

## **MORTGAGE FRAUD UPDATE**

In the past, we have provided several articles discussing the then latest form of mortgage fraud and the ways to spot it and avoid it. Also, in the past we have commented on the lack of action by law enforcement to charge and prosecute persons engaged in mortgage fraud. That is not the case today. There are a number of federal or state task forces actively pursuing claims of mortgage fraud against persons in Michigan.

This update on mortgage fraud will focus on two (2) case studies, both of which are based upon actual cases. Both involve allegations of mortgage fraud or inappropriate conduct in conjunction with short sales.

### **I. Case One – Moving Assets Around**

A. In September, 2001, husband and wife grant a \$1,475,000 mortgage for a home in Gross Pointe Park, Michigan (the “Lakeview Home”).

B. A little less than two years earlier (1999), husband bought a home in Windermere, Florida, for approximately \$600,000 (the “Florida Home”). There was no mortgage on the Florida home.

C. In March, 2010, husband and wife quit claimed the Florida Home (then valued at \$664,682) to the wife’s stepdaughter for \$10.00 (“Stepdaughter S”).

D. In April, 2010, husband and wife buy a home in Grosse Pointe Park for \$168,000 (the “Windmill Point Home”). The source of funds for the purchase was allegedly a cash out of a retirement fund.

E. On September 15, 2010, husband and wife convey the Windmill Point Home to a stepson (“Stepson K”).

F. On October 10, 2010, husband and wife list the Lakeview Home for sale for \$1,200,000. When the Lakeview Home was purchased in September, 2001, they granted \$1,475,000 mortgage on the Lakeview Home.

G. On December 14, 2010, husband and wife submitted an application for a short sale on the Lakeview Home. It was claimed in the application that they had “serious personal issues” and had drained their savings to make house payments, maintain the Lakeview Home, pay taxes and defend the husband in a lawsuit related to a prior sale of an apartment building in which he had an interest.

H. In March, 2011, wife gave another stepdaughter (“Stepdaughter K”), \$195,000 from a retirement fund. Stepdaughter K used the \$195,000 to buy another home in Gross Pointe Park (the “Balfour Home”). The Balfour Home is never disclosed to the lender, ING Direct, who owned the mortgage on the Lakeview Home.

I. In June, 2011, the lender, ING Direct, asked the attorney for the husband and wife about their ownership of the Windmill Point Home and the Lakeview Home. The husband and wife denied ownership of both of those properties, which was literally, technically correct, since the Florida property had previously been quit claimed to Stepdaughter S and the Windmill Point Home had been quit claimed to Stepson K.

J. On October 12, 2011, the lender, ING Direct, approves husband and wife for an \$850,000 short sale on the Lakeview Home. On this date, husband and wife owed approximately \$1,400,000 on the Lakeview Home. The short sale resulted in the cancellation of a sheriff's sale of the Lakeview Home scheduled for November, 2011.

K. On November 7, 2011, husband and wife sold the Lakeview Home in a short sale for \$850,000.

L. On December 1, 2011, Stepdaughter K quit claims the Balfour Home to husband and wife. Husband and wife currently reside in the Balfour home.

M. On March 8, 2012, Stepdaughter S conveys the Florida Home back to husband and wife.

N. On November 13, 2012, the United States Attorney's Office for the Eastern District of Michigan files a lawsuit seeking forfeiture of the Florida Home (the "Forfeiture Action"). In the Forfeiture Action, it is contended by the government that the Florida Home constitutes proceeds or property traceable to financial institution fraud in violation of Title 18, United States Code Section 1344 and/or was the proceeds of or property involved in Money Laundering a violation of Title 18, United States Code Section 1956. It is specifically alleged that on December 10, 2010, husband and wife submitted a hardship letter to ING Direct in support of their claim to be forgiven debt of \$600,000 in a short sale in connection with their sale of the Lakeview Home. It was further alleged that prior to the submission of the hardship letter and with intent to defraud, husband and wife systematically and fraudulently transferred property and hid assets in order to support their claim to ING Direct that they did not have the financial resources to pay the mortgage on the Lakeview Home. Further, it was claimed that the Florida Home was part of the fraudulent transfers by husband and wife. The government claimed that the fraudulent transfers resulted in ING Direct being defrauded in the amount of \$600,000.

O. Title 18, USC § 1344 provides:

Whoever knowingly executes, or attempts to execute, a scheme or artifice --

- (1) to defraud a financial institution; or
- (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;

shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

P. On January 18, 2013, the United States Attorney for the Eastern District of Michigan filed a Criminal Information alleging that the wife committed bank fraud pursuant to 18 USC § 1344. In the Criminal Information, it was alleged that when the wife negotiated with ING Direct for a short sale in January, 2010, she indicated she could no longer afford to pay the mortgage on the Lakeview Home; transferred certain real property to others to conceal her ownership interest from ING Direct; and made false statements and omitted information in the Hardship Letter trying to conceal assets from ING Direct. All of this contributed to approval of the short sale by ING Direct and the resulting financial loss to ING Direct.

Q. On January 21, 2013, wife plead guilty to one count of bank fraud, 18 USC § 1344 which imposes a maximum penalty of 30 years and a maximum fine of one million dollars with a supervised release after jail not less than 3 or more than 5 years.

R. In entering into a plea agreement, wife admitted the following:

[Wife] with intent to defraud, failed to report all assets under her control at the time she applied for the short sale. On December 10, 2010, [wife] filed a 'hardship letter' with ING. The hardship letter failed to declare available funds as well as the recent transfers of real estate out of her name and into the names of others. These concealments were done by [wife] with the intent to hide her true and more favorable financial condition from ING, and influence ING's decision on her short sale request.

Based on the false and misleading statements and omissions in the hardship letter, and false and fraudulent representations made by [wife] during the short sale negotiations, ING approved the short sale of Lakeview and required [wife] to contribute only \$10,000 towards the shortfall in the mortgage. Having known [wife's] true financial status, ING would have required [wife] to contribute between \$50,000 and \$100,000 towards the shortfall in the mortgage. Thus, ING suffered a loss in the amount between \$40,000 and \$90,000 as a direct result of [wife's] conduct. The government has no information suggesting [wife] used her status as public employee to perpetrate the scheme to defraud.

As part of the plea agreement, the civil forfeiture action was dropped, thus husband and wife shall retain ownership of the Florida Home.

A review of the lessons to be learned from this case study includes the danger in concealing assets; the fact that an omission to a lender is equally as bad as a misrepresentation; and that regardless of their position in the World, persons will be prosecuted for mortgage fraud.

## **II. Freddie Mac And Its Exclusionary List**

A. This case does not involve any criminal proceedings. Instead, the case exists due to Freddie Mac placing Broker A and Broker A's company on its exclusionary list. After being placed on Freddie Mac's exclusionary list, Broker A and his company commenced litigation in federal court to seek an injunction requiring Freddie Mac to remove Broker A and his company from its exclusionary list. The litigation remains pending at the time of the preparation of this article.

B. A description of the Freddie Mac exclusionary list is contained in a document entitled "Information on Federal Home Loan Mortgage Corporation's Exclusionary Policy," a copy of which is attached to this article (the "Information"). The Information was attached to a pleading by Broker A in the pending litigation in federal court. Placement on the exclusionary list excludes persons or entities from participating, either directly or indirectly, in any Freddie Mac transaction. The information provides:

This means that excluded persons or entities may not be involved in the 1) the origination of any Freddie Mac loan or the underlying real estate transaction, 2) the sale of a loan to Freddie Mac, or 3) the servicing of any Freddie Mac loan or property, including any related loss mitigation activities.

The Information sets forth examples of prohibited roles. The Information also provides examples of the grounds for being placed on the exclusionary list. It provides:

Examples of grounds for placement on the Exclusionary List include, without limitation:

- Fraud;
- Misrepresentation, misstatements or omissions of material facts;
- Willful or reckless violation of statutory or regulatory requirements;
- Business practices that Freddie Mac determines present an undue risk;
- Lack of business controls to ensure the integrity of the mortgages sold to or serviced for Freddie Mac;
- Evidence that demonstrates a lack of integrity or business competences; or
- Other grounds that in Freddie Mac's judgment may adversely affect Freddie Mac.

C. It has been alleged by Broker A in the litigation in federal court that:

Freddie Mac's actions cast a shadow of impropriety over his operation, and now servicers, lenders, and other real-estate-market participants are refusing to do business with him or his companies. Freddie Mac has also put his customers on notice that he and his companies are 'under investigation' or otherwise 'accused of fraud.'

D. The primary issue between Freddie Mac and Broker A and his company revolves around a claim by Freddie Mac as follows:

You [Broker A] as well as [your company] have been materially involved with short sale transaction on at least five properties securing Freddie Mac loans. In each of these transactions, you or your employees instructed Freddie Mac borrowers to purchase a new home prior to applying for short sale assistance on the Freddie Mac loan. The short sale packages that your employees submitted to Freddie Mac servicers on behalf of the Freddie Mac borrowers failed to disclose the acquisition of the new home.

It appears that the borrowers' inability to repay the Freddie Mac loans as represented by you or your employees was not genuine or was created as a result of the purchase of new homes made possible through you and your Companies.

E. Broker A and his company, in the federal court litigation, have vigorously denied the truthfulness of the allegations made by Freddie Mac.

F. Broker A and his company vigorously deny that they ever advised their clients to purchase a new home and then apply for a short sale on their current home. They further vigorously deny that they ever advised clients not to disclose the purchase of a new home in the application for a short sale to Freddie Mac. Instead, they contend that the failure of a client to report the purchase of the new home on their application for short sale on their current home is due to Freddie Mac's own guidelines.

G. In their Verified Complaint for Preliminary and Permanent Injunctive Relief and Damages (the "Verified Complaint"), Broker A and his company describe how the results of Freddie Mac's own guidelines result in the purchase of a new home not being reported to Freddie Mac in conjunction with an application for a short sale on a client's current home.

H. Broker A and his company in their Verified Complaint describe Freddie Mac's policies and the process as follows:

Generally, Freddie Mac will approve a short sale if (1) the borrower is severely delinquent – defined as 90 days or greater - on their mortgage payments or (2) the borrower demonstrates a hardship, such as a death, divorce, disability, or distant relocation.

According to Freddie Mac’s widely-circulated, non-proprietary service guide and other publications, delinquency in mortgage payments greatly facilitates the short sale approval process. For example, the guidelines generally require the borrower to “submit a complete Borrower Response Package” to be considered for a short sale, but when the borrower is “90 days or more delinquent in the Mortgage payment and has a FICO score of less than 620 as of the evaluation date,” the servicer is not required to “Obtain or review the Borrower Response Package; or Verify an eligible hardship.” (Freddie Mac Single Family/Single Family Seller/Servicer Guide, Volume 2/Chs. 64--69: Servicing Nonperforming Mortgages/Chapter 65 (10/1/2012), Section 65.36(a), attached as Exhibit C.)

Under Freddie Mac’s guidelines, the borrower who is 90 days or more delinquent also does not have to give any cash contribution at closing of the short sale; this “delinquency benefit” waives the usual 20% contribution of cash reserves the borrower must ordinarily provide at closing to obtain short sale relief.

[Broker A and Broker A’s Companies] use these same guidelines and publications when they provide truthful and accurate counsel to their clients before those clients decide to act in the short sale process.

Both entities explain to potential short sellers that they must either qualify for one of the so-called “4 Ds”, death, divorce, disability, or distant relocation to qualify for a short sale; or, they must be 90 days late on their mortgage payments. These guidelines established by Freddie Mac and enforced by Freddie Mac’s loan servicers encourage home owners to forego payment of their mortgage if they do not qualify by virtue of a death, divorce, disability or distant relocation. Whether by design or default, these same regulations do not prohibit potential short sale homeowners from purchasing a second home with lower payments before they stop paying on the first mortgage.

I. Broker A and his company further contend in the litigation in federal court that he and his company are bound by Michigan’s law of agency and have an absolute duty to act solely for the benefit of their clients without regard to the interests of Freddie Mac or its loan servicers.

In other words, Broker A and his company cannot disclose any information to Freddie Mac or its servicers which would be adverse to the interest of their clients. Broker A and his company alleged these duties and this situation as follows in their Verified Complaint in the federal litigation.

Michigan courts have similarly obliged real estate brokers and real estate sellers to follow traditional common law principles of agency. For instance, over 100 years ago the Supreme Court of Michigan wrote ‘the general rule of agency is that an agent to buy or sell is bound to make the best bargain he can for his principal.’ *Leathers v. Canfield*, 117 Mich. 277, 286 (1898). Michigan law follows the majority rule. *See* 19 Williston on Contracts, § 54.28 (4th ed. 1990); Restatement (Second) of Agency § 387.

Michigan statutory and common law impose an onerous and inescapable duty upon Broker A and Broker A’s Companies, and on any other real estate broker to act solely for their clients, to consummate sales to the best advantage of their clients—on the best terms and at the best price possible—without regard to the interests of Freddie Mac or loan servicers. Their client-borrowers’ interests in a short sale are necessarily adverse to those of the loan holder—in this case, Freddie Mac.

J. A Freddie Mac fraud investigator has also filed a complaint against Broker A’s company with the Department of Licensing and Regulatory Affairs. A copy of the Statement of Complaint was attached to a pleading filed by Broker A in the litigation pending in federal court. In the Freddie Mac fraud investigator’s Statement of Complaint, he alleged that Broker A’s company and Broker A were placed on Freddie Mac’s exclusionary list “as results of fraudulent business model.” Attached as an exhibit to the Statement of Complaint was a claim by the Freddie Mac fraud investigator that Broker A’s business practices, including non-disclosure of a new home purchase in the application for a short sale, resulted in losses to Freddie Mac on ten (10) short sales totaling \$501,312.

K. It should be emphasized that at the time of preparation of this article, no criminal charges of any kind had been asserted against Broker A or his company. Further, the federal district court has not determined whether Broker A and his company should be removed from the exclusionary list. Broker A and his company are continuing to vigorously deny any wrongdoing of any kind which would result in their placement on the exclusionary list.