their short-term construction loans. The potential indicators of builder bailouts include:

- Repetitive use of the same escrow or settlement agent
- Repetitive use of same appraisers
- Repetitive use of employers
- Borrower is barely qualified or unqualified
- Sales price and appraisals are inflated
- No money down sales are included
- "Silent" second mortgages

### **Mechanics' Lien Fraud**

Another closely related scam involved mechanics' lien. In this scam the closing agent will receive a refinance transaction. There will either be a recently recorded mechanics' lien on the property or one will appear after the order has opened. Most likely the loan broker will ask for an updated commitment that reflects the lien. Most times, the lien will be *backdated* even though it has been recently recorded. This will be the first clue that there *may be fraud* occurring.

The process of accomplishing the mechanics' lien scam is usually as follows. A contract is made on the suspect property. Many times, a typed "invoice" of work to be done is attached to the document to be recorded. Then, the unscrupulous "transaction arranger" seems to have a justified increase of value on the property as a matter of public record. Actual scams have used a couple of the following scenarios.

The agent receives a sale on the property for an inflated value, based on the filing of this mechanic's lien. The property may receive a higher appraisal based on inaccurate information that major improvements have been completed. If this is investigated it would be discovered that no work has been done. Usually, someone will appear with a release prior to close of escrow – stating that the lien has been paid in full.

### **Appraisal Fraud**

Without falsely inflated property values the scammer can not generate the excess cash to create the necessary gain or down payment needed to accomplish the scam. These are most often third party originations and not direct lender loans. By careful and calculated omissions or misrepresentations of information, the lender maybe influenced in their decision making

process. Initially appraisal fraud required a cooperative appraiser, but now technology has made it possible for others to create the appraisal with out their involvement.

### **Red Flags of Mortgage Fraud**

There are indicators of fraud that can assist the real estate practitioner in discovering it before they or their clients become a victim. The following breaks down these red flags by the segment of the transaction involved.

#### **Escrow/Closing**

- Cash paid from buyer to seller outside of escrow
- Down payment paid into escrow upon opening
- Flip or double escrow
- Related parties to the transactions
- Unusual credits from seller to buyer
- Use of power of attorney
- Seller is business entity perhaps actually related to buyer/borrower
- Change of sales price to “fit” appraisal
- No amendments to escrow
- Purchase of the house is NOT contingent upon inspection
- Payments to third parties who do not have liens on the property
- Sale is subject to seller acquiring property (flip/double escrow).
- Buyer/borrower required to use a specific loan broker/lender
- Odd amounts paid as deposit or down payment
  - Small money orders, cashiers checks and travelers checks
  - Funds not drawn on bank account shown on loan application and credit report
- No real estate commission
- Unusual credits or disbursements shown on settlement statements
- Cash proceeds to borrower in a sale transaction
- No monies due from buyer/borrower
- Discrepancies between the HUD-1 & escrow instructions/purchase agreement.
- Difference in sales price on HUD-1 and purchase contract

#### **Title Report or Commitment**

- Prepared for and/or mailed to a party other than the lender
- Income tax or similar liens against borrower on refinances
- Delinquent property taxes
- Seller not on title (possible flip/double escrow)
- Buyer has pre-existing financial interest in property
- Chain of Title – do you see buyer, real estate agent, and broker?

#### **Purchase/Sales Agreement**

- No real estate broker is used
- Lease option to buyer
- Name and address on deposit check are different from the buyer on the contract

- Deposit checks have inconsistent dates
- Multiple contracts
- Power of attorney is used
- Sale is subject to seller acquiring title
- Odd amounts used as earnest money
- No real estate agent signs the contract
- Contract dated after credit documents
- Excessive real estate commission
- Seller is noted as a contract buyer
- Buyer is not shown as purchaser on contract
- Seller is a real estate broker relative, employer
- Name & address on deposit check is different from buyer
- Earnest deposit check is not cashed

### **Appraisals**

- “For Lease” of “For Sale” sign – on refinance
- Appraiser is not local
- Photos and comps look familiar
- Occupant unknown
- Appraisal ordered before contract is written
- HUD or deed on original purchase is less than 2 years old for refinance.
- Photos reveal information not disclosed on appraisal
  - Commercial property next door
  - Rail road tracks
  - School
- Ordered by a party to the transaction
- Comps not verified or submitted by potentially biased party
  - Failed to note that address is different than position plotted on map
- Undesignated appraiser
- Tenant shown as occupant on owner-occupied property
- Photo does not match description of property
- Appreciation in declining market
- Distance of comps

### **Credit Report**

- Unable to confirm borrower’s employment
- Employment info or history varies on loan application and VOE (verification of employment)
- No credit
  - Could be ID theft
  - Could be multiple social security numbers
- Recent inquiries from “other” lender
- Invalid Social security number or variance
- All accounts paid in full
  - Could mean a consolidation loan undisclosed.

- Difference in information of loan application and credit report
- Length of time on file is inconsistent with borrower's age
- Co-borrower's maiden name shows data difference from application
- Over 25 with no credit history
- Personal information not consistent with handwritten mortgage application
- Borrower cannot be reached at place of business
- Multiple social security numbers or names

### **Form W-2**

- Employer ID is formatted other than XX-XXXXXXX – may be invalid
- FICA wages/taxes and loan taxes exceed ceilings or set percentages
- Copy submitted is not "Employee's Copy" – Copy C
  - Watch for change of font or type
  - Could be altered – look for cut and paste
- Form is handwritten – unusual and certainly by a large employer
- Hourly pay is rounded up

### **Verification Of Employment (VOE)**

- VOE not letterhead or standard Fannie Mae/Freddie Mac form
- Out of town employer – may signal false or non-existent firm
- Rounded dollar amounts
- Overlap of employment – current and past
- Date of hire was weekend or holiday
- Employer uses mail drop or P.O. Box
- Borrower changed professions
- Business entity does not exist or is not in good standing
- Illegible signature of person verifying employment and salary
- VOE completed same day as ordered or dated prior to VOE
- VOE says company car and loan application shows car loan
- Employee paid monthly vs. weekly or bi-weekly
- Answering machine for employer
- Watch for incorrect spellings
- Excessive praise in remarks section

### **Verification of Deposit (VOD)**

- Cash in bank is not sufficient to close
- Round dollar amounts
  - Especially on interest bearing account
- Watch for incorrect spellings
- Loan secured by checking or savings account
- Illegible bank employee's signatures with no further identification
- Excessive balance in checking account vs. savings account
- Date of certification by bank was a weekend or holiday
- VOD completed same days as ordered
- Deletions, cross outs

- If VOD not created, may have been hand carried
- P. O. Box
- Checking account with average two-month balance exactly equal to present balance
- Funds for down payment on deposit for a short period of time
- Typeface or handwriting is not consistent throughout the form
- Low income borrower with large cash on deposit
- Account not in borrower's name or joint account with third party
- Look for date stamp of bank on VOD
- Credit union for small employer
- IRS is shown as source of down payment – Require proof of liquidation prior to funding
- Escrow receipt used as verification
  - may be personal check or
  - NSF or
  - Money from seller
- Funds paid outside of escrow
- VOD “returned to sender”
- Squeezed in numbers on the VOD

### **Payroll Check Stub**

- Review stub where it shows borrower/s name and social security numbers
  - White out
  - Cut and Paste
- Review stub for deductions for child support, garnishment, etc.
- Watch for copies of stubs which are easier to alter
- Look for inconsistencies with employers you are familiar with

### **Loan Application**

- Watch for patterns or similarities in application received from a specific seller, broker or loan officer
- Is there heavy concentration of loans to individuals related to a certain project?
- Are signatures on credit document illegible with no further identification?
- Consistency – is the applicants handwriting consistent throughout the file?
- New housing is too small to accommodate occupants
- Buyer is downgrading from a larger to smaller home (except empty nesters)
- Buyer resides in property (purchasing from landlord)
- Borrower intends to rent or sell current residence with no documentation
- Down payment other than cash
- Deposit or down payment is a promissory note
- Stocks, bonds not publicly traded
- Price and date of original purchase not shown for refinances
- Borrower is buyer investment property but does not own current residence.
- P. O. Box is the only address for employer
- Same home number for home and business
- Personal property value exceeds one year's salary
- High income borrower has little or no personal property



- New housing expense exceeds 150% of current housing expense.
- Source of down payment is repayment of a personal loan
- Unsigned or undated application
- Face of live insurance policy rather than the cash surrender is shown as a liquid asset.
- Borrowers age and the number of years employed are not consistent
- Unreasonable accumulation of assets compared to income.
- Borrower claims to have no debt – most unusual
- Excessive real estate currently owned
- Job title and responsibilities are inconsistent with high salary.

### **Occupancy**

- Borrower owns one or more rental properties and the value of the primary residence is materially in excess of the value of the property the borrower intends to purchase as a primary residence, without sufficient explanation for the change
- Borrower has within the last three years purchased similar properties, which have later been rented.
- Borrower has within the last three years purchased one or more similar properties and occupied them for less than one year.
- Borrower is employed in a real estate or real estate related business and is moving the primary residence from a single family detached dwelling to a single unit of two – to four – unit property without sufficient explanation for the change
- Borrower has within the last 12 months purchased a property, represented to be owner-occupied, in the same or similar neighborhood.
- Borrower is purchasing a home under one of the following circumstances which is not consistent with the intent to occupy:
  - Excessive distance from primary employment
  - Does not appear to be a desirable alternative to existing primary residence
  - Has not demonstrated a commitment to seller or leasing borrower's current primary residence
    - Listing or purchase agreement
    - Lease on the current residence
    - Other appropriate evidence

### **Identity Theft**

The definition of identity theft is the theft or misuse of personal or financial identifiers in order to gain something of value and or facilitate other criminal activity. It became a Federal Crime in the United States in 1998 for anyone who knowingly transfers or uses, without lawful authority, any name or number that may be used, alone or in conjunction with any other information, to identify a specific individual with the intent to commit, or to aid or abet, any unlawful activity that constitutes a violation of Federal law, or that constitutes a felony under applicable State or local law.

The reason that a party commits identity theft is because without the appearance of legitimate financial information, the loan would not be approved. With the stolen identity the criminal can take over an individual's identity to conduct a wide range of crimes:

False applications for loans  
False applications for credit cards  
Fraudulent withdrawals from bank accounts  
Fraudulent use of telephone calling cards  
Obtaining goods that the criminal might be denied

With modern technology is not required to steal another's identity. The most common low tech methods are still:

- Dumpster Diving
- Shoulder surfing
- Pre-approved credit cards
- Mail boxes with access to the public

Of course technology has increased the ability of criminals to obtain personal information. This can be accomplished by the simple use of the internet or high tech skimming methods. No matter what technique is used the damage to the victim is the same. The average victim spends 600 hours (approximately 15 - 40 hour work weeks) repairing credit and financial information.

It is possible to detect false identification by following a few simple rules:

#### Scrutinize identification

- Look at the type face. If they do not match, the ID may be fraudulent.
- Look at the physical description which should specify the individual's height, weight, color or hair and eyes. Compare what is written to the physical characteristics of the person appearing in front of you.
- Look at issuance date. All ID cards get some wear and tear. If the issuance date is old but the card looks brand new, the ID may be fake.

Look at the photo and run your finger over the edge of it. If the photo is raised, a new photo may have been laminated over the original one.

#### **Conclusion**

1. There must be disclosure to the lender of all funds in your transaction
2. Disburse exactly as the HUD-1 indicated – no deviations
3. Make sure the seller and buyer/ borrower are who they say they are
4. Read the lender's instructions
5. NO LAST MINUTE CHANGES!