Mortgage Fraud

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Why Mortgage Fraud Matters

The Honorable Benjamin B. Wagner
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Eastern District of California
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Financial Fraud Enforcement Task Force

Mortgage fraud has been a significant contributor to the nation's financial woes, wreaking havoc from residential neighborhoods to global financial centers. It has contributed to a dramatic increase in home foreclosures, leaving clusters of empty and shuttered neighborhoods in many states. It has triggered a steep decline in home prices, devaluing many families' primary asset. Mortgage fraud has also destabilized our financial services sector and securities markets by reducing the value of mortgage-backed securities, causing enormous investor losses, driving some financial institutions out of business, and weakening others. The resulting credit squeeze has been harmful to homeowners and businesses across the country. Local governments and schools, heavily dependent on property tax revenues, have also been negatively impacted.

In the early years of this decade, a booming real estate market, combined with a relaxation of underwriting standards, created an ideal environment for fraud to flourish. With real estate prices rising rapidly, lenders were able to ease their underwriting standards since increasing home values would normally cover the mortgage in the event of a default, regardless of the creditworthiness of the buyer. Moreover, a booming secondary market for mortgages meant that mortgage lenders increasingly passed the risk of loss on to others, minimizing their incentive to probe mortgage applications for fraud. A host of professionals—real estate agents, appraisers, closing agents, attorneys, title insurance agents, and mortgage brokers—are expected to ensure the legality and soundness of real estate transactions. During our recent real estate boom, however, many of the financial incentives provided to these professionals were solely directed at ensuring that real estate transactions closed, regardless of whether the mortgage loans were prudently made.

The lure of easy money was an open invitation to those propelled by greed, whether savvy fraudsters, ethically-challenged real estate professionals, or corrupt mortgage lenders, and they took advantage of the opportunities presented. Across the nation, and especially in rapidly expanding suburban areas, many homes sold at inflated prices, supported by questionable appraisals. The loans funding the sales were often obtained with false loan applications supported by forged financial documents, or sometimes, no documents at all. The borrower was often a "straw buyer" who had no intention of actually living in the home, but rather merely allowed a con artist to use their name and good credit to purchase a home that would be foreclosed upon soon after the con artist made off with the excess loan proceeds.

By 2007, real estate values began to fall and mortgage lenders began experiencing large losses due to fraud, reducing their ability to fund new mortgage loans. Securities backed by fraudulently obtained mortgages lost value. Foreclosures left houses empty and ill-kept, while their artificially inflated prices kept new buyers from buying them. Neighbors, who had seen their real estate tax bills increase steeply due to the inflated sales prices of the fraudulently mortgaged homes, found themselves surrounded by empty, decaying houses that invited crime. In sum, the financial and human costs of the mortgage fraud crisis have been enormous. While many governmental and nongovernmental entities will play a role in facilitating the recovery from this crisis, the task of rooting out criminals in the mortgage industry and

restoring confidence in a real estate market that is a bedrock of our nation's prosperity falls to us and our colleagues in law enforcement.

On November 17, 2009, by executive order, President Obama created the Financial Fraud Enforcement Task Force (FFETF). Chaired by the Attorney General, FFETF brings together high-ranking officials from all affected federal agencies, as well as our state, local, and tribal law enforcement partners, to address issues relating to mortgage fraud and many other serious financial crimes. FFETF is leading an aggressive, coordinated, and proactive effort to investigate and prosecute financial crimes. It is marshaling the government's criminal, civil, and administrative resources to address financial frauds, recover stolen funds for victims, address discrimination in lending, and enhance inter-governmental cooperation. It is also promoting training, data collection, and information sharing. One of the crucial components of the FFETF is the Mortgage Fraud Working Group, which is engaged in coordinating a national strategy to combat mortgage fraud.

The nation's United States Attorneys are the centerpiece of that strategy. We are using all of the tools at our disposal. Criminal prosecutions are being supplemented by civil enforcement and injunction actions. We are cooperating with regulatory agencies that have authority to pursue administrative remedies. We are working closely with our state and local partners, leveraging our investigative and prosecutorial resources through state, federal, and local mortgage fraud task forces and working groups. We are raising public awareness, increasing law enforcement training, and working with industry associations and nonprofit groups to detect and prevent mortgage-related fraud schemes.

Because of the broad scope of the nation's mortgage fraud problem and because United States Attorneys are focusing such resources on the issue, many Assistant United States Attorneys (AUSAs) are now handling their first mortgage fraud cases. Additional AUSAs have been hired specifically to prosecute mortgage fraud. This edition of USA Bulletin is designed to assist those AUSAs new to mortgage fraud prosecution. The following articles will provide a basic understanding of mortgage fraud origination schemes, investigation, charging and sentencing issues, and the remedies available to United States Attorneys. We hope you will find the material useful.

Bringing those who have committed mortgage fraud to justice will help restore confidence in our real estate and securities markets, deter future acts of fraud, and restore victims to the greatest extent possible. Thank you for being part of this important effort.❖

ABOUT THE AUTHOR

❑ **The Honorable Benjamin B. Wagner** was appointed United States Attorney in November 2009. Prior to that, he served as Assistant United States Attorney for the Eastern District of California for over 17 years, including 9 years as Chief of the Special Prosecutions Unit. He has prosecuted mortgage fraud, investment fraud, money laundering, tax evasion, public corruption, domestic terrorism, and other cases. The Eastern District of California currently has two active mortgage fraud task forces.✠

United States Exhibit #3: How To Commit Mortgage Fraud

David Grise
Assistant Director
Executive Office for United States Attorneys

The United States hereby moves to introduce Exhibit #3, a letter found during the search of the defendant's home.

March 30, 2006

Dear Pat:

Your mother told me that you finally agreed to get out of the drug business. We are all very pleased. There are a number of unsavory characters in that business and your mom would prefer not to see your photo on the 11 o'clock news.

Moms always tend to worry about something, so she has now started worrying that you will go hungry. She asked me if I knew of a way you could make a good living in a short period of time without much effort and with little risk. I've got the perfect answer. It's real estate. You can get some big mortgage loans on houses you get other folks to buy and keep most of the money yourself. It's the kind of thing that makes America great. Because you tend to forget things (with the flashbacks and all), I'm going to spell it out for you, and you can look back at this letter as a reminder after you have one of your black-out periods.

I'll list the details for you, but the bottom line is that you need to arrange the sale of a house for a lot more than it's actually worth, get a mortgage loan on it for as much as possible, and skim as much of the loan as you can in cash. There are a million variations on this basic scheme and you're really only limited by your own imagination.

The two most important things to remember are never use your name as a buyer or seller and never actually put any of your own money into the transaction. Keeping you and your money out of the way is good because, in real estate, you don't want to draw too much attention to yourself and you can't lose money that isn't yours.

Finding a house and a buyer

The first thing you need to do is find a suitable house. I like to find one that needs a real handyman because then you can pretend you had it fixed and that will boost the price. Sometimes it's good enough to find a home in a neighborhood where no one is sure what the values are. New neighborhoods or ones on the upswing are ideal. If other people in the same line of work have been inflating the values of houses in the area, that's even better - it makes your price look reasonable.

The next thing you need to do is find someone to buy the house or at least let you use their name to buy it. There are lots of people walking around with good credit ratings they don't use much. Other people have hardly any credit, so they don't have bad ratings. I've used friends, relatives, street people, and addicts (no offense). One time, I used someone else's ID and acted like I was them. I know a fellow who used a dead guy's once.

You are going to need to offer these folks something for their help. With the poor folks, you can just offer them a couple of thousand dollars in return for signing a few documents. For others, you may tell them that they can live in the house until it gets foreclosed on (it usually takes the bank about a year to get them out). Once, when I found some people with money, I told them I was going to invest their money in real estate, the safest investment going. I told them that they didn't need to do anything except give me the money and sign some papers, and then I'll come back with their profits. (I haven't done that yet, but times are hard.) It took awhile for them to learn that I was buying property in their names.

Arranging the sale

Once you've found a house and got a buyer, you'll need to arrange the sale. Pick a price about double what the house is worth. Approach the seller with care and explain how you're going to arrange a transaction that's going to make everyone happy. Offer them at least what they ask for or even more. For example, if they want $200,000, tell them they'll get $250,000 if they follow your lead. Make sure that they know the price on the contract is going to have to be more than they'll actually get. Say, maybe $350,000. They'll get their $250,000, just like you promised, but the extra money will go to you.

You are going to have to have a written contract. It has to list a down payment, but don't take that too seriously. No one is actually going to have to come up with the money. The loan is going to be for way more than the house is actually sold for, so all the money to buy it can come out of the loan money. Oh, and if there is a real estate agent involved, encourage them to follow your lead. Remind them that the higher the price listed on the contract, the higher their commission. Also, make sure they know that you'll be buying lots of houses through lots of friends in the future.

Applying for a mortgage

Once you've got a contract, you're going to have to team up with some cooperative, understanding professionals. You'll need a mortgage broker and an appraiser. The good news is that you might find a mortgage broker you know from your previous line of work. A good broker will fill out a loan application for the buyer and secure the mortgage loan from a lender that is interested in making home loans as fast as it can. Some lenders seem to be suspicious of everybody. They ask lots of financial questions and want to check up on what the broker and buyer say about the buyer's financial situation. Your broker will want to avoid lenders like that. Anyway, a good broker will know which lender asks few questions and checks up on nothing. The good thing these days is that so much money comes from unregulated companies, rather than banks, and the unregulated lenders generally don't have to be so picky about the loans they make.

Even the best lender will ask some questions about income and debts, but the broker will know what needs to be said to get the loan. You may need to help the buyer come up with some documents backing up what is on the loan application, but that's not hard. You can get fake W-2s, bank statements, financial statements, and tax returns online (Uncle Martin can help you with this, once his counterfeiting charges are dropped), or you can get some help from a friendly CPA who doesn't have much work otherwise. You might want to get your buyer to sign the application form before any information is added. Tell them it's more efficient that way.

Oh, I almost forgot. Always have the buyer say that they are going to live in the home, even if you're putting their name on ten homes. You'll get better loan terms and less attention to the application. If the bank notices the buyer has other houses in their name, just say that they are being leased to other people and that they provide the buyer with lots of rental income.

Also, you might want to put the phone number of a friend down as the number of the buyer's employer, just in case the lender calls to check on the buyer's employment and income. Make sure you give the friend a script of what to say to the bank when it calls.

One sticking point is the bank account "verification form." It seems the lender wants to know that the buyer actually has a down payment in the bank. Problem is, the buyer probably won't have a dime. You can rely on a friend at the bank to stretch the truth for you or produce a fake letter yourself. However, I've found that it's easier just to give the buyer the down payment money to put into a bank account one day, get the verification letter the next day, then have the buyer take the money back out and give it back to you. (It's best to go to the bank with the buyer when they deposit the money and when they get it back. You don't want to risk your money wandering off somewhere. I can't believe how shady some of these straw buyers are.)

Another possible danger is the tax returns. In the unlikely event that the feds start snooping around, they can get the buyer's real tax returns from the IRS and compare them to the ones on the application. It's best to submit unsigned "preliminary returns" to a lender, stating that they are not final, but, if worse comes to worse, remember that they're the buyer's returns, not yours.

Of course, you're probably wondering how in the world the lenders are going to let this paperwork slide by them. They're counting on the fact that home prices always go up, never down. Even if they make a bad loan, they'll make it up when they sell the house at foreclosure for more than the buyer paid. Or, if the buyer is in trouble, they'll just let them refinance based on the higher value of the house. Home prices haven't gone down for years, so I guess the bankers are right, at least for now.

Getting an appraisal

While the broker is working on getting the loan, the appraiser will work on paperwork showing that the house is worth whatever you say it's worth. Make sure the appraiser knows in advance what the appraisal needs to show, that no one wants to pay for a disappointing appraisal, and that you'll be glad to hire a cooperative appraiser for all the other houses you'll buy. Reassure the appraiser that, no matter what the appraisal says, the appraiser doesn't have to worry. An appraisal is only an opinion and no one ever got in trouble for expressing an opinion, even if it was way wrong.

The appraiser can make the paperwork pretty by describing the house in the best possible terms, comparing it to houses with high values and ignoring things which might worry a lender. I've asked appraisers I work with to compare my houses to other houses I worked. The prices on those houses have already gone through the roof. If the house has been sold recently for a lower price, it would probably be best just to leave that off the appraisal altogether.

These days, most appraisals include photos. You'll have to be careful about the part of the house shown. A long shot without a big lens might be best. Or, because most lenders don't actually go and look at the house, you may just want to substitute a photo of a different home. Make sure it's made of the same materials. Pictures of a wooden house don't do well when the one being appraised is brick.

The closing

All real estate transactions involving a mortgage will have a "closing" where the people involved get together, pass around the money, and transfer the deed. Then the person handling the closing reports to the lender what was done with the money. In your state, you'll have a closing attorney who will run all the money through his escrow account. The lawyer will have a document called a HUD-1 Settlement Statement (named after someone named "Hud," I guess) that will say where the money came from and where it went. The form is required by the feds (always a pain).

The attorney needs to understand that the distribution of the money doesn't need to match what is on the HUD-1 exactly. If you get an attorney who is a real stickler for detail, suggest that you use two HUD-1s, one for the closing and one to show the lender. They don't have to match. The lender just has to feel good about the transaction. Finally, make sure that you've got a check for the down payment ready. No one will cash it, but a copy of it can stay in the file in case some auditor comes around.

Now, the problem with the closing is that you've got to make sure that the extra loan money comes to you. If all the money goes to the seller, you'll have to rely on the seller handing your share of the money over to you after the closing. If the seller is your buddy, or wants to do more real estate business with you, maybe that's okay. But, the sad truth is that some sellers are just dishonest and won't hand over the extra money. Here's what you do. List your share of the money on the paperwork as money owed to you or your company for home repairs, a lien on the property, or another loan. Then you'll get the money at the closing to pay off that fake debt and walk out with it.

After the closing

Once the closing is over and you've got your money, you don't have to worry about anything anymore. If you want to, you can make a mortgage payment or two, just so the lender doesn't think that there was something wrong with the loan up front. Then just let the loan default. The "buyer" will be the one the bank chases for its loan money, who will be liable for any taxes, and whose credit rating will take the hit. If they whine too much, tell them to declare bankruptcy. That will slow the bank way down. If you want to help the buyer, you can file bankruptcy in the buyer's name. You don't even need to tell them the nice thing you've done for them.

It's going to take the bank months to foreclose. The house will sit empty and start to decay, but you can always invite some of your old drug business buddies to move in to the empty house until someone kicks them out. The neighbors probably won't care. You're ready to move on to the next house and start all over again.

I've found that one of the great things about this business is the friends you'll make. The buyer, the real estate agent, the seller, the broker, and the appraiser are all going to make money because you've arranged the sale of a house. They'll think you're great. And, since they've all done what needs to be done to get the sale to go through, they won't be eager to say too much to the law, if it should come snooping around.

Don't worry about competing against me. I've moved on. I've started a new business helping people who are faced with foreclosures. Seems they're desperate for help and transferring their property to my new business will stop the bank from foreclosing on them. Once again, I'm the hero in the drama. Of course, once my company owns the house, I'll find a straw buyer, and then . . . well . . . you know.

You're going to find that financial innovation is the road to success. I sure have. Your Mom originally wanted me to send you some money, but I thought this advice would keep you going on your own. You know the old saying: "Give a man a fish and he'll eat for a day. Teach him how to steal fish and he'll eat forever."

Keep this letter handy where you can look back at it any time you need to. Just keep it somewhere private. The feds would have a field day with it.

Yours,

Uncle Jake❖

ABOUT THE AUTHOR

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The above letter is solely a product of the author's imagination.

Finding the Smoking Gun

Barbara E. Nelan
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Northern District of Georgia

I. Introduction

Your supervisor just dropped off a new case on your desk. A note on top of the file portrays the case as being on the leading edge of punishing those responsible for the recent economic meltdown, interesting, an important part of a national priority, supported by highly motivated federal agents and, last but not least, bound to result in a DOJ award for your excellent prosecutorial work. Oh, this cannot be good! This kind of hard sell is generally reserved for really fun cases like a Klein conspiracy tax case or an accounts receivable commercial factoring case. You open the file with trepidation. Your trepidation turns to total dismay. The case is a 50-property mortgage fraud case with 15 potential targets including more than one closing attorney, broker, organizer, appraiser, lender insider, builder, and borrower. Your first thought is, "I must have been really bad in a prior life." Your next thought is, "Where do I start?" As your breathing starts to return to normal you think, "Maybe I can gather documents, find the proverbial 'smoking gun,' get lots of guilty pleas, call myself a hero, and move on." Unfortunately, nothing is that easy, but a person can dream.

The good news about tracking down and proving mortgage fraud is that, in spite of its often seemingly overwhelming nature, fraud is fraud. Mortgage fraud is no different from any other scheme to defraud; it is about lying or hiding the truth for money. The fact that mortgage fraud occurs in the business environment is actually a huge plus for the investigation and your prosecution. The business environment requires documentation, and documentation means the fraud has left tracks. While you may have to buy both a rubber finger to turn pages and bandages for paper cuts, the boxes upon boxes of documents that you will be reviewing are the key to successful prosecution. If you were good in a prior life, you will find a single, dispositive smoking gun. The more common result of a thorough investigation

is finding an unending series of smoking BB guns. While small, even smoking BB guns, when tied together with your excellent analytical skills, can equal a smoking bazooka.

The purpose of this article is to serve as a primer on where to find the boxes upon boxes of documents and other evidence you will need to prove your case and, once you have the documents, what smoking guns are hidden therein.

II. Following the money

Because mortgage fraud is all about the money, explaining to the jury how a fraudster can scam a bank by buying property and taking out loans is the key to a successful mortgage fraud prosecution. Understanding the money flow is also a necessary starting point to any investigation. The explanation of money flow in the more typical mortgage fraud scenarios below is purposefully written on a level that you can use to convey the basic concepts to a jury.

A. Money flow in a non-fraud purchase transaction

In order to understand fraud money flow, it is best to start with a discussion of money flow without fraud. Take a scenario of a seller with a house on the market at its fair market value of $100,000. A buyer offers to buy the property for the $100,000 value and acquires an 80 percent loan-to-value loan, thus providing $80,000 in lender funds for the purchase. The buyer/borrower must come up with the extra $20,000 down payment, generally referred to as "cash from borrower" (CFB) on a HUD settlement statement. If the seller has an existing mortgage, part of the total $100,000 ($80,000 from the loan and $20,000 CFB) will go to pay that off and, ignoring closing costs for ease of explanation, the rest of the proceeds will go to the seller. If there is no existing mortgage, the seller correctly keeps the full $100,000.

B. Money flow in a fraud-for-property scheme

Now let's change this non-fraud scenario into a fraud-for-property scheme. The seller still wants $100,000 and the buyer/borrower wants to pay $100,000, but does not have the necessary CFB. The buyer suggests to the seller that the price be inflated to $125,000. Now the buyer gets an 80 percent loan that provides $100,000 (80 percent of $125,000) in lender proceeds with $25,000 due from the buyer/borrower. Remember that the seller only wants $100,000, but receives a total of $125,000. When the loan is funded, the seller can give the extra $25,000 to the buyer/borrower to be used as the CFB. The seller is happy because he ended up netting the $100,000 asking price. The buyer/borrower is happy because he got the house without having to come up with any down payment. The victim in this scheme is the lender who thought it was lending 80 percent on the purchase of a house worth $125,000. The lender was actually lending $100,000 on a house worth $100,000, or making a 100 percent loan. If the loan is not paid off, the lender will likely suffer some loss because the 20 percent equity cushion (the amount of CFB) the lender thought was present did not exist.

Staying with this example, what if, pursuant to the closing instructions of the lender, the closing agent insists that the $25,000 buyer/borrower funds (CFB) be provided before the loan is funded? This requirement will necessitate a change in the money flow if neither the seller nor the buyer/borrower has the $25,000 to front the deal. In a fraud-for-property case, there are three common ways this requirement is overcome. First, the buyer/borrower and seller may tell the closing agent that the buyer/borrower funds have already changed hands in that the buyer gave the seller $25,000 in escrow funds. This false assertion will often be documented with a false check that purports to evidence the escrow funds supposedly paid before the closing. Given that it is not the closing agent who received the $25,000 escrow check, he might

not know it is not a true check. The fact that $25,000 is an unusually large pre-closing escrow payment that the lender might question leads to the second and third ways the buyer and seller might defeat the requirement.

The second method of defeating the need to evidence buyer/borrower funds will work if the lender allows a subordinated second mortgage. That is, the seller purports to take back a $25,000 seller-financed second mortgage to seemingly provide the buyer/borrower funds. In this scenario, the seller receives the $100,000 in lender loan proceeds and a note for $25,000. There is no intention on the part of the buyer or seller to have the seller-financed note paid; rather, its only purpose is to convince the lender that the buyer/borrower really paid $125,000 for the house.

If the lender will not fund a loan with a subordinated seller loan, the buyer and seller may turn to the last commonly utilized option of using a down payment assistance program. These programs are willing, for a fee, to help the buyer and seller document CFB. The down payment assistance program (under the cover of a charity) provides the $25,000 CFB given to the closing agent at the closing. After the loan closes, rather than give the extra $25,000 back to the buyer, the seller gives it to the down payment assistance program with an additional fee for the service of fronting the CFB. This use of the down payment assistance program results in the same happy seller, happy buyer, and scammed lender.

Obviously, regardless of who the bad guy is, success of this fraud-for-property scheme will depend, in part, on obtaining a $125,000 appraisal to support the inflated price. Appraisers are often happy to comply with providing such an appraisal. In a fraud-for-property scheme, the inflation of the price is usually not as great as in a fraud-for-profit scheme and the appraiser has the plausible deniability of a willing seller and buyer at a $125,000 "price."

C. Money flow in a fraud-for profit scheme

Now change the money flow from a fraud-for-property to a fraud-for-profit scheme. The fraud-for-property scheme worked so well that we can just escalate the same scheme. The money flow will change depending on who the bad guy is. Look first at the scenario of the bad guy being the buyer. The seller is still selling a house worth $100,000, but the buyer now wants to pay $100,000 for the house, does not have the necessary CFB, and would like to walk away from the deal with money in his pocket. The buyer suggests to the seller that the price be inflated to $200,000. Now the buyer gets an 80 percent loan that provides $160,000 (80 percent of $200,000) in loan proceeds with $40,000 CFB due at closing. Remember that the seller only wants $100,000 but received a total of $200,000. Rather than just use the extra funds to pay the CFB, the loan proceeds are now enough to cover the true property value, the CFB, and still have money left over. After closing, the seller keeps the $100,000 he wanted for the house and provides the extra $100,000 to the buyer. The buyer uses $40,000 for the CFB and still has an extra $60,000. The seller is happy because he ended up receiving the $100,000 asking price. The buyer is happy because he got into the house without having to come up with the down payment and has an extra $60,000. The victim lender has now loaned $160,000 on a house worth $100,000, or made a 160 percent loan. But, you might correctly observe, how did the buyer win in the deal if he has a $160,000 loan to repay? The answer is simple. This burdensome loan is not a problem to the buyer who does not intend to repay it, hence we call this fraud-for-profit not fraud-for-property because the object was the money, not the property. Even if the buyer uses part of the extra $60,000 to make several mortgage payments to avoid a telltale early payment default, there still will be plenty of money to make the scam worthwhile—in a way that any self-respecting fraudster would love.

Staying with this example, how does the money flow change if the seller is the main bad guy? The house is still worth only $100,000, however, the seller convinces a person with good credit to "lend their credit to the deal" by being a buyer/borrower for a fee of $5,000. The seller convinces the good-

credit buyer/borrower (a.k.a., straw) that after the sale the seller will take back the house, rent it, pay the mortgage, and then resell it in a year at a profit. The straw thinks, "Wow, $5,000 and all I have to do is sign some papers and then walk away. What a deal!" The seller inflates the price to $200,000. As before, the 80 percent loan provides $160,000 (80 percent of $200,000) in proceeds with $40,000 CFB due at closing. The seller can use the extra $100,000 funds to pay the $40,000 CFB, pay the $5,000 fee to the straw, and still have $55,000 left over. In this scenario, by the time the straw discovers the seller is not living up to the promise to pay the mortgage and re-sell the property, the bad guy seller is long gone.

Finally, the same basic scenario may occur with the main bad guy being neither the buyer nor the original seller. The bad guy can buy the original seller's house for $100,000 and then put the house in a business or trust name which then becomes the new seller. This scenario can then play out in one of two ways. First, with the original seller out of the picture, it is the bad guy that recruits the straw and follows the scenario outlined above by inflating the house price to $200,000 and selling it to the straw who has applied for a 80 percent ($160,000) loan. To avoid the problem of falsifying the CFB or having to come up with a method to front the CFB, the second method is to use a refinancing scheme. In this type of scheme, the bad guy sells to the straw at the inflated $200,000 price with "owner financing" of $160,000. There is no outside lender in this first part of the transaction, so no one is reviewing the appropriate HUD forms to verify the CFB. After this first transaction, the new owner—who is now the straw—refinances the $160,000 owner financing with a lender. The lender has again loaned $160,000 on a house worth only $100,000. This fraud is made easier by the fact that often refinancing loans have less stringent qualifying requirements and the falsification of CFB is not on the HUD going to the lender.

The boldest method of carrying out the multiple transaction fact patterns outlined above is to have the transactions occur on the same day. Such a same-day flip is generally carried out so that the loan proceeds from the second transaction can be used to pay for the first transaction. The extra loan proceeds generated by the flip will go to the new seller (i.e., a business the bad guy controls) or can be paid directly to the bad guy by having the closing agent pay a false lien that has been placed on the property.

Like the fraud-for-property scheme, the fraud-for-profit scheme will require an inflated appraisal to convince the lender of the inflated value. In addition, the fraud-for-profit scheme is often more aggressive about falsifying the nonexistent CFB at closing. In such a case, the closing agent is often passively complicit or an active co-conspirator.

III. Evidence of fraud

Proving a mortgage fraud case must include proving the money flow. However, there are other material facts involved in the lending process, such as appraisals, source of funds, borrower qualifications, and title history of the property that are often falsified to accomplish the fraudster's desired money flow. These material facts and money flow are evidenced in a number of source documents that will be available in the typical mortgage fraud investigation.

A. Closing agent file

In Georgia, the closing agent must be an attorney. While this is not true in all states, regardless of whether the closing agent is an attorney, title company, or some other agent, this file is fertile ground for evidence of fraud.

Application (HUD form 1003): While you will have a copy of a loan application from the lender, and possibly from other sources, the copy in the closing agent file is important. First, this application should be compared to others to ascertain if it is the same. Second, this is the copy of the application that most lenders are going to require be initialed by the borrower at closing. Accordingly,

this copy should answer any question in the investigation regarding whether the borrower saw the application.

Title documents: The closing agent file most often includes documents related to the title of the property. Look for falsification of owner, liens, and timing of property transfers. So, for example, if the fraudster buys the property from the seller and flips it the same day to a straw buyer/borrower, look to see if the title commitment and title policy reveal who is the buyer and seller and the fact that it is being flipped the same day. Also look for evidence of satisfied liens on the HUD-1 statement. If the HUD-1 statement said Lien #1 was paid at closing, look at the title documents to see if there is a Lien #1 and, if so, when it came into existence.

Closing instructions from the lender: The closing instructions from the lender to the closing agent are very good evidence of what factors are material to the lender. For example, the closing instructions will often state that the agent cannot fund until the CFB is received. Closing instructions will also often address payoffs that must occur at closing and mandate that the lender be notified of certain circumstances, such as a rapid turnover in title.

Settlement Statement (HUD-1 form): Because mortgage fraud is all about money, in most cases the HUD-1 will prove to be the most important document in your investigation. As with the application, the HUD-1 in the closing agent file must be compared with the one in the lender file and any you gathered from the seller or other participants to the sale. A word of caution: it is not at all unusual for the HUD-1 to change while the closing is being planned. There are often one or more preliminary HUD-1s that are different from the final HUD-1, and this difference may be perfectly legitimate. Examine the nature of any difference between a preliminary HUD-1 and the final. If, for example, the sales price changes but there is only one sales contract, this might evidence fraud where the players are manipulating the numbers to make the loan-to-value match the lender's requirement. On the other hand, if the tax or payoff amounts change because the date of the closing changed, this would be expected in a legitimate closing.

The main focus of the investigation will be on the final HUD-1. As an initial matter, the final HUD-1 in the closing agent file should not differ from the final HUD-1 in the lender file or from the HUD-1 the closing agent gave the seller or buyer. Such a difference in the HUD-1 from different sources might very well evidence fraud. Note as well that most lenders require receipt of the final HUD-1 prior to funding (often faxed the same day). This last-minute requirement is good evidence that the accuracy of the information on the HUD-1 is material to the lender.

The final HUD-1 must also be compared to the actual money flow. This comparison has two parts. First, the HUD-1 must be compared to the receipt and disbursement record and checks in the closing agent's file. The receipt and disbursement record is often a document such as a LandTech printout, which is a software program that closing agents use to track closings. This record should match both the HUD-1 and the checks. Second, the receipt and disbursement record and checks must be matched to the escrow account. Do not assume that just because you see a photocopy of a check that the transaction actually took place. The escrow account should evidence that lender and CFB funds were deposited. For example, the HUD-1 and receipt and disbursement record may indicate that the closing agent received $20,000 CFB with the file containing a photocopy of a $20,000 cashier's check. When you check the escrow account you might find: (1) the deposit occurred as indicated on the HUD-1; (2) there was no deposit of $20,000; or (3) there was a $20,000 deposit but it was after closing, and it was not the borrower's check as depicted in the file, but rather a check from the seller or another source. Likewise, cash flow out of the escrow account must match. For example, if the HUD-1 indicates that a check of $15,000 was given to pay off a lien, when you check the escrow account you might find: (1) there was no

check out; (2) there was a check out but to a different entity; or (3) the check out was endorsed over to someone other than the original payee.

B. Broker file

_______**Application (HUD form 1003)**: If a non-lender broker is utilized, the file should be obtained and compared to that of the lender. If such a broker is used, there are often several copies of the application. The initial application is often handwritten and called the "scratch" copy. There could be several more versions and then a final version. As discussed above, if there are differences in the versions, these differences have to be examined to determine if they are for legitimate reasons or if the application is being manipulated to meet the requirements of the lender.

Other documents: The broker file will often contain communication between the broker and borrower which is helpful in determining the knowledge and involvement of the borrower in any fraud. Other communications, such as verifications of deposit, rent, or employment, will also be helpful if any of these documents are false. The broker will generally have run a credit report on the borrower. This report can contain helpful information about the borrower. For example, the credit report may tie the borrower to New York but the application may seek a primary residence loan for a home in Georgia. The bottom of the credit report will also show the number and timing of credit inquiries which, in turn, reveal some level of how active a straw has been in seeking loans.

Comparisons across files: If you suspect that a broker is a participant in a multiproperty fraud, a comparison of documents across several transactions can be helpful. For example, the broker may use the same false employers in several files or the same tax preparer. If there is no relationship between the borrowers in the files, the broker becomes the common denominator and hence the most probable source of the false documents.

C. Lender file

Application (HUD form 1003): It is surprising how often even a lender will have several versions of an application in its loan file. It is important to examine such versions because it is difficult to contend that a change in the application is evidence of fraud if the change is evident in the lender's file. There are times when the application in the lender file indicates review, which is again helpful in establishing materiality of any falsehood in the application. Such review may also be noted on verifications of deposit, rent, or employment.

Underwriting: The lender file is the best evidence of the loan program and underwriting requirements of the loan. This again goes to materiality. So, for example, a set debt-ratio requirement in the underwriting documents will help establish that an application's falsification of assets or liabilities is material.

HUD-1: The lender file will generally establish the importance of the HUD-1 statement by evidencing its approval of the final version prior to funding. As stated above, the HUD-1 statement in the lender file must be compared to the one in other files and compared to the actual money flow.

D. Appraiser file

Legitimate appraisers keep files on any appraisal they have completed. Such files may also be obtained from supervisory appraisers if one is used on an appraisal. Such a file generally includes documentation of the appraiser's research and pictures. While far from conclusive, failure to have such a file may be an indication of fraud. If an appraiser's file is obtained, the research it contains will be helpful to your evaluation of the transaction. In addition, if you suspect that the appraiser is in on the fraud, check

to see if your state's appraisal regulatory body has undertaken any investigation on your properties or others involving the same appraiser. Such an investigation, and the appraisers response, can be useful in your case regardless of the outcome of the investigation. For example, in a recent trial of an appraiser, he took the position that he was inexperienced and any errors were due merely to his negligence. *See USA v. Alcindor, et al,* No. CR00269, 2007 WL 4564195 (N.D. Ga. Jan. 28, 2007). However, in the appraisal board file concerning a past investigation, the same appraiser had asserted his overwhelming experience and attention to detail.

E. Borrower or seller files

Depending on who is in on the fraud, the seller or borrower may have records that help establish the fraud. For example, in a flip to a straw scenario, it is not at all uncommon to find that the straw borrower has been given some documentation, in the form of a written sales pitch, showing how the deal will work. Similarly, when the seller is not in on the fraud, he or she may have been given a different HUD-1 that does not include an inflated price or a payoff on a false lien. With regard to the buyer or seller, either one may have correspondence or e-mails that will help establish who the players are in the fraud.

The most common outside verifications relate to facts in the application and supporting documentation regarding the qualifications of the borrower. Examples of such verification include bank documents of the borrower to verify the accuracy of deposits, employment records, property records, tax records (state and federal), and possible rental records if the application indicates the borrower owns rental property.

Verifications related to the property can also be important. This verification may include something as simple as going to see the property. There is obviously a problem if the beautiful picture and description of the property in the appraisal turns out to be an empty lot, a half-built house, or a house in ill-repair. Along the same lines, physical verification of the properties utilized as comparables in an appraisal is often helpful. Property real estate records and property tax records will also reveal (for the subject property and comparables) if there have been changes in ownership or prices that differ from the chain of title in the lender's file.

Real estate sales information can be very important in determining value. For example, if a house sells for $200,000, but you discover that it was listed for sale in a multiple listing service at $100,000 and did not sell for the prior 6 months, it is likely that the price has been fraudulently inflated. In this same regard, the real estate agent that had the house listed for $100,000 can be an excellent first-hand fact witness concerning the value of the house, without having to qualify an expert witness.

IV. Conclusion

This article has hopefully given you some valuable ideas about where to find your smoking gun. One obvious limitation is the ever-changing methods by which the bad guys manage to defraud the lending system. You will just have to get used to the fact that stopping mortgage fraud is a little like playing the game "Whack a Mole." You hardly have time to congratulate yourself for successfully beating down one type of fraud scheme when another new and improved scheme pops up. But remember, fraud is fraud, it is simply lying for money, so the methods discussed above should help you investigate historical cases and future mortgage fraud schemes yet to be invented by the fertile minds of fraudsters.❖

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Using Community Outreach to Find and Prosecute Mortgage Fraud

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Mortgage fraud presents a variety of challenges to the federal prosecutor. We operate on lean budgets, we must be nimble enough to recognize the ever-changing nature of the fraud, and we often find ourselves frustrated with our inability to help victims. Developing and maintaining relationships with community groups that come in contact with mortgage fraud victims helps with meeting each of these challenges.

Many, if not most, United States Attorneys' offices work with other federal, state, and local law enforcement agencies on mortgage fraud task forces. These structures are valuable organizational tools that help law enforcement set resource priorities, share those resources, and use them more efficiently. The law enforcement task force, put together to address a particular problem, is well known to federal prosecutors; we use it in a wide variety of contexts, and it has proven to be effective.

The law enforcement task force is not the only way to coordinate efforts to combat mortgage fraud. Although task forces are effective in maximizing our resources and making the most of intelligence, federal prosecutors must have relationships with community groups to effectively combat mortgage fraud. Such relationships can help law enforcement to investigate and prosecute mortgage fraud, prevent such fraud from happening in the first place, and assist victims of the fraud.

In the Eastern District of Pennsylvania, we recently created a Community Advisory Committee. Our Community Advisory Committee works parallel to our Mortgage Fraud Task Force. The Committee is not new; it is the formal entity that embodies a set of relationships we have nurtured over nearly a decade of focusing on mortgage fraud. Those relationships have been vital to our prosecutorial efforts.

All prosecutors have relationships with community groups from whom they take complaints and receive referrals. We have expanded this familiar concept to include as many groups as we could find that have contact with potential victims of mortgage fraud or that have some type of consistent information regarding the latest mortgage fraud scams.

Developing useful community partnerships takes some leg work. The relationships that we have developed in the Eastern District of Pennsylvania can be duplicated elsewhere. The key is tapping into the networks of organizations and individuals who care about and are working to address mortgage fraud. We have found that there are many networks and organizations out there and these groups are anxious to provide information to us. What they look like and who comprises them will differ by community. Learning about them may seem mysterious at first but, with a little time, will be easy.

Here are some tips that helped us:

- Speak with your local HUD-OIG agents who have access to information about community groups focusing on foreclosure prevention.
- Check with the local legal services or legal aid office and ask who works on housing issues.
- Look up the HUD-approved housing counselors in your area and knock on their doors.
- Find out whether there is a "Don't Borrow Trouble" hotline nearby and see who runs it (Don't Borrow Trouble is a Freddie Mac-sponsored program to help people avoid predatory mortgage loans).
- Call up the local offices of large banks and ask to speak with their Community Reinvestment Act officers.

These people and organizations are entry points into the pre-existing networks. They can guide your understanding of the makeup and structure of the particular networks in your community. You may learn that the center of the network is a private law firm, religious organization, or community development corporation. Once you find the network and its center, you can begin to forge relationships with the people and organizations that make up that network. The groups that we have contacted in our district have been uniformly excited about talking with us. At our first meeting of the Community Advisory Committee, we filled a large conference room with dozens of representatives from groups from all over our district. They were anxious to talk to us about the problems they were seeing and to meet in the future. Following the meeting, several groups contacted us about potential cases and also told us about additional victims in investigations that were already pending.

Like it has for us, the investment in legwork will reap dividends. The most obvious of these dividends will be the better use of your investigative and prosecutorial resources. The people and organizations with whom we work closely—legal services attorneys, housing counselors, and housing activists—have direct, personal contact with the people that mortgage fraud affects. By contacting us right away when someone comes to them, they can save us the time of searching out victims. They hear from the senior citizen who was misled into getting a reverse mortgage he did not need, the homeowner in danger of foreclosure who paid someone for loan modification assistance that never materialized, and the young couple who can no longer afford the house they purchased by letting a mortgage broker convince them to lie about their income. They see the mortgage fraud schemes in our community as they are

happening. From them, we have learned about the schemes that are the most harmful, thereby allowing us to adjust our resources so that our prosecutions will have the greatest impact. Put simply, our community partners are tipsters. Also, putting a human face on the federal government breeds trust and fosters confidence in us.

The local citizens and organizations do more than just come to us with tips. Our community partners come to us with evidence. In the course of their own work—whether it is litigating a case of predatory lending or advising a client on a loan refinance—our community partners have gathered a great deal of information. By the time they speak with us, they have talked to the victims of the fraud, they may have obtained transactional documents, or they may have even deposed a possible target. Having such information is invaluable. It helps us to decide whether a federal prosecution is warranted and, if so, it identifies for us important witnesses, key documents, and fruitful leads. We can therefore economize our investigative resources.

In that regard, our Community Advisory Committee is working toward more formal methods of sharing information with us and with each other. For example, we are in the process of exploring the creation of a local mortgage fraud "wiki," a Web site that will allow its users to update its content. (The popular Web site Wikipedia is just one large wiki.) Using such a forum, our community partners can publicize to each other and to us the kinds of things they are hearing and seeing in the mortgage market. We envision funding the project by tapping into government and private foundation grants. As another example, we are now working closely with fair housing advocates who pioneered the use of "testers" in policing the housing market and ensuring that sellers and lessors did not discriminate unlawfully. These advocates won a federal grant to expand their use of testers into the area of mortgage fraud prevention. With these advocates, we are creating a testing protocol meant to flush out mortgage fraud schemes.

These partnerships also educate the community on our role and the proper role of law enforcement. Our experience is that many community groups know little about what we do. Many think we have control over all facets of the government and can change policy overnight or, at least, in a very short time. Also, many believe that we represent their clients or constituents and can reverse foreclosures and immediately make victims whole. They also may not understand that federal investigations take time, especially ones where investigators are looking at dozens or even hundreds of transactions, and are conducted in secret. They may not understand that the only satisfaction they may get is seeing their victimizer face justice some time in the future. To maintain credibility and not raise expectations, we need to speak clearly and candidly to these groups about the limitations we deal with while at the same time ensuring that they know what we can offer. We can offer victims a chance to tell their story to a federal judge, who may consider what they have experienced and use that as justification when sentencing their victimizer. We can also offer victims a chance at restitution and a chance that they will see justice. They must know that we are not the only solution, rather we are one part of the solution.

Information sharing helps not only in investigating and prosecuting mortgage fraud but also in preventing mortgage fraud from happening in the first place. Mortgage fraud, like all fraud, is a crime of opportunity. Open the door to such fraud and someone will walk right through. With our community partners, we want to close that door. We have attempted to do so by focusing on education and training. Much of mortgage fraud is retail. It happens individual transaction by individual transaction —in a person's home, over the telephone, or through a direct mail solicitation. It happens when someone tries to save his home from foreclosure by agreeing to sell it to a "foreclosure specialist" and then lease it back, only to learn that the sale-leaseback was a scam. It happens when someone agrees to act as a straw purchaser in a flipping scheme in exchange for a few thousand dollars, only to learn that he has bought a house going to a sheriff's sale and has ruined his credit. The more that people know about mortgage transactions and the fraud that occurs in such transactions, the less likely they are to become a victim or unwitting participant.

With our community partners, we have worked to alert people to the red flags of mortgage fraud. We created a training module and accompanying workbook that teaches people about the documents that they will encounter in any mortgage transaction. Consumers who go through the training, put on by one of our community partners learn where to look in the documents for possible signs of fraud. Hundreds of people throughout Pennsylvania have been through the training. We have also printed a brochure with tips on how to avoid mortgage fraud. The brochure, which is in English and Spanish, includes contact information for organizations that can advise consumers about their mortgage loans. Our community partners have distributed the brochure to thousands of people. Prosecutors in our office speak at conferences set up by our community partners. There, we share our experiences investigating mortgage fraud and give community members practical ideas to avoid it.

These relationships with community groups also strengthen our relationships with local law enforcement. We bring local law enforcement to every meeting we have with community groups. We cannot investigate all of the cases referred to us. In our experience, consulting with the local police and district attorneys about referrals we receive and sending appropriate cases to them creates goodwill. Even just having local law enforcement at the community group meetings keeps them informed.

Unfortunately, all of the resources devoted to preventing and prosecuting mortgage fraud are unlikely to entirely stamp it out. Mortgage fraud will continue to occur and with it will come victims. The victims of mortgage fraud face tragic consequences. All too often, the result of the fraud puts its victims in danger of losing their homes to foreclosure. Just as often, the perpetrators of the fraud are in no position to help. The money they may have stolen in the fraud is long gone or there is too little left to stave off the foreclosures. The criminal process is not set up to help the victims find ways to fix all the problems the fraud has caused. That is where community partnerships can help. Housing counselors can assist victims in finding loan modification programs that may be available to them. Private, civil attorneys can bring actions to stop foreclosures while homeowners work with lenders to refinance loans. Credit counselors can help homeowners take control of their finances so they do not again fall prey to mortgage fraud scams. In the Eastern District of Pennsylvania, our community partners have done all of that and more. Because of longstanding relationships with our community partners, we have been able to help victims in ways that criminal prosecution alone cannot. We are tied into the network of people and organizations who help consumers with their mortgage loans, and we can refer victims to places we trust so that they get the help they need.

Should you choose to employ community partnerships in the way that we do in the Eastern District of Pennsylvania, you will likely create relationships that will be very different from our relationships with our community partners. The communities in our region have unique characters and, to some extent, face unique frauds. Our partners have helped us to understand that uniqueness and to respond accordingly. That is the ultimate benefit of community partnerships; they ensure that you are meeting the law enforcement needs of the communities that you serve.❖

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Making Choices: Charging and Plea Negotiations

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I. Introduction

In 2008, mortgage fraud resulted in over $1.4 billion in losses, an increase of 83.4 percent from 2007. FED. BUREAU OF INVESTIGATION, 2008 MORTGAGE FRAUD REPORT "Year in Review," http://www.fbi.gov/publications/fraud/mortgage_fraud08.htm. Losses reported for the first half of FY 2009 exceeded the same period in FY 2008 by $208 million. *Id.* While the actual amount of loss is unknown and perhaps unknowable, the losses are huge, with devastating effects on the housing and financial markets and on the economy in general. Such losses beg for increased prosecutorial response, and the Department of Justice has obliged. While mortgage fraud is a specialized area of prosecution, it remains a fraud investigation. This article will discuss considerations in charging and plea negotiations in the context of mortgage fraud.

II. What statutes are in our arsenal? What are their relative advantages and disadvantages?

In the federal system, there is no specific statute aimed at mortgage fraud. However, because there are many traditional statutes aimed at fraud, this is not a problem for the prosecutor. For example, wire fraud, mail fraud, and the other fraud statutes are familiar to courts and lawyers and are completely satisfactory for use with mortgage fraud.

Choosing among the various statutes in our arsenal requires consideration of which statute will be most effective and least problematic for the situation at hand. What is the evidence in the case? Do some statutes fit the facts better than the others? Do some statutes have greater impact with the jury? Do some statutes result in higher sentencing exposure, both statutorily and under the sentencing guidelines? Do some statutes provide venue and others not?

III. Mail fraud and wire fraud

The mail fraud statute, 18 U.S.C. § 1341 (2009), is the grand dame of the fraud statutes, and the wire fraud statute, 18 U.S.C. § 1343 (2009), is its sister. Both are expansive in their coverage of fraudulent activity. The case law is plenteous, and pattern jury instructions are readily available for both wire and mail fraud. Furthermore, judges and lawyers are familiar with the statutes and the law.

Increasingly, however, documents are not sent by mail but rather by wire, fax, or, more likely, by e-mail. The elements of wire fraud are identical to that of mail fraud with one exception: wire fraud requires that the defendant cause interstate wire facilities to be used, whereas mail fraud simply requires that the mails be used. If the lender is situated in your state, you may lack the interstate element of wire fraud. However, because many lenders send wire transfers from locations other than their own offices, you may still be able to charge the wiring of the funds as a wire fraud violation even if the lender is in your district.

Both mail fraud and wire fraud have a 20-year statutory maximum sentence. Under U.S. SENTENCING GUIDELINES MANUAL § 2B1.1 (2009), the sentencing range is driven by the amount of loss and applicable enhancements.

IV. Bank fraud

Like mail and wire fraud, the bank fraud statute, 18 U.S.C. § 1344 (2009), has existed for a long time, has lots of case law, and has pattern jury instructions. Judges and lawyers are also familiar with the statute and the law. Furthermore, the phrase "scheme to defraud" is defined very broadly.

To charge a violation of the bank fraud statute, a financial institution must be the victim of the fraud. If the financial institution is complicit in the fraud scheme, this statute would not apply. Furthermore, the financial institution must fall within the definition of "financial institution" in 18 U.S.C. § 20 (2009). Until the Fraud Enforcement and Recovery Act of 2009 (FERA), effective May 20, 2009, changed the definition of financial institution, mortgage lending businesses were usually not covered by the bank fraud statute; bank fraud was limited to FDIC-insured institutions, credit unions, federal home loan banks, and other such entities. FERA, however, added mortgage lending businesses within the coverage of the statute and defined a "mortgage lending business" as "an organization which finances or refinances any debt secured by an interest in real estate . . . whose activities affect interstate or foreign commerce." Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617 (2009). The Act is not retroactive; therefore, the fraudulent conduct must have occurred after May 20, 2009 to take advantage of the expanded definition.

A violation of the bank fraud statute has a 30-year statutory maximum sentence. Like mail and wire fraud, bank fraud is under U.S. SENTENCING GUIDELINES MANUAL § 2B1.1 (2009), with the sentencing range driven by the amount of loss and applicable enhancements.

V. Interstate transportation of funds obtained by fraud

The statute criminalizing the interstate transportation of funds obtained by fraud or of stolen property (commonly referred to as ITSP), like the other fraud statutes, is a classic statute to use in fraud cases. 18 U.S.C. § 2314 (2009). Like mail and wire fraud cases, there are lots of case law and pattern jury instructions.

The statute requires that the property taken or the money obtained by fraud have a value of $5,000 or more. This is not a problem in mortgage fraud cases, but it is an element of the offense. The statute also requires that the defendant have knowledge that the property was taken by fraud, although specific intent is not required.

An advantage of the ITSP statute is that, even if there were no wirings or mailings, the statute applies as long as the property or money was taken across a state line. In districts such as the Western District of Missouri, where fraudulent activity may take place on the Kansas side of the state line but the money is brought into the state of Missouri, the ITSP statute provides venue in Missouri, even though all the wirings were in Kansas, as long as the money was transferred to a bank account in Missouri or otherwise brought into the district.

A violation of this statute has a 10-year statutory maximum sentence. Like the other fraud statutes, it is under U.S. SENTENCING GUIDELINES MANUAL § 2B1.1 (2009), with the sentencing range driven by the amount of loss and applicable enhancements.

VI. False statements to a financial institution

A violation of 18 U.S.C. § 1014 (2009), which prohibits false statements to a financial institution, has the same advantages, disadvantages, and considerations as a violation of § 1344 (the bank fraud statute). Like the bank fraud statute, the definition of financial institution was amended by FERA, effective May 20, 2009.

VII. Money laundering

The money laundering statutes, 18 U.S.C. §§ 1956–1957 (2009), have been on the books for more than 20 years and are well known to judges and lawyers. There is a wealth of case law and pattern jury instructions for these statutes as well. Unfortunately, the jury instructions for a violation of § 1956 are convoluted, confusing, and difficult for a jury to understand. The instructions for a violation of § 1957 are easier to understand and less confusing than the instructions for § 1956.

In 2008, the Supreme Court held in *United States v. Santos*, 128 S.Ct. 2020 (2008), that the proceeds of criminal activities under the money laundering statutes included only the criminal profits, not the criminal receipts, of the underlying criminal conduct. In response to what many lawmakers believed to be the negative impact of the *Santos* case, Congress amended §§ 1956–1957 in FERA, specifically changing the definition of "proceeds" to include the gross receipts of illegal activity. Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1618 (2009).

Congress also included in FERA a "sense of Congress." *Id.* at 1618–19. This requires government attorneys to obtain prior approval of the Attorney General, Deputy Attorney General, Assistant Attorney General, Deputy Assistant Attorney General, or U.S. Attorney before a prosecution is initiated under either §§ 1956 or 1957, if the money laundering offense is "so closely connected with the conduct to be charged . . . that there is no clear delineation between the two offenses." *Id.*

Section 1956 has a 20-year statutory maximum, and § 1957 has a 10-year statutory maximum. Under U.S. SENTENCING GUIDELINES MANUAL § 2S1.1(b)(2)(B) (2009), a violation of § 1956 adds two levels to the underlying fraud guideline. Under U.S. SENTENCING GUIDELINES MANUAL § 2S1.1(b)(2)(A) (2009), a violation of § 1957 adds one level to the underlying fraud guideline.

VIII. Conspiracy options

The traditional conspiracy statute is 18 U.S.C. § 371 (2009). The books are replete with cases under this statute and pattern jury instructions abound. Drafting a § 371 conspiracy charge requires setting forth the overt acts, which takes more work on the prosecutor's part, but it provides an opportunity to describe the scheme in detail. This description of the overt acts goes with the jury to the jury room for their consideration during deliberations since they have to find at least one overt act to convict. This is immensely beneficial to the prosecution, as it is a summary of the prosecution's evidence, communicating indirectly to the jury when direct communication is no longer possible. Section 371 has a 5-year statutory maximum. There is no increase under the Sentencing Guidelines for a conviction under § 371; the calculation is based on the guideline for the underlying substantive offense. U.S. SENTENCING GUIDELINES MANUAL § 2X1.1(a) (2009).

Passed in 2002, 18 U.S.C. § 1349 (2009) is another conspiracy statute. It applies to violations of the fraud offenses included in Chapter 63 of the criminal statutes, including mail fraud, wire fraud, and bank fraud. Because this is a relatively new statute, case law and pattern jury instructions are more scarce. No overt acts are needed in the indictment. The maximum penalty is the same as for the underlying fraud

statute: either 20 or 30 years. U.S. SENTENCING GUIDELINES MANUAL § 2B1.1(a)(1) provides for an extra base point to be added to the guideline calculation for a conviction under § 1349.

IX. Additional statutes

While the statutes described above are the common statutes to charge in mortgage fraud cases, do not forget to consider other potential charges which may apply, including:

- 18 U.S.C. § 1001 (2009): false statements to a government agency or agent
- 18 U.S.C. § 1028 (2009): identity theft
- 18 U.S.C. § 1028A (2009): aggravated identity theft
- 18 U.S.C. § 1342 (2009): use of a false name or address in mailings
- 42 U.S.C. § 408(a) (2009): use of a false Social Security number

X. When to charge

As in any case, the main factor to consider in the timing of an indictment is whether you are ready to pull the trigger. Is the investigation completed? Are the facts developed? Have the witnesses been interviewed? Have the witnesses who need to be locked in appeared before the grand jury to testify? Have you obtained all the property files from all the sources (real estate agent, mortgage broker, lender, title company, or closing attorney)? Are you ready?

Another major consideration in the determination of when to charge is that the scheme will likely continue and the losses continue to escalate as you continue investigating. If you wait until you have everything, you will be in continual pursuit of a moving target!

XI. How to charge: indictment or information

If all your targets are willing to plead to an information, wonderful! You are in an enviable position. If some are and some are not willing to plead, you need to determine whether there will be logistical problems if some are charged by information and some by indictment. Will the different timing create problems? Will there be logistical problems with the court? Will it be better to charge all by indictment and take early pleas from those willing to do so? Regardless of other possible issues, do you want to allow cooperators to plead to information?

XII. Plea negotiations

Pre-indictment plea negotiations are frequently a process of educating the defense attorneys regarding the case. It is often beneficial to offer to meet with defense attorneys and walk them through the evidence against their clients, with the agents present. Either the prosecutor or the agent can present the information and in varying degrees of detail. If there are smoking-gun documents, this is the time to pull them out. However, do not oversell your case. If there are problems or lack of evidence, be candid. The weaknesses will be revealed in the discovery anyway and your credibility is more important in the long run than getting a plea on any case.

Plea negotiations may result in agreements to charge certain statutes instead of others. For example, instead of charging a § 1349 conspiracy, you may agree to charge a § 371 conspiracy; instead of charging mail or wire fraud, you may agree to charge interstate transportation of funds obtained by fraud; instead of charging a number of substantive counts, you may agree to charge the conspiracy and only one

or no substantive counts. Regardless of the charge(s) you consider, in conformance with Department policy, we must require pleas to the most serious, readily provable offenses.

XIII. Conclusion

The options for charging a mortgage fraud case are many and varied. Among the available statutes are several that will no doubt apply to any fact situation. Choose the ones best suited to your case, charge the case when and in the manner most advantageous to the prosecution, and may you soon be involved in successful plea negotiations.❖

ABOUT THE AUTHOR

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Civil Remedies for Mortgage Fraud

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I. Introduction

The number of reported mortgage frauds has been growing at an astronomical rate. According to an FBI report, from 2004 to 2008, the number of suspicious activity reports (SARs) describing mortgage fraud has risen by over 272 percent. It is expected that the number of SARs filed in 2009 will exceed 70,000. *See* FED. BUREAU OF INVESTIGATION, 2008 MORTGAGE FRAUD REPORT, "Year in Review," http://www.fbi.gov/publications/fraud/mortgage_fraud08.htm. These numbers are all the more striking because they only include reports from federally-insured financial institutions and not independent mortgage companies. These statistics make it clear that the traditional approach of considering criminal prosecutions as the exclusive remedy in responding to this endemic problem is inadequate.

Fortunately, extremely powerful civil remedies are available to supplement criminal prosecutions in providing both punishment and deterrence. This article will provide a basic overview of three of the weapons in our civil arsenal. The first is 12 U.S.C. § 1833a (2009), a civil penalty statute that was passed as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) in response to the 1980s savings and loan crisis. *See* Pub. L. No. 101-73, § 951, 103 Stat. 183, 498–99 (1989). The second is the Civil False Claims Act (FCA). *See* 31 U.S.C. § 3729(a) (2009). The third is injunctive relief available to enjoin fraudulent activities. *See* 18 U.S.C. § 1345 (2002).

II. FIRREA

FIRREA was enacted in 1989 in the wake of the savings and loan crisis of the 1980s. Among other provisions, it established the Resolution Trust Corporation to close hundreds of insolvent thrifts and

created two new deposit insurance funds, both administered by the FDIC (later combined in 2005). Significantly, for our purposes, FIRREA created a powerful civil penalty provision to punish past fraud and deter future fraud against financial institutions.

The FIRREA civil penalty provision, codified at 12 U.S.C. § 1833a (2009), provides for a maximum civil penalty of $1 million. For continuing violations, the maximum penalty increases to $1 million per day or $5 million, whichever is less. If, however, there is a gain to the violator or a loss to another, these maximum penalties increase to the amount of the gain or loss, whichever is greater.

A. FIRREA's application

Violations of specific criminal statutes trigger the civil penalties available under FIRREA. Although a violation of a criminal statute is required, there is a lower "preponderance of evidence" burden of proof that applies when a civil action is brought under FIRREA. *See* 12 U.S.C. § 1833(a) (2009). This is one aspect of FIRREA that makes it a very useful tool to supplement criminal prosecutions. Because of the lower standard of proof, investigations and prosecutions pursuant to FIRREA tend to be more efficient and faster than criminal investigations. Moreover, civil actions under FIRREA can be brought in cases in which the evidence is insufficient to prove guilt beyond a reasonable doubt.

Under 12 U.S.C. § 1833a(c)(1) (1996), a violation of FIRREA occurs when there is a violation of, or conspiracy to violate, any of the following:

- 18 U.S.C. § 215 (2009): receipt of commissions or gifts for procuring loans
- 18 U.S.C. § 656 (2009): theft, embezzlement, or misapplication by bank officer or employee
- 18 U.S.C. § 657 (2009): theft, embezzlement, or misapplication by lending, credit, or insurance institution officer, agent, or employee
- 18 U.S.C. § 1005 (2009): false entries, reports, or transactions by officer, agent, or employee of a bank
- 18 U.S.C. § 1006 (2009): false entries, reports, or transactions by officer, agent, or employee of a federal credit institution
- 18 U.S.C. § 1007 (2009): false statements to the FDIC
- 18 U.S.C. § 1014 (2009): false loan or credit applications
- 18 U.S.C. § 1344 (2009): financial institution fraud

Sections 1014 and 1344 of Title 18 will apply in the vast majority of the mortgage fraud cases pursued under FIRREA. Until recently, these and other statutes set forth above applied only to frauds against federally-insured financial institutions or federal regulatory or credit agencies. Therefore, fraud upon a private mortgage company historically was not generally pursued as a FIRREA violation under § 1833a(c)(1). As discussed below, this has now been largely remedied by legislation that will apply to recent frauds.

For violations that predate the legislative changes, 12 U.S.C. § 1833a(c)(2) allowed us in many instances to reach fraud relating to loans originated by private mortgage companies. Under § 1833a(c)(2), a violation of FIRREA occurs when there is a violation of, or a conspiracy to violate, any of the following sections that affect a financial institution:

- 18 U.S.C. § 287 (2009): false claim upon an agency of the United States

- 18 U.S.C. § 1001(2009): false statement in any matter within the jurisdiction of the government of the United States
- 18 U.S.C. § 1032 (2009): concealment of assets from conservator, receiver, or liquidating agent of financial institution
- 18 U.S.C. § 1341(2009): mail fraud
- 18 U.S.C. § 1343 (2009): wire fraud

Under § 1833(a)(2), for example, if the fraud was committed in connection with a loan originated by a private mortgage company and the loan was subsequently sold to a federally insured institution, in most instances there would likely be sufficient evidence to establish mail or wire fraud. If this were the case, we could then use FIRREA and allege under section 1833a(c)(2) that mail or wire fraud affecting a financial institution occurred.

Two recent legislative changes have made it even easier to bring FIRREA charges in cases in which the loans originated with private mortgage companies. First, on July 30, 2008, 18 U.S.C. § 1014 (2009) was amended to include "any false statement . . . for the purpose of influencing the Federal Housing Administration . . . ." *See* 18 U.S.C. § 1014 (2009). Therefore, § 1014 and FIRREA apply to all loan applications submitted to the Federal Housing Administration (FHA) for guarantee after July, 30, 2008, regardless of whether the loans were originated by a federally-insured financial institution.

The second major change was signed into law by President Obama on May 20, 2009. The Fraud Enforcement and Recovery Act of 2009 (FERA) redefined "financial institution" to include "mortgage lending businesses." *See* 18 U.S.C. § 20 (2009). A mortgage lending business is defined as "an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce." FERA, Pub. L. No. 111-21, § 27, 123 Stat. 1617 (2009). Thus, any mortgage fraud committed against a mortgage lending business after May 20, 2009 may be a violation of 18 U.S.C.§ 215 or § 1344, and consequently a violation of FIRREA.

B. Sources of FIRREA investigations

The source of the investigation will differ in each district. It is suggested that you meet with the criminal prosecutors and appropriate law enforcement agencies in your district to identify potential investigations. There are a number of sources of investigations that have been fruitful in some districts.

Financial institutions are required to file SARs with the FBI when they detect possible mortgage fraud. These SARs include a short summary of the suspected violation. Some districts have committees that review SARs on a regular basis. During the review it can be determined whether to open a criminal or joint investigation or refer the case for civil penalties. Note that the SARs may only be used for criminal, tax, or regulatory purposes.

Another good source of FIRREA investigations is cases that have been declined by your criminal division because of insufficient evidence to prove a violation beyond a reasonable doubt or for other reasons such as falling below prosecutorial guidelines or simply a lack of resources. Review of these cases may be fruitful because there may be sufficient evidence to prove a case by the lower civil standard, preponderance of the evidence.

Your district may also want to run a report that identifies mortgage fraud investigations that have been open for some period of time. Again, the evidence may be insufficient to warrant a criminal prosecution but sufficient to prove a case by FIRREA's lower burden of proof. Alternatively, the criminal Assistant United States Attorney may have hesitated to close the file even though there may be

insufficient evidence to prosecute the case criminally. Finally, you may want to look at some less culpable defendants in open or closed criminal cases to determine whether they should be the subject of a FIRREA civil monetary suit.

As part of the Department of Housing and Urban Development (HUD), the FHA has become the major insurer of mortgages in the United States. The HUD Office of Inspector General is very active in mining data to uncover ongoing mortgage fraud and is a good source of referrals. You may want to reach out to the Regional Office of the Inspector General to discuss how your offices can work together to identify potential FIRREA investigations. In addition, because the FHA is the victim, these investigations can also lead to False Claims Act cases.

C. FIRREA investigative tools

There are three primary methods to obtain evidence in a FIRREA investigation. These are: (1) FIRREA administrative subpoenas, (2) Federal Office of the Inspector General subpoenas, and (3) evidence produced to a grand jury.

FIRREA administrative subpoenas may be issued during investigations pursuant to 12 U.S.C. § 1833a(g) (2009). These subpoenas may be authorized by the Assistant Attorney General for the Civil Division, the United States Attorneys, and the Branch Directors in the Federal Programs and Commercial Litigation Branches of the Civil Division. *See* Attorney General Memorandum, May 4, 1992 (authorizing re-delegation of authority to issue FIRREA subpoenas from the Civil AAG) and the Civil Division Directive, May 5, 1992 (re-delegating authority pursuant to the May 4, 1992 Memorandum).

FIRREA subpoenas may be used to obtain documents and take testimony prior to the filing of any lawsuit. Significantly, this includes taking the sworn testimony of the target of the investigation. While the target may assert his or her constitutional right against self incrimination in such a proceeding, it has been our experience that the great majority of these individuals testify with no such assertion. If the witness does assert such a privilege, you then have the option of offering a "queen for a day" letter. This allows the potential defendant to proffer evidence with the understanding that it will not be used against him in the government's case-in-chief. The government may, however, use any leads provided in the proffer to further its investigation.

It is important to note that the Right to Financial Privacy Act of 1978 applies to subpoenas issued under FIRREA. *See* 12 U.S.C.A. § 3401 (2009). Therefore, unless you obtain a court order to the contrary, the subpoena must be accompanied by a letter to the subpoenaed party instructing them not to return the documents until they receive a subsequent notice from you. You must also notify the party whose documents are being subpoenaed how to file a motion to quash. This notice requirement is rarely a problem.

A Federal Inspector General has authority under the Inspector General Act of 1978 to require the production of documentary evidence by subpoenas addressed to parties other than federal agencies. *See* 5 U.S.C. app. 3 § 6(a)(4) (2009). If a Federal Inspector General, such as the HUD Inspector General, is involved in an investigation, you may decide to proceed by way of Inspector General administrative subpoenas to obtain documents. Once the documents are collected, you may then decide to take testimony pursuant to FIRREA subpoenas. The Right to Financial Privacy Act of 1978 also applies to Federal Inspector General subpoenas.

Grand jury information may be disclosed to a government attorney for use in enforcing § 951 of FIRREA. *See* 18 U.S.C. § 3322(a)(2) (2009). Therefore, if there has been a previous grand jury investigation, any information obtained by the grand jury may be used. Similarly, if there are parallel criminal and FIRREA investigations, grand jury information may be used in the FIRREA case. For

example, your office may decide to investigate a case targeting major real estate professionals criminally, but to consider FIRREA for lower level individuals such as straw buyers or cooperating witnesses. In such a case, grand jury material may be used in the FIRREA case.

It is important to note that the Right to Financial Privacy Act of 1978 also applies to documents subpoenaed by the grand jury if they are used for FIRREA. Because the Right to Financial Privacy Act of 1978 does not apply to the original grand jury subpoenas, it must be complied with before any covered documents are transferred for use in FIRREA investigations and prosecutions.

D. Approval of requests to file FIRREA cases

Authority to file civil FIRREA cases has been delegated by the Attorney General to the Assistant Attorney General of the Civil Division. While it is not necessary to obtain authority to initiate an investigation, authority to file a lawsuit under FIRREA is required. The authority to file such a suit may be obtained by directing a prosecution memorandum to the Assistant Attorney General through Arthur Goldberg, Assistant Director, Regulatory Enforcement and Financial Institution Litigation, Federal Programs Branch.

III. The False Claims Act

The False Claims Act is another significant civil tool for the punishment and deterrence of mortgage fraud. *See* 31 U.S.C. § 3729(a) (2009). It should be seriously considered in any investigation involving fraud upon the FHA, whether there is a criminal prosecution or civil action under FIRREA.

United States v. Eghbal, 548 F.3d 1281 (9th Cir. 2008), *cert. denied*, 130 S. Ct. 153 (2009), is instructive of the False Claims Act's application to mortgage fraud relating to HUD-guaranteed loans. The *Eghbal* case involved two mortgage brokers who purchased HUD-foreclosed homes and sold them to buyers with mortgages guaranteed by HUD. *Id.* at 1282. The mortgage brokers were aware that the buyers had insufficient funds for the down payments, so they personally provided the down payments for the buyers. *Id.* The brokers signed the HUD-1 Settlement Statements falsely representing that they provided no funds towards the down payments. *Id.* The brokers "sold 200 properties, at least 62 of which defaulted on their HUD insured mortgages." *Id.* at 1282–83. Nearly 30 of these properties (for which HUD paid out $2.8 million) were the subject of *Eghbal*. *Id.* at 1283.

The defendants argued that they were not liable under the False Claims Act because they only "sought . . . to fraudulently induce HUD to insure the mortgage, not to have the buyers default or cause the mortgage holders to make claims on HUD." *Id.* The court rejected this argument and found liability, reasoning that the false statements were "relevant to the government's decision to confer a benefit." *Id.* (quoting *United States ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166, 1173 (9th. Cir. 2006)).

The court also discussed an acceptable method of calculating treble damages in a mortgage fraud case. *Id.* at 1285. The False Claims Act provides for a penalty of anywhere from $5,000 to $10,000 per violation, plus three times the loss to the government. *Id.* In *Eghbal*, HUD paid claims totaling $2.8 million and recovered $2.7 million from selling the properties. *Id.* at 1283. The district court agreed with the government that the total penalty based on HUD's loss was $5.7 million, calculated by first trebling the claims HUD paid (for a total of $8.4 million) and then subtracting the amount recovered by HUD ($2.7 million). *Id*. The Ninth Circuit affirmed, stating that the lower court's calculation of treble damages did not violate the Eighth Amendment's prohibition on excessive fines. *Id.*

It is important to keep in mind two significant caveats in pursuing False Claims Act cases. First, FIRREA subpoena authority can only be used if the investigation is for a potential FIRREA civil penalty case and not solely for a False Claims Act case. Second, 18 U.S.C. § 3322(a)(2) only provides that

matters occurring before a grand jury may be used in a FIRREA case. Therefore, you will have to obtain a court order to use materials covered by the secrecy provisions of Rule 6(e) of the Federal Rules of Criminal Procedure in a False Claims Act case.

Also note that in a government loan guarantee case, a False Claims Act cause of action based on a false statement in a loan application does not arise until there is a default on the underlying loan and a demand is made for payment on the guarantee. *United States v. McNinch*, 130 F. Supp. 711 (D.S.C. 1956), *aff'd*, 242 F.2d 359 (4th Cir. 1957), *aff'd in part, rev'd in part*, 356 U.S. 595 (1958); *United States v. Tieger*, 234 F.2d 589 (3d Cir. 1956); *United States v. Hill*, 676 F. Supp. 1158 (N.D. Fla. 1987).

IV. Injunctions under 18 U.S.C. § 1345

An injunction pursuant to 18 U.S.C. § 1345 (2009) is another important tool that should not be overlooked. Section 1345 provides a civil remedy to enjoin a person who is violating or is about to violate the bank, mail, or wire fraud statutes or who is committing, or is about to commit, a banking law violation. This statute can be effectively used not only to enjoin the illegal conduct but also to enjoin alienation or disposition of property, thus preserving assets for recovery either to pay civil penalties or as restitution.

V. Conclusion

Civil remedies provide various options that can be used to punish those responsible for mortgage fraud schemes, enjoin those that are currently engaged in such schemes, and deter those that may commit them in the future. Often these options can provide a more efficient use of resources than traditional criminal prosecutions and may be just as effective. They should be considered by any district as part of a comprehensive plan in addressing mortgage fraud.❖

ABOUT THE AUTHOR

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Last But Not Least: Sentencing and Restitution

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The complexities and challenges (and the aggravations) of mortgage fraud prosecutions do not end with the criminal conviction. In many ways, they are just beginning. These cases involve the normal issues of Sentencing Guidelines application, but the issues are oftentimes made more difficult due to the number of transactions in question and the challenge of gathering information from victim institutions and public records. Furthermore, our obligations under the Mandatory Victim Restitution Act, 18 U.S.C.A. §3663A (1996), make it essential to turn our attention early and persistently to identifying and notifying the ultimate victims of the fraud (frequently, institutions who were not parties to the original transactions). The key is to begin thinking about victims and loss calculation early in the investigation. Indeed, negotiating a plea will often require an understanding of the parameters of these issues.

I. The Sentencing Guidelines

Each case presents its own unique set of facts and circumstances that will implicate different guidelines in different ways. This article seeks to identify a few of the guidelines that are commonly addressed in mortgage fraud cases and a basic analysis that generally applies.

A. The loss calculation

First, the bad news: loss calculation will generally require taking on the persona of an accountant. Familiarity with Excel spreadsheets or with someone who has such a familiarity (like an IRS agent) is key. There is some good news, however: the Guidelines require only a "reasonable estimate" of the pecuniary harm that resulted from the offense, both "monetary" as well as harm that "otherwise is readily measurable in money." U.S. SENTENCING GUIDELINES MANUAL, § 2B1.1, app. notes 3(A)(i),(iii), 3(C)(2009). The other good news is that mortgage fraud schemes prosecuted in federal court typically have losses that fall within very broad loss ranges (for example, $7 million to $20 million). In other words, the Guidelines will not require a precise dollar calculation. That amount may, however, be needed for restitution purposes.

Given the collapse of the real estate market, loss is nearly always calculated based on "actual loss" rather than "intended loss." Many defendants will argue, sometimes persuasively, that they did not intend for any loss to occur because they hoped that real estate values would increase, surpassing the amount of the fraudulent loan.

In mortgage fraud cases, which generally involve pledged collateral (unless it is a case of house theft or deed theft, in which case there may be no collateral), loss is calculated based on the proceeds obtained from the fraud (or, arguably, the principal balance) less "the amount the victim has recovered at the time of sentencing from disposition of the collateral, or if the collateral has not been disposed of by that time, the fair market value of the collateral at the time of sentencing." *Id.* at note 3(E)(ii).

In most cases, the loss calculation is based on the remaining balance of the mortgage at the time the fraud is uncovered less the value of the collateral. Frequently, the underlying collateral (most typically, residential homes) are somewhere in the foreclosure process. If the collateral has already gone through the foreclosure process and been sold to a third party, the offset to the loss amount is set. Oftentimes, however, the properties have not been resold postforeclosure, in which case you may need to rely on some sort of market analysis, such as an appraisal, a third-party listing price, or comparable sales prices to establish a value of the collateral. The Guidelines' prescription that the valuation of the collateral occurs at the time of sentencing is significant in that it makes plain the defendant bears the burden of market downturns (which the defendant will argue is unrelated to the fraud).

Loss calculations may include costs incurred as a result of the foreclosure process, but will not include interest, finance charges, and late penalties. *Id.* at note 3(D).

Some fraud schemes involve scores, even hundreds, of properties. This is where spreadsheets can help specify each fraudulent transaction as well as the mortgage proceeds obtained in each transaction and the resale or appraisal for each residence. If there is an appeal on the loss calculation, a spreadsheet can be a big help for the judge, the probation officer, and an appellate court.

In cases involving an ongoing fraud, consideration should be given to utilizing the antifraud injunction statute set forth at 18 U.S.C. § 1345 (2009). Under this statute, the court can appoint a receiver to liquidate the collateral. The receiver can be an invaluable resource in calculating loss and the value of any collateral unsold at the time of sentencing.

Generally, the losses of the victim lending institutions drive the loss calculation and the relevant guideline loss range. One should consider, however, the losses that may have been incurred by other victim groups, such as municipalities and subcontractors. It may well be, however, that their losses, while sometimes substantial and significant to them, may be immaterial to the applicable loss range.

As an alternative loss calculation methodology, a court may look to the gain from the fraud as a substitute measure but only if the loss cannot be reasonably determined. U.S. SENTENCING GUIDELINES MANUAL, § 2B1.1, app. note 3(B) (2009). In light of the real estate market collapse, a gain analysis will typically be very favorable to a defendant and will substantially understate the loss and the offense.

B. Other specific offense characteristics

1. Number of victims

A victim is any person who "sustained any part of the actual loss determined under section (b)(1)." *Id.* at note 1. Where there are 10 or more victims of the fraud, offense level enhancements are triggered. *Id.* at § 2B1.1(b)(2).

The originating lending institution may not be a victim if the mortgage was subsequently resold. Instead, the current holder of the mortgage is generally the victim suffering actual loss. As a result, it is critical to identify who holds the mortgages at issue. While the mortgage documentation of the fraudulent transaction generally will not provide the information, mortgages are typically publicly recorded, so public records will. County Web sites, county offices of the Recorder of Deeds, and the Mortgage Electronic Registration System (MERS) are all likely sources of information. Having contacts with the fraud investigation departments of large mortgage companies can also be of great assistance in this area.

One other potential victim group deserves special note: investor/buyers. It is often the case that the principal organizers and beneficiaries of mortgage fraud schemes are not the buyers of the properties (as buyers are left holding the debt). Instead, investor/buyers can range from co-conspirator to innocent

dupe to somewhere in the middle. Duped investors can suffer substantial harm and oftentimes are forced into bankruptcy as a result of the collapsed investment scheme. They often perceive themselves as victims and can be more vocal than the lending institutions that have lost millions. They may also come to the table with some degree of unclean hands (for example, they received "incentive" payments at closing). Considerations of evidence of knowing participation, economic gain and/or loss, and a lack of sophistication all go into the mix of determining where this groups fits into the picture and how they should be viewed at sentencing.

2. Sophisticated means

Depending on the overall sophistication of the scheme—looking to the complexity of the transactions, the use of corporate shells, and types of false documents—a two-level enhancement may be applicable. *Id.* at § 2B1.1(b)(9) & app. note 8.

3. Unauthorized use of identification

In cases involving the use of a stolen identification, a two-level enhancement may apply. *Id.* at § 2B1.1(b)(10)(C)(I) & app. note 9(C).

4. Proceeds from a financial institution

Many mortgage fraud prosecutions will involve schemes in which a defendant individually derived $1 million in proceeds from a financial institution (which include non-bank mortgage companies). *Id.* at § 2B1.1(b)(14)(A) & app. note 11.

C. Chapter Three enhancements

1. Role/vulnerable victims

Application of the role adjustments, set forth in U.S. SENTENCING GUIDELINES MANUAL, §§ 3B1.1, 3B1.2, and the vulnerable victim adjustment, set forth in § 3A1.1(b), follows the common analysis and is dependent on the facts and circumstances of the case.

2. Position of trust/special skill

Federal prosecutions frequently involve market professionals, such as mortgage brokers, real estate agents, and appraisers, among others. Depending on the position of a particular defendant and the facts of the offense, a two-level enhancement is often warranted under § 3B1.3, because the defendant abused a position of trust and/or used a special skill to commit and to conceal the offense. Application Note 4 defines "special skill" as "a skill not possessed by members of the general public and usually requiring substantial education, training or licensing." Courts have upheld, albeit not uniformly, such enhancements in the context of real estate professionals. Although defendants have argued that mortgage brokers are not in a fiduciary relationship with either the borrower or lender, a number of courts have applied the enhancement nonetheless because the nature of the relationship cultivates a trust relationship in which parties rely on mortgage brokers for information. In many instances, defendants may be professionally licensed by the state, which may serve as an independent basis for application of the enhancement.

II. Statutory sentencing factor considerations

In the new world of *Booker*, the sentencing analysis is not limited by the prescriptions set forth in the Sentencing Guidelines. *United States v. Booker*, 543 U.S. 220 (2005). This additional layer of analysis works both for us and against us.

Defendants will frequently argue that the losses and the applicable guidelines far overstate their criminal culpability, in terms of their criminal intent and their personal gain from the scheme (which can be small in relationship to the losses they caused). They will also argue that they should not be held responsible for the nationwide collapse of the real estate market.

On the other hand, these defendants, through their fraud, contributed to the collapse of the real estate market. Often, the scheme involves numerous separate transactions occurring over time, demonstrating the calculated risks knowingly undertaken by the defendant. Moreover, harm that may not be "readily measurable in money," and is therefore not included for purposes of the loss calculation, may be, and should be, considered in terms of an appropriate sentence pursuant to 18 U.S.C. § 3553(a) (2009). Thus, testimony and other evidence from municipal entities and members of the community can impress upon a sentencing judge the broad and very real impact of the fraud not only on lending institutions, but on the community at large.

III. Restitution

Victims in mortgage fraud cases are statutorily entitled to restitution. 18 U.S.C. § 3663A (2009). Unlike loss calculations for purposes of sentencing, which are determined based on a "reasonable estimate of loss" within broad ranges, courts typically require something more concrete for restitution orders in terms of a provable amount based on evidence proven by a preponderance of the evidence. Generally, this will require cooperation and information from the victims. In the context of victim institutions (some of which may be in receivership or may have been sold), early identification and contact is critical. It may also be necessary to explain differences between compensable restitution under the Mandatory Victim Restitution Act and compensable damages in a civil action (which remain available even after a criminal restitution order).

The process of identification and notification can be a time-intensive and lengthy process. In order to address this reality, while also moving the criminal proceedings forward expeditiously, prosecutors may seek to defer the issue of restitution for a short period of up to 90 days following sentencing. 18 U.S.C. § 3664(d)(5) (2009).❖

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Mortgage Fraud Terms, Participants, and Documents

I. Terms

Air Loans:

These are loans on properties that do not exist (or where a lot exists, but no building exists). Sometimes "Air Loans" refer to loans for property that exists but where no transaction actually took place.

Alt-A Loans:

Sometimes referred to as "stated income" or "liars loans," Alt-A Loans are those which require little or no verification or documentation of the buyer's assets and income. They are ideal for fraud exploitation. Alt-A loans are offered by both prime and sub-prime lenders.

Builder Bail-Out:

Unscrupulous home builders sometimes employ "bailout" schemes to offset losses and circumvent excessive debt and potential bankruptcy as their home sales suffer from escalating foreclosures, rising inventory, and declining demand. Builder-bailout schemes saddle lenders with mortgage loans secured by straw borrowers on homes with no equity. Straw borrowers use falsified financial information, typically make no actual down payment, and quickly default, allowing the mortgages to foreclose.

Equity Skimming:

This is the act of cheating a homeowner out of the equity they have in their property and absconding with it. This is often done by getting a homeowner to take out a second mortgage or to refinance.

Flipping:

Property which is quickly resold based on a new inflated value is said to have been "flipped."

Foreclosure Rescue Scam:

The act of cheating a homeowner who is in danger of losing their home through promises of assistance with their mortgage loan or general finances. The scams come in a myriad of varieties. Many involve false promises to assist the homeowner in renegotiating loan terms with the lender in return for a fee. Others involve getting the homeowner to transfer the house to the scam-artist's business on the promise that it will be transferred back to the homeowner at a later date.

Ghost Checks:

Copies of checks that were never cashed or deposited are sometimes placed in a real estate transaction file to make it appear that payments were actually made. Some fraudsters refer to these as "ghost checks."

HECM:

"Home Equity Conversion Mortgage"– a "reverse mortgage" obtained by a person age 62 or older who obtains loan proceeds in return for future transfer of the borrower's property interests upon the borrower's death or permanent relocation.

HELOC:

"Home Equity Line of Credit"– a mortgage loan taken out by someone who already owns the home. The loan proceeds are sometimes paid out as the borrower "draws" on the line of credit, as opposed to a single payout.

Option Adjustable Rate Mortgage Loans:

An option ARM loan is an adjustable rate mortgage loan that provides the borrower with the option to pay a specified minimum payment, an interest-only payment, a 15-year fully amortizing payment, or a 30-year fully amortizing payment. This type of loan is very popular during a housing boom as lenders often qualify borrowers for much larger loans than would otherwise be possible by using the non-fully amortizing options. Option ARMs are usually offered with a very low "teaser" rate. However, unsophisticated borrowers may not anticipate the potential substantial payment increases resulting from scheduled interest rate adjustments, long term interest rates increasing, and the rise or fall in home values which can occur in short periods of time.

Quit Claim Deed:

A quit claim deed transfers to the transferee whatever interest in the property is held by the transferor. There is no guarantee that what is transferred is full ownership or that the title is not blemished or restricted in some way. However, they do not require a title search and can be used in transactions conducted very quickly. In many cases, transferors may be tricked into signing deeds without realizing that they are transferring ownership of their property. After the deed is recorded, the transferee may resell the property.

Secondary Market:

Lenders frequently do not keep the mortgage loans they make. They sell them. The buyers often bundle groups of mortgages. Interests in the bundles of mortgages are sold as securities to investors. The market for the transfer of mortgages, or interests in groups of mortgages, by firms other than the original lender, is referred to as the "secondary market."

Short Sale:

When a lender who is foreclosing on a property agrees to sale of the property for a lower amount than the mortgage to avoid the time and cost of foreclosure, they are "selling short." Some real estate fraudsters cause foreclosures on over-valued homes, then bring in a straw buyer to purchase the property for less than it is worth. The property may then be used in another mortgage fraud scheme.

Shotgunning:

A fraudster may arrange for two or more mortgages to be simultaneously issued on the same property for the same sale. If the papers on all mortgages can be executed prior to the filling of any mortgage, the lenders frequently become aware of the other mortgage loans only after the proceeds have been disbursed.

Silent Second:

A "silent second" is an unrecorded second loan taken to finance the purchase of real property. Mortgage fraud perpetrators sometimes use silent seconds to provide the down payment on behalf of the borrower. The buyer of a property borrows the down payment from the seller or a third party. The primary lender incorrectly believes the borrower has invested his own money in the down payment.

Sub-Prime Loan:

Sub-Prime mortgage loans are designed for persons with blemished or limited credit histories. To compensate for the increased credit risk, sub-prime loans carry a higher rate of interest than prime loans and are often Option Adjustable Rate Mortgage (ARM) loans.

II. Participants

Technically, a single homeowner may commit mortgage fraud by securing a residence through false statements on a mortgage loan application. However, an organized scheme to profit from mortgage fraud generally requires the participation, or at least acquiescence, of a number of players, including licensed professionals. These often include:

Initiator:

The initiator of the scheme develops the idea for the scheme, recruits coconspirators, and takes most of the profits. The initiator frequently plays one or more other roles in the scheme. The initiator is frequently a mortgage broker, the true property buyer, or a home builder. The initiator will sometimes actually make up to a year's worth of mortgage payments on a property to prevent an early default from making a lender suspicious.

Seller:

The seller may or may not be part of the scheme. The seller may agree to a false inflated sales price, and agree to kick back part of that price to other conspirators. The seller may also falsely state that

they will make improvements on the property, driving up its value, when no improvements are to be made.

Straw Buyer or "Investor":

The straw buyer is allowing their name to be used to purchase the property. They have no intention of actually making a down payment or making mortgage payments (unless someone else provides the money). They frequently lie about whether they will live in the house and whether they own other properties. They sign false loan applications. Straw buyers are frequently paid a fee for their participation, and are sometimes allowed to live on the property until evicted by a foreclosing lender. Sometimes a buyer believes that they are simply an investor in a real estate business, not realizing that they are actually the purchaser of one or more properties. Sometimes the initiator will steal identifying information of a real person and use it as the buyer. An "actor" will stand in for the false identity at closing.

Real Estate Agent:

Real estate agents are often left out of fraudulent transactions because their commissions reduce the profit available to others. However, they may be called upon to draft a real estate contract with an inflated price (often more than the asking price), with an inaccurate description of the property and false promises of improvements to the property. An agent has an incentive to participate in the scheme because the scheme ensures a sale, and agreeing to an inflated price raises the agent's commission.

Appraiser:

The appraiser will need to ensure that the property appraises for the inflated sales price. Characteristics of the property will need to be falsified on the appraisal report. Inappropriate or previously inflated comparable structures will need to be used to arrive at an inflated value. Prior sales and the original listing price of the property may be ignored.

Mortgage Broker:

While some transactions are completed directly with a lender, many transactions start with a "mortgage broker" who collects loan application documents and then "shops around" for a lender willing to make the loan. An honest mortgage broker will look for the loan with the best terms for the borrower. Others will look for a loan which provides the greatest compensation to the broker. Unscrupulous mortgage brokers will create loan applications and supporting documents containing false information to convince a lender to make the loan. The broker will then provide those documents to the lender. A discussion of the documents follows this section.

Closing Attorney /Closing Agent / Escrow Agent:

A real estate transaction will be executed at a "real estate closing." At the closing, the money involved will be collected and distributed. The closing will be handled by someone responsible for making sure that the money involved in the transaction is collected and distributed according to the terms set by the real estate contract and the mortgage terms, including any real estate title insurance contract. Depending on your jurisdiction, the person "closing" or "settling" the real estate transaction may be an attorney, a professional closing agent, or an escrow agent.

The appropriate distribution of the money is documented on a HUD-1 real estate transaction form, which all parties sign. An unscrupulous closing agent will collect and distribute the money as directed by other conspirators, rather than as required. Down payments may not be collected. Previous mortgages may not be paid off. Fictitious liens and home improvement bills may be paid to fictitious firms. Kickbacks may be paid to the buyer. The unscrupulous closing agent will then lie to the lender and the title company about the distribution of funds, perhaps by using a second, differing HUD-1 form.

Lenders:

The lender is normally the victim. However, there are instances in which an insider at the lending institution assists the conspirators. The insider is often an employee or officer who is either attempting to impress superiors by expanding a loan portfolio or is eligible to receive incentive compensation based on the number and type of loans issued.

Remember that the lender is not always a bank or other federally-regulated institution. Private lenders proliferated in the early 2000s. Mortgage lenders, and especially unregulated lenders, have been frequently criticized for lax underwriting efforts when housing prices were rising.

Other important parties in real estate mortgage transactions are: (1) the title and mortgage insurance corporations that are often stuck paying claims on fraudulent transactions; (2) entities which buy mortgages from lending institutions (such as Fannie Mae and Freddie Mac) and sell mortgage-backed securities to investors; and (3) mortgage "servicers" who, once the mortgage loan has been made, will be responsible for collecting payments.

III. Documents

Real Estate Contract:

Contracts for the sale of real estate must, by law, be in writing. Lenders also require detailed contracts, although forms are often used. In mortgage fraud schemes, the real estate contract will often contain:

- The name of a straw buyer who has no intention of residing in the house or making payments on the mortgage. Alternatively, the contract may list a shell company (that is, a company without legitimate business activities) actually controlled by the initiator of the scheme, or a stolen identity.
- An inflated purchase price (which will be false because there will be a "kickback")
- False property characteristics
- False statements concerning anticipated home improvements
- It is possible that the same contract will be used to obtain mortgage loans from more than one lender simultaneously.

Appraisal Report:

Appraisals are normally required for all mortgage loans. A false appraisal will often include:

- False statements concerning the characteristics of the house
- Misleading or totally false photographs of the property

- Improperly chosen comparison structures (e.g. from distant locations or with significantly different characteristics) or comparison structures with intentionally inflated values
- Omitted prior sales
- It is possible that an appraisal may have been merely "cut and pasted" from an appraisal for a different property.

Loan Application:

Loan applications differ based on the terms of the loan. Generally, loans made on preferred terms require greater documentation of the borrower's financial status. Because mortgage fraudsters have no intention of repaying the loan, regardless of the terms, they prefer applications requiring less information and verification. Loan applications in mortgage fraud schemes frequently contain false information concerning the borrower's:

- employment and income
- assets
- liabilities (including other mortgages)
- account balances

Loan Application Supporting Documents:

Frequently, a number of supporting documents are submitted with a loan application to verify the false statements made on the application. These may include:

- Tax returns, which differ from those actually submitted to the IRS.
- W-2 forms for businesses which do not exist, or at which the buyer is not employed, but are controlled by another conspirator. False "verification of employment" forms are also used.
- Bank Balance Verification Forms, which are to be completed by the buyer's bank, and may be altered or entirely fictitious. The conspirators may also obtain a misleading form by temporarily depositing another's money into buyer's account to inflate its balance.
- Gift letter forms, supposedly completed by the donor, which explain that the buyer obtained down payment money through receipt of a gift. The letter may be fictitious.

HUD-1:

All real estate settlements must, by law, utilize a form created by the U.S. Department of Housing and Urban Development. The HUD-1 form documents the collection and distribution of monies at the closing. In addition to repeating false information from other documents, such as the sales price, the HUD-1 will likely misstate the disposition of the funds. For example, the form may:

- Incorrectly state that a down payment has been made
- Show false prior mortgages (allowing monies to be routed to a different source)

- List false liens and contracts for home improvement (same)
- Fail to reflect kickbacks and other "incentives"

Electronic Closing Records:

Checks for distribution of monies at closing are often produced by computer programs based on information entered into an electronic HUD-1 form. If monies are not distributed pursuant to the HUD-1 forms used a closing, the closing information in the computer may have to be changed. Alternatively, a second, differing HUD-1 may have to be produced.

Similarly, information provided to lenders, title insurance companies, and mortgage insurance companies is frequently submitted electronically. Computers may contain two sets of records – one for the actual closing and one for distribution to others.❖