The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Criminal Justice Committee

BILL: CS for SB's 352 and 240

INTRODUCER: Banking and Insurance Committee and Senators Margolis and Bullard

SUBJECT: Real Property Fraud

DATE: March 13, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	**Fav/Combined CS**
2.	Clodfelter	Cannon	CJ	**Favorable**
3.			JU	
4.			CM	
5.				
6.				

I. Summary:

In 2005, Florida was ranked first or highest in the United States for mortgage loans that contained alleged fraud against the lenders, according to the Mortgage Asset Research Institute, Inc. This committee substitute creates the "Florida Real Property Fraud Act," to provide additional enforcement and investigative tools for prosecuting perpetrators of real property fraud. The committee substitute creates a felony of the third degree for real property fraud and provides that a person commits the offense of real property fraud if, with the intent to defraud, the person knowingly:

- Makes any material misstatement, misrepresentation, or omission during the mortgage lending process with the intent that such information would be relied upon by a party to the real property transaction;
- Uses or facilitates the use of any material misstatement, misrepresentation, or omission, knowing that such information contains such a misstatement, misrepresentation, or omission and will be relied on by a party to the transaction;
- Receives any proceeds or other funds in connection with a real property transaction that the person knew resulted from such a misstatement, misrepresentation, or omission; or
- Files with the clerk of the court for any county in Florida a document related to a real property transaction that contains a material misstatement, misrepresentation, or omission.

Since the bill creates real property fraud as a criminal violation of ch. 817, F.S., and ch. 817, F.S., violations are defined as racketeering activities under ch. 895, F.S., and the proceeds of these fraudulent activities could be subject to civil forfeiture under ch. 895, F.S.

The bill also provides that any real property fraud violation is considered to have been committed in the county in which the real property is located or in any county in which a material act was performed in furtherance of the violation. The provision will allow flexibility for the venue for prosecution and investigation.

This bill creates section 817.545 of the Florida Statutes.

II. Present Situation:

Mortgage fraud is one of the fastest growing white collar crimes in the United States. Mortgage fraud is defined as a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan.[1] According to the Federal Bureau of Investigations' (FBI) statistics, the number of reported mortgage fraud cases more than tripled from 6,890 in 2003 to 21,944 in 2005, based on Suspicious Activity Reports required to be filed by financial institutions and certain other entities with the Financial Crimes Enforcement Network of the U.S. Department of the Treasury. The extent or dollar amount of the fraud is unknown; however, the dollar amount potentially exposed to mortgage fraud is significant, as shown by the sheer volume of U.S. annual mortgage originations, estimated to have reached $2.8 trillion in 2004, according to the Mortgage Bankers' Association. It is estimated that up to 10 percent of all residential loan applications have some form of material misrepresentation, both inadvertent and malicious.[2]

What accounts for this ranking? In recent years, there has been a dramatic growth in the housing market accelerated by low interest rates. This area is vulnerable for exploitation as credit is strong, profits are high, and technology is enhancing criminals' ability to access financial institution data.

Mortgage fraud is divided into two types: fraud for property and fraud for profit. Fraud for property is a misrepresentation made by a borrower or other party in order to qualify for a mortgage loan. The applicant may alter or falsify tax returns or misrepresent income or expenses. Generally, the buyer intends to repay the loan. The FBI estimates that this type of fraud accounts for 20 percent of all the fraud.

Fraud for profit generally involves multiple loan transactions with several financial institutions involved. Parties to these schemes generally perpetuate the transaction by using fictitious, forged, or altered documents, fraudulently transferring deeds, grossly inflating the value of purchased homes, and submitting fraudulent escrow letters or other documents to mortgage companies. This type of fraud may involve numerous gross misrepresentations regarding the true identity of the buyer or seller, income, assets, collateral, and employment. Documents relating to title insurance that confirm the stated owner's title and right to transfer the property can be altered to change the financial institution lender or omit prior liens. Often, the borrower assumes the identity of another person (straw buyer). The following scenarios are forms of fraud for profit:

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[1] Federal Bureau of Investigations website: http://www.fbi.gov/page2/dec05/operationquickflip121405.htm.
[2] *The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties: White Paper,* Federal Financial Institutions Examination Council, February 2005.

- Rapid buildup of a real estate portfolio with an inflated value to perpetrate a land flip scheme. In these scenarios, the appraised value and sales price is inflated for each transaction and the mortgage loan advances increase with each purchase until the amount of the mortgage greatly exceeds the actual value of the property. The goal of this scheme is to extract as much cash as possible from the property.
- The identity of the borrower is concealed through the use of a straw buyer who allows the borrower to use the straw buyer's name and credit history to apply for a loan. This scheme is accomplished by convincing a person to apply for credit in his own name and immediately remitting the loan proceeds to the third party who may be unable to or may never intend to make payments. Subsequently, a default occurs. The straw borrower may or may not be paid a fee for his or her involvement or know the full extent of the scheme.
- Acquisition of residential property by preying on financially distressed homeowners who are desperate to sell due to a delinquent loan or past due taxes. The perpetrator misleads the homeowners into believing that they can save their homes in exchange for a transfer of the deed and payment of up-front fees by the homeowner. The perpetrator profits by re-mortgaging the property or pocketing the fees paid by the homeowner.
- Misrepresentation of personal identity, i.e., use of illegally acquired personal financial information to illegally obtain a loan or to sell or take cash out of equity on a property with no intention of repaying the debt.
- Acquisition of property through a phantom sale occurs when a perpetrator identifies an abandoned property and records a fictitious quit claim deed to transfer the property into his or her name, applies for and receives the proceeds of a loan, then absconds with the proceeds.

The FBI estimates that 80 percent of all mortgage fraud involves collaboration or collusion by industry insiders. However, the FBI also estimates that the pervasiveness of check fraud and counterfeit negotiable instrument schemes, technological advances, and the availability of personal information through illicit means make external fraud schemes more prevalent than those involving insiders.

Residential Mortgage Fraud in Florida

In recent years, the investigations, arrests, and prosecutions of mortgage cases have increased dramatically. According to the Miami-Dade Police, the number of reported mortgage and real estate fraud cases increased from 16 in 2003 to 78 in 2006. The FBI reported 1,191 cases of real estate and mortgage fraud in Miami, making it the fourth highest location for fraud for the quarter ending September 30, 2006. Los Angeles was ranked first with 2,293 reported cases.

The following is a summary of a recent case in Florida. According to the Florida Department of Law Enforcement (FDLE), 24 straw buyers were recruited from Miami and Naples to purchase houses in the Ocala area. Most of the straw buyers did not speak, read, or write English or had very limited English vocabulary. They were recruited by a third party who purportedly told them that no down payment was required and that they would not have to occupy the house because the builder would rent the house for them and make the mortgage payments for several years. Then, the buyer could move into the house or sell it for a profit and increase their credit ratings for future purchases. The straw buyers were told that the developer/seller of the properties would pay the first month's mortgage and then use subsequent monies received from the buyers to pay its bank loans, free its credit line, and qualify for purchases of lots in a new project. Ultimately, the straw buyers were left with bank mortgages after the builder received its money. Many of the buyers had to file for bankruptcy and suffered severe damage to their credit.

In February 2006, the Office of the Statewide Prosecution in the Department of Legal Affairs and the FDLE arrested several persons for allegedly conducting this mortgage fraud. The mortgage broker completed the loan applications, which included false credit information of the borrowers. A title company approved the transactions with knowledge of false information being filed. These activities resulted in fraud against mortgage lenders in an amount exceeding $3.7 million. Six persons were charged under ch. 895, F.S., with participation in an enterprise through a pattern of racketeering activity in violation of the Racketeer Influenced and Corrupt Organization (RICO) Act and conspiracy to commit RICO, both first degree felonies.

Regulation of Mortgage Brokerage and Lender Transactions

The Office of Financial Regulation (OFR) is responsible for all activities of the Financial Services Commission relating to the regulation of financial institutions, mortgage brokers and lenders, finance companies, securities industries, and money transmitters.[3] Mortgage brokers, lenders, and transactions are regulated by the OFR pursuant to ch. 494, F.S., the Mortgage Brokerage and Lending Act. The OFR also is charged with enforcing the Florida Financial Institutions Code, chs. 655-667, F.S. Monetary fines and civil sanctions can be levied if a person or company is discovered to be operating in Florida without being properly licensed or exempt.

Section 494.0025(4), F.S., addresses mortgage fraud. It provides that it is unlawful for a person to: (1) knowingly or willingly employ any device, scheme, or artifice to defraud; (2) engage in any transaction or practice that operates as a fraud in connection with the purchase or sale of a mortgage loan; or (3) to obtain property by fraud, willful misrepresentation of a future act, or false promise. Section 494.0025(5), F.S., provides that it is unlawful for a person to knowingly and willfully falsify, conceal, or cover up a material fact by a trick, scheme or device, or to either make a false or fraudulent statement or representation, or make or use any false writing or document, knowing of the false or fraudulent statement or entry. These offenses are third degree felonies, elevated to a first degree felony if the value of the land and property exceeds $50,000 and there were five or more victims.

Section 655.0322(5) and (6), F.S., provides criminal penalties for fraudulent transactions involving land or property for the purpose of obtaining a loan. Willfully making a false statement or overvaluing any land, property, or security for the purpose of influencing the action of a financial institution or other entity authorized to extend credit is a second degree felony. Knowingly executing or attempting to execute a scheme to defraud a financial institution or other entity authorized to extend credit by means of false or fraudulent pretenses, representations, or promises is also a second degree felony.

The Bureau of Financial Investigations in the Office of Financial Regulation routinely investigates cases involving alleged fraud in mortgage transactions. These investigations involve various forms of fraud. In general, however, the OFR’s investigations focus on persons licensed or subject to licensure by the OFR. If the OFR has reason to believe that any state criminal law

[3] Section 20.121(3), F.S.

has been violated, it will refer the case to the appropriate law enforcement or prosecutorial agency, and provide investigative assistance to that agency pursuant to s. 20.121(3)(a)2, F.S.

Prosecution of Residential Mortgage Fraud in Florida

According to prosecutors in south Florida, various criminal provisions are used to prosecute residential mortgage fraud, including ss. 494.0018 (discussed above), 812.014 (theft), 817.03 (making false statement to obtain property or credit), 817.034(4)(a)(1) (organized fraud), 817.54 (obtaining of mortgage, etc., by false representation), and ch. 895 (RICO), F.S.

Section 812.014, F.S., provides that:

> (1) A person commits theft if he or she knowingly obtains or uses, or endeavors to obtain or to use, the property of another with intent to, either temporarily or permanently:
>
> (a) Deprive the other person of a right to the property or a benefit from the property.
>
> (b) Appropriate the property to his or her own use or to the use of any person not entitled to the use of the property.

The punishment for theft can depend upon various factors, including the value of the stolen property. It is grand theft in the first degree, punishable as a first degree felony, to steal property valued at $100,000 or more.

Under s. 817.03, F.S., it is a first degree misdemeanor for a person to make or cause the making of a written false statement relating to his or her financial condition, assets, or liabilities with a fraudulent intent of obtaining credit, goods, property, or money. Venue for prosecution may be in the county where the statement was written.

Section 817.034(4)(a), F.S., provides that a person who obtains property by engaging in a scheme to defraud is guilty of organized fraud and is subject to penalties based on the aggregate value of the property obtained. It is a first degree felony if the value of the property is $50,000 or more, a second degree felony if the value is from $20,000 up to $50,000, and a third degree felony if the value is less than $20,000.

Section 817.54, F.S., addresses criminal penalties for obtaining a mortgage, promissory note, or other instrument by false or fraudulent representation. It is a third degree felony to: (1) obtain a mortgage or other instrument evidencing a debt from any person with intent to defraud; (2) to obtain the signature of any person to a mortgage or other instrument evidencing a debt by fraudulent or false representations or pretenses; or (3) to obtain the signature of another person evidencing debt in circumstances that would be chargeable as forgery.

Under the RICO Act, ch. 895, F.S., “racketeering activity” means to commit, attempt to commit, conspire to commit, or solicit, coerce, or intimidate another person to commit any of a number of crimes that are delineated in s. 895.02, F.S. This list includes offenses under chs. 812 and 817, F.S. Section 895.03, F.S., provides that it is unlawful for any person who has criminal intent to receive any proceeds derived from a pattern of racketeering activity. Engaging in racketeering activity is a first degree felony.

According to the Miami-Dade Police Department, it is not appropriate to charge use of a false quit claim deed to obtain property as theft under s. 812.014, F.S., because the house remains intact on the property even though the equity has been taken and mortgaged. In regards to the fraud or falsification of information during the application process, s. 817.54, F.S., applies only to the person who obtains the loan and does not cover other parties involved in the lending process such as a notary public who notarizes a false quit claim deed or an appraiser who artificially inflates the property value.

III. Effect of Proposed Changes:

Section 1 provides legislative findings, creates criminal penalties for real property fraud, and creates the "Florida Real Property Fraud Act."

Subsection (3) of the bill provides: A person commits the offense of real property fraud if, with the intent to defraud, the person knowingly:

1. Makes any deliberate misstatement, misrepresentation, or omission during the mortgage lending process with the intention that the misstatement, misrepresentation, or omission will be relied upon by a mortgage lender, borrower, or any other party to the mortgage lending process. However, a material omission does not occur when such omission is made as part of a lending program in which income, assets, or employment are not factors for qualifying for the program.
2. Uses or facilitates the use of any deliberate misstatement, misrepresentation, or omission knowing the misstatement, misrepresentation, or omission contains the misstatement, misrepresentation, or omission, during the mortgage lending process with the intention that the misstatement, misrepresentation, or omission will be relied upon by the a mortgage lender, borrower, or any other party to the mortgage lending process. However, a material omission does not occur when such omission is made as part of a lending program in which income, assets, or employment are not factors for qualifying for the program.
3. Receives any proceeds or any other funds in connection with a real property transaction that the person knew resulted in a violation of (1) or (2).
4. Files or causes to be filed with the clerk of the circuit court for any county in Florida any document materially relating to the real property transaction which contains a deliberate misstatement, misrepresentation, or omission.

These provisions would address potential misrepresentations by various parties to the real property transaction, including the appraiser, title insurers, broker, lender, seller, and borrower. Any person who violates this section commits an unranked third degree felony, punishable by imprisonment for no more than five years, a fine of no more than $5000, and any applicable enhanced penalties as a habitual felony offender. The bill provides that an offense of real property fraud shall not be predicated solely upon information lawfully disclosed under federal laws, regulations, or interpretations related to the mortgage lending process.

The criminal provision in the bill is similar to existing criminal violations under s. 494.0025(4) and (5), F.S. Obvious differences are that the new statute clearly covers omissions, applies to persons who knowingly receive proceeds from a fraudulent real estate transaction, and prohibits filing of false documents with the clerk of court. A knowing violation of s. 494.0025(4) or (5), F.S., is a third degree felony, unless the value of the land and property exceeds $50,000 and there were five or more victims. In that case, the offense is a first degree felony. It is not clear whether the doctrine of statutory construction that a specific offense controls over a more general law (*see Adams v. Culver*, 111 So.2d 666 (Fla. 1959)) would allow prosecuting a violation of the more specific provisions of the new criminal offenses as a violation of s. 494.0025, F.S.

According to prosecutors and criminal investigators, the venue for prosecuting residential mortgage fraud needs to provide greater flexibility for the investigation and prosecution of the cases. Some cities or counties might not have the resources to pursue such cases. Presently, a property that is the subject of a loan could be located in Dade County; however, the actual closing transaction might occur in Broward County. For purposes of venue, the bill provides that any such violation is considered to have been committed in the county in which the real property is located or in any county in which a material act was performed in furtherance of the violation.

Section 2 provides that this act will take effect October 1, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The bill provides greater enforcement tools and more severe criminal sanctions for prosecuting unscrupulous participants engaged in real property fraud, which will provide greater protection for homeowners and potential homeowners.

A reduction in fraudulent mortgage loans, as a result of greater investigations and prosecutions, could reduce the number of mortgage loan defaults. A study has linked loans that had egregious loan misrepresentation with higher default rates within the first 6 months than loans that did not have such misrepresentations.[4]

[4] *Fraud Linked to Up to 70 percent of Early Payment Defaults,* BasePoint Analytics. 2007.

C. Government Sector Impact:

The Criminal Justice Impact Conference has not yet determined whether the new criminal offenses will have a significant fiscal impact. There could be an increase in prosecutions because of the new offenses and the greater investigative and enforcement tools to assist in the prosecution of persons engaging in real property fraud.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The committee substitute creates a criminal penalty for "real property fraud" instead of "residential mortgage fraud" (original bill) but the operative provisions still pertain to fraud relating to mortgage loans (commercial and residential). The transactions or offenses addressed in the committee substitute do not appear to have been expanded to cover other kinds of real property fraud, such as impersonating an absentee property owner and selling the property to a third party.

Subsection (3), relating to real property fraud offenses, carves out material omissions relating to loans that do not require income, asset, or employment verification. However, as an unintended consequence, this language may imply that a person could make material omissions in such loans with impunity.

VIII. Summary of Amendments:

None.