A Look Behind the Statistics on Mortgage Fraud

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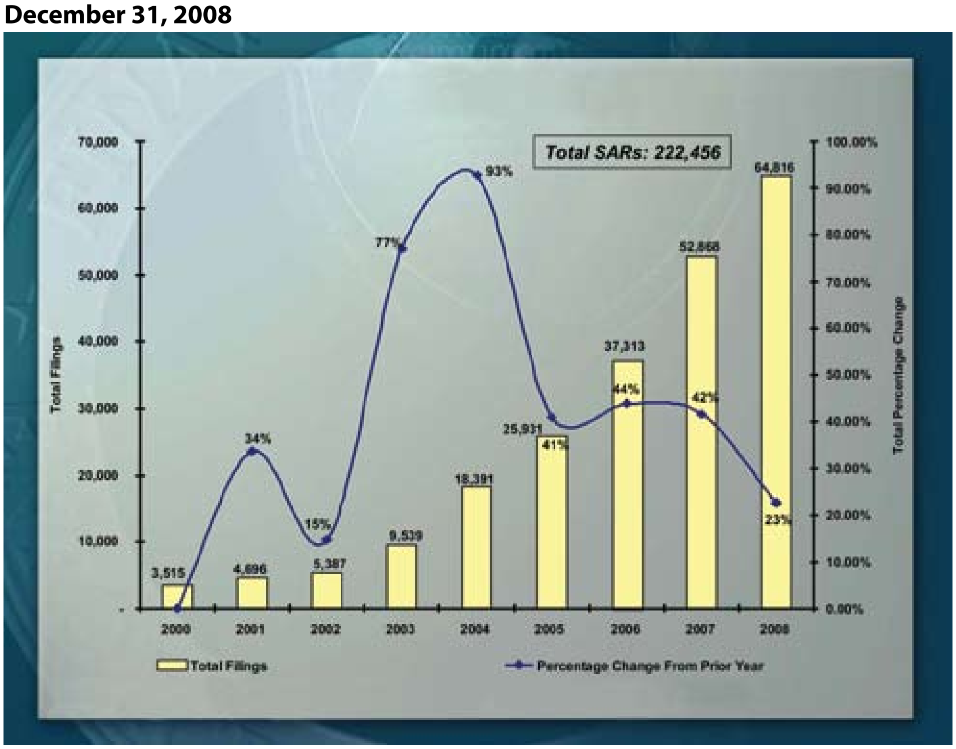
Despite lower loan volumes, more conservative underwriting practices, and greater awareness of fraudulent schemes by mortgage lenders, the incidence of mortgage fraud is continuing at a breakneck pace in the United States. In the most recent seven-month period for which statistics are available, the Federal Bureau of Investigation received nearly 41,000 suspicious activity reports (SARs) (FBI 2009). At this rate, the 2009 totals will outpace 2008—a record year when close to 65,000 fraud cases were reported. (See figure 1.)

These FBI statistics are compiled by FinCEN, the Financial Crimes Enforcement Network, in the U.S. Department of the Treasury. The data are supplied by regulated financial institutions that are required by law to file reports on suspected illegal activity such as money laundering and mortgage fraud. This group includes banks, savings and loans, credit unions, U.S. branches of foreign banks, and mortgage lenders that are non-bank subsidiaries of bank holding companies. A process also has been established to enable Fannie Mae and Freddie Mac to report suspected fraud (FinCEN 2009a, 1).

The fraudulent activity reported on a SAR form is counted in the year the report is filed, not in the year the loan was originated. According to a FinCEN study (2009a), most loan frauds are discovered within 12 months of origination. Some frauds, such as those involving early payment defaults (EPDs) in which home purchasers often fail to make a single mortgage payment, become apparent within a few months. It can take up to 19 months on average, the study found, for loan purchasers in the secondary market or mortgage insurers to detect a fraudulent loan. Other schemes that are uncovered only when the property enters foreclosure can take years to discover. According to the study, only 34 percent of all frauds are detected before the loan is funded.

Figure 1. SARs reporting mortgage loan fraud: January 1, 2000, through December 31, 2008



Source: FinCEN 2009b.
Note: Percentages represent change from previous year.

Fraud Rankings by State

Another source of fraud statistics is the Mortgage Asset Research Institute (MARI®) yearly report for the Mortgage Bankers Association. In these reports, MARI compares the incidence of mortgage fraud to the number of loan originations in each state and then ranks the states according to the prevalence of mortgage fraud (Mortgage Asset Research Institute 2009a). The data are supplied by the company's subscribers, which include national and regional lenders as well as independent mortgage banking companies, secondary market agencies, and private mortgage insurers (Mortgage Asset Research Institute 2009b).

Unlike SARs, these data are entered in the year the loan was originated, not the year the fraud was discovered. Since it is not unusual for a fraud to surface even years after the original loan was made, the yearly totals are being continually updated. For this reason, the current year's totals are considered preliminary (Mortgage Asset Research Institute 2009a, 5). It also explains why a state's ranking in a past year can change in a subsequent report.

The statistic used to measure the relative incidence of mortgage fraud between states is the MFI or MARI Fraud Index. The MFI is based on the concept that the percentage of fraudulent loans in a state should be the same percentage as its loan origination numbers compared to the national total. An MFI of 100 means that the percentage of loans that were fraudulent in a state equals the percentage of loans originated in the state. The current fraud leader, Rhode Island, has an MFI of 315. This means that Rhode Island had three times as many fraudulent loans for its loan volume as the national average. Only two states in the top ten, Colorado and Missouri, have MFI scores below 100. The most current state ranking by MFI is found in table 1.

Top Mortgage Fraud Methods

MARI also compiles data on what subscriber investigations have shown were the means used to perpetrate a fraud.

Although appraiser fraud has received much media attention and prompted a collection of state laws to prevent its occurrence, application misrepresentation has remained, for five years in a row, the method of choice for conducting mortgage fraud schemes (table 2). These misrepresentations range from putting incorrect names and fake Social Security numbers on the application to falsifying employment, income, or asset and liability information.

Application misrepresentation was behind 61 percent of all mortgage loan frauds committed in 2008. The second leading method—false income tax returns or financial statements—was used to obtain 28 percent of the 2008 loans. By comparison, appraiser fraud was present in only 22 percent of 2008 fraud cases. Interestingly, first-ranked Rhode Island led all the states in appraiser fraud at 38 percent and was the only state in which appraiser fraud exceeded application misrepresentation as the primary method of deception.

The FBI (2008) identifies two categories of mortgage fraud schemes—fraud for profit and fraud for property. Perpetrators of mortgage-fraud-for-profit scams seek to extract illicit cash from the targeted property, often by inflating its appraisal value or by subsequent sales at inflated prices to co-conspirators. The authors of this month's cover story, "Assessing Mortgage Fraud," discuss in significant detail how these frauds are carried out. In mortgage-fraud-for-property cases, purchasers falsify income or debt information to obtain a loan on a property they otherwise could not afford.

Fraud's Impact on Values

No matter the motive behind the fraud, its prevalence in a jurisdiction skews the market values used for comparable sales. Not only do fraudulent sales add inflated values to the comparables pool, but they can also raise the level of asking prices when nearby homeowners put their properties on the market. This effect was demonstrated by Carswell (2009) in a recent study that compared home values in fraud-affected neighborhoods with those in similar but non-fraud-affected neighborhoods. In addition, those who are willing to misrepresent their finances to buy houses beyond their means help to keep sale prices at higher levels than normal market forces could sustain.

In either type of fraud, the residences often end up in foreclosure. At what point foreclosure sales represent the market has become a hotly debated topic among assessment professionals. Meanwhile, state legislatures are passing bills mandating that foreclosures and other distressed sales be included as comparables (see Legal Trends, p. 22). Under these circumstances, mortgage-fraud properties introduce an additional source of uncharacteristically low-value properties into market value computations.

Table 1. MARI fraud index (MFI) by state—all originations 2004–2008

State	2008 Rank	2008 MFI	2007 Rank	2007 MFI	2006 Rank	2006 MFI	2005 Rank	2005 MFI	2004 Rank	2004 MFI
Rhode Island	1	315	5	173	18	66	18	65	41	16
Florida	2	279	1	312	1	210	3	177	5	176
Illinois	3	215	6	122	6	127	5	152	8	134
Georgia	4	180	7	115	5	139	1	305	1	421
Maryland	5	170	15	70	16	67	26	47	29	41
New York	6	165	14	72	12	90	10	104	12	99
Michigan	7	136	3	211	3	158	2	191	4	204
California	8	111	4	175	2	181	8	121	19	65
Missouri	9	98	12	78	20	63	13	94	7	136
Colorado	10	98	17	65	8	105	6	138	3	208

Source: Eleventh Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association, *Mortgage Asset Research Institute, LLC 2009.*

Table 2. Mortgage fraud types, 2004–2008

Fraud Classification	Mortgage Origination Year (All States)				
	2008	2007	2006	2005	2004
Application	61%	62%	67%	67%	65%
Tax Return/Financial Statements	28%	17%	18%	18%	24%
Appraisal/Valuation	22%	19%	16%	20%	23%
Verification of Deposit (VOD)	21%	24%	19%	17%	16%
Verification of Employment (VOE)	15%	12%	11%	10%	12%
Escrow/Closing Documents	10%	12%	11%	11%	11%
Credit report	4%	9%	14%	11%	9%

Source: Eleventh Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association, *Mortgage Asset Research Institute, LLC 2009.*

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