

Mortgage Fraud

RED FLAGS
AND WARNING
SIGNS FOR
VALUATION
EXPERTS

By Nathalie Roy-Patenaude, AACI, P.App,
Director-Counsellor, Professional Practice

“March is *Fraud Prevention Month*. Fraud-related offences are now thought to be as profitable as drug-related offences, estimated at between \$10 and \$30 billion annually in Canada by the RCMP’s Commercial Crime Branch. The majority of these crimes are not committed by kids at their computers, 80% or more of the work is conducted by criminal organizations.

Fraud should concern all Canadians because it de-stabilizes our national economy while strengthening organized crime groups. The impact on individuals, families and businesses is devastating: retirement savings, homes, businesses – and, in some cases, lives – have all been lost. The only good news is that the majority of frauds can be prevented by identifying the methods used by fraudsters. The more you know about a fraud, the less likely you are to fall for it.”¹

Mortgage fraud occurs when someone *deliberately misrepresents information* at one point or another along the loan application

process. This can include, but is certainly not limited to, falsified income statements, letters of employment, borrower identification, property information, ownership and/or occupancy information.

Rules of ethical conduct are common and come from the obligations that arise from being a profession. Appraisal Institute of Canada (AIC) members are expected to provide quality services within their areas of competence and in compliance with the Institute’s *Code of Conduct*, *Code of Ethics* and the Ethics and Appraisal Standards under the *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)*. Compliance with *CUSPAP* is the AIC’s contract and our members’ contract with the public we serve. This article is not intended to be a lecture on ethics, however, ethical conduct is very much a matter of the individual conscience. It is about moral duty and obligation, about our fundamental values as individuals and as professional appraisers. *When fraud occurs, this suggests a fundamental shift or change in one’s beliefs and values.*



Fraud is often driven by one or all of the following:²

- ▶ **Greed** – the desire to improve one’s financial situation through an opportunity (e.g., to quickly make money), sometimes at someone’s expense.
- ▶ **Rationalization** – the logic behind one’s action for committing fraud.
- ▶ **Opportunity** – a situation that presents itself and allows one to achieve his or her goal (financial or other).

The question then becomes: Which comes first? The chicken or the egg? The **opportunity** or the **greed** or the **rationalization**?

Mortgage fraud is clearly recognized in residential real estate and, unfortunately, is easier to commit because of the simplicity of the real estate process. Most Canadians aspire to homeownership and, sadly, fraudsters prey on vulnerable consumers and create ‘fairy tale’ opportunities to make that dream come true – at a cost (financial and emotional) to the new homeowner.

Commercial real estate transactions are more complex, undergo financial scrutiny by the purchasers and their team of experts, and do not typically get negotiated as quickly as residential properties – a commercial deal can take months or longer to get negotiated and closed. That said, commercial real estate fraud is more sophisticated and the outcome can be catastrophic.

In the fall of 2012, the AIC was invited to participate in a couple of initiatives regarding mortgage fraud. AIC had the opportunity of being a panelist at the CMHC-led discussion on fraud prevention in real estate valuation at the CAAMP Fraud Summits in Toronto and Calgary, and of lecturing on the same topic at the Canadian Police College, as part of a week-long course for police officers involved in the investigation of mortgage fraud.

“FRAUD AFFECTS ALL OF US AND INDUSTRY MEMBERS MUST WORK TOGETHER TO COMBAT IT.”³

A question that came up during these discussions is whether the AIC sees occurrences of valuation fraud by appraisers. The reality is not so much valuation fraud by appraisers as the risk of appraisers being *used as ‘bait’* in a mortgage fraud operation. Why? Because someone needs a market value to determine the loan to be advanced on a property. With the changes to the Residential Mortgage Underwriting Guidelines introduced by the Office of the Superintendent of Financial Institutions (OSFI) in June 2012, which made provisions for mortgage insurers and Federally Regulated Financial Institutions (FRFIs) to obtain more on-site appraisals, a qualified appraisal professional:

- ▶ provides the assurance that the subject property does in fact exist;
- ▶ validates and reports the property and neighbourhood characteristics required for lending institutions to make sound underwriting and risk-mitigating decisions; and,
- ▶ provides an unbiased and independent assessment of the market value of the subject property.

What follows are red flags and warning signs for valuation experts. These do not suggest fraud, but are key signs to watch for when being requested to complete or completing an appraisal assignment.

Be vigilant, be diligent.

Consider occupancy fraud

- ▶ Find out who is living in the home, the owner or a tenant?
- ▶ If a tenant is the occupant, how long has the tenant been there?
- ▶ If vacant, how long has the unit been vacant?

These questions also apply to commercial tenants.

- ▶ How long did the commercial tenant lease the space and why is the space now vacant?
- ▶ Who is the tenant – is it just a storefront for something else?
- ▶ Interview the owner to get details on the property.
- ▶ Sometimes the client asks that the appraiser not speak to the owner. Ask why?
- ▶ Is the owner aware that his/her property is being refinanced?
- ▶ The client does not want a full appraisal, just a drive-by and no property photos, and is vague about the applicant or the occupant.

Sales and listing history of the subject

- ▶ Look for an appraisal that reports a pending sale – has it closed?
- ▶ Some fraudsters report false transactions at inflated valuations in an attempt to influence the appraiser and the valuation.
- ▶ The purchase price is higher than the list price.
- ▶ The selling price appears high in comparison to the neighbourhood value range.
- ▶ The previous sale price of the subject property was substantially lower within a short time frame.
- ▶ The property changed ownership several times over a short period of time with price increases on each sale.
- ▶ In reviewing listings, offers to purchase, etc., the parties are ‘undisclosed,’ identified as ‘Care of Listing Broker,’ or ‘nominee.’
- ▶ The property was listed for a very short period of time (i.e., 24–48 hours) or the listing was cancelled prior to the sale (therefore, the true sale price is unknown).
- ▶ All or many units in a building are sold at the same time with coinciding possession dates.

Identity theft – protect your signature and your designation

We have all heard of identity theft. Unfortunately, it also happens within our offices. A colleague today can be a competitor tomorrow.

- ▶ Members are reminded to protect their signatures, especially their digital signature, and to password-protect their systems, data and files.
- ▶ Protect your designation and your credentials. Under *CUSPAP*, any AIC member who signs **any report** must identify their designation or membership status (AACI, CRA or AIC Candidate member).



Misrepresented information

The client

- ▶ requests that the appraiser keep everything confidential and not approach others involved in the transaction for information;
- ▶ withholds key and relevant information; and
- ▶ wants 'once renovated/as if complete' value, but does not provide specifications or details on work to be completed.

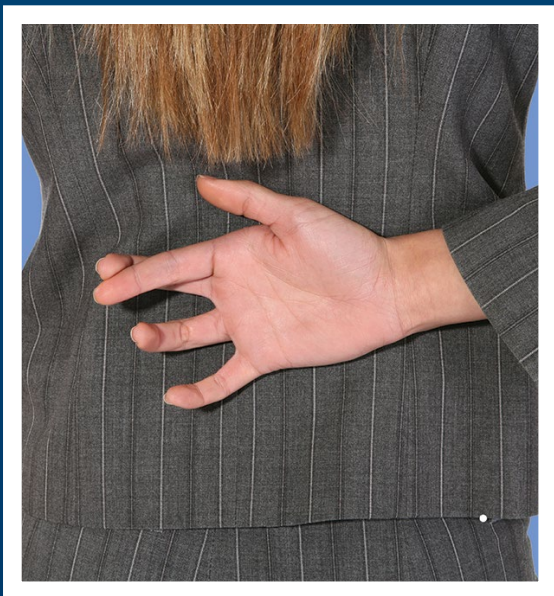
Client-appraiser relationship

The client

- ▶ ordering the appraisal indicates the property value expected;
- ▶ is a new client and mentions that he/she has not been happy with the services of other appraisal companies and would like you to do their appraisal work from now on;
- ▶ tries to influence the appraiser with the explicit or implicit promise of additional work if the current appraisal value meets their request; and
- ▶ gives the appraiser select information in an attempt to influence them.

Preventing appraisal and mortgage fraud

- ▶ Know the borrower, the client and the intended users.
- ▶ Know the market you are working in, economic trends, buyers' profiles.
- ▶ Research and validate the data, do the cross-reference checks.
- ▶ Look for signs of data manipulation, misrepresentation and / or inconsistency of information.
- ▶ Be wary of requests for quick turnarounds. Take the time to do your research, to analyze the data.



Supplementary sources of information:

CAAMP -

Canadian Association of Accredited Mortgage Professionals:
<http://mortgageconsumer.org/how-to-prevent-and-protect-yourself-from-mortgage-fraud>

Canada Guaranty:

<http://www.canadaguaranty.callenders/mortgage-fraud-prevention/>

CMHC - Canada Mortgage and Housing Corporation:

http://www.cmhc-schl.gc.ca/en/co/buho/plmayom/plmayomo_004.cfm

Competition Bureau Canada:

http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/b_00122.html

FCAC – Financial Consumer Agency of Canada:

<http://www.fcac-acfc.gc.ca/eng/media/pressrelease/posting-eng.asp?postingId=310>

Genworth MI Canada:

<http://investor.genworthmicanada.ca/English/site-tools/information-safety/default.aspx>

RCMP - Royal Canadian Mounted Police:

<http://www.rcmp-grc.gc.ca/scams-fraudes/month-mois-eng.htm>

End notes

¹<http://www.rcmp-grc.gc.ca/news-nouvelles/2012/03-01-frau-eng.htm>

²Fraud Prevention in Commercial Real Estate Valuation, Vernon Martyn, Appraisal Institute 2011

³Canada Mortgage and Housing Corporation:

http://www.cmhc.ca/en/hoficlincl/moloin/rean/rean_017.cfm ◀