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MORTGAGE MELTDOWN/PLENTY OF BLAME FOR LENDING MESS/

Suits filed, agents hunting perpetrators of loan scams that devastated the nation

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The hunt is on for the mortgage disaster's bad guys.

Across the country, task forces of prosecutors, FBI agents, securities investigators, class-action lawyers and others are mobilizing to figure out who broke the law during the high-flying days when lenders were handing out mortgage money like drunken sailors. Investors, home buyers, lenders and even cities blighted by foreclosures are filing lawsuits.

Regulators are taking heat for lax oversight. Congress is likely to hold hearings. Assigning blame is a spectator sport played out from "60 Minutes" to the blogosphere.

This week, the FBI confirmed that it is conducting 14 separate criminal inquiries of different companies that participated in subprime lending.

The companies encompass a range of financial institutions, including mortgage lenders and investment banks that repackaged subprime loans for sale, spokesman Bill Carter said. The bureau is not naming them.

The lending debacle, which wiped out hundreds of billions on Wall Street, made the stock market tank, triggered hundreds of thousands of foreclosures and led the nation to the brink of recession, may be the biggest financial mess of all time.

But unlike other big financial scandals such as Enron and the savings and loan crisis, the perpetrators are not a cadre of easy-to-finger folks in the executive suite.

Instead, they're everywhere in the mortgage food chain. Borrowers who lied about their income, mortgage brokers who flogged risky loans, appraisers who inflated home values, lenders that originated dicey mortgages, Wall Street firms that packaged them as securities and sold them, ratings firms that said those were safe investments - many participants in the market pushed the envelope, or, in some cases, may have committed outright fraud.

The one clear culprit is greed, a culture of consumerism that led countless people to seek a quick buck in the go-go real estate market of the past decade.

The FBI says mortgage fraud is the nation's fastest-growing white-collar crimes, reaching epidemic proportions in recent years as get-rich-quick mania flooded the housing market. Bank reports of "suspicious activity" related to mortgage fraud spiraled to 46,717 in fiscal year 2007, more than double the 21,994 reports in 2005, the bureau said.

California, with its spiraling property values and history of loosey-goosey lending, is one of 10 "hot spots" nationwide where mortgage fraud proliferates, the FBI said.

Because the real estate and lending industries are so vast and complex, haphazardly supervised by a hodgepodge of state, federal and local agencies, untangling what actually happened is a mammoth undertaking.

"It's a crazy patchwork quilt," said Bill Denny, senior deputy district attorney for Alameda County and head of its real estate fraud unit. "It's very hard to explain to a jury. I'd rather try a homicide without a body than explain this."

Traditionally, a borrower with tarnished credit, a sketchy employment history, and little or no money in the bank had trouble qualifying for a mortgage. But as Wall Street realized that there was a vast untapped market of such subprime borrowers - and that it could diffuse their risk by slicing and dicing loans into "mortgage-backed securities" and "collateralized mortgage obligations" - it opened the floodgates to peddle mortgages to them a few years ago. High-interest subprime mortgages were lucrative, carrying immediate payoffs for the brokers who sold them and the lenders that originated them, as well as the promise of fat yields down the line for investors that bought them. By 2005, the subprime market was \$630 billion a year - triple the \$210 billion of 2002.

Those loose lending standards created a climate that allowed bad behavior to thrive - at many levels of the mortgage business.

Here's a look at the different entities involved and the allegations being floated against them:

The borrowers

Many home buyers say they were misled or didn't understand the terms of their loans, particularly the "exploding ARMs" that adjusted to stratospheric rates after a low introductory period. But plenty of borrowers took advantage of lax lending standards - particularly "stated income" and "no doc" loans, in which they could declare their income and assets without showing proof.

Those were dubbed "liar loans" for a reason. Janitors claimed six-figure salaries and were able to buy half-million-dollar homes. That's how so many borrowers ended up over their heads - from the get-go, they did not make enough money to pay their mortgage. The Mortgage Asset Research Institute found that almost 60 percent of stated-loan applicants padded their incomes by at least half.

One Oakland woman, who asked not to be identified, explained how she exaggerated her income - with encouragement from her mortgage broker - when she refinanced her home.

"He didn't say anything illegal out loud," she said. "He didn't say 'lie,' he just made a strong suggestion. He said, 'If you made \$60,000, we could get you into the lowest interest level of this loan; did you make that much?' I said, 'Um, yes, about that much.' He went clickety clack on his computer and said, 'Are you sure you don't remember any more income, like alimony or consultancies, because if you made \$80,000, we could get you into a better loan with a lower interest rate and no prepayment penalty.' It was such a big differential that I felt like I had to lie, I'm lying already so what the heck. I said, 'Come to think of it, you're right, I did have another job that I forgot about.' "

The mortgage brokers

On the first rung of the lending ladder were mortgage brokers. In California, anyone with a real estate license can hang out a shingle as a mortgage broker. Scores of mortgage brokers, often in sole proprietorships or mom-and-pop shops, sprang into action to cater to the new rush of borrowers, collecting big loan origination fees plus an extra bonus called "yield spread premium" for writing subprime loans. According to trade publication Inside Mortgage Finance, 63.3 percent of all subprime mortgages in 2006 were originated by brokers.

"These were people who maybe didn't have a college degree, who were new to the industry. In a few months, if they could get five to seven loans a month, they were making a quarter million dollars a year," said Frank McKenna, co-founder and chief fraud strategist at BasePoint Analytics, a Carlsbad (San Diego County) firm that helps lenders detect fraud. "The commission structure created a lot of greed."

To be sure, the majority of mortgage brokers are ethical and try to find the best loan their clients can afford. But experts said the new rules of lending encouraged bad apples to push riskier loans because they yielded fatter commissions.

One Bay Area man who worked as an account executive at several subprime lenders said he witnessed mortgage brokers who blatantly falsified information on loan applications.

"I had a broker open a drawer full of blank W-2s and pay stubs while he told me he could get me whatever I needed" in terms of "proving" borrower's income, the man said.

The man said that when he would call credit bureaus to verify potential borrowers' credit scores, they frequently turned out to be much lower than the numbers written on the loan applications.

The practice was so common that when the bank stopped doing business with mortgage brokers who submitted applications with inflated credit scores, "there were some days when we cut off three brokers a day," the man said.

Federal and state legislation is pending that would clamp down on mortgage brokers, requiring that they have a fiduciary duty to their clients, for instance.

The lending institutions

A generation ago, you got a mortgage from your local savings and loan, which lent you its own money or that of depositors, then kept the mortgage on its books. Your banker had major motivation to make sure you would make your payments.

The rise of mortgage-backed securities changed all that. Once lenders began selling off mortgages to investors, they had less incentive to make sure borrowers were well-qualified, because defaults would not hurt them. (Although, in fact, lenders were contractually obligated to take back loans that went sour in the first few months - something that came back to bite many lenders.)

"Lenders structured themselves so the underwriting department (which determines lending guidelines) reported to the salespeople," said McKenna, the fraud expert. "You had the fox guarding the henhouse."

A new breed of "direct lenders" - independent mortgage companies, not subject to the same federal regulations as banks, was a big factor.

At subprime lenders "the (loan) form was always signed by unlicensed salespeople," said Denny, head of the Alameda County district attorney's real estate fraud unit. "They hired them from Good Guys, Circuit City, used-car places. They operated out of boiler rooms." Denny said he found repeated income padding at some direct lenders.

"When you would see the loan information, every elderly woman over 65 'ran' a child care center and made \$13,000 a month," he said. "The interviewer would say to the woman, 'You have a couple of spare bedrooms; you could be running a child care.' That's a lot of kids."

Carolyn Warren, author of the book "Mortgage Rip-offs and Money Savers," worked for several direct lenders and said she was uncomfortable with their practices.

"There is a lot of pressure from management to write expensive loans," she said. "Unscrupulous, greedy loan officers will do anything to close another deal for commission regardless of whether it works for the borrower."

A raft of allegations say many lenders played fast and loose with their loan standards. Take Ameriquest Mortgage Co., once the nation's biggest subprime lender. After being probed by the attorneys general of 49 states, it agreed to pay \$325 million to settle charges that it misled borrowers about home loan terms, refinanced borrowers into inappropriate loans, inflated home appraisals and charged excessive loan origination fees and prepayment penalties. The company did not admit wrongdoing as part of the January 2006 settlement.

Now investigators are pouring over documents to see if similar charges can be leveled against other big lenders. Another allegation is that lenders, like brokers, steered clients into more-lucrative subprime loans even when they qualified for prime mortgages - a practice that disproportionately targeted minorities, consumer advocates say. In January, the city of Baltimore sued Wells Fargo, claiming it pushed higher-interest subprime loans on black customers, a charge the bank disputes.

The appraisers

An appraisal that verifies a home's value is key to any real estate sale. Many appraisers, as well as prosecutors, say that appraisers were routinely pressured by lenders to "hit the target" - sign off on inflated home values so transactions would close. New York Attorney General Andrew Cuomo sued appraisal management firm eAppraiseIT in November alleging that it colluded with lender Washington Mutual to pump up appraisals. Both companies deny the allegations; WaMu was not charged.

"I've been an appraiser for 20 years and I've never not felt pressure," said John Ferguson, a nationally known appraiser licensed in California.

"The appraisal is the last thing that happens after all the credit is taken care of. At that point, everyone is frothing at the bit to get this loan closed and get paid, (so they see) the appraisal as more of a hurdle than anything." Fake appraisals are a linchpin of many mortgage fraud schemes, such as con artists buying homes at artificially high prices to skim off equity, said Tom Pool, a spokesman for the California Department of Real Estate.

The FBI says the most common frauds perpetrated by real estate insiders involve "straw buyers" who use fake appraisals to purchase houses at inflated values, pocket the difference between the actual value and the fake purchase price, then let the house fall into foreclosure. Such transactions helped drive up prices for everyone because they created new benchmarks for ever-higher property values.

The investment banks

The big Wall Street institutions that bundled up mortgages and resold them as securities are among those the FBI is now scrutinizing. The city of Cleveland, in an innovative legal strategy, is taking aim at investment banks too. In January, it sued 21 such institutions, claiming their subprime lending practices created a public nuisance.

Mark Hanson, a 20-year mortgage lending veteran who now works as an independent industry consultant in Walnut Creek, said the focus on firms at the top of the food chain makes a lot of sense because they bear responsibility for creating the system that allowed fraud to spread.

"Mortgage brokers and bankers don't come up with money unless the Wall Street investment banks say they'll buy it," Hanson said. "All the big Wall Street investment banks would put out guidelines on what they would buy. The mortgage brokers originated loans based on what those guys said they wanted. They never told anyone to lie. But they said, 'We don't need this documentation (of borrowers' income and assets); we won't do any due diligence to check it out.' "

The ratings agencies

The alchemy that made risky mortgages salable on Wall Street involved getting an imprimatur from credit-ratings agencies such as Moody's, Standard & Poor's and Fitch's. Bond issuers pay the agencies to rate their offerings; investors use those ratings to decide whether to buy.

Now Ohio's attorney general says that the credit-ratings firms were too cozy with their clients - that they approved risky mortgage-backed securities in pursuit of a payday. All the agencies deny a conflict of interest or any wrongdoing.

Needless to say, the investors all over the world who bought mortgage-backed securities and saw most of their worth evaporate are none too happy these days. They are feverishly interested in uncovering evidence of fraud so they can force the Wall Street banks that sold them these products to buy them back at their original price.

"With all this paper we pushed to Asia and Europe, I hear they have hired thousands and thousands of manual auditors to get their hands on this collateral (lending documents) to go through it and find one thing that's wrong," Hanson said. "If you said you had \$12,000 in your bank account and you actually had \$11,000, the investment bank that securitized the deal has to take it back. The whole thing is going to the finger-pointing phase."

Common mortgage fraud schemes

Property flipping: Property is purchased, falsely appraised at a higher value, then quickly sold to a "straw buyer" who lets it go into foreclosure. The schemes typically involve one or more of the following: fraudulent appraisals, doctored loan documents, inflating buyer income. Kickbacks to buyers, investors, property/loan brokers, appraisers, and title company employees are common.

Silent second: The buyer of a property borrows the down payment from the seller through a nondisclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status.

Nominee loans/straw buyers: The borrower's identity is concealed through the use of a nominee who allows the borrower to use his or her name and credit history to apply for a loan.

Fictitious/stolen identity: A false or stolen identity may be used on the loan application. The applicant may be involved in an identity theft scheme. The applicant's name, personal identifying information, and credit history are used without the true person's knowledge.

Inflated appraisals: An appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender. The report inaccurately states an inflated property value.

Foreclosure rescue scams: The perpetrator identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Perpetrators mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The perpetrator profits from these schemes by remortgaging the property or pocketing fees paid by the homeowner.

Equity skimming: Scam artists get title to a home at below market value - often by convincing a distressed home buyer that they can prevent foreclosure - then uses refinancing or home-equity loans to strip out any equity in the property.

Air loans: This is a nonexistent property loan where there is usually no collateral. An example of an air loan would be where a broker invents borrowers and properties, establishes accounts for payments, and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.

Source: FBI