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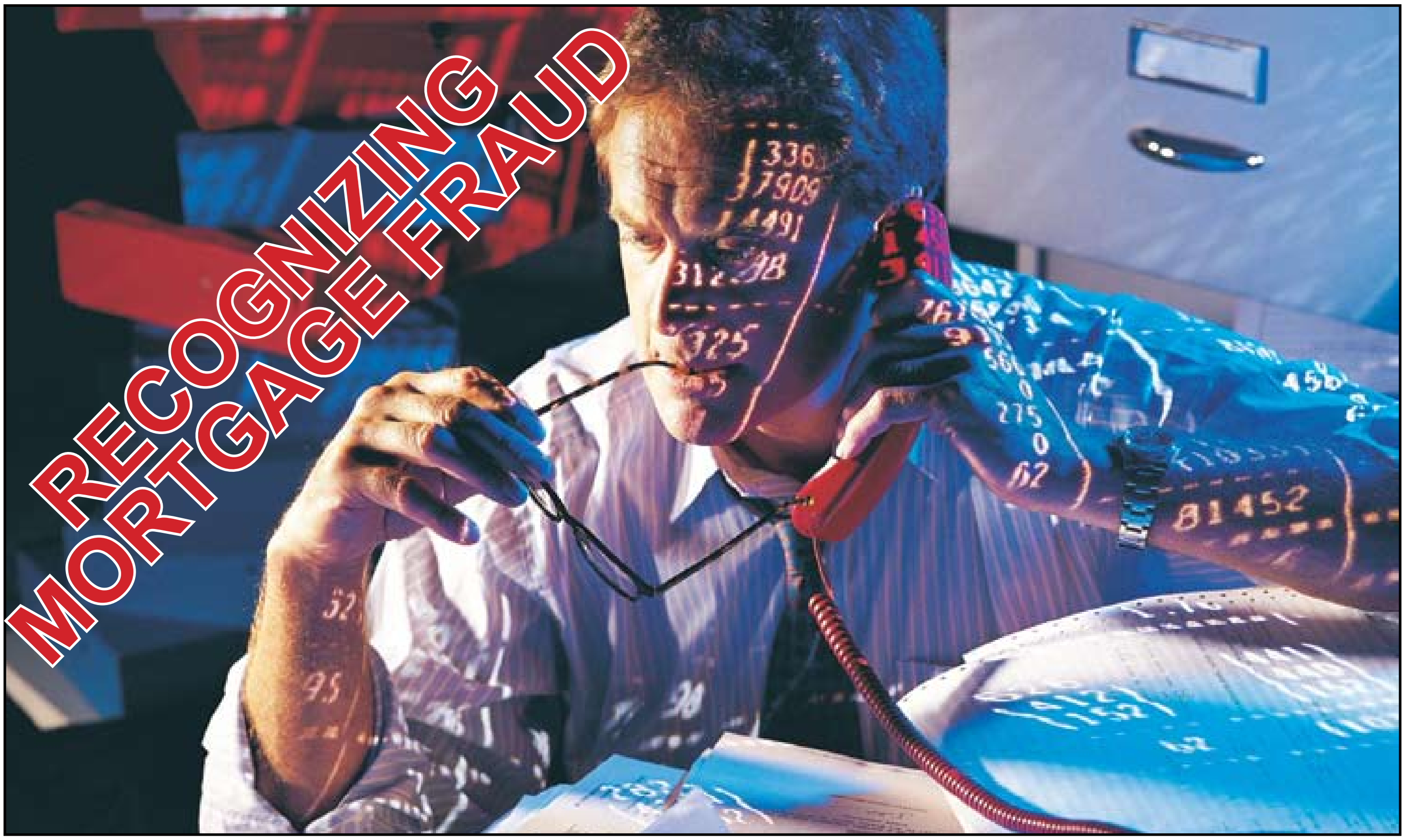

By Charlotte M. Meyer, Ruth W. Garner and Judon Fambrough

Mortgage fraud is the fastest growing white-collar crime in America, according to the FBI. Real estate practitioners need to be aware of this illegal activity and report it to the proper authorities. Texas law provides immunity for those who do so.

Lenders are most vulnerable. When originating loans, they depend on others for assurances regarding the borrower's creditworthiness, sufficiency of the collateral and the validity of the lien to secure the loan. They must rely on information provided by the borrower, mortgage brokers, title companies, appraisers, surveyors and others. Culprits may commit loan fraud alone or in collaboration with others.

Types of Fraud

The FBI classifies mortgage fraud as either fraud for housing or fraud for profit. Fraud for housing is committed by borrowers acting alone. They misrepresent, and possibly omit, critical information on loan applications. For example, the borrower may inflate his or her income and assets and, at the same time, reduce debts and liabilities.

Fraud for profit involves industry professionals acting collectively. FBI data indicate this represents about 80 percent of reported fraudulent activities. Land flipping is one of the most prevalent types of fraud for profit.

Land flipping is not necessarily fraudulent or illegal. In a legal transaction, the buyer finds and purchases bargain-priced property and resells it at its fair market value. The resale may occur before or after the finder takes title. With proper disclosures, this is a legitimate money-making activity.

An illegal land flip may take several forms. The most common involves a falsified or inflated appraisal coupled with fraudulent loan documentation.

The scheme goes like this. A "flipper" purchases property for its fair market value of $20,000. The flipper, in collusion with an appraiser, obtains an inflated appraisal for $80,000 and sells the property to a "straw" buyer. The buyer obtains an 80 percent loan for $64,000 to finance the purchase. The colluding parties realize a profit of $44,000. The lender, upon foreclosing, owns property worth $20,000 to satisfy a $64,000 loan.

An official with the Texas Department of Savings and Mortgage Lending notes that inflated appraisals and the constant use of the same appraiser are two of the most common signs of mortgage fraud. Agents acting in dual roles such as real estate agent and mortgage broker are another indicator.

Other warning signs include:

- uncommon, unexplained or excessive fees paid to brokers or other third parties at or outside of closing;
- falsification of information on loan applications;
- fake supporting documentation;
- borrowers not shown as the purchasers on the land sales contracts; and
- outrageous promises of extraordinary profits in a short period.

Legislation Targeting Mortgage Fraud

House Bill 716, passed by the 80th Texas Legislature, implemented several measures to guard against mortgage fraud for housing. The statute (1) requires a specific notice be presented to and signed by home-loan applicants, (2) amends several

Texas statutes, including the Penal Code, and (3) establishes the Residential Mortgage Fraud Task Force.

As of Sept. 1, 2007, Texas lenders and mortgage brokers are required to provide a specific notice to home-loan applicants. The written notice must be placed on a separate document in 14-point type. Applicants must verify the information and sign. According to the newly enacted Section 343.105 of the Texas Finance Code, the notice must contain the following or substantially similar language.

> Warning: Intentionally or knowingly making a materially false or misleading written statement to obtain property or credit, including a mortgage loan, is a violation of Section 32.32 of the Texas Penal Code, and depending on the amount of the loan or value of the property, is punishable by imprisonment for a term of two to 99 years and a fine not to exceed $10,000.
>
> I/we, the undersigned home loan applicant(s), represent that I/we have received, read, and understand this notice of penalties for making a materially false or misleading written statement to obtain a home loan.
>
> I/we represent that all statements and representations contained in my/our written home loan application, including statements or representations regarding my/our identity, employment, annual income, and intent to occupy the residential real property secured by the home loan, are true and correct as of the date of the loan closing.

The applicant must sign the document. Failure to provide the notice to the home-loan applicant does not affect the validity or enforceability of the loan.

Amendments to Other Statutes

A new statute amends Section 32.32(b) of the Texas Penal Code to read "A person commits an offense if he intentionally or knowingly makes a material false or misleading written statement to obtain property or credit, including a mortgage loan."

Under the revised Code of Criminal Procedure, prosecutors have as long as seven years to prosecute those who make false statements to obtain property or credit, measured from the date of the offense (Article 12.01).

The Texas Government Code was amended to define a fraudulent activity as "any act that constitutes a violation of a penal law and is part of an attempt or scheme to defraud any person" [Section 402.031(a)(2)].

Reporting Violations

If someone determines or reasonably suspects that a fraudulent activity has been committed or is about to be committed, he or she should report it to an authorized government agency. The person filing the report is immune from liability for doing so.

An authorized government agency includes the attorney general and local or state law enforcement agencies. The person reporting the violation (or suspected violation) and the authorized government agency receiving the report are prohibited from informing the suspected party or parties of the filing.

The Texas Government Code directs the attorney general to establish and oversee a Residential Mortgage Fraud Task Force (Section 402.032). The task force's mission is to form a strategic partnership between state, federal and local law enforcement agencies to track and prosecute mortgage fraud statewide. The agencies are charged with sharing information and resources to successfully enforce administrative and criminal penalties against perpetrators.

The task force consists of the following persons or their appointees:

- the attorney general,
- the consumer credit commissioner,
- the banking commissioner,
- the credit union commissioner,
- the commissioner of insurance,
- the savings and mortgage lending commissioner,
- the presiding officer of the Texas Real Estate Commission and
- the presiding officer of the Texas Appraiser Licensing and Certification Board.

The new statute requires the task force to submit an annual report to the governor, lieutenant governor and speaker of the house on the progress of each agency in tracking and prosecuting mortgage fraud.

Lender Fraud Penalties

Texas Penal Code 32.32 protects lenders in general. The statute discourages making false statements to obtain property or credit, presumably in loan applications. Credit is defined as, among other things, a loan to obtain money or credit.

The offense carries misdemeanor charges if the value of the property or amount of credit is less than $1,500. For amounts over $1,500, the offenses are felonies and carry the following classifications and punishments.

If the value of the property or amount of credit is:

- more than $1,500 but less than $20,000, it is a state jail felony punishable with jail time between 180 days and two years and a fine not to exceed $10,000;
- at least $20,000 but less than $100,000, it is a third-degree felony punishable with a prison sentence between two and ten years and a fine not to exceed $10,000;
- at least $100,000 but less than $200,000, it is a second-degree felony punishable with a prison sentence between two and 20 years and a fine not to exceed $10,000; or
- more than $200,000, it is a first-degree felony punishable with a prison sentence between five and 99 years or life and a fine not to exceed $10,000.

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THE TAKEAWAY

Mortgage fraud is a serious offense that negatively affects the entire industry. Practitioners can report suspected fraud to authorities without fear of reprisal.

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