



Preventing Mortgage Fraud

Best Practices to Protect Your Business From Mortgage Fraud

Protecting your business from fraud can be a daunting task. It sometimes seems as though there are as many different fraud schemes as there are criminals who use them to defraud lending institutions. One of the best ways you can safeguard yourself against fraud is through a rigorous post-funding quality control program, in addition to sound pre-funding quality control practices.

> Key Resources

- Report fraudulent practices to Freddie Mac's Fraud Hotline at (800) 4FRAUD 8.
- Visit our Fraud Prevention Web site at www.FreddieMac.com/singlefamily/preventfraud/ for more information on fraud schemes and how to spot fraud red flags.
- Review the quality control policies in Chapter 48 of our *Single-Family Seller/Servicer Guide* (Guide).
- For Seller and Servicers: Review our Exclusionary List of institutions excluded from performing any functions related to the sale of mortgages or the servicing of mortgages sold to Freddie Mac. Refer to Guide Chapter 51 for applicable uses of this list.
- Visit our Quality Control Resources at www.FreddieMac.com/dgtq/.

> Types of Fraud

- **Fraud for property:** This type of fraud is primarily committed by borrowers and/or loan officers. They provide falsified information about employment, income or assets in order to qualify for a loan. In many cases, the borrower can make the housing payment.
- **Fraud for profit:** These schemes often involve a group of people who play multiple roles in the fraud. Generally, the scheme will involve multiple industry professionals and the participants perpetrate the scheme in order to extract extraordinary profits and/or compensation.

COMMON MORTGAGE FRAUD SCHEMES	
Builder Bailout Scheme	<p>Builder bailouts occur when the builder or developer is motivated to move property quickly in a depressed real estate market. Some of the following red flags may occur in builder bailouts:</p> <ul style="list-style-type: none"> • The builder is willing to "do anything" to sell property. • Buyer incentives are built into the sales price, inflating the purchase price and utilizing an inflated appraisal. • No-money-down sales are included. • The HUD-1 Form, <i>Settlement Statement</i>, may indicate a portion of the net proceeds going to unrelated third parties. • The source of funds is questionable. • Buyers are often recruited from out of state.
Condominium Conversion Bailout Scheme	<p>Condominium conversion bailouts are similar to builder bailouts and occur when the developer is motivated to move units quickly in a depressed real estate market. Condominium conversion bailouts are apartment conversions typically located in areas that have larger apartment complexes in declining rental communities. The appraisal will often indicate a fully rehabilitated property. Some of the following red flags may occur in condominium conversion bailout schemes:</p> <ul style="list-style-type: none"> • Buyer incentives are built into the sales price, inflating the purchase price and utilizing an inflated appraisal. • No money down sales are included. • Renovations made to the units are non-existent or superficial. • Buyers are often recruited from out of state. • The HUD-1 Form may indicate a portion of the net proceeds going to unrelated third parties. • Occupancy misrepresentation occurs, i.e., buyer states that a property is owner occupied when it is a rental. • The appraisal uses only comparables from within the subject complex.
(Illegal) Property Flips	<p>Property flips often occur when ownership of one property changes several times in a brief period. Illegal property flips are often used to artificially inflate the value of the property to obtain larger loans than what might otherwise be possible and drain the phantom equity out of the property. Illegal property flips also may be used to conceal the identity of the true buyer or seller of the property. Some of the following red flags may occur in flips:</p> <ul style="list-style-type: none"> • Ownership changes two or more times in a brief period of time with the property value increasing significantly. • Two or more closings occur almost simultaneously. • The seller has owned the property for only a short time. • The property seller is not in title.
Investment Property Scheme	<p>An investment property scheme involves an individual or a group of individuals who use legitimate investment buyers or straw buyers to purchase one or more investment properties either locally or out of state. Investment property schemes have been linked to builder bailouts and condominium conversion bailouts as well as the resale of distressed properties in declining neighborhoods. Some of the following red flags may occur in investment property schemes:</p> <ul style="list-style-type: none"> • No money down offers on multiple properties sold to one borrower. • Purchases disguised as refinances to circumvent the down payment requirement. • Artificially inflated appraisal values. • Buyers often recruited from out of state.
Cash-Out Purchases	<p>A cash-out purchase normally involves one closing and occurs when properties have been on the market for an extended length of time – usually when a desperate seller is unable to find a qualified buyer. The seller may be offered a way out with an offer that exceeds the listing price of the property with an agreement to refund money to the buyer after closing. Some of the following red flags may occur in a cash-out purchase:</p> <ul style="list-style-type: none"> • The home may have been on the market for an extended period of time. • The sales price is significantly higher than the listing price. • The sales contract may have been modified or may include an addendum regarding the payment to the borrower. • The appraisal may be artificially inflated to the sale price.
MORTGAGE FRAUD RED FLAGS	
Pre-funding and Post-Closing	<ul style="list-style-type: none"> • The property seller is a business entity or LLC. • The same mortgage brokers, appraisers, and closing agents appear in numerous transactions. • A borrower is purchasing several properties within a short period of time. • The seller in a purchase transaction is not in title to the subject property. • The borrower in a refinance is not in title to the subject property, or has only been in title for a short time. • The qualifying documentation is inconsistent or appears altered. • No real estate commissions were paid. • Unreasonable fees were charged. • Disbursements were made to individuals or entities with no apparent interest in or liens on the subject property.
Valuation/Appraisal	<ul style="list-style-type: none"> • The appraisal is dated prior to the loan application or prior to the sales contract. • A third party participating in the transaction ordered the appraisal. • The subject property is noted as vacant or tenant occupied. • Comparable sales are lacking similarities to the subject property and are outside the neighborhood. • Reports are incomplete—no photos, adjustments are not supported, no prior sales listed. • The owner of record is not the seller on the contract or not in title.
PROTECT YOURSELF FROM MORTGAGE FRAUD	
Important Tips	<ul style="list-style-type: none"> • Know the parties with whom you are doing business • Provide all appropriate employees in your organization with the following: <ul style="list-style-type: none"> ▪ Clear directives as to their responsibility when they suspect fraud. ▪ An awareness of the major types of fraud. ▪ An understanding of the underwriting red flags and their use. ▪ A list of resources available to them to detect and investigate fraud. ▪ Empowerment to suspend or decline a questionable transaction until all red flags have been cleared.