2008-2009 Broker-in-Charge Annual Review

LENDING LAWS & LOAN FRAUD

OUTLINE:

- **Introduction**
- **North Carolina Legislation**
  - **Predatory Lending**
  - **Residential Mortgage Fraud Act**
  - **Identification of Loan Originator**
  - **Conduct of Loan Collectors**
- **Loan Fraud**
  - **Elements of Loan Fraud**
  - **Examples of Loan Fraud**

INTRODUCTION

This Section will first review relevant North Carolina lending laws, several of which were just enacted in 2007 and/or 2008 and were designed specifically to target the abuses that led to the subprime mortgage crisis and resulting consequences. Thereafter, common loan fraud practices will be highlighted to heighten brokers' awareness of these practices so they might be more alert to suspicious activity, which still thrives in North Carolina.

The Commission's auditors and members of its legal staff have worked closely with several agencies over the past decade, including the State Bureau of Investigation, the Federal Bureau of Investigation, and the North Carolina Banking Commission which regulates lenders, mortgage brokers, and now mortgage servicers, to investigate loan fraud activity and to punish those who engage in it, whether through disciplinary actions and/or criminal prosecutions. There have been attorneys, appraisers and real estate brokers who have lost their professional licenses and some have incurred prison sentences as a result of their illegal activity. As recently as April 2008, a Senior Auditor/Investigator with the Commission received special recognition from both the Internal Revenue Service's Criminal Investigation Section and HUD's Office of Inspector General Investigations for his assistance in helping uncover a $40 million dollar mortgage fraud/money laundering case.

NORTH CAROLINA LEGISLATION

In 1999, North Carolina became the first state in the United States to enact comprehensive predatory lending laws. These laws are designed to protect North Carolina consumers from unscrupulous real estate financing practices that separate consumers from their money or the equity in their homes. In addition to predatory lending laws, North Carolina has enacted legislation requiring the licensure of lending professionals, mandating additional disclosures, and in 2007 a series of mortgage laws regarding mortgage lending practices. The goal of much of this new legislation is to help eliminate home loan lending and loan collection abuses, reduce home loan foreclosures, and require that mortgage companies ensure that borrowers do not receive loans they cannot afford to repay.

Predatory Lending

Because it can take so many forms, it is difficult to define the term "predatory lending." As a general proposition, that term covers loans made on significantly unfavorable terms accompanied by lending practices that usually involve varying amounts of deception and outright fraud on the part of the lender. Predatory lending practices result in loans that include exorbitant costs and highly disadvantageous terms for consumers. In most instances, the victims of predatory lending practice are borrowers who are experiencing financial difficulties and are ignorant of their legal rights. Most predatory lending practices constitute an unfair or deceptive trade practice under North Carolina General Statute § 75-1.1.

A recent article on predatory lending and other sources summarize predatory loan terms as follows:

> Commonly mentioned predatory terms include prepayment penalties for paying off the loan before the term ends; balloon payments that are greater than the borrower is able to raise except with even higher interest loans; high interest rates; negative amortization; high appraisal costs; requirement of up front credit insurance; mandatory pre-dispute arbitration clauses that result in borrowers waiving rights to trial and appeal if a dispute arises; yield spread premiums that are really prohibited "kickbacks" to [loan] brokers.

The same article [Celeste Hammond, *Predatory Lending - A Legal Definition and Update*, 34 Real Estate Law Journal 176 (Fall, 2005)] also notes that predatory lending can involve the following practices:

- Encouraging loan applicants to exaggerate or submit false information about their ability to repay the loan.
- Materially inflated appraisals.
- Equity-stripping loans that totally disregard the ability of the borrower to repay.
- A HUD-1 settlement statement that discloses a mortgage loan on more onerous terms and at a higher cost than the borrower reasonably expected.
- A practice known as "loan flipping" where the loan is refinanced repeatedly to the detriment of the borrower in the form of additional up-front fees.

"Loan flipping" and other abusive home loan practices are prohibited by North Carolina General Statute § 24-10.2. These prohibitions include no prepayment penalties for home loans of $150,000 or less and no financing of upfront single premium credit, life, unemployment, disability or health insurance coverages.

A licensee who knowingly participates in a predatory lending practice, including but not limited to the above listed practices, may also be in violation of the Unfair and Deceptive Trade Practices Act (General Statute §75-1.1), federal legislation and regulations, the North Carolina Real Estate License Law, and North Carolina Real Estate Commission Rules.

High Cost Loans

General Statute §24-1.1E addresses restrictions and limitations on high-cost home loans. It defines a "*high cost loan*" as *residential home loans of $300,000 or less with any of the following: 1)High fees* – loans in which the borrower is charged more than 5% of the loan amount in upfront points, fees, or other charges. The 5% calculation does not include escrows or true third party fees; or *2) High interest rate* – loans where the borrower is charged 8% more than the comparable Treasury bond rate; or *3)Prepayment penalty* (if permitted), longer than 30 months or more than 2% of the amount pre-paid. The law mandates other loan terms for lenders extending a high cost loan. These include: no financing of upfront fees and insurance premiums; required counseling for high cost loan borrowers prior to closing; no balloon payments allowed; no negative amortization allowed; and no lending without consideration of consumer's ability to repay.

Consumer's Ability to Repay

To better protect consumers in certain types of mortgage loan transactions, the General Assembly amended various statutes and added important new statutory protections to Chapter 24 of the General Statutes. The legislation is intended to deal with consumer abuses by some mortgage brokers. It deals with special terminology, defining the terms "table-funded transaction" and "rate spread home loans." A table-funded transaction is "a loan transaction closed by a mortgage broker in the mortgage broker's own name with funds advanced by a person other than the mortgage broker in which the loan is assigned contemporaneously or within one business day of the funding of the loan to the person that advanced the funds." [G.S. 24-1.1E(a)(5a).] A rate spread home loan is defined in G.S. 24-1.1F(a)(7) as:

> A home loan in which all the following apply:
>
> a. The difference between the annual percentage rate for the loan and the yield on U.S. Treasury securities having comparable periods of maturity is either equal to or greater than (I) 3 percentage points (3%), if the loan is secured by a first mortgage or deed of trust, or (ii) 5 percentage points (5%), if the loan is secured by a subordinate lien mortgage or deed of trust. ...
>
> b. The difference between the annual percentage rate for the loan and the conventional mortgage rate is either equal to or greater than (I) 1.75 percentage points (1.75%), if the loan is secured by a first lien mortgage or deed of trust, or (ii) 3.75 percentage points (3.75%) if the loan is secured by a subordinate lien mortgage or deed of trust...

This legislation contains sweeping reforms aimed at transactions that traditionally had a high incidence of predatory lending. Among other reforms, it requires mortgage companies to ensure that certain loans are affordable to the consumer. General Statute §24-1.1F(c), provides, in part:

> No lender shall make a rate spread home loan unless the lender reasonably and in good faith believes at the time the loan is consummated that one or more of the obligors, when considered individually or collectively, has the ability to repay the loan according to its terms and to pay applicable real estate taxes and hazard insurance premiums. If a lender making a rate spread home loan knows that one or more mortgage loans secured by the same real property will be made contemporaneously to the same borrower with the rate spread home loan being made by that lender, the lender making the rate spread home loan must document the borrower's ability to repay the combined payments of all loans on the same real property...

North Carolina Amortization Notice and Disclosure

The "Notice of Information and Examples of Amortization of Home Loans" form promulgated by the North Carolina Commissioner of Banks is used to comply with General Statute §24-1.1A(a1)(1). Additionally, if the loan applied for is a fixed rate loan requiring periodic payments, the lender is required to provide the borrower with an amortization schedule specific to the loan at closing or postmarked within three business days thereafter.

Residential Mortgage Fraud Act

Criminal law legislation creates a new Article 20A, titled "Residential Mortgage Fraud Act," of Chapter 14 of the North Carolina General Statutes. This legislation makes a violation involving a single mortgage loan a serious violation of criminal law (a felony). The penalty for commission of a felony can include incarceration, the forfeiture of property, and restitution. A key section, General Statute §14-118.12(a), provides:

> (a) A person is guilty of residential mortgage fraud when, for financial gain and with the intent to defraud, that person does any of the following:
>
> (1) Knowingly makes or attempts to make any material misstatement, misrepresentation, or omission within the mortgage lending process with the intention that a mortgage lender, mortgage broker, borrower, or any other person or entity that is involved in the mortgage lending process relies on it.
>
> (2) Knowingly uses or facilitates or attempts to use or facilitate the use of any misstatement, misrepresentation, or omission within the mortgage lending process with the intention that a mortgage lender, borrower, or any other person or entity that is involved in the mortgage lending process relies on it.
>
> (3) Receives or attempts to receive proceeds or any other funds in connection with a residential mortgage closing that the person knew, or should have known, resulted from a violation of subdivision (1) or (2) of this subsection.
>
> (4) Conspires or solicits another to violate any of the provisions of subdivision (1), (2), or (3) of this subsection.

District attorneys may criminally prosecute violations on their own initiative or based on evidence of possible wrongdoing received from the North Carolina Commissioner of Banks, the North Carolina Real Estate Commission, the North Carolina Appraisal Board, the Attorney General, or other sources. Real or personal property gained through the fraudulent transaction may be subject to forfeiture under the provisions of General Statutes §14-2.3 and §14-7.20, subject to certain claims of good faith lienholders and innocent bona fide purchasers who had no knowledge of the violation. Real estate agents should be aware of mortgage fraud, never participate in it, passively or actively, and should report suspected mortgage fraud to the proper governing or regulatory authority.

Identification of Loan Originator

General Statute §45A-4, titled "Duty of Settlement Agent," now requires that settlement agents include the identity of the loan originator on the deed of trust and that lenders include information regarding the loan origination in the loan closing instructions. It provides that, if the settlement agent has received information from the lender or has actual knowledge that a mortgage broker or other person acted as a mortgage broker in the origination of the loan, then information identifying that mortgage broker or other person shall be placed on page 1 of the deed of trust and shall not be considered confidential information.

Conduct of Loan Collectors and Ability to Contest Foreclosures

Session Law 2007-351 (House Bill 1374) revises and adds to various real property and foreclosure statutes and adds a major new article to Chapter 45 of the General Statutes titled "Mortgage Debt Collection and Servicing." The new legislation is consumer oriented and regulates the conduct of loan collectors, limits fees that loan collectors can charge, and increases the ability of borrowers to contest foreclosures.

LOAN FRAUD

Occasionally a buyer-borrower will attempt to bend the loan qualifying rules in his favor by providing false personal, financial or transaction information in connection with a loan application. Sometimes this is done at the suggestion or with the assistance of the real estate agent and/or the loan officer (or others). Such conduct constitutes "loan fraud," is illegal, and can have severe consequences for the parties involved.

Extent of Loan Fraud

Loan fraud is reportedly widespread. The Federal Bureau of Investigation has estimated that nearly one-third (⅓) of all mortgage loans are made based at least in part on false information, with an estimated $60 billion being improperly obtained by borrowers as a result of loan fraud in 1998 alone. It has been estimated that as many as 20% of all mortgage loans would not have been made if the lender had known the correct information.

Why Loan Fraud Is a Problem

There is a tendency for people to think loan fraud is no big deal and that nobody is really hurt if a big lending institution makes a loan for a few thousand dollars more than is called for by lending guidelines. The truth is that everyone is hurt. Remember the great savings and loan crisis of the 1980s when thousands of thrift institutions and banks failed *due to bad loans* (mostly real estate loans) and it cost hundreds of billions of dollars in taxpayer money to bail out our thrift and banking system. Our entire economy is adversely affected by loan fraud. Anytime a loan is made based wholly or in part on false information, the risk of loan default assumed by the lender and any secondary mortgage market investors is increased. This increases the costs for all borrowers and if there are too many borrowers who are barely able to make their mortgage payments, there could be major problems in the future if general economic circumstances change.

Loan Fraud: A Serious Felony and License Law Violation

Loan fraud in virtually ***all** loan transactions* involving a lending institution in the United States is a *felony under federal criminal law*. **18 U.S.C. §1001** provides that any person under the jurisdiction of the federal government who knowingly and willfully falsifies, conceals, covers up by trick, scheme or device a material fact or who makes a *materially false statement or uses a writing or document knowing that it is false* is guilty of a felony punishable by fine or up to five years imprisonment or both. The statute is intentionally broad to prevent easy circumvention. **18 U.S.C. §1014** is even more severe. It punishes one who:

> "*...knowingly makes any false statement or report, or willfully overvalues any land, property or security, for the purpose of influencing in any way the action of* ... [any governmental agency, lender, bank, credit union, corporation, etc.] ... *upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor,* ***shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both***.

NOTE that these loan fraud statutes apply to all federally insured transactions and *all submissions involving virtually any governmental entity*. Thus, the reach of the loan fraud statutes applies not only to residential transactions, but also to sales of subsidized housing, business, commercial, agricultural and other transactions which may be exempt under RESPA.

A **borrower** who obtains a loan by fraudulent means not only may have his loan canceled (called due early), but in some cases may be criminally prosecuted under federal law. Loan fraud by a **loan officer** not only exposes the loan officer to possible criminal prosecution, but also may endanger the approval of the lending institution by federal government agencies (such as the FHA or VA) to make certain types of loans, and may make it difficult for the lender to sell future loans in the secondary mortgage market. It is also possible for a **seller** or a **closing attorney** to be actively involved in loan fraud. If so, they too would be subject to criminal prosecution, and the attorney would be subject to disciplinary action by the North Carolina State Bar.

*A **real estate agent** who participates in loan fraud in connection with a transaction is not only subject to criminal prosecution for loan fraud, but also violates one or more provisions of the Real Estate License Law and runs the risk of having his/her license suspended or revoked. Remember that General Statute §93A-6(a)(1) prohibits any "willful or negligent misrepresentation or omission" to anyone involved in a real estate transaction, including a lender. Also, General Statute §93A-6(a)(10) prohibits any "improper, fraudulent or dishonest dealing" by a real estate agent in connection with any transaction. **Licensees have an affirmative duty to disclose material facts not only to their buyer and seller clients and customers, but also to the lenders and other persons participating in the transaction**.*

Elements of Loan Fraud

Loan fraud involves making false representations in order to obtain a loan of a larger amount of money than the borrower is entitled to under the lender's guidelines. The primary elements of loan fraud are:

- an intentional misrepresentation of fact
- to a lender, mortgage broker, other loan originator, underwriter, governmental agency, or any person or agency serving a lender, underwriter or government guarantor
- for the purpose of obtaining more money than the borrower could otherwise obtain
- with the expectation that the mortgage broker, originator, lender, government agency or underwriter will rely on the false information.

In almost every loan fraud, false documents are created and supplied to lenders, closing attorneys, real estate agents, and others involved in the transaction. *The loan-to-value ratio is a factor in virtually every loan fraud case, with the borrower attempting to manipulate the ratio to obtain more money than for which he or she would otherwise qualify*.

Examples of Loan Fraud

Presented below are a few examples of "loan fraud" that agents should be careful to avoid. Please note that this is not an all-inclusive list by any means, and that there can be many variations of the schemes mentioned below.

False Gift Letter

It is not uncommon for buyers to lack sufficient funds either for the minimum down payment needed to qualify for a particular loan or to pay closing costs and to receive financial assistance from a relative or other person in order to meet these cash demands. So long as the lender is aware of the nature and source of the funds, this is not loan fraud. However, occasionally the buyer-borrower obtains a *loan* that is described to the lender as a "gift" in order to deceive the lender into thinking the buyer is qualified. This is loan fraud.

> *Example:* A buyer is applying for a first mortgage loan that will require the buyer to have at least $7,500 in cash for the down payment. The buyer actually has only $4,000 available

for the down payment, but the buyer's aunt is willing to lend him the other $3,500. Knowing that the lender will question the sudden acquisition of $3,500 in cash by the buyer and will not approve the loan if the $3,500 is a loan, the real estate agent working with the buyer suggests that the buyer have the aunt provide a letter to the lender stating that the $3,500 is a "gift" to the buyer and that the buyer does not have to repay the money. The buyer does this and the lender approves the requested loan because of the false gift letter. In this situation, the buyer, the aunt and the real estate agent have all engaged in loan fraud.

Falsification of Debt Reduction

Frequently, a buyer-borrower has total recurring obligations that are too high for the buyer to qualify under the expense-to-income ratios. Misleading the lender into thinking that certain of these obligations have been paid and should not be considered in calculating the expense-to-income ratios is loan fraud.

False Claim of Owner Occupancy

In order to obtain a Farmers Home Administration, a Veterans Administration loan, or a Federal Home Administration loan, a borrower typically must certify that he or she will own and occupy the property him or herself for a specific period of time. A common loan fraud scheme involves the borrower making a false statement that he or she intends to occupy the subject property when in fact he or she does not. *Many conventional loans also require a borrower to sign an affidavit affirming personal occupancy for a prescribed period*. The ***false statement of personal occupancy*** when in fact the borrower does not intend to live there, but rather use the property for rental or other investment purposes ***constitutes loan fraud*** in that it may induce a lender to issue a loan at owner-occupied interest rates, which may be lower than interest rates offered on investment property.

False Employment and/or Income History

This category of loan fraud includes lies about borrower income, debt, employment and/or assets. In a typical case, the agent and/or other persons involved falsify or alter documents to show that the buyer is qualified when he or she is not.

In one case before the Commission, a woman who had never worked outside the home was approved for a $125,000 loan after the loan originator and real estate agent fabricated an entire employment history for her. This included business cards and letterhead showing her as a self-employed "house keeper" and submitting false income tax returns, made by substituting her name on copies of her ex-husband's tax returns.

In another case, a father was selling property to his son, who was required to pay 15% down unless the son could show that he had paid rent on the property, in which event his down payment would be only 5%. The mortgage broker and real estate licensee fabricated a tax Schedule E to reflect the father's alleged receipt of rents the son never actually paid.

Secret Second Mortgage

A long-used scheme that is similar to the false gift letter in purpose, but considerably more complex, is the use of a secret second mortgage (deed of trust). As is usually the case in most loan fraud situations, this typically occurs when the buyer-borrower does not have sufficient funds to make the necessary down payment and pay all closing costs. The seller, the agent, or some other third party agrees to advance the buyer-borrower the additional funds needed to qualify for the loan in exchange for being provided a second mortgage on the property being purchased. The *lender*, or at least the underwriter, *is not made aware of the second mortgage and no reference to it appears in any of the closing documents*. Some other subterfuge (such as a false gift letter) may be necessary to explain to the lender the sudden acquisition of substantial funds by the borrower.

After the closing, the second mortgage may or may not be recorded, but the buyer must make payments on the secret second mortgage, thus increasing the possibility that the buyer will not be able to make timely payments on the first mortgage. Obviously, this increases the risk assumed by the lender (and secondary mortgage market investors). The agreement between the buyer and the provider of the funds may or may not be in writing. Sometimes, the closing attorney may be involved in, or at least aware of, the scheme. Anybody who participates in such a scheme is guilty of loan fraud.

> **Example:** A buyer has contracted to purchase a house for $100,000 and will incur an additional $4,000 in closing costs, for a total due at closing of $104,000. The buyer only has $5000 cash and thus needs a loan of $99,000, which would represent a 99% loan to value ratio. The lender will only give a 90% loan, namely, $90,000 maximum. Some individual, whether the seller, a licensee, a loan originator, whoever, agrees to fund $9,000 of the buyer's settlement costs in exchange for a second deed of trust against the property, which arrangement is not disclosed to the lender.

Typically, the deed of trust evidencing the second "secret" mortgage is recorded a day or two after the first deed of trust held by the lender. Nonetheless, the paper trail exists and the evidence can be found by a simple search of the grantor index, part of the public records in the Register of Deeds office (now accessible for many counties on-line).

A slight wrinkle on the foregoing scheme, but similarly illegal, is where someone advances monies to an inadequately funded buyer, but rather than take a second mortgage against the property which is the subject of the transaction, the advanced funds purportedly will be secured by a deed of trust/mortgage against some other real property owned by the buyer. The buyer may or may not disclose the source of these funds to the lender, who may or may not have a copy of the prepared deed of trust against the other property in its file. Often, however, the parties' intent is to substitute the subject property to the second lien after closing. Thus, two deeds of trust are prepared, one against the non-subject property and a second against the subject property. The deed of trust against the non-subject property is never recorded; the deed of trust against the subject property is recorded after closing, thus becoming a secret (i.e. undisclosed) second mortgage as in the first scenario.

Again, the key distinction between this practice and current conventional loan practices involving a first and second mortgage previously described is that in the latter instance, the lender is fully aware of the legitimate existence of the second mortgage which also appears on the HUD-1 form and is in fact recorded. *Loan fraud arises where the lender is not aware of the second mortgage against the subject property*.

Advance Brokerage Commission Rebate

It is not unusual for buyers to run a little short of cash needed to close a deal. Closing expenses may prove to be more than anticipated, and the buyers just cannot come up with the additional money. Occasionally, an agent may be willing to effectively reduce his brokerage commission by secretly advancing the buyer the additional funds needed. If the lender is not told, and the brokerage commission reduction is not shown on the closing statement, this is loan fraud. Understand, however, that so long as the lender knows that the broker is sharing part of his or her commission with the buyer ***and*** the payment is reflected on the HUD-1 as a credit to buyer, it is entirely permissible.

False Earnest Money Deposit

The loan to value ratio is designed to insure that the buyer-borrower is financially committed to the transaction. In a false deposit case, the intent is to convince the lender that the buyer has made a sizeable earnest money deposit or down payment, when in fact he has not. In a simple false deposit case, the sales contract recites earnest money being paid, but no one can produce any records to substantiate payment or receipt. The broker may falsely advise the closing attorney that the earnest money was applied to the broker's commission and the closing statement will show the earnest money as "paid outside of closing." More complex schemes attempt to create a false paper trail to support the deception, such as *false checks*, (proffering a check supposedly written for the earnest money knowing that it was never negotiated).

Concealed Concessions

In secret or concealed concession cases, the seller or broker pays or gives certain monies to the borrower which are not disclosed on the closing statement. A typical case is where the property does not appraise at the desired value so the borrower can not obtain the loan amount originally contemplated. The seller or broker agrees to pay certain concessions to the buyer, e.g. $2000 towards closing costs, which concessions are not reflected on the HUD-1 settlement statement. This failure to tell the lender, an intentional omission, constitutes a "false statement" and is loan fraud.

Contract Kiting

Contract kiting is another complex loan fraud scheme. It involves the use of two sales contracts, one real and one fake, to deceive the lender into thinking the terms of a transaction are different than is actually the case. The point of all such schemes is to have the lender make the loan on the basis of a sale price that is higher than the price to which the parties have actually agreed. By so doing, the lender will make a loan for a higher amount than would normally be the case. In this situation, the seller, the real estate agent, and/or the closing attorney may be involved in the scheme.

> *Example:* The contract provided to the lender states the contract price as $200,000 but the parties have a second secret agreement (may be written or oral) calling for a

price of $195,000. The buyer is applying for a 90% loan-to-value loan amount. The buyer needs the sale price to be higher because he needs a $180,000 loan rather than a $175,500 loan. If the appraised value proves to be at least $200,000, the buyer will get $4,500 more than he should get based on the actual sales price.

Note: There are many variations of the contract kiting scheme, some quite complex. Often, these schemes combine different approaches discussed above, but all have the same basic purpose — to defraud the lender.

Lastly, the following description of a typical scenario is reprinted from a May 2004 *Real Estate Bulletin* article (Vol 35, No.1) written by a Commission staff attorney who has been integrally involved in the investigation and prosecution of loan fraud cases.

"The Many Faces of Loan Fraud"

In order for loan fraud to work on such a large scale, participants in the fraud typically include appraisers and mortgage loan brokers, and occasionally real estate agents and closing attorneys. The newer types of scams have different variations, but basically work like this:

The scam organizer or promoter identifies himself or his company as a type of real estate developer or investor. The promoter selects a home, usually a new construction property, and negotiates a purchase price with the seller/builder - let's say $200,000. This price is usually at market value, or it may be significantly lower if the home has been on the market for a while or if the promoter arranges to purchase multiple properties from the same seller/builder. Once the promoter has a property lined up, he recruits a buyer. These buyers are usually homeowners with relatively good credit, but typically don't have enough income to purchase a second home in a legitimate transaction.

The promoter offers the buyer the property at a greatly inflated price - for our scenario, let's say $300,000. The written contract is usually between the seller/builder and the buyer, but reflects the $300,000 purchase price. The promoter convinces the buyer that he can purchase the home with no money down and, in most cases, even promises to give the buyer anywhere from $1,000 to $5,000 in cash outside closing if the transaction closes. The promoter promises the buyer that a tenant is ready to move into the property, and that the rent the tenant pays will be used to pay the mortgage payment. The promoter promises the buyer that the house will be sold within a relatively short period to the tenant for a huge profit, and that the promoter and buyer will then split the profits from the sale.

Once the buyer is on board, the promoter directs the buyer to a particular mortgage broker and sometimes a closing attorney. Appraisers are used who greatly inflate the value of the property in order to substantiate the purchase price the buyer is to pay for the property. A mortgage broker creates false documents to show that the buyer intends to live in the property, to make sure the buyer appears to be qualified for the loan and to make the property appear to be worth more than the true market value. When the actual lender receives the paperwork, everything appears to be in order and the loan is approved.

At closing, the promoter has to make sure that he gets the profits from the loan, not the seller/builder. The seller/builder's existing loan is paid off and he gets $200,000 for the property, less his closing costs. Closing costs may include a commission to a real estate agent that is based on the amount the seller agreed to receive, $200,000, rather than on the $300,000 purchase price shown on the HUD-1. The promoter receives the remaining funds from the loan, usually shown on the closing statement as a false second mortgage payoff or false assignment fee. Although the closing statement shows the buyer bringing funds to closing, in fact the promoter uses the funds from the loan to pay the buyer's closing costs, and pay off the appraiser, mortgage broker, and buyer outside of closing. In the end, the promoter walks away with an average profit of $35,000 -$50,000 per transaction.

The tenant, if there is one, pays rent to the promoter, who in many cases is running an unlicensed property management business. The promoter makes a few mortgage payments and then quits. In many cases, no tenant ever moves into the property and no mortgage payments are ever made. The buyer can't afford to make two mortgage payments, and the property soon goes into foreclosure. The lenders can't come close to recovering the full amount of their loans through foreclosure, and the buyer's credit is ruined.

Banks and other lenders lose millions of dollars every year through mortgage loan fraud. Losses are often passed on to consumers through higher fees. Losses on government-insured loans end up being paid for by taxpayers. Individual consumers who dreamed of a business opportunity that seemed "too good to be true" learn the truth of the old adage the hard way when their credit is ruined and in many cases they are forced into bankruptcy. In addition, because promoters have targeted certain subdivisions repeatedly, false appraisals have caused property tax values in those subdivisions to soar, leaving the few existing legitimate home purchasers in houses that are overvalued for tax purposes and stigmatizing the neighborhoods with numerous foreclosures.

The FBI and SBI have been vigorously pursuing groups of promoters across the state. Some promoters, appraisers, and mortgage brokers have already been charged and other investigations are ongoing. The U.S. Attorney's office has made a commitment to vigorously prosecute mortgage fraud at all levels, including individuals holding professional licenses who are seen as key factors in safeguarding the system. Such professionals include real estate agents. In addition, the Real Estate Commission has taken an active role in identifying real estate agents involved in these types of transactions and taking disciplinary action when appropriate, including the revocation of licenses and pursuing injunctive relief against unlicensed participants.

Loan fraud can be disguised in many ways. Whether it's a single transaction loan fraud or a sophisticated scam, the Real Estate Commission expects its licensees to be the guardians of consumers and lenders alike. As such, it is your responsibility to further investigate any real estate transaction in which you are involved if it appears to include possible elements of loan fraud. You are required by law to make full disclosures to all parties, including the ultimate lender, if you suspect fraudulent behavior. Failure to do so may result in disciplinary action against your license, or criminal prosecution by federal and state authorities.