

# Mortgage Fraud & Organized Crime in Canada



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### Issue

The purpose of this assessment is to outline how mortgage fraud occurs and examine the nature and scope of organized crime's involvement in this fraud type in Canada.

### Highlights

- According to industry estimates, losses from mortgage fraud in Canada range into the hundreds of millions of dollars annually. Some criminal groups are each responsible for losses, primarily to financial institutions, of tens of millions of dollars. Mortgage fraud can leave victims with inflated property values, higher property taxes, an inability to sell their homes, or damaged credit histories.
- Following the location of strong housing markets across the country, mortgage fraud occurs nationally but is more concentrated in the large urban areas in Quebec, Ontario, Alberta and British Columbia (B.C.).
- Numerous criminal groups across Canada are involved in a wide variety of mortgage frauds for profit or to further other criminal activities. Some undertake a limited number of relatively simple mortgage-related frauds while others commit multiple mortgage frauds involving anywhere from several dozen to over one hundred properties.
- Mortgage fraud schemes undertaken by organized crime groups will become increasingly sophisticated through the use of technology, for example, involving online sources of fraudulent documents, such as black-market websites, to obtain stolen or counterfeit financial information.
- Financial institutions' heavy reliance on computer-automated underwriting and property-valuation systems to conduct mortgage transactions, coupled with the difficulty of verifying the borrower's income or identity, will continue to be a major vulnerability contributing to mortgage fraud.
- Criminal groups across the country will remain involved in mortgage frauds for profit, as there are always ways to illicitly manipulate the age, size and value of a property. Organized crime will continue to exploit professionals within the financial and real-estate industries who will knowingly or unknowingly assist them in their fraudulent activities.

## Defining Mortgage Fraud

Mortgage fraud is commonly defined as the deliberate use of mis-statements, misrepresentations or omissions to fund, purchase or secure a loan. Simply put, mortgage fraud is any scheme designed to obtain mortgage financing under false pretences, such as using fraudulent or stolen identification or falsifying income statements.

## Risk Factors for Mortgage Fraud

Social, political and economic trends can affect the scope and magnitude of mortgage fraud. A risk factor for mortgage fraud is the strong competition between financial lending institutions during a period of economic boom and the subsequent widespread pressure for rapid mortgage approvals as individuals seek the best mortgage rates. In this competitive environment, it is often a challenge for financial institutions to ensure that all the information about the purchaser, vendor and property is accurate, a practice known as due diligence or “know your customer”. In addition, financial professionals also face pressures to approve mortgages quickly as those who deny or delay a mortgage transaction may face lost fees or sales as a consequence.

Financial crimes like mortgage fraud are facilitated in large measure by technological advances, specifically in underwriting systems and property-valuation models as well as communication technologies. These types of crimes take advantage of processes and institutions within the legitimate economy. Criminal groups undertaking mortgage fraud exploit online transfers of funds and electronic communications that reduce the need for individuals to meet in person. In many cases, financial transactions can occur completely electronically and this can facilitate the creation of false personal and financial information.

Stolen and counterfeit identification and financial documents – such as job letters, tax forms, RRSP slips and pay stubs – are tools that underpin mortgage fraud. Methods of obtaining personal and financial information range from theft and online data mining to compromising corporate databases and using black-market websites that sell stolen data. Criminal groups use the stolen and counterfeit information to compile fraudulent identities and financial profiles and to obtain mortgages illegally.

Mortgage frauds commonly involve the cooperation of mortgage industry insiders. Any individual within the mortgage industry can potentially be involved in mortgage fraud; from the purchaser, vendor, real estate agent, and mortgage broker to the lawyer, credit agency employee, lender and title insurer. These insiders may, for example, knowingly or unknowingly accept the use of false personal or financial information, use inaccurate appraisals, or transfer mortgage funds to an individual knowing they will be misused.

In the United States, the Federal Bureau of Investigation estimates that 80% of mortgage fraud losses involve industry insiders<sup>1</sup>. While no similar reliable statistics are published in Canada, corrupt insiders will continue to be an ongoing risk and concern to law enforcement.

1) Mortgage Fraud Report 2006. Federal Bureau of Investigation (FBI). May 2007

## Types of Mortgage Fraud

Mortgage fraud schemes range widely in terms of sophistication and complexity. Common features in these schemes include misrepresentations of the borrower's income and/or identity and manipulation of the property's age, size and value. Generally, borrowers fraudulently overstate their income and use false names on mortgage documents. In addition, the targeted property is often fraudulently described as newer, larger and in better condition than it is in reality.

Mortgage fraud can be separated into three general categories though more than one category of fraud may be involved in each overall criminal enterprise:

- fraud to further other criminal activities;
- fraud for profit; and
- fraud for shelter.

Criminal Intelligence Service Canada (CISC) Central Bureau focuses on assessing the scope and magnitude of organized crime's involvement in mortgage frauds that further other criminal activities and mortgage fraud for profit.

### Fraud to Further Other Criminal Activities

Mortgage fraud is sometimes undertaken to facilitate other criminal activities such as:

- marihuana grow operations;
- clandestine drug laboratories; and,
- money laundering.

#### Fraud for Marihuana Grow Operations and Clandestine Drug Laboratories

Criminal groups using mortgage frauds for marihuana grow operations or clandestine ecstasy or methamphetamine labs often provide fraudulent personal or financial information, or use nominees to obtain residential or commercial properties. The crime group may make superficial renovations to conceal the damage before the property is sold to unsuspecting buyers. Or, less commonly, the criminals may stop the mortgage payments and default on the loan. After the default, the financial institution may be left with a property with significant structural and environmental damage from clandestine drug operations.

#### Fraud for Money Laundering

Criminal groups use a variety of techniques to launder their proceeds of crime through fraudulent real-estate transactions. In a scheme known as "value tampering," a criminal seeks a property owner who agrees to sell the property on paper for a price below its actual value and then surreptitiously accepts the difference in cash. The true nature of the financial transaction (i.e. purchase price, source of income, employment) would likely be misrepresented and this would constitute fraud. The criminal can then sell the property for its actual value in a transaction that has laundered the illicit funds.

### Mortgage Fraud for Profit

There are multiple schemes within mortgage fraud for profit. Criminals may undertake one of these schemes, combine schemes or operate multiple schemes simultaneously.

### Appraisal Fraud

Appraisal fraud, which involves the fraudulent inflation of the property's value, is a common feature of many mortgage fraud schemes. This scheme may involve a dishonest real-estate appraiser providing an inaccurate valuation report to the lender, or it may involve a criminal group deliberately manipulating computerized real-estate-appraisal systems.

Criminal groups may pretend they are buying or selling properties that are much larger, newer or more recently renovated than other homes in the area. These properties receive fraudulently inflated values from which a large mortgage is illicitly obtained. When the criminals deliberately default on the mortgage, the financial institutions are left with a mortgage that is much larger than the property's actual value.

### Illegal Property Flipping

There have been multiple instances of organized illegal property flipping occurring across Canada. Illegal property flipping involves repeatedly and fraudulently selling a property between colluding individuals or nominees. The price is artificially driven up through false appraisals or successive sales between colluding individuals. The properties are then repurchased several times over a short period of time for a higher price by associates of the "flipper". The property can then be acquired by a straw buyer using stolen or false information who intends to let the property default and be untraceable to the financial institution. As the price is artificially inflated, the loss to financial institutions can be significant.

Criminally inclined owners, lenders, mortgage brokers, real-estate agents and developers may all try to have a property appraised for more than its actual value for illicit gain. Illegal property flipping schemes may involve one or more of the following:

- fraudulent appraisals;
- straw buyers;
- false loan documentation;
- inflated buyer income; or
- kickbacks to buyers, investors, or compromised industry professionals.

### Air Loans

Air loans involve an application for a mortgage on a property that does not exist, for example a non-existent address. This may involve the creation of a false property profile in a realty listing and the collusion of an individual acting as the buyer who knowingly obtains a mortgage for a non-existent property. In some circumstances, title insurance will cover a lender's losses. However, in cases where the lawyer is compromised or the lawyer's identity is stolen, the title insurance policy may also be falsified. As mortgage insurers may not reimburse loan funds for non-existent properties, this type of fraud can result in a significant loss for the financial institution that issued the mortgage.

In more sophisticated air loans, borrowers and properties may be invented, compromised real-estate agents may be used to post fake MLS (multiple listing service) listings and compromised lawyers used to process the funds for non-existent vendors and purchasers in order to circumvent the financial institution's verification processes.

### Title Fraud

Title fraud involves the fraudulent transfer of property. Homeowners who rent out their homes or who have no existing mortgages on high-value properties are more vulnerable to being targeted

in title-fraud schemes as a large mortgage can be secured with the property. In a title fraud, the perpetrator assumes the legitimate owner's identity to fraudulently sell or refinance the property based on the existing owner's credit rating and property. The individual then absconds with the stolen funds. The criminal may also illicitly sell the property to a straw buyer who intends to default while the criminal seller steals the mortgage funds. The legitimate homeowner is left with unwanted refinancing, an illicitly obtained new mortgage, or a property that has been sold to someone else.

The perpetrator can undertake title theft without the existing homeowner's knowledge by using false identification and forged documents to take advantage of automated financial and real-estate records systems. The legitimate owner may be unaware of the fraud until the bills for the fraudulently obtained mortgage arrive. If the property were sold to an unsuspecting buyer, both the original homeowner and new buyer would each believe they have clear title to the property. Title-theft victims in Canada have paid extensive legal fees and spent considerable time to restore the title to their property.

### **Foreclosure Fraud**

Foreclosure-rescue services can be legally and ethically undertaken and can benefit the homeowner if there is full verbal and written disclosure of the deal, terms the consumer is capable of fulfilling and moderate fees for the service. However, in fraud schemes, because of the complexity of the transactions and the deception that the owners can regain their property titles, victims are often unaware they are being defrauded. These schemes have been reported in Canada but are much more prevalent in the U.S.

Individuals perpetuating foreclosure scams generally target vulnerable, low-income individuals whose homes are in foreclosure, or who are at risk of defaulting on their loans. While there are many variations within foreclosure scams there are several common elements. A criminal approaches a legitimate owner with a debt-consolidation scheme that typically involves the owner paying up-front fees and transferring the property title (sometimes unwittingly) to the fraudster. The legitimate owner typically receives a cash payout from the fraudster to address immediate bills and remains in the home paying "rent" or "consolidated debt payments" to the fraudster. However, in contrast to legitimate debt consolidation programs, the fraudster pockets all payments from the owner and ignores bills and taxes which leads to debt-collection procedures against the owner. The fraudster then may re-mortgage or sell the property to an accomplice leaving the owner without the property title, homeless and in debt.

### **Fraud for Shelter**

In contrast to fraud-for-profit schemes, fraud for shelter typically involves individual borrowers who often intend to live in the property as law-abiding home owners. These individuals falsify their personal or financial information in order to obtain a larger mortgage than their income can support. As these individuals are already financially stretched to cover a larger mortgage than they can afford, they are particularly vulnerable to any changes in their financial situation. CISC Central Bureau focuses on fraud for shelter only when organized fraudsters target individuals struggling to make their mortgage payments and exploit them in foreclosure-fraud schemes.

## Organized Crime's Involvement in Mortgage Fraud

Following the location of strong housing markets across the country, mortgage fraud occurs nationally but is more concentrated in the large urban areas in Quebec, Ontario, Alberta and B.C. Criminal groups target Canadian neighbourhoods that are gentrifying from older, neglected or industrial areas into desirable places to live. Criminal groups target the extreme price discrepancies in these blended neighbourhoods between newly built or restored properties of higher value and the existing properties of lower value.

Numerous criminal groups across Canada are involved in a wide range of mortgage frauds at varying levels. The criminal capabilities of groups involved in mortgage fraud vary in terms of sophistication. Some criminal groups also have an extensive criminal history in various frauds, ranging from counterfeit currency, payment card and cheque fraud to loan and real-estate frauds. These groups may commit a limited number of mortgage frauds using relatively simple fraud schemes. Other, more sophisticated, criminal groups undertake multiple fraudulent mortgages, ranging from several dozen to a hundred per group, in a series of complex transactions. Organized crime groups continue to seek out individuals with specialized skills in the real-estate and financial sectors in order to facilitate (knowingly or unknowingly) mortgage frauds.

A number of criminal groups involved in mortgage fraud seek out vulnerable or criminally inclined individuals to use as straw buyers. Some groups recruit (or coerce) individuals who are newly arrived to the country to act as nominees on fraudulent mortgage applications. Some of these nominees are unaware that their personal information is being used to facilitate a fraud while others are afraid to raise objections. In return for the use of their name and personal financial information, the nominees sometimes live in the residence for a few months rent-free. Other, more unfortunate nominees are unknowingly left responsible for the mortgage which enters default after the mortgage funds are stolen by the criminal group.

## Harms from Criminal Activities

In terms of measuring threat, "harm" refers to the adverse consequences of criminal activities. Harms can be direct and tangible, such as fraud or thefts, whose effects can be quantified in terms of monetary loss. Criminal harms also encompass a range of intangible effects more difficult to quantify. For example, the loss of quality of life is difficult to measure or to compare objectively against a merchant's loss of business due to counterfeit goods.

Criminal harms can also broadly affect society as a whole, such as the costs of responding to and bringing offenders to justice through the criminal justice process (including law enforcement, medical care, victim services, courts, legal aid and correctional institutions).

The criminal intelligence community, through the CISC network, is working to objectively assess the harms caused by organized criminal activities. Integrating both threat and harm in threat assessments further assists senior law enforcement leaders in setting enforcement and intelligence priorities at the municipal, provincial and federal levels.

## Harms from Mortgage Fraud

In terms of **social harms**, mortgage fraud can cause significant psychological or mental stress to the victims. The consequences to victims can include guilt and shame, disbelief, anger, depression, a sense of betrayal and a loss of trust. Individuals can also spend a considerable period of time recovering lost or stolen identification and repairing damaged credit histories.

Multiple mortgage frauds within a neighborhood can result in inflated neighbourhood property values, higher property taxes, an inability to sell homes, and abandoned properties. Individuals who unknowingly buy properties that were former marijuana grow operations or clandestine laboratories may expose themselves and their families to toxic chemicals, mould and structural problems. Negative consequences also result from the corruption or collusion of individuals working in either the public or private sectors. Mortgage fraud can damage the professional integrity and reputations of mortgage-industry professionals and their related institutions.

In terms of **economic harm**, the corruption of professionals in the real estate and mortgage industries is difficult, expensive and time consuming to investigate. According to the Law Society of Upper Canada in Ontario, each mortgage-fraud investigation involves, on average, reviewing and analyzing 75 property deals<sup>2</sup>. As a result, an investigation by the Law Society of one of its members for mortgage fraud requires approximately the same time and resources as investigating 20 non-mortgage fraud investigations.

The number of fraudulently obtained mortgages, and losses related to them, are difficult to calculate because fraud is often difficult to prove. In Canada, dollar losses related to mortgage fraud are estimated to be in the hundreds of millions annually. The size of loss largely depends on the value of the property at the time of foreclosure. At a meeting of the Canadian Association of Forensic Investigators in April 2007, Peter Vukanovich, President of Genworth Financial Canada, a major insurance company, said that the average mortgage fraud loss per property was approximately \$100,000.

One challenge is that the healthy real-estate market has caused housing prices generally to increase. As a result, it is sometimes difficult to detect fraudulently over-valued properties. However, after a real-estate market downturn, the prices of some of these fraudulently over-valued properties will fall. As a result, defaults will occur and some frauds will be readily apparent.

Financial lenders and/or mortgage or title insurers bear most of the financial burden from mortgage fraud. Some of these losses may be passed on to all consumers in the form of increased mortgage-insurance premiums. Consumers may have to deal with higher loan rates and fees, stolen identities and possibly impaired credit ratings. Title-theft victims spend time, effort, and legal fees to recover lost title to their homes and repair damaged credit ratings.

2) Mortgage Fraud: Report to Convocation. Law Society of Upper Canada. March 24, 2005.

## Looking to the Future

Mortgage fraud for profit will remain a significant criminal threat as there are always ways to illicitly manipulate the age, size and value of a property and to commit fraud. Mortgage fraud will continue to occur in major urban centres across the country, as well as within newly renovated urban sub-pockets.

Criminal groups across the country will remain involved in mortgage frauds for profit, with some expanding from another fraud type such as payment card fraud. Criminal groups will continue to exploit professionals within the financial and real-estate industries who will knowingly or unknowingly assist them in their fraudulent activities. Organized crime will also continue to use mortgage fraud to further their criminal activities, such as acquiring properties for marijuana grow operations or clandestine drug laboratories.

Mortgage-fraud schemes undertaken by organized crime groups will become increasingly sophisticated. This could involve, for example, greater use of fake financial information such as credit histories, employment letters, tax returns and automatic-payroll deposits and incorporating false companies. It may also involve the use of corporate shell companies, corporate-identity theft and the use or threat of bankruptcy or foreclosure to dupe homeowners and investors.

Online sources of fraudulent documents, such as black-market websites that deal in illicit data like stolen or counterfeit financial information, will remain tools to facilitate frauds.

Financial institutions' heavy reliance on computer-automated underwriting and property-valuation systems to conduct mortgage transactions, coupled with the difficulty of verifying the borrower's income or identity, will continue to be a major vulnerability contributing to mortgage fraud.

Criminal groups undertaking mortgage fraud will continue to exploit individuals in the financial, real-estate and mortgage industries to – knowingly or unknowingly – facilitate the frauds. These industry insiders will continue to pose a substantial threat with their access to corporate systems and/or databases, and their ability to bypass physical and electronic security measures through legitimate means.

## Key Terminology

**Appraisal** - The process of determining the value of property, usually for lending purposes. This value may or may not be the same as the purchase price of the home.

**Appraised value:** An estimate of the value of the property. This appraisal is done for mortgage lending purposes and should reflect the market value of the property.

**Appraiser:** A qualified individual who uses his or her experience and knowledge to prepare the appraisal estimate. This individual is normally a professional and member of the Appraisal Institute of Canada or equivalent association.

**Broker:** An individual in the business of assisting the arrangement of funding or negotiating contracts for a client but who does not loan the money himself. Brokers normally receive a commission from the lender for their services.

**Credit Agency or Credit Bureau:** A company that gathers, records, updates, and stores financial and public records information about the payment records of individuals who are being considered for credit. The information includes payment habits, number of credit accounts, balance of accounts, and length and place of employment. The reports are made available to individuals and to creditors who profess to have a legitimate need for the information. The three credit bureaus in Canada are Equifax, TransUnion, and Experian (which acquired the Northern Credit Bureau).

**Data mining:** The process of electronically sorting through large amounts of data to extract useful information, important values or key relationships.

**Debt Consolidation:** The replacement of multiple loans with a single loan, often with a lower monthly payment and a longer repayment period. This is often done to secure a lower interest rate, secure a fixed interest rate or for the convenience of servicing only one loan.

**Deed:** The legal document signed by both the purchaser and vendor that transfers ownership. The deed is registered – electronically or physically depending on the province – at the local land registry office as evidence of ownership.

**Default:** Failure to repay as agreed an outstanding debt.

**Foreclosure:** A legal procedure whereby the lender eventually obtains ownership of the property after the borrower has defaulted on payments.

**Harms:** In terms of organized crime, the adverse consequences of criminal activities which can be economic or social in nature with effects ranging from direct and tangible to intangible and difficult to quantify.

**MLS (Multiple Listing Service):** MLS is a database which allows real-estate brokers representing sellers to widely share information about properties with brokers who may represent potential buyers.

**Straw Buyer:** In terms of mortgage fraud, an individual who pretends to be a legitimate buyer for a property but in reality is in collusion with another criminally inclined individual to further a mortgage scam. The straw buyer often uses fake or stolen identification to prevent being traced.

**Title:** The document that gives evidence of an individual's ownership of property.

**Title Insurance:** An insurance policy that protects against losses resulting from errors or disputes in the ownership of property such as from forged documents.

**Underwriting:** The process of evaluating a loan application to determine the risk involved for the lender. It involves an analysis of the borrower's creditworthiness and the quality of the property itself and then selecting the appropriate loan term and interest rate.

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