Mortgage Fraud and America’s Foreclosure Crisis

How to Protect the American Dream of Home Ownership
Dear Friend:

Millions of Americans are suffering from the foreclosure crisis. Many are at risk of losing their most valuable asset – their homes. This rampant foreclosure problem has had serious repercussions not only for individual families, but also for communities across the country – and it has taken a major toll on the health of our nation’s economy.

The crisis has its roots in subprime lending practices. These practices include extending loans to people with less-than-optimal credit histories, and burdening them with loans that look good on the surface – but carry hidden costs and skyrocketing interest rates.

The unprecedented increase in foreclosures – especially in states like California, Nevada and Arizona that have borne the brunt of the housing crisis – has given rise to another problem. As people desperately try to stay in their homes, there has been a substantial increase in mortgage fraud perpetrated by unlicensed and unregulated brokers trying to take advantage of homeowners’ anxieties.

The sheer number of homes moving through the foreclosure process has allowed more bad actors to slip through the cracks and profit off of an overburdened system. Part of the problem is that there have been no uniform standards in the mortgage industry – only a thin patchwork of regulation by the states.

In July 2008, Congress passed – and the President signed into law – comprehensive legislation to address this crisis. I’m proud to report that the legislation includes the SAFE Mortgage Licensing Act, which I introduced in February 2008 with Senator Mel Martinez (R-FL). This law sets national licensing and oversight standards for America’s mortgage brokers and lenders.

On July 31, 2010, California enacted the standards mandated by the SAFE Mortgage Licensing Act to ensure that all brokers and lenders in the state are licensed professionals. This means that homeowners in California are better protected and have more access to information about their mortgage brokers than ever before. I believe this is an important first step toward removing the bad actors from the industry – and toward restoring the American Dream of home ownership.

Sincerely,

Dianne Feinstein
U.S. Senator
America’s ongoing subprime mortgage crisis first emerged in 2006 with the bursting of the “housing bubble.” As home prices declined and mortgages adjusted upward, millions of Americans found themselves at risk of losing their homes.

This was particularly true of borrowers with lesser credit histories who had signed on to subprime loans. Unlike in boom times — when housing values were rising — these borrowers found it increasingly difficult, or impossible, to refinance their loans and were unable to afford their escalating monthly payments.

This led to record defaults and foreclosures, many driven by loan interest rates adjusting higher and higher. The damage has been widespread: In 2010, more than 2.8 million American homes were subject to foreclosure, an increase of 123 percent from 2007.

The impact of the subprime mortgage crisis has now spread globally. Even after receiving assistance from the federal government, banks in the United States continue to write down losses originating from home loans. Fannie Mae and Freddie Mac remain in conservatorship, and debate has now focused on when, not if, these housing giants will be reformed.

In the aftermath of the bubble bursting, we learned that many homeowners had been sold mortgages they couldn’t afford because their financial qualifications were never verified.
Others were enticed into refinancing their homes with bogus offers of quick cash from crooked lenders, without being told that their subprime loan rates would reset.

Though not the main culprit, the extension of “liar loans” and “no-documentation” loans to irresponsible or uninformed homebuyers exacerbated the problem. Bad actors were able to game the system and profit from making loans that were doomed to fail. As the foreclosure crisis continues to unravel, the opportunities for these unscrupulous mortgage lenders increases because homeowners are desperate.

Increasing accountability and safety in this vital part of the American economy is an integral part of the economic recovery. The SAFE Mortgage Licensing Act, in concert with other reforms, raises the standards and rearranges the incentives in the mortgage industry in a way that will help restore confidence in the housing market.

**Unscrupulous Lending Practices –**

*President Obama with Federal Reserve Chairman Ben Bernanke, who has been credited with pulling the economy back from the brink of depression.*
The Human Toll

Behind the foreclosure numbers and the headlines are real people who have suffered greatly as a result of the crisis. Many of them – such as retirees Charles and Patricia Simmons of Los Angeles – have been preyed upon by unscrupulous mortgage brokers who engage in predatory lending practices.

The story of the Simmons’ is a cautionary tale. The couple have lived in their home in Crenshaw Heights, near Inglewood, since 1969. After Mr. Simmons suffered a stroke, they refinanced several times to help defray medical expenses.

In 2007, they decided to refinance out of a $550,000 loan that had an 8% interest rate. About this time, they received a cold call from a broker who told them they could get a $629,000 loan with cash back. The broker told them the loan had a 4.5% adjustable interest rate. They were also told their monthly payments would be $2,000, after four initial monthly payments of $5,300 to lower the interest rate.

Mrs. Simmons said she trusted the broker, and signed the papers in August 2007. Unfortunately, the actual loan terms included an 11.2% adjustable interest rate, $5,300 payments every month, and no cash back. An escrow official would later tell Mrs. Simmons that any cash she hoped to pull out of the loan had to go to closing costs.

Closing costs totaled nearly $24,000, with $19,500 going to the broker.

“I really feel misled by this broker,” said Mrs. Simmons. “This is predatory lending. They should not be allowed to take advantage of the elderly the way they’ve been doing. We’re in a hole and we’re trying to get out of it. And we put our trust in these people.”

The episode sparked a financial crisis for the Simmons’ – who were forced to dip into their life savings to pay the mortgage. They began to fall behind by $4,000 every month and were at risk of losing their home of nearly 30 years.
Fortunately, the Simmons’ were able to work with their bank to get out from under the predatory loan terms.

Another story – that of the McFatten family of Fresno – stands out. Steve McFatten worked on an assembly line, and his wife, Valvina, was an office assistant. The couple had two teenage daughters, and money was tight.

When the McFattens saw the listed price of their dream home they thought it was out of their reach. The year before, a bank had told them their finances could only support a mortgage of roughly half of what they would need to purchase the home.

But an unlicensed broker promised them that their credit wasn’t a problem and steered them into two adjustable-rate mortgages, which allowed them to buy the home with a minimal down payment.

The couple set aside their concerns and signed the loan at the urging of the broker, who pocketed a considerable fee. But almost as soon as they moved into their new home, they were overwhelmed by enormous monthly payments and unexpected tax bills.

When their story came to Senator Feinstein’s attention, the family was behind on their payments and facing foreclosure.

Fortunately, Senator Feinstein was able to help the family obtain more reasonable terms for their mortgage and save their home.

But untold thousands of other Americans have been victimized by unscrupulous lending practices, which led Senator Feinstein to work with a key Republican colleague on legislation to police the mortgage-lending industry and protect American homeowners and prospective home buyers.
After hearing stories like the Simmons’ and the McFattens’, Senator Feinstein teamed up with Senator Mel Martinez (R-Fla.) in February 2008, to introduce housing reform legislation aimed at curbing predatory lending practices.

The SAFE Mortgage Licensing Act is intended to address growing reports of abusive lending practices by unscrupulous mortgage industry participants. It will ensure that all mortgage professionals are trained in federal lending laws, ethics, consumer protection, and the sub-prime mortgage marketplace. It also will allow consumers at no charge to verify actors in the mortgage lending industry through a newly created nationwide registry.

**The SAFE Mortgage Licensing Act:**

- Ensures that all residential mortgage loan brokers and lenders meet basic professional standards.
- Requires brokers and lenders to obtain a state license.
- Requires states to establish minimum standards for applicants, including:
  - No felony convictions for the past seven years;
  - No similar license revoked;
  - Demonstrated record of financial responsibility;
  - Meeting minimum net worth or bonding requirement;
  - Fulfilling education requirements (20 hours of approved courses, to include at least 3 hours related to federal laws, 3 hours on ethics and consumer protection in mortgage lending, and 2 hours on the sub-prime mortgage marketplace); and
  - Passing a written exam (minimum score of 75% required to pass).
- Requires state regulators to develop a satisfactory licensing system by January 1, 2011. As of June 2010, all 50 states, the District of Columbia, the Virgin Islands and Guam have enacted legislation to this effect.
- Enables consumers at no charge to verify whether their broker or lender has a state license, or is employed by a federally regulated bank.
SAFE Mortgage Licensing Act – Cleaning up the Industry

Top Mortgage Fraud States 2009
(by Multiple Indicators)

1 - 7
8 - 15
16 - 27
28 - 37
38 - 61

Combined Score based upon Ranking of All Indicators (70 is the Highest Score Possible)

California
Arizona
Oregon
Nevada
Utah
Colorado
Texas
Minnesota
Michigan
Illinois
New York
Rhode Island
Ohio
Pennsylvania
New Jersey
Maryland
Virginia
Georgia
Florida

Figure 8: FY2009 Percent of FBI Pending Mortgage Fraud Investigations by Region

West 29%
North Central 22%
South Central 11%
Southeast 24%
Northeast 14%

2009 data is most recent available. 2010 data will be released in summer 2011.
The Rampant Mortgage Fraud Problem

The FBI has analyzed the growth of mortgage fraud schemes as more and more homes slip into foreclosure. The FBI’s 2009 report, which was published in June 2010, revealed disturbing trends in mortgage fraud cases, including:

- A 71% increase in pending FBI mortgage fraud investigations between 2008 and 2009;
- California had the highest rate of mortgage fraud in the nation in 2009;
- Seven out of the top ten cities for mortgage fraud are located in California, with Stockton being the most vulnerable; and,
- The prevalence of new mortgage fraud schemes is increasing rapidly.

In June of 2010, federal authorities filed charges against 1,200 bad actors in the mortgage industry accused of perpetrating $2.3 billion in mortgage fraud schemes. The potential financial windfall from mortgage fraud ensures that more and more cases like this will be uncovered. In 2010, the FBI reported 3,000 ongoing investigations. Some of the most prevalent mortgage fraud schemes include:

- Foreclosure rescue schemes: The unprecedented number of homeowners looking for affordable loan refinancing has led bad actors to take advantage by misrepresenting the terms of contracts or charging exorbitant fees for loan modifications that are never completed.
- Loan origination schemes: Bad actors will falsify documentation required to obtain loans including income statements, employment and credit history. This can include using stolen identities.

The FBI investigated the fraudulent appraisal and sale of this house, whose heavy damage was concealed from speculative buyers by the appraiser and home seller.
• Fraudulent appraisal schemes: Bad actors engaged in the flipping of homes will collude with appraisers to report fraudulent home valuations that increase their profit margins. Perpetrators will also convince struggling families to sell their homes well below market value, then turn around and flip the home for a substantially higher price.

By implementing higher mortgage industry standards, states will better protect already vulnerable homeowners from predatory lenders, unscrupulous appraisers, and other bad actors. As we sort through the foreclosure crisis, it is imperative and timely that these added safeguards be implemented.

### Protecting Homebuyers

<table>
<thead>
<tr>
<th>Rank by Mortgage Fraud Risk Index</th>
<th>MSA</th>
<th>Percent Change in Index from 2008 to 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Stockton, CA</td>
<td>61</td>
</tr>
<tr>
<td>2</td>
<td>Modesto, CA</td>
<td>66.4</td>
</tr>
<tr>
<td>3</td>
<td>Las Vegas-Paradise, NV</td>
<td>41</td>
</tr>
<tr>
<td>4</td>
<td>Riverside-San Bernardino-Ontario, CA</td>
<td>62.6</td>
</tr>
<tr>
<td>5</td>
<td>Merced, CA</td>
<td>52.1</td>
</tr>
<tr>
<td>6</td>
<td>Reno-Sparks, NV</td>
<td>44.1</td>
</tr>
<tr>
<td>7</td>
<td>Valleho-Fairfield, CA</td>
<td>54.2</td>
</tr>
<tr>
<td>8</td>
<td>Bakersfield, CA</td>
<td>40.2</td>
</tr>
<tr>
<td>9</td>
<td>Cape Coral-Fort Myers, FL</td>
<td>44.7</td>
</tr>
<tr>
<td>10</td>
<td>Fresno, CA</td>
<td>37.9</td>
</tr>
</tbody>
</table>

Figure 19: Top 10 MSAs with Mortgage Fraud Risk per Interthinx, 2009

*Seven of the 10 metropolitan areas with the highest incidence of mortgage fraud are in California.*

*A foreclosed home in Stockton.  A foreclosed home in Fresno.*
Starting this week, Californians can make more informed, careful decisions when hiring a mortgage broker to help navigate the complex process of purchasing a home.

That's because California now requires all mortgage brokers and lenders to be licensed, as mandated by the SAFE Mortgage Licensing Act. This federal law, which I sponsored with then-Sen. Mel Martinez in 2008, directs all states to establish professional and ethical standards for the mortgage industry. As of July 31, every mortgage broker and lender in California must have a license, which can only be obtained after a full background check.

Shockingly, before this bill became law, some brokers sold mortgages with no license or training, some even had criminal backgrounds. This was a recipe for disaster, as we found out when the subprime market collapsed in 2008.

In the aftermath of this crisis, we learned that many homeowners had been sold mortgages they couldn't afford because their financial qualifications were never verified. Others were enticed into refinancing their homes with bogus offers of quick cash from crooked lenders, without being told that their subprime loan rates would reset.

As a result, many homeowners were left with toxic mortgages they couldn't pay. Some were forced to let banks foreclose on their homes.

California has been particularly hard hit by the foreclosure crisis, with 340,740 foreclosures filed so far this year, and 1.4 million since 2009.

California’s new regulations will help clean up this troubled industry and restore confidence in homeownership.

In order to qualify for a license, all brokers and lenders now must have a demonstrated record of financial responsibility and complete basic education requirements -- and have a clean criminal record. Brokers employed by federally regulated national banks must register with the nationwide licensing system in lieu of obtaining a state license. All this information is now publicly available online at: http://www.nmlsconsumeraccess.org/.

This law was inspired by the stories I heard from Californians who were victimized by unscrupulous brokers and lenders. One story from Fresno -- a family of four -- stands out.

The husband worked on an assembly line, and his wife was an office assistant. The couple had two teenage daughters, and money was tight.

When they saw their dream home listed at more than $250,000, they thought it was out of their reach. The year before, a bank had told them their finances could only support a mortgage of up to $135,000.

But an unlicensed broker promised them that their bad credit wasn’t a problem and steered them into two adjustable-rate mortgages totaling $250,000, with only $1,000 down.

The couple set aside their concerns and signed the loan at the urging of the broker, who pocketed a fee of $10,000. But almost as soon as they moved into their new home, they were overwhelmed by enormous monthly payments and unexpected tax bills.

When their story came to my attention, the family was behind on their payments and facing foreclosure. We were able to help the family save their home and obtain more reasonable terms for their mortgage.

But unfortunately, this case is not unique. The Federal Bureau of Investigation reports that complaints of mortgage fraud increased by 71% between 2008 and 2009.

The problem is particularly acute in California, which last year was considered the top state for mortgage fraud. In fact, seven of the top 10 mortgage fraud “hotspots” were in California, many of them in the Central Valley: Stockton (1), Modesto (2), Riverside (4), Merced (5), Vallejo (7), Bakersfield (8), and Fresno (9).

To be sure, many mortgage brokers and lenders are responsible professionals. But buying a home is too important a transaction to entrust to the wrong person.

That's why I encourage everyone who is looking to buy their dream home or refinance an existing property to go online today and confirm that your broker or lender is a licensed professional. You deserve to know the facts.
How to Avoid Becoming a Victim

The FBI and the Department of Housing and Urban Development (HUD) have compiled the following set of guidelines to help consumers avoid the risk of falling prey to mortgage fraud. For more information, or if you feel you may be the victim of mortgage fraud, please contact your local FBI field office. (http://www.fbi.gov/contact/fo/fo.htm)

• **Get referrals for real estate and mortgage professionals when you want to buy or sell a home.** And once you do, check out their licenses with state, county, or city regulatory agencies. Most of these people are exceedingly honest and above-board—it’s just a small percentage who have given the overall profession a black eye.

• **Do your own research into what other homes in the neighborhood have sold for.** Also, look into recent tax assessments of neighborhood homes.

• **Hire a properly qualified and licensed home inspector to carefully inspect the property.** Fraudulent appraisal schemes work by low-balling the valuation of a victim’s home in order to generate a wider profit margin upon resale. Hiring a qualified home inspector to conduct your appraisal will insure impartiality and reduce the risk of fraud.

• **Beware of “no money down” loans.** These are a gimmick used to entice people to buy a home they really can’t afford.

• **Don’t let anyone (i.e., a realtor, mortgage broker) talk you into making a false statement on your loan application,** like overstating your income or lying about where your down payment is coming from.

• **Never sign a blank document or a document containing blank lines.** Be sure to read and review all loan documents signed at closing. If you don’t understand what you’re signing, get an attorney who can review the documents for you.

• **Don’t be pressured into signing a contract.** Take your time to shop around and compare prices and houses. Beware lenders or investors that tell you they are your only chance of getting a loan or owning a home.

• **Beware of e-mails or web-based ads from companies claiming to be able to eliminate your mortgage debt for an up-front paperwork fee.** This is a scam.
Taking Advantage of the SAFE Mortgage Licensing Act

The SAFE Mortgage Licensing Act not only implements a set of standards for mortgage brokers, it also allows consumers to access information about their mortgage brokers’ employment history, qualifications, and training. Please visit the Nationwide Mortgage Licensing System & Registry pictured below at www.nmlsconsumeraccess.org.

For More Information

If you are interested in receiving further information about these important issues, please log on to Senator Feinstein’s website at http://feinstein.senate.gov and register to receive email updates.

And for assistance understanding the government resources available to help you with your housing needs and concerns, please contact Senator Feinstein’s offices in California:

- San Francisco: (415) 393-0707
- Los Angeles: (310) 914-7300
- San Diego: (619) 231-9712
- Fresno: (559) 485-7430
Mortgage Fraud and America’s Foreclosure Crisis

How to Protect the American Dream of Home Ownership