

Q4 2010 Mortgage Fraud Risk Report

In depth analysis of nationwide
risk as indicated by the
Interthinx® Fraud Risk Indices

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Executive Summary

While the national Mortgage Fraud Risk Index, still elevated at 140 (n=100), remains essentially flat from both the previous quarter and from a year ago, increases in fraud in the Chicago area may illustrate the danger of previously localized risks spreading throughout a metropolitan area.

- Illinois, with a jump of 26 points, saw the largest quarter-on-quarter fraud risk increase. It contains the Chicago zip code 60621, which has been the most risky zip code in the United States for three consecutive quarters. Over those three quarters, the overall risk in the Chicago MSA has increased dramatically, from “moderate risk” in Q2 2010 to “very high risk” in this quarter, which suggests that previously localized risks may be spreading throughout the metropolitan area.
- Nevada continues to be the state with the highest fraud risk with an index value of 255, followed by Arizona and Florida with index values of 210 and 181 respectively. California, which contains six of the top ten most risky MSAs, is in fourth place with an index value of 180.
- The Employment/Income and Identity Fraud Risk indices are up by more than 25% over the last year. The sharp rise in fraud risk in these categories is primarily associated with re-finances, loan modifications, and purchase mortgages involving the resale of distressed properties.
- The Occupancy Fraud Risk Index, which is closely associated with undisclosed investment properties, continued a decline that began in Q2 2010. This downward trend is likely due to the fact that short sale purchasers are increasingly turning to private “transactional” and non-bank funding sources and away from traditional mortgages with occupancy requirements.
- The Property Valuation Fraud Risk Index has also declined each quarter since Q1 2010, most likely due to the fact that properties acquired through “flopping” short sale frauds, which played a large part in the run up in this index in 2008 and 2009, are now being sold to end buyers at or near actual fair market values.
- Short and REO sales constitute a significant share of all sales in the majority of the highest risk MSAs in the Occupancy and Property Valuation Fraud Risk indices and present an area of critical fraud risk for lenders today in view of an abundant supply of distressed borrowers and government pressure to avoid foreclosures. The risk is acute for lenders and servicers who do not employ risk controls and analysis in their servicing, loss mitigation and origination departments. The aggregated financial losses to lenders, servicers and investors from short sale and other default related fraud schemes are significant and rising.

Mortgage Fraud Risk Hot Spots and Trends

The national Mortgage Fraud Risk Index remains elevated at 140 (n = 100). This index value declined three percent from a year ago, and two percent quarter-on-quarter. The trend has been relatively flat over the last year, with the exception of a brief foray over 150 in Q1 2010. Figure 1 shows the distribution of current mortgage fraud risk in MSAs throughout the United States. The “very high risk” MSAs continue to be distributed throughout the nation with – for the sixth consecutive quarter – California, Florida, Arizona, Colorado, Michigan, Ohio and Nevada all having multiple MSAs in the “very high risk” category. The Memphis and Nashville, Tennessee; Bend, Oregon; Minneapolis-St. Paul, Minnesota; Atlanta, Georgia; Trenton, New Jersey; and Boston, Massachusetts metros remain in the “very high risk” category, and the Washington DC metro returns to this category. The Illinois MSAs of Chicago and Rockford appear in the “very high risk” category for the first time, following the appearance of several Chicago zip codes in the “most risky” list over the past few quarters.

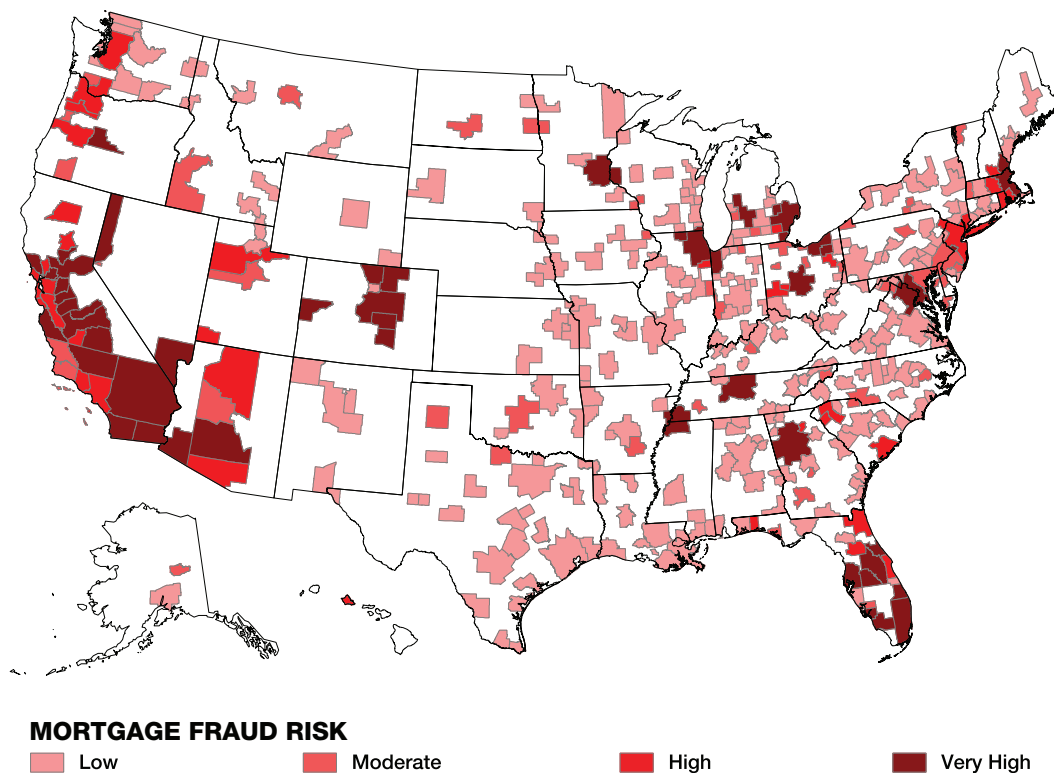


Figure 1: Mortgage Fraud Risk in Q4 2010 by Metropolitan Statistical Area (MSA)

Table 1 shows the Mortgage Fraud Risk Index for the ten MSAs with the highest mortgage fraud risk. Las Vegas, which has been in the top ten for seven consecutive quarters, remains in the number one spot with an index value of 288. It is likely to remain in the top ten for the foreseeable future because current fraud risk predominantly involves distressed borrowers and properties, and Las Vegas has an overabundance of both: in the third quarter of 2010, at least 75 percent of borrowers were underwater; 11 percent of households were in the foreclosure process; and short sales and REOs represented 30 percent and 60 percent, respectively, of all sales.

Other perennial entries on this list include the California MSAs of Vallejo, Modesto, Salinas, Riverside, Stockton and Bakersfield. The Stockton MSA dropped to sixth place – the first time that it has been outside the top five since the inception of this report in Q2 2009. Cape Coral-Fort Myers, Florida; Phoenix, Arizona and Detroit, Michigan complete the top ten.

Rank	Metropolitan Statistical Area	Mortgage Fraud Risk Index Q4 2010	% Change Since Q4 2009	% Change Since Q3 2010
1	Las Vegas-Paradise, NV Metro	288	25.8%	5.5%
2	Vallejo-Fairfield, CA Metro	269	-9.3%	4.0%
3	Modesto, CA Metro	266	-12.4%	2.9%
4	Salinas, CA Metro	262	-1.6%	20.0%
5	Riverside-San Bernardino-Ontario, CA Metro	251	-9.0%	-5.9%
6	Stockton, CA Metro	251	-15.5%	2.0%
7	Cape Coral-Fort Myers, FL Metro	242	-10.8%	-1.3%
8	Phoenix-Mesa-Scottsdale, AZ Metro	237	2.4%	2.4%
9	Bakersfield, CA Metro	231	3.3%	17.5%
10	Detroit-Warren-Livonia, MI Metro	224	28.2%	-4.1%
United States		140	-3.3%	-2.2%

Table 1: MSAs with the Highest Fraud Risk in Q4 2010

Table 2 shows the Mortgage Fraud Risk Index for the ten zip codes with the highest mortgage fraud risk. Most of these zip codes are located within MSAs that are in the “very high risk” category in Figure 1, but it is worth noting that two Newark zip codes, which are part of the New York City MSA, appear in this quarter’s top 10 even though the New York MSA is at lower overall risk.

Rank	Zip	City and State	Mortgage Fraud Risk Index 2010 Q4
1	60621	Chicago, IL	568
2	85302	Glendale, AZ	547
3	80538	Loveland, CA	515
4	92301	Adelanto, CA	512
5	93635	Los Banos, CA	510
6	89115	Las Vegas, NV	506
7	07105	Newark, NJ	494
8	60411	Chicago Heights, IL	487
9	07107	Newark, NJ	483
10	34117	Naples, FL	483

Table 2: Zip codes with the Highest Fraud Risk in Q4 2010

There is some evidence that very high risk can extend from one zip code to adjacent or nearby areas and thus move an entire MSA into a higher risk category. This appears to have occurred in Chicago, whose zip code 60621 has been the most risky zip code in the nation for the past three consecutive quarters. Chicago was a “moderate risk” MSA when its 60621 and 60636 zip codes made their debut at first and third place, respectively, in Q2 2010. The Chicago MSA moved to the “high risk” category in Q3 2010 and to the “very high risk” category in this quarter, suggesting that previously localized risks may be spreading.

A more detailed examination of the most risky Chicago zip codes from one year ago to the present quarter, shown in Table 3, confirms this hypothesis. A year ago only one zip code, 60621, had a Fraud Risk Index value in excess of 350. At that time zip code 60621 had an index value of 458, more than 120 points higher than the then-second place zip code, 60609. Since then it appears the risk has spread more widely throughout the Chicago MSA. In the present quarter, all of the top ten zip codes have index values greater than 350. While the index value for 60621 increased 24% year-over-year, the spread of fraud risk throughout Chicago increased the MSA-level index value by 38%. These findings demonstrate the value of analyzing aggregated loan application data at granular levels in order to help identify hot spots and to determine which additional controls might help to prevent the spread of risk.

Rank	2009 Q4		2010 Q4	
	Zip	Mortgage Fraud Risk Index	Zip	Mortgage Fraud Risk Index
1	60621	458	60621	568
2	60609	336	60411	487
3	60636	307	60623	471
4	60644	304	60651	461
5	60637	270	60191	388
6	60087	270	60459	376
7	60624	256	60172	361
8	60659	251	60139	361
9	60426	248	60154	357
10	60623	248	60619	352
Chicago-Naperville-Joliet, IL-IN-WI Metro		134	—	185

Table 3: Chicago MSA Zip codes with the Highest Fraud Risk in Q4 2009 and Q4 2010

Geographic Fraud Risk Migration

Mortgage fraud migrates geographically to take advantage of local market conditions. This section examines the geographic migration of mortgage fraud risk at the state level.

Figure 2 depicts the Mortgage Fraud Risk Index for the individual states, with the ten highest risk states shown in red. Nevada and Arizona continue to be the two most risky states with index values of 255 and 210, respectively. Florida, with an index value of 181, takes over third place from California, which fell to fourth. The index value spread between the top three states is wider than in the past, with Nevada surpassing Arizona by 45 points, and with Arizona besting Florida by 29 points. The District of Columbia is in fifth place with a value of 176. Illinois, which had the largest quarter-on-quarter increase, 26 points, is in sixth place with a value of 171. The top 10 is rounded out by Michigan, Colorado, Massachusetts and Maryland. In addition to the top ten states, Oregon, Minnesota, New Jersey, Ohio, Hawaii, Rhode Island, Tennessee and Georgia also have index values above the national value of 140. The ten states with the lowest risk, shown in green, are Kansas, Mississippi, West Virginia, Wyoming, Montana, Maine, Kentucky, South Dakota, Alabama, and Iowa. All of the ten least risky states, with the exception of Iowa, have Index values of less than half the national value.

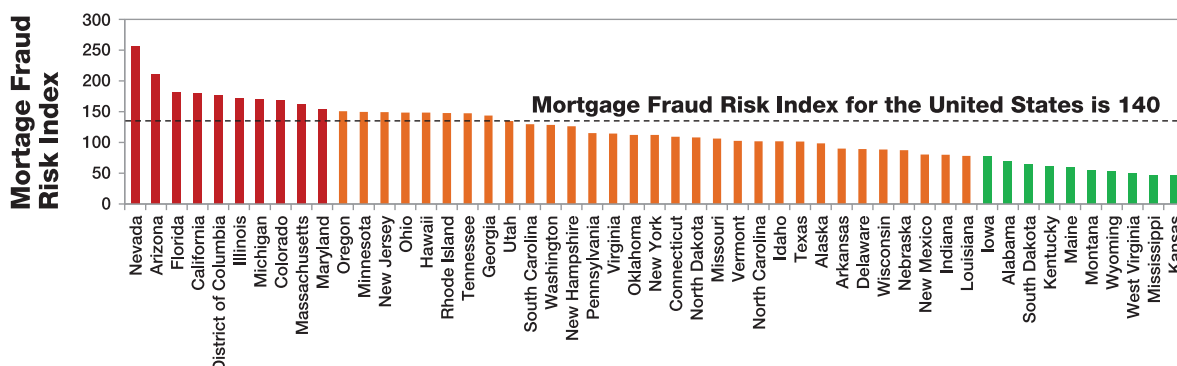


Figure 2: Mortgage Fraud Risk Index in Q4 2010 by State

Type-Specific Mortgage Fraud Risk Hot Spots and Trends

Interthinx tracks four type-specific fraud risk indices: Property Valuation, Identity, Occupancy and Employment/Income. This section examines the hot spots and trends for these type-specific fraud risks.

PROPERTY VALUATION FRAUD RISK INDEX

Property Valuation Fraud is perpetrated by manipulating property value to create “equity” which is then extracted from loan proceeds by various means. Table 4 shows the five MSAs with the highest property valuation fraud risk. Las Vegas, the only MSA to experience an increase from last quarter and from a year ago, is in first place, followed by the California MSAs of Modesto, Vallejo, Riverside, and Stockton. All of these markets have Index values that are more than double the national value of 254, and in all, the number of short and REO sales as a percent of total sales is significant. While the national index value doubled between 2008 and 2009, it has been relatively stable since then, as evidenced by the relatively small year-on-year and quarter-on-quarter decreases of 7.3% and 3.6%, respectively.

Rank	Metropolitan Statistical Area	Property Valuation Fraud Risk Index Q4 2010	% Change Since Q4 2009	% Change Since Q3 2010
1	Las Vegas-Paradise, NV Metro	654	19.3%	3.1%
2	Modesto, CA Metro	623	-20.9%	1.4%
3	Vallejo-Fairfield, CA Metro	602	-24.9%	-2.3%
4	Riverside-San Bernardino-Ontario, CA Metro	546	-23.5%	-13.4%
5	Stockton, CA Metro	542	-30.8%	-10.2%
United States		254	-7.3%	-3.6%

Table 4: MSAs with the Highest Property Valuation Fraud Risk in Q4 2010

OCCUPANCY FRAUD RISK INDEX

Occupancy Fraud is a favored vehicle of professional real estate investors who falsely claim the intent to occupy the purchased property so as to obtain a mortgage with lower down payments and/or interest rates. The Occupancy Fraud Risk Index decreased by 4% from the previous quarter, and by 28% over the last year. This decline is likely due to continued downward pressure on housing prices, which reduces the need to obtain a mortgage, and to the increasing use of non-bank and “transactional” sources to fund purchase transactions.

Table 5 shows the five MSAs with the highest occupancy fraud risk. The metros of Miami, Florida and Detroit, Michigan, which have been in the top five every quarter since the inception of this report in Q2 2009, head the table, which is rounded out by Las Vegas, Nevada; Naples, Florida and Bakersfield, California. All these MSAs have become hubs of investment activity due to the extreme reduction in housing prices caused by high unemployment rates and economic distress, as occurred in Detroit or by overbuilding and speculative investing which left an abundant supply of foreclosed properties as the economy faltered, as in coastal Florida markets, California's Central Valley, and Las Vegas.

Rank	Metropolitan Statistical Area	Occupancy Fraud Risk Index Q4 2010	% Change Since Q4 2009	% Change Since Q3 2010
1	Miami-Fort Lauderdale-Pompano Beach, FL Metro	154	1.8%	0.5%
2	Detroit-Warren-Livonia, MI Metro	122	-9.9%	-3.4%
3	Las Vegas-Paradise, NV Metro	113	-2.1%	-7.7%
4	Naples-Marco Island, FL Metro	110	-2.9%	24.7%
5	Bakersfield, CA Metro	109	-7.2%	34.1%
United States		64	-27.6%	-3.8%

Table 5: MSAs with the Highest Occupancy Fraud Risk in Q4 2010

IDENTITY FRAUD RISK INDEX

Identity Fraud is frequently used in mortgage fraud schemes in order to hide the identity of the perpetrators and/or to obtain a credit profile that will meet lender guidelines. The Identity Fraud Risk Index is essentially unchanged from the previous quarter but has increased 27% from the same quarter a year ago. This increase could be symptomatic of incidents of so-called “fraud for property” where more creditworthy relatives or friends with higher incomes act as straw buyers for the actual future homeowner.

Table 6 displays the top five MSAs for identity fraud risk. The neighboring Ohio metros of Cleveland and Akron, whose index values have tripled over the last year, are in first and third place. This is the second consecutive quarter that Cleveland has ranked number one. The Trenton, New Jersey metro, whose index value doubled since the last quarter, the Fayetteville, Arkansas metro, and the New York City metro round out this table.

Rank	Metropolitan Statistical Area	Identity Fraud Risk Index Q4 2010	% Change Since Q4 2009	% Change Since Q3 2010
1	Cleveland-Elyria-Mentor, OH Metro	606	260.9%	53.5%
2	Trenton-Ewing, NJ Metro	496	143.0%	124.3%
3	Akron, OH Metro	444	255.0%	39.1%
4	Fayetteville-Springdale-Rogers, AR-MO Metro	351	89.5%	28.4%
5	New York et al, NY-NJ-PA Metro	344	68.5%	14.6%
United States		190	27.3%	0.4%

Table 6: MSAs with the Highest Identity Fraud Risk in Q4 2010

EMPLOYMENT/INCOME FRAUD RISK INDEX

Employment/Income Fraud occurs when an applicant's income is misrepresented in order to qualify for a loan. The Index rose by eight percent over the previous quarter, and by 28 percent over the past year, after falling by more than 50 percent between 2008 and 2009. The increase in the employment/income fraud risk index is likely another indication that so-called 'fraud for property' is on the rise as borrowers, possibly encouraged by mortgage professionals, exaggerate their income to qualify for purchase loans, re-financings and modifications. The Employment/Income Fraud Risk Indices for the top five MSAs are shown in Table 7. Burlington, Vermont is the MSA with the highest employment/income fraud risk for the second consecutive quarter. Salinas, California; St. George, Utah; Honolulu, Hawaii and Reno, Nevada round out the table.

Rank	Metropolitan Statistical Area	Employment/Income Fraud Risk Index Q4 2010	% Change Since Q4 2009	% Change Since Q3 2010
1	Burlington-South Burlington, VT Metro	221	187.1%	42.6%
2	Salinas, CA Metro	168	10.7%	38.0%
3	St. George, UT Metro	166	137.4%	163.8%
4	Honolulu, HI Metro	159	85.0%	28.3%
5	Reno-Sparks, NV Metro	158	267.3%	14.4%
United States		101	28.1%	7.5%

Table 7: MSAs with the Highest Employment/Income Fraud Risk in Q4 2010

Extended Forecast

The Interthinx Fraud Risk Indices have proven to be a leading indicator of foreclosure activity. Therefore, the regions that currently have high Fraud Risk Indices are likely to continue to experience high default, re-default, and foreclosure rates going forward. Based on the Fraud Risk Indices, regions that bear close scrutiny going forward include:

- Illinois, which enters the top ten with a jump of 26 points, the largest quarter-on-quarter increase of any state. The Chicago MSA, whose overall Index value jumped 38%, contains the 60621 zip code which, for the third consecutive quarter, is the most risky zip code in the nation.
- Nevada, which is by far the most risky state with an index value of 255. Nevada's Las Vegas MSA has the highest overall and property valuation fraud risk, the third highest occupancy fraud risk, and contains the sixth highest risk zip code in the nation.
- Arizona, which is in second place with an overall fraud risk index value of 210.
- Florida and California, which are in third and fourth places with overall index values of around 180, and which combined contain seven of the ten riskiest MSAs.

About the Interthinx Fraud Risk Indices

The Fraud Risk Indices are calculated based on the frequency with which indicators of fraudulent activity are detected in mortgage applications processed by the Interthinx FraudGUARD® system, a leading loan-level fraud detection tool available to lenders and investors.

The Interthinx Fraud Risk Indices consist of the Mortgage Fraud Risk Index, which measures the overall risk of mortgage fraud, and the Property Valuation, Identity, Occupancy and Employment/Income Indices, which measure the risk of these specific types of fraudulent activity.

The Mortgage Fraud Risk Index considers 40+ indicators of fraudulent activity including property mis-valuation; identity, occupancy and employment/income misrepresentation; non arms-length transactions; property flipping; straw-buyers; “silent seconds”; and concurrent closing schemes. The four type-specific indices are based on the subset of indicators that are relevant to each type of fraudulent activity.

Each Index is calibrated so that a value of 100 represents a nominal level of fraud risk, a value calculated from the occurrence of fraudulent indicators between 2003 and 2007 in states with low foreclosure levels. For all five indices, a high value indicates an elevated risk of mortgage fraud and each Index is linear to simplify comparison across time and location.

The Interthinx Indices are leading indicators based predominantly on the analysis of current loan originations. FBI and FinCEN reports are lagging indicators because they are derived primarily from Suspicious Activity Reports (SARs), the majority of which are filed after the loans have closed. The time lag between origination and the SAR report can be several years. For this reason, the Interthinx Fraud Risk Indices’ top geographies and type-specific findings may differ from FBI and FinCEN fraud reports.

About the Interthinx Mortgage Fraud Risk Report

The Interthinx Fraud Risk Report represents an in-depth analysis of residential mortgage fraud risk throughout the United States as indicated by the Interthinx Fraud Risk Indices. Published quarterly, as part of the Fraud Risk Report, Interthinx will report on the geographic regions with the highest Mortgage Fraud Risk Index as well as those with the highest Property Valuation, Identity, Occupancy, and Employment/Income Fraud Risk Indices. The Interthinx Fraud Risk Indices track these risks in all States, Metropolitan areas, Counties and county equivalents, throughout the United States.

About Interthinx

Interthinx, a Verisk Analytics subsidiary, is a leading national provider of comprehensive risk mitigation solutions focusing on mortgage fraud, collateral risk and valuation, regulatory compliance, forensic loan audit services, loss mitigation, and loss forecasting. With more than 20 years of experience in customizable risk evaluation technology, Interthinx offers proven and effective predictive analytics to the residential mortgage industry through its experience with millions of loan applications and fraud incident data from thousands of monthly loan reviews. Throughout the mortgage life cycle, the Interthinx suite of services can increase the value of client portfolios with its comprehensive and holistic approach to loan quality and compliance. Winner of multiple awards for technology, Interthinx helps clients reduce risk, increase operational efficiencies, satisfy regulator demands, manage data verification, remain compliant and mitigate loan buybacks. The Interthinx quarterly Mortgage Fraud Risk Report is a standard for the financial services industry. For more information, visit interthinx.com or call 1-800-333-4510.

MEDIA CONTACT:

Rick Grant

Telephone: 800-979-9049

Cell: 570-497-1026

Email: rick@rickgrant.net