



## Subprime 'Liar Loans' Fuel Bust With \$1 Billion Fraud (Update1)

By Bob Ivry

April 25 (Bloomberg) -- Cheating on mortgage applications is so widespread and so seldom punished that it's fueling an increase in foreclosures that will prolong the housing slump, said Robert W. Russell, counsel to the director of the Office of Thrift Supervision, which oversees savings and loans.

Borrowers and brokers commit fraud when they exaggerate the applicant's income, qualifying the borrower for a home he otherwise couldn't afford. Such fraud robbed lenders of an estimated \$1 billion last year, according to data collected by the Washington- based Mortgage Bankers Association and the Federal Bureau of Investigation.

"Misstatements about employment and income are being made every day," Russell said. "The brokers are just putting down on paper what the underwriters would require. There are borrowers providing false information as well."

Loans that require little or no documentation of income soared to \$276 billion, or 46 percent, of all subprime mortgages last year from \$30 billion in 2001, according to estimates from New York- based analysts at Credit Suisse Group. Homebuyers with those loans defaulted at a 12.6 percent rate in February, compared with 1.5 percent of fully documented prime mortgages, said San Francisco- based First American LoanPerformance, a mortgage consulting group.

A 2006 study cited by the Mortgage Asset Research Institute showed that almost 60 percent of stated income loans were exaggerated by at least 50 percent.

'Liar Loans'

"Everyone calls these loans 'liar loans' because we know these people were lying," said Jim Croft, a spokesman at the Reston, Virginia-based Mortgage Asset Research Institute.

Nancy Olland's application for a mortgage said she made \$6,900 a month. She needed that much income to qualify for her loan. The 48-year-old mental health therapist from Cleveland Heights, Ohio, actually makes \$3,286, based on her pay stub.

She said she wasn't asked to document her income. She signed the mortgage without reviewing it and discovered the discrepancy months later.

"I don't know where the information came from," Olland said. "I didn't give it to my mortgage broker. Was it literally fabricated out of thin air?"

New Century Financial Corp., the second-largest U.S. subprime lender last year, was Olland's lender.

Laura Oberhelman, a spokeswoman at Irvine, California-based New Century, said in an e-mail that the company only approves loan applications "that evidence a borrower's ability to repay the loan." To stem fraud, she said New Century used electronic and manual systems "designed to detect red flags like inflated appraisal values, unusual multiple borrower activity or rapid loan turnover."

New Century filed for bankruptcy on April 2.

Red Flags

As part of a pending class-action lawsuit in State of Minnesota District Court alleging Ameriquest

Mortgage Corp. charged borrowers extra fees, former account executive Mark Bomchill, who worked in the Plymouth, Minnesota, branch office, said it was "a common and open practice at Ameriquest for account executives to forge or alter borrower information or loan documents."

"I saw account executives openly engage in conduct such as altering borrowers' W-2 forms or pay stubs, photocopying borrower signatures and copying them onto other, unsigned documents and similar conduct," Bomchill said in a sworn statement.

"It wasn't really done behind closed doors," Bomchill said in an interview.

Ameriquest spokesman Chris Orlando said the Irvine, California-based company, which once was the biggest subprime lender, has "zero tolerance for fraud" and works hard to find it and prevent it.

#### Fraud Complaints

"When we discover an employee involved in fraudulent activity, we take decisive action up to terminating employment and pursuing criminal action," Orlando said.

Mortgage fraud complaints more than doubled in the U.S. from 2003 to 2006, according to the Financial Crimes Enforcement Network, a division of the U.S. Treasury Department. Suspicious activity reports pertaining to mortgage fraud increased 14-fold from 1997 to 2005, according to the organization.

There is a pattern of "exaggerated or fabricated income information associated with subprime loans," the Vienna, Virginia-based enforcement network said in a report in November.

The difficulty in calculating mortgage fraud is only one-third of lenders are required to report suspicious behavior, said Mortgage Bankers Association spokesman John Mechem.

The FBI targets what it calls "fraud for profit," which is related to conspirators who lie to get multiple mortgages and have no intention of repaying them, said Special Agent Stephen Kodak in Washington.

#### Ten Arrested

Ten men were charged today in Brooklyn, New York, in a "fraud for profit" scheme that the FBI said used false identities to defraud more than a dozen mortgage lenders. The FBI said the homes the conspirators bought typically appreciated by about \$100,000.

Individuals lying about their income to buy a house they intend to live in, or "fraud for housing," occurs more often but accounts for less money lost, Kodak said. The FBI generally does not go after "fraud for housing," he said.

Yet many "fraud for housing" schemes end up as "fraud for profit" conspiracies, said David McLaughlin, head prosecutor for the Georgia attorney general.

"Even the most benign-looking fraud can have far-reaching consequences," McLaughlin said. "Those properties will fall into foreclosure and there's a risk when you have a fraud scenario and the person is in so far over their heads, those are the prime targets for fraud-for-profit criminals to prey on."

McLaughlin said his priority is "fraud for profit" cases, though he would like to prosecute homebuyers who lie on their mortgage applications.

#### 'Anyone With a Pulse'

Low documentation loans were established in the 1980s mainly for the self-employed and non-U.S. citizens whose pay was difficult to verify. They can be processed quicker than standard loans and typically cost the borrower an extra quarter point on his mortgage. They were made possible by relaxed lending guidelines, or what Bear Stearns Cos. analyst Gyan Sinha calls "Hail Mary underwriting."

"The loans were available to anyone with a pulse," said Greg Bass, a former account executive in Austin, Texas, for subprime lender Long Beach Mortgage Co.

When interest rates started to climb from the lows of June 2003, subprime lenders eased their standards so more people could afford homes, said Sandor Samuels, executive managing director of Calabasas,

California-based Countrywide Financial Corp., the biggest U.S. mortgage lender.

Homeowners flooded lenders with requests to refinance mortgages during the U.S. housing boom from 2001 to 2006 when median home prices increased 56 percent, according to the Washington-based National Association of Realtors.

#### Prices Peak

"When everyone was eating up the subprime market, it was great to be in the business," said Josh Tullis, sales director for A. Anderson Scott Mortgage Group in Falls Church, Virginia. "In the heyday, I knew guys who went from making \$2,000 a month working 60 hours a week at McDonald's and they'd come over here and work 15 hours on a loan and make \$4,000."

The riskier mortgages generally command higher broker commissions. Tullis said one subprime mortgage, which typically costs 2 to 3 percentage points more than a standard loan because it goes to borrowers with bad or limited credit, pays him the same as five mortgages for borrowers with good credit.

The number of subprime mortgages has grown 10-fold in the past seven years to 5.97 million, according to the Mortgage Bankers Association.

As many as 2.4 million U.S. homes are in danger of foreclosure, according to the Durham, North Carolina-based Center for Responsible Lending. Foreclosure filings rose 47 percent last month from a year ago, said RealtyTrac Inc. of Irvine, California.

Borrowers with low-documentation subprime mortgages were almost 10 times more likely to suffer foreclosure than homeowners with fully documented prime loans, the company said.

#### Increase in Foreclosures

The number of subprime borrowers who are late on their mortgage payments is at a four-year high, according to the Washington-based Mortgage Bankers Association. The median U.S. new home price peaked at \$257,000 in April 2006 and slipped to \$250,000 in February, according to the U.S. Census Bureau.

"A lender funding the transaction doesn't have an incentive to make a fraudulent loan," said Chuck Cross, a director at the Conference of State Bank Supervisors in Washington. "But the originator does not have the same economic incentive not to. He makes the fee regardless of whether the loan is good or not."

With prices falling, it's no longer as easy for homeowners to wring cash out of their properties by refinancing. New home sales slowed to a seven-year low in February.

Nancy Olland said the loan she took out last year is too expensive and she can't make her monthly payments. She tried to contact the broker who wrote her mortgage, but she said she can't find him.

The broker's boss, William Gregg of Tanager Mortgage Group Inc. in Cleveland, said Olland's broker was fired for not following the firm's "strict guidelines."

Olland said she is considering bankruptcy.

"Probably the most difficult thing for me in all of this is I'm well-educated," Olland said. "I have a master's degree. I'm not stupid, but I handled this situation stupidly."

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