Chairman Ney, Ranking Member Waters and other members of the Subcommittee, it is my pleasure to testify before you today on the HUD Inspector General perspective on mortgage fraud and its impact on financial institutions.

Of all homes purchased in the United States each year, 8% are financed with FHA mortgage insurance. Each year FHA accounts for 30% of all insured mortgages. FHA activity has fallen off nearly 20% from the same period a year ago.

FHA insured mortgages may be more prone to mortgage fraud because FHA insures mostly first-time homebuyers with limited credit histories and little money down.

A closer look at the makeup of the FHA portfolio would indicate that FHA's insurance risk is increasing. A comparison of active insured FHA cases to FHA claims cases over the past two years shows an increasing claim rate.

As you can see from our chart, our investigative workload is increasing with more than 450 open criminal single-family investigations and our arrests in the single-family mortgage area have increased by 800% in a four-year period. We believe there is a direct relationship between our increasing workload and FHA's increasing claims rate.

Annual Financial Audit

The annual audit of the Federal Housing Administration's financial statement has found the FHA in basically sound fiscal condition. FHA's claims rate, however, continues to rise each year and with fewer FHA mortgage applicants there is less premium income to cover the claims.

A future economic downturn and/or future interest rate increases would provide opportunities for those who would prey upon homeowners who cannot make their mortgage payments.

Types of Mortgage Fraud in FHA Programs

We repeatedly have found unlawful and deceptive practices and outright fraud in mortgage lending that often exploit first-time and uninformed FHA borrowers.

Of particular concern is the illegal profiteering on the purchase and quick resale of homes called "property flipping." The illegality arises because one or more parties to the transaction conspire to inflate the value of the home and then pocket the excessive profits at loan closing.

Another concern is "equity skimming." A common form of equity skimming involves an investor who exploits a homeowner facing foreclosure and other financial stress.

Calculating Fraud?

Mortgage frauds can go undetected and not all fraud results in losses to the government. This makes it difficult to quantify the exact amount, or even an estimated amount, of mortgage fraud.

Every month, one out of every nine FHA mortgages is reported as delinquent. That means 600,000 FHA borrowers are a month behind in paying their mortgage. Some portions of these delinquencies may be due to mortgage fraud in new mortgages, where the underwriter intentionally misrepresented the borrower's ability to pay the mortgage.

Some Examples of Specific Frauds

Below are two examples of combined OIG and FBI investigations of property flipping frauds and the results of a recent audit of mortgage fraud.

- Three conspirators preyed on unwitting FHA borrowers in Chicago's south and west sides, saddling the new homeowners with overvalued properties and unmanageable mortgage debt. The fraud scheme was a typical flip. The investor would contract to purchase a property, recruit homebuyers, and then partner with a crooked appraiser and attorney to complete the resale and closing at an inflated price.

As you can see from the pictures on the easel, this example of one of the properties shows how significantly it declined in appearance and how it could potentially impact the surrounding neighborhood when one of these fraudulent transactions occurred.

- Earlier this year, a 158-count indictment was handed down in the Northern District of Georgia.

  From mid-1999 through March 2004, it was alleged that the settlement attorney and co-conspirators perpetrated a property flipping scam.

  The defendants purchased residential properties primarily in the Stone Mountain, GA vicinity and resold them at artificially inflated prices, using the proceeds of the resale to pay for the initial purchase.

- In a recent audit of an FHA-approved lender, we found the lender was fabricating or altering borrower credit and employment documents to make the loans approvable. In this audit we found pervasive document falsifications in 48 of 65 (74%) FHA loans originated by a HUD approved correspondent lender in the greater Phoenix metropolitan area.

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Chairman Ney, I appreciate the Subcommittee's concern over the increasing problem of mortgage fraud. The result of these types of financial crimes undermines the confidence in this nation's housing industry and frustrates honest Americans' dreams for home ownership. In addition, the victims include the honest mortgage company employees that lose their jobs because they are victimized by the unsavory business practices of other staff, the homebuyers whose credit was destroyed when they had to default on a loan that they really could never afford in the first place, or the new FHA homebuyer that is paying a higher than necessary mortgage premium to cover growing losses to the insurance fund.