Testimony

before the

Subcommittee on Housing and Community Opportunity

at a Hearing regarding

“Mortgage Fraud and its Impact on Mortgage Lenders”

October 7, 2004

Testimony Written and Presented by:

Ecima (Lez) Trujillo
National Field Director
ACORN Housing Corporation
3655 S. Grand Ave. #250
Los Angeles, CA 90007
213-748-1345
ahcwestlc@acorn.org

on behalf of

The ACORN Housing Corporation
www.acornhousing.org

Chairman Ney, Ms. Waters, and members of both subcommittees, thank you for the opportunity to address you on the important issue of subprime lending. My name is Lez Trujillo, and I am the national field director of the ACORN Housing Corporation. Previously, I was the west coast regional director for ACORN Housing from 2000 to 2004.

ACORN Housing has offices in 34 cities throughout the United States. To carry out our mission, we undertake three groups of activities:

1. We build and rehabilitate homes to increase the supply of affordable housing.

2. We provide housing counseling services to more individuals than any other organization in the country. 50,000 of our clients have become first time homebuyers. Our program emphasizes the one-on-one approach to counseling that has proven to be most effective at giving clients the information and tools they need. We counsel clients on the full range of housing finance needs: pre-purchase, delinquency, refinance, home equity, subprime, and predatory rescue.

3. We educate local, state, and national policy makers on affordable housing and housing finance issues, and on the threats to personal and community stability that are posed by predatory lending and abusive financial service practices

ACORN Housing works closely with our sister organization, ACORN, the Association of Community Organizations for Reform Now. With over 150,000 members in over 60 cities, ACORN has been a leader in the fight to end redlining through a strong Community Reinvestment Act (CRA), to crack down on predatory lending through testimony, publicity, and direct action, and to win economic justice for our communities. ACORN fights to win a voice for our families to improve education, increase access to health care, and assure fair housing for all Americans.

Mortgage fraud is a nationwide problem. In recent weeks, much of the attention has been about how lenders are hurt by this form of fraud, but it is even more important to look at the people all over the country who have been taken advantage of. While it hurts the bottom line of financial institutions when they are taken advantage of, it devastates the lives of citizens when they are victimized by these scams.

When we listen to the stories of victims, we learn that there is more than one element of the problem. Many scams are caused by outrageous local fraudulent operators, but others are dependent on the behaviors of large and often apparently respectable players in the industry. There needs to be national solutions to this crisis, but we must also maintain the ability of local authorities to react quickly to scams that arise. Just as important, we must remove incentives that lead to dangerous behavior on behalf of lenders and others in the industry, and we must give consumers the tools they need to spot those who are out to get them.

Let me begin by describing some of the cases we have come across from throughout the country.

The efforts of Senator Mikulski and others have brought attention to the problems of mortgage fraud in Baltimore. It is worth looking at one of these cases again, because although great progress has been made in cracking down on some of the abuses there, we see these same practices emerging in other cities.

American Skycorp abused the FHA program to extend loans on homes with inflated values and unmet promises of future repairs. These loans were generally made without regard of the borrower's ability to repay. One family with an income of $13,000 were loaned $77,000 for a house. A loan like that is virtually impossible to repay. These loans targeted African-Americans, who received 77% of the company's loans. An investigation by the Maryland Attorney General's office found that the company "sold homes at inflated prices, using falsified appraisals" and "falsified documents to provide first-time homebuyers with mortgages they could not afford and [the company] then sold the mortgages." The Attorney General's office said, "Not only do have these practices adversely affected individual consumers, they have created significant problems for the neighborhoods in which these consumers live…When the consumers default and the property is foreclosed upon, the practice hurts the neighborhood in which the consumer lives."[1]

In 1998, Matilda Watson, a participant in the welfare-to-work program, bought a house with American Skycorp. The loan officer falsified information on her application to get the loan approved, insisting Matilda include child support payments even though she was not receiving them. Matilda thought $54,000 sounded high for a house in that neighborhood, but her realtor insisted that a FHA lender would not approve a loan if the house wasn't worth it. When she later asked about a home inspection, she was assured that the lender would make sure the house was in good shape.

Although the house seemed fine on the surface, as soon as Matilda closed on the loan, she found out the house was falling apart. The furnace stopped working, the upstairs plumbing leaked into the kitchen, and the wiring was faulty. The appraiser noted none of these problems.

Most tragically for Matilda and her family, the Department of Social Services deemed the house unfit for her children to live in, and they removed her children from the home.

When ACORN brought these problems to light, they were sued for $10 million by Skycorp for defamation of character. The suit was quietly dropped when the federal government successfully prosecuted the company for precisely the same practices ACORN had accused them of.

[1] John B. O'Donnell "4 Accused of Flipping Must Pay Purchasers; Men Ordered to Cover Cost of Probe, Prosecution," *The Baltimore Sun*, Saturday, October 26, 2002.

Another example of mortgage fraud that has received a great deal of attention lately is in the Poconos. There are documented cases of over 3500 defaults and foreclosures in this one small area in northeast Pennsylvania. As the *New York Times* has reported, there was a huge development initiative by several developers that provided a one-stop-shop for the following: development (they had purchased the land and controlled the development process), contractor work (done by the same people as the development or they controlled the construction), legal work and appraisals related to the transaction and mortgage brokerage services

In a typical one stop shop there are no checks and balances by outside parties, and in Pennsylvania, no borrower attorney is required, so borrowers were on their own. Nobody was watching, not the state, not the banks and the results were catastrophic for the homebuyers, who are mostly working-class Latinos and African-Americans from New York City, looking for affordable housing.

The developers that began the development projects "set the market:" that is, they set the appraised value. "Comps" used by appraisers were based on the other houses they had built, not anything that was out there already, since these were all new development going up at approximately the same time

The developers were, or were related to, the contractors, and construction was flawed in many instances

The result was that properties were over appraised. The market was set artificially and set far too high. When residents had job loss, family crisis or necessary repairs (due to shoddy construction), they were in real trouble. The houses had the maximum loan to value ratio or they exceeded loan to value, so there was no way to refinance or pull any equity from the house to tide the residents over. They were just out of luck, and defaults and subsequent foreclosures followed.

Only when record numbers of foreclosures were documented did the Pennsylvania Banking Department begin to pay attention. There is a plan of action but there really is no remedy or recourse by borrowers for the faulty pretenses, over appraisal, and shoddy construction. Once again, ordinary people pay the price for mortgage fraud.

In Albuquerque, New Mexico, residents of Rio Bravo Estates, a new development, found out about the project when shopping for manufactured homes. They were steered to the development where a businessman arranged for their land purchases and verbally promised such things as a park and a perimeter fence. One of the agents for the land development company is also on the Board of Directors of Valley National Bank, the bank financing the land purchases.

The land was overpriced – for a quarter of an acre in the South Valley, a block away from the Sewage treatment plant (a fact that was not disclosed) people paid from $30,000 to $55,000. Evidence has emerged that this property was tremendously overpriced. The "full land value" listed on one resident's taxes is $7,000. An appraiser friend of another resident suggested the maximum value for the land would be $14,000. The real estate contracts with Valley National Bank for the land were set up with 8% interest rates that would adjust to 12% after a year. Most of the residents knew that this would happen and were told they would have help refinancing. This arrangement meant that Valley National would get their money after a year, and could then get out.

It would be difficult to find a legitimate bank to refinance loans that were so much more than the actual value of the property. For example, one home was financed for $140,000, while a recent CMA puts its value at the low-to-middle 80s. A woman who residents identified as working for the businessman who put the deal together, helped most people refinance, but she referred them to sub prime lenders, regardless of their credit history. Almost without exception the appraisals were done by one company, even though they were financed with different mortgage companies. Further, the copies of the appraisals show that the appraiser was from far away, and may not have been aware of (or may be able to claim that he wasn't aware of) the sewage treatment plant.

The ultimate result of this is that people paid well over twice what they should have on their land, and were financed through loans with predatory terms they were not aware of, and which they could not afford, regardless of their personal credit history or ability to pay. Only a predatory lender would be willing to look the other way and finance property for more than its value. These loans also had other common predatory characteristics. One woman was refinanced one day after buying the home, and worked with the same individuals on both loans. She was still sold $4,000 in points and $6,000 in insurance on the first loan, which would be invalid when she refinanced the next day. Further, at least two residents are carrying $10,000 notes with the responsible bank, above and beyond their refinanced mortgages. They were unaware of these notes when they signed their paperwork, and in one instance a woman was told before closing not to mention it to the title company.

Residents report many code violations including homes built too close to the railroad tracks, electrical wiring which was jerry rigged off of other lines, foundations which were not allowed to cure, concrete which was not reinforced and which was not poured as thick as is required. When residents complained to the local Manufactured Housing Committee, they found that the businessman who set up this deal had been appointed as the head of the committee! This despite the fact that he had run several manufactured housing sales corporations where his license had been revoked.

Some residents ended up paying about $1,500 a month, far more than they could afford, and about one third of the residents lost their homes. Many are FHA homes, so the taxpayers ended up footing the bill.

While the responsibility for this fraud has been distributed, the victims bear the full brunt of its consequences. Many have had their credit ruined trying to keep up with predatory loans, others have lost their homes, all have watched their neighborhood deteriorate before their eyes.

Another scam we have come across is the practice of "contract-for deed," which has been called "nothing less than modern day sharecropping." We first came across this practice in Houston.

Houston ACORN has worked with a group of low income home buyers who have all purchased houses using a "Contract For Deed" from a developer named Jack Markman or one of his associates. All of the homebuyers are Spanish speaking immigrants. They all conversed with Spanish speaking representatives of one of the Markman companies, and then signed contracts in English which they did not understand. In general the buyers did not understand the main problem with the contract: the fact that they would have to complete the entire contract before they would be owners of the house. In many cases there are no legal descriptions or maps with the contracts.

According to the Texas Secretary of State, Jack Markman is affiliated with nineteen different development companies. The homebuyers have purchased their homes from one of four of his companies: St. Mary's Construction, Markman and Martinez Investments, Markman and Humphries Investments, or Markman Bros. Investments. It appears Markman or on of his companies own over 800 pieces of property in Houston, and some of the properties have as many as 40 houses on them. We understand that the houses are typically bought on auction, and sold to families who are willing to fix them up. According to ACORN's research, it appears that most of the property is not properly platted nor subdivided. Most of the properties are also not registered with the Harris County Appraisal District with individual tax accounts for the homebuyers.

Markman requires people to pay anywhere from $300 to $5000 as a down payment to get the house. All of them were told that after they paid the down payment they would do the "closing." All of the contracts have an interest rate between 10% to 11%. Most residents pay between $250 to $500 a month.

While there are numerous concerns about the transaction, the most common concern brought by the families relates to their increasing monthly payments. Markman attributes the increases in monthly payments to rising taxes and insurance that has created a delinquent escrow account that people need to catch up on. This was impossible for residents to confirm. When buyers have gone to Harris County Appraisal District to request to see their property's tax bill, most have been told that their property is not registered as an individual property with the county. In most cases the property is part of a larger tract of land, which is being taxed as either one house on a large piece of land or one large lot. Since the property does not have an individual tax account it is difficult to decipher if the rising escrow cost is truly attributed to their rising taxes or if Markman is arbitrarily charging money to the buyer's escrow accounts.

Buyers are also paying for insurance with their escrow account. The insurance appears to have a $5,000 deductible, and company's offices are based out of the Turks & Caicos Islands and does not have a license to operate in Texas. One homebuyer's house burned down not long ago and she was never able to get money from the policy.

Many residents have moved out because they were intimidated by the company or frustrated and confused by the situation. Once buyers realize that their individual properties are not on the tax roles nor are they platted or registered, often they decide to cut their losses and move out of their house. Markman has sold these houses time and time again after buyers move out and he has kept the down payments. Some residents have been intimidated into leaving. For example, one buyer was charged $2,300 all at once for what they were told were delinquent taxes and insurance costs. She could not pay and she left out of fear that she would be forcibly removed.

In a few cases Markman has sold an entire group of houses, between 20 and 45 at a time, to a third party, small time investor. The third party is usually looking to convert the houses into rental units as an investment. Through other forms of intimidation the third party has forced many families out of the houses, or tricked them into converting their contracts into rental lease agreements.

Residents are not taking this lying down. Over 140 families who have bought houses from Markman or one of his associated companies on a "contract for deed" basis are organizing to obtain the clear title from Markman to their home. Most have joined ACORN and they meet regularly. They have elected leadership from among the group to mobilize the families as needed, and to develop organizing strategies to address the problem.

Since mid-January, 2003 these residents have been taking a variety of actions to address their concerns. After a demonstration at Markman's office on Friday January 30th a negotiating committee of the homebuyers met with Markman and his associates. Markman refused much of their demands but he did clarify in a written statement that he would accept prepayments, without penalty, on the contracts. He claimed that this has always been his policy, regardless of the fact that the contracts clearly state, "no prepayments may be made," and regardless of the fact that a number of people tried to pay out and were refused. Of course, since the houses do not seem to be registered nor platted, it is difficult for the families to get traditional financing from a lender to pay off the contract.

On Wednesday March 3rd, sixty seven homebuyers filed their contracts with the Harris County Real Property Division so that the purchasers' names are now on record as having an interest in buying the properties. This was done to prevent third party investors from buying from Markman without recognizing those who have been paying on the properties for the last seven to fifteen years. We also hope it will enable the homebuyers to set up their own tax accounts in their names and qualify for a variety of homestead exemptions.

Markman has violated the law in a variety of ways, which should give these homebuyers leverage to get Markman to convert their contracts to warranty deeds and notes/deeds of trust. Litigation will likely be needed to bring him to the table, judging by his entrenched policies and statements made to the homebuyers thus far. Those that have moved want proper compensation for their years of investment in their homes.

The overall goal of the homebuyers is to obtain good, marketable title to the homes they have been paying for. They also want an agreement that Markman will change his business practices and stop preying on low income and minority homebuyers. In the long term, ACORN members want to pass both local and state policies to tighten up the law to provide protections for homebuyers and to prohibit real estate investors like Markman and others from offering abusive “contract for deed” scams.

There are many contributing factors to the problem of mortgage fraud, but here are a few. Low documentation or no documentation loans make fraud far easier. Another contributing factor is the lack of alternatives to these shoddy operators; reputable lenders making good loans at good rates would help drive these criminals from the market.

But perhaps the most important reason for the explosion in these predatory factors is that the volume-driven, securitization-based market gives incentives to be reckless. Because too many market participants—from lenders to brokers to appraisers—make money up-front, with little financial incentive to ensure that their actions do not harm consumers, there is an incentive to take actions that harm borrowers—and often other market participants—down the road.

This is especially apparent in the subprime market, where business is done without lawyers and other protections. Because so much money is made up front in the form of points and fees—and in the form of yield spread premiums to brokers--there is less incentive to ensure that the loans perform. There is also less access to legal recourse because of the prevalence of mandatory arbitration clauses.

Unfortunately it is not just fly-by-night operators who have been involved in these scams. For example, there have been reports of repeated and major appraisal problems from big lenders, as well, with lenders accused of pressuring appraisers to come up with appraisals that justify their loans. The American Banker reported on a recent case in Iowa that involved the Des Moines mortgage unit of Wells Fargo & Co.

The appraiser “had a long-standing relationship with Brenton Bank, a Des Moines lender that merged with Wells in 2001. He said the Benton loan officers he had dealt with in the past stayed at Wells, but when their compensation shifted to commissions from salaries, they became more aggressive in their demands for higher appraisals. When his shop refused to play along, ‘we saw a real slowdown in orders, and they stopped altogether for two-month periods,’ and Wells was slow to pay for appraisals on loans that did not close.”[2] The volume-driven market here is providing incentives that harm consumers.

Who do these scams effect?

Our experience, as reflected in the cases above, is that these scams target the most vulnerable, often low- or moderate-income people, many elderly, and often immigrants.

---

[2] Erick Berquist, “A View of the Refi Boom From the Appraisal Trenches,” *American Banker*, Thursday, February 5, 2004.

In addition, low-income homebuyers and people of color are much more likely to be in the subprime market, where much of these practices occur. Our reports "The Great Divide" and "Separate and Unequal", available on our website, document the large percentage of subprime loans that go to these borrowers.

Vulnerable borrowers in the subprime market are in effect punished twice—they pay more for risk, and then if things go wrong, as in cases above, they face the consequences

Let us now briefly examine what can be done to solve these problems.

We need both national protections against predatory practices and state and local action against predators. It is states' ability to respond quickly to problems—whether they be in inner-city Baltimore or rural Pennsylvania—that makes it vitally important that federal action not preempt their ability to protect their citizens. This is why we oppose the Office of the Comptroller of the Currency's preemption of state laws as they affect national banks.

We must make sure that the bad actors are held responsible for their actions. The entire chain of actors involved in these transactions has a responsibility to help solve the problem, from lenders, to mortgage brokers, to appraisers and real estate agents.

This chain also includes consumers themselves, which is why we are so involved in housing counseling. Counseling helps ensure that borrowers can spot bad actors, and it helps connect borrowers with reputable market participants. We think adequate funding of housing counseling is very important.

Responsibility also means more resources for enforcement to help crack down on the scam artists.

It means appraisal reform, so that appraisers are not pressured to give false appraisals.

Finally, it means a strong Community Reinvestment Act, so that responsible financial institutions have an incentive to lend in underserved communities, and so that those institutions that participate in predatory practices are punished with lower ratings.
We believe that the FDIC's action in exempting many banks from the stronger large institution test is wrong, and should be reversed.

Mortgage fraud is a complicated and troubling issue. While it causes heartache for banks and other lenders as they look at their bottom line, it causes far worse anguish for many of the families we represent. We hear their stories, and we believe strongly their experiences must be part of the debate in how to end mortgage fraud. Thank you for the opportunity to address you today and I am happy to answer any questions you may have today.