

Detecting and Curing Mortgage Fraud: Mitigating Risks in the CRE and Financial Markets

A Whitepaper on Navigating Market Challenges Positioning Foundation Specialty Finance as a Leader in Fraud Prevention Solutions

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Executive Summary

Mortgage fraud poses substantial risks to the CRE lending and financial sectors, leading to compromised loan portfolios, significant financial losses, and reputational damage. The complexity and sophistication of mortgage fraud schemes continues to evolve, necessitating the adoption of advanced fraud detection technologies and comprehensive risk management strategies. This whitepaper outlines the most prevalent types of mortgage fraud, advanced technological solutions for detection, and the proactive measures employed by **Foundation Specialty Finance (FSF)** to safeguard against fraud.

Common Types of Mortgage Fraud

Mortgage fraud involves a range of deceptive practices aimed at manipulating the loan application process and property valuations. Below are the most common types of fraud:

- **Application Fraud:**

This fraud involves the falsification of critical information, such as inflating income, misrepresenting employment history, or altering financial statements. Application fraud accounts for approximately 61% of reported cases and remains one of the most significant fraud types.

- **Appraisal Fraud:**

Appraisal fraud occurs when an appraiser inflates or deflates a property's value in collusion with interested parties. This type of fraud, often underreported due to the subjective nature of property valuations, continues to distort real estate values.

- **Identity Theft/Affinity Crime/Related Party Transactions:**

Fraudsters use stolen identities or collaborating third-parties to apply for mortgages, leading to significant financial losses for lenders. Identity theft is among the fastest-growing threats to the mortgage industry, particularly as digital lending processes become more prevalent.

- **Straw Buyer Schemes:**

Straw buyer schemes involve using a third party's identity or financial status to purchase property, concealing the true buyer's identity. This bypasses standard vetting processes,

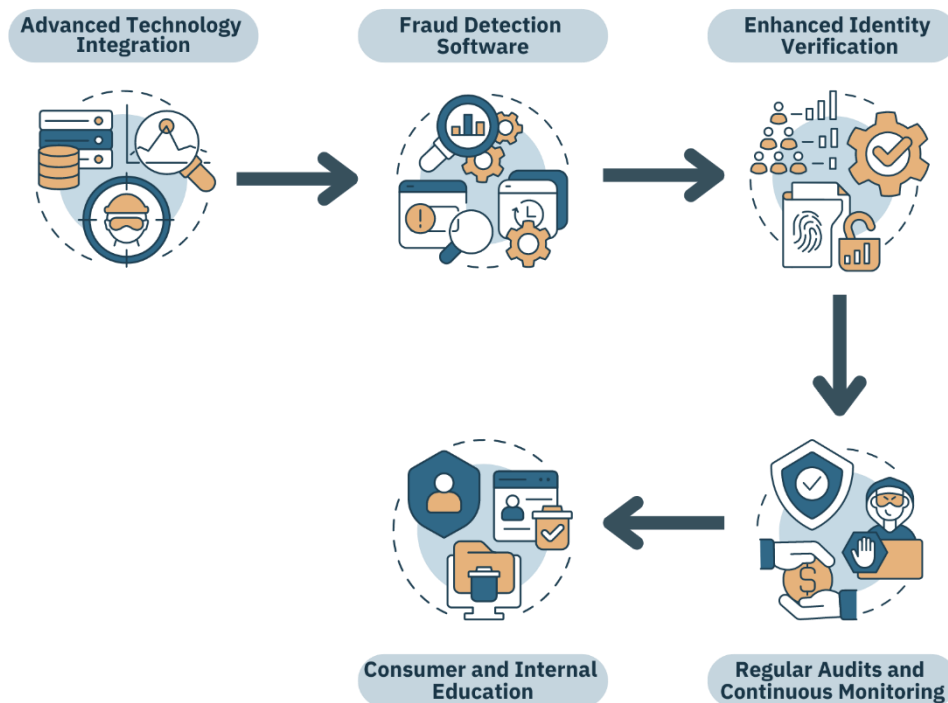
creating risks for all parties.

- **Commercial Real Estate Mortgage Fraud:**

Fraud in commercial real estate often involves manipulating appraisals, fabricating leases, submitting falsified rent roll or operating reports thus concealing financial issues and inflating property profitability. Given the larger loan amounts in commercial transactions, this form of fraud poses particularly significant risks.

Detection and Prevention Strategies

Mitigating mortgage fraud requires the integration of advanced technology, rigorous verification processes, and continuous monitoring. Institutions increasingly rely on AI-driven solutions and automation to enhance fraud detection capabilities and protect against evolving schemes.



1. Advanced Technology Integration

AI and machine learning tools have revolutionized fraud detection. Lenders now utilize automated systems to review documents, detect inconsistencies, and analyze large datasets in real-time, leading to faster identification of fraudulent activities. Platforms like CoreLogic’s LoanSafe remain industry standards, using AI to flag anomalies in loan applications and property valuations.

2. Fraud Detection Software

Key platforms such as Ocrolus' Detect leverage AI and machine learning to identify document tampering, income misstatements, and identity theft that manual reviews may miss. Ocrolus provides a high level of accuracy in document verification, offering detailed visualizations of tampering and automated alerts to help lenders respond to fraud quickly and decisively. Ocrolus' Authenticity Score helps condense fraud indicators into clear, actionable metrics, allowing lenders to efficiently make informed decisions.

3. Enhanced Identity Verification

In response to rising identity theft cases, biometric data analysis and facial recognition technologies are essential for verifying borrower identities. By integrating these tools into their workflows, lenders minimize identity-related fraud risks.

4. Regular Audits and Continuous Monitoring

Continuous portfolio monitoring and regular transaction audits add a critical layer of fraud prevention. By proactively reviewing loan data, financial institutions can identify early red flags such as inconsistent documentation or rapid property flips, both key indicators of potential fraud.

5. Consumer and Internal Education

Educating both borrowers and internal teams about the signs of mortgage fraud is crucial. Borrowers should be aware of foreclosure scams, while internal staff must remain vigilant in detecting fraud indicators during the loan origination process. This combination of training reduces the likelihood of fraud going undetected.

Curing Mortgage Fraud

Once mortgage fraud is detected, swift and effective actions are required to mitigate financial losses and maintain the integrity of the loan portfolio.

- **Strengthened Due Diligence Processes**

Enhanced borrower vetting procedures, including third-party audits, background checks, and in-depth financial reviews, are critical for preventing fraudulent loans from entering the pipeline.

- **Legal Recourse and Remedies**

Upon discovery of fraud, financial institutions must pursue swift legal recourse, including foreclosure, litigation, or settlements. This helps lenders recover lost funds and minimizes broader financial exposure.

- **Loan Modifications and Buyback Agreements**

In some cases, lenders may resort to loan modifications, extensions, or buyback agreements to mitigate losses. These agreements ensure accountability and help reduce financial risk when dealing with non-performing loans resulting from fraud.

Foundation Specialty Finance: Safeguarding Against Mortgage Fraud

At FSF, combating mortgage fraud is a core priority. FSF uses a multi-pronged approach that integrates advanced technology, automation, and rigorous internal oversight. FSF has built the CRE industries leading fully integrated technology platform leveraging Decipher LOS, HubSpot CRM, Homegenius Data Analytics, and Ocrolos AI Powered Fraud Detection and Document Integration to detect, prevent, and mitigate fraud risks across its loan portfolios.

- **Technological Framework and Automation**

FSF's Decipher Loan Origination System (LOS) automates critical aspects of the loan process, including document verification, borrower vetting, and transaction management. With real-time cross-verification of borrower data, Decipher identifies inconsistencies such as misrepresented income or employment history, which are common signs of application fraud. Ocrolos enhances document review, using AI to flag tampered documents and discrepancies in borrower-provided information.

- **Property and Broker Portals**

FSF also employs Homegenius within its PropertyPortal™, allowing the company to analyze property valuations and track asset performance in real-time. The platform provides key insights into property histories, helping FSF detect fraudulent schemes like appraisal fraud and property flipping before they impact loan performance. FSF's Broker Portal allows brokers to submit loan applications securely, reducing the risk of tampered documents.

- **Data Integration and Continuous Monitoring**

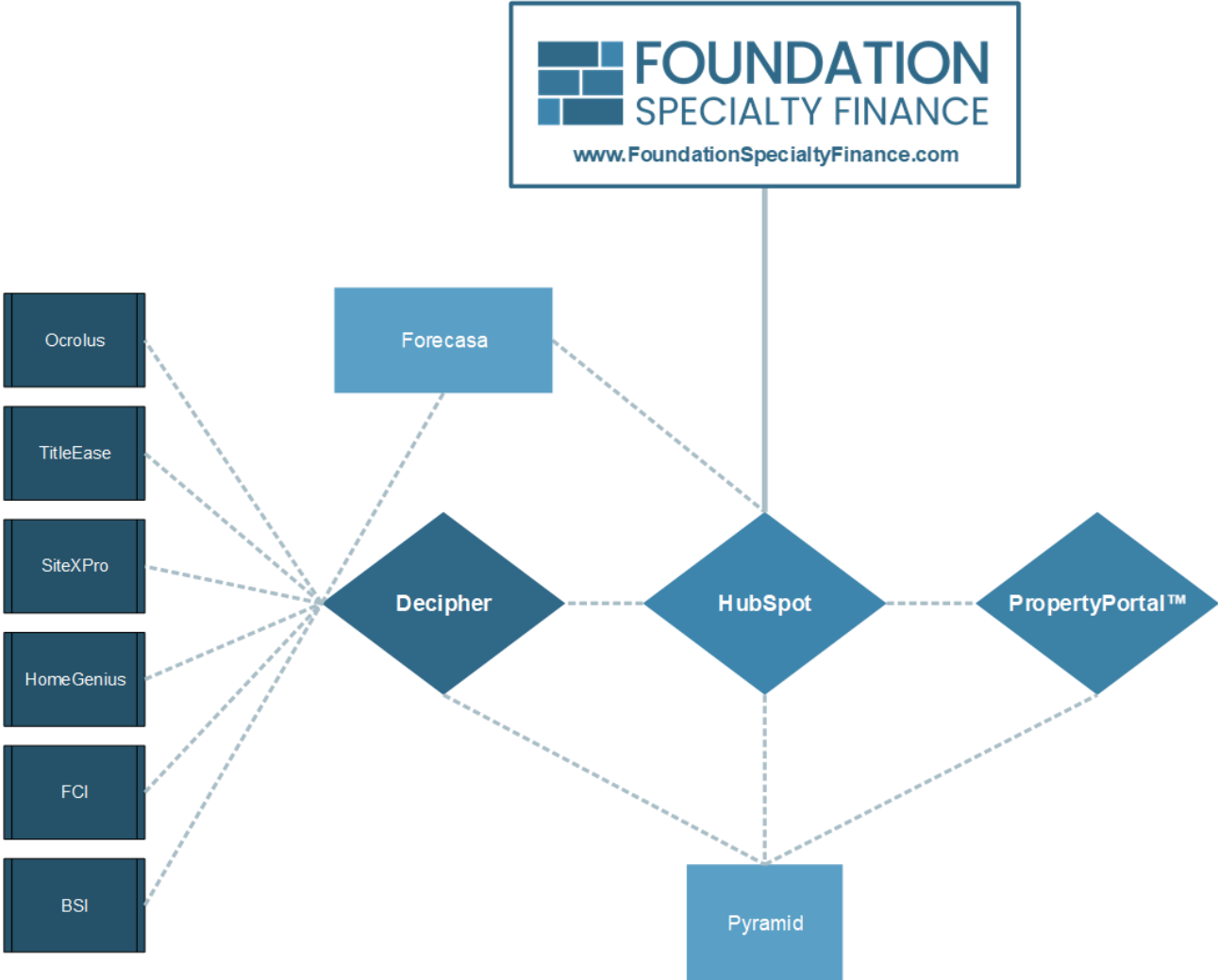
FSF utilizes the Pyramid data warehouse system to aggregate and monitor loan, borrower, and property-related data. This system integrates data across portfolios, allowing FSF to generate real-time analytics and identify potential fraud early. Commercial real estate fraud, such as inflated property values or false leases, is detected through proactive data analysis, ensuring potential risks are identified before loans become distressed.

- **Internal Training and Preventative Measures**

FSF complements its technological safeguards with ongoing fraud awareness training for its loan officers and underwriters. By maintaining a robust internal education program, FSF ensures that team members are equipped to detect fraudulent activity before it becomes a larger issue.

Conclusion

Mortgage fraud remains a significant threat to the real estate and financial markets. However, by integrating AI-driven fraud detection tools, implementing rigorous internal oversight, and continuously educating stakeholders, institutions like FSF effectively mitigate these risks. FSF's fully integrated platform including applications from platforms like OcroLus, Decipher LOS, and Homegenius establishes a benchmark for safeguarding loan portfolios against fraud, while ensuring long-term protection for lenders, investors and borrowers.



Appendix A

Types of Mortgage Fraud

A summary of lesser-known types of fraud not covered in the main body includes:

- **Air Loans:** Loans based on fictitious properties where fraudsters create false borrower profiles and forge documentation to acquire funds.
- **Builder Bailout Fraud:** Builders use straw buyers to inflate property values and meet lending agreements, leading to inflated sale prices and manipulated loan applications.
- **Equity Skimming:** Fraudsters use straw buyers and falsified income documentation to acquire loans, renting the property until foreclosure while making no payments.

Red Flags for Mortgage Fraud Detection

- **Inflated Property Appraisals:** Suspiciously high valuations with limited or unverifiable comparable.
- **Bogus Leases:** False leases created to inflate the perceived profitability of a building and justify higher loans.
- **Rapid Property Flips:** Properties bought and sold in short periods with suspiciously high markups.