Anatomy of a Mortgage Fraud – How I Stopped One from "Going Down"

Written by: David P. Leibowitz
Leibowitz Law Center/Lakelaw; Waukegan, Ill.
dleibowitz@lakelaw.com

As a chapter 7 trustee, I have often encountered debtors with limited means, but who own several properties in foreclosure. In a recent case, the debtor was a 24-year old woman who owned three houses allegedly worth close to a million dollars at the time of her bankruptcy case.

As it turns out, a friend of her boyfriend introduced her to a real estate broker and a mortgage lender who had great opportunities for her. Incidentally, the boyfriend met this "gentleman" while they were in prison together. In any event, the debtor bought three houses at inflated values, and the mortgage broker-lender received exorbitant fees. The debtor received $10,000 each from two sales and $7,500 from another sale. She used this money to buy a car for her boyfriend.

The "gentleman" promised that he would "take care" of the mortgage and get the properties leased up and fixed up so that they would support themselves; this did not happen. The properties went into foreclosure and the boyfriend and the "gentleman" disappeared. The not-altogether-innocent, but fresh-faced young woman was left holding the bag and facing bankruptcy.

This situation is actually rather common around the country. Such cases might cost the lender $50,000 – $100,000 and there are many thousands of them. As can be seen by recent events, this can add up to real money.

Recently, in a case where I was serving as a chapter 7 trustee, the debtor asserted that he had a real estate contract pending and that it would be in the interests of the estate for the property to be sold. The debtor's attorney also was of the opinion that it would be beneficial to allow the property to be sold.

The property was a two-unit house located in a rather poor area of Chicago. All indications of value suggested that it was worth around $250,000. The property was fully encumbered at that value. It does not take a rocket scientist to know that we are not experiencing an ultra-hot market for real estate—particularly in the South Side of Chicago. Nevertheless, the debtor presented a contract to sell this property for $370,000. Strangely, the contract did not purport to result in any net proceeds of sale for the seller—in this case the bankruptcy estate.

Initially, the debtor's attorney applied to the bankruptcy court for authority to allow this pre-petition contract to close and represented that it would be beneficial to the estate. In my role as trustee, I filed a notice of the pendency of the bankruptcy case pursuant to

§549 with the Cook County of Recorder of Deeds. This was done so that a closing could take place without my involvement.

At that point, things really got interesting. It turned out that the seller (the debtor) had agreed to tens of thousands of dollars as a credit to the purchaser as a so-called “closing cost credit.” Beyond that, there were close to $50,000 in fees to the “facilitator” of this transaction.

One wonders who appraised this very ordinary South Side property for more than $100,000 in excess of its last sale even though there had been no new improvements to the property. One must also wonder even further why Chase Mortgage was ready, willing and able to fund 100 percent of the loan on this particular property.

I examined the debtor at an evidentiary hearing. He professed to be shocked at this transaction and claimed to have no idea that he had been so abused. He stated that he had not been planning on any gains from this transaction. Do you believe that? If you were aware of what happened in the first transaction I described to you, you wouldn’t—and I didn’t either.

Anyway, we will never know how much would have been kicked back to the debtor under the table for facilitating this mortgage fraud. We will never know what possessed the appraiser to appraise this property as he did and we will certainly never know what possessed Chase to agree to make this mortgage loan. We will, however, have a greater understanding of why we are now looking at the subprime mortgage meltdown, which threatens to infect our entire economy.

Fraud is no laughing matter. It is a crime that corrodes our economy and hurts us all. We must maintain vigilance within our own nation as well as far away.