

Q2 2009

Mortgage Fraud Risk Report

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

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Executive Summary

The *Interthinx Mortgage Fraud Index* tracks the risk of mortgage fraud throughout the United States. The Fraud Index declined 4% from the first quarter of 2009 but increased 7% year-over-year due to continued general economic deterioration. The dynamic nature of mortgage fraud, which reacts to and capitalizes on current market conditions, is evidenced in Index changes in predominant fraud geographies and types.

FRAUD GEOGRAPHIES

Fraud risk over the last year exhibited a strong westward migration, with Nevada and California now dominating the ten riskiest Metropolitan Statistical Areas (MSAs). The states with the highest overall levels of mortgage fraud risk correspond closely to the states with the highest levels of foreclosure activity.

- Nevada has the highest mortgage fraud risk, with a Fraud Index value of 245.
- California, which contains 8 of the 10 riskiest MSAs, has the next highest index value of 176.
- The national index value is 130.

FRAUD TYPES

Fraud types shift in response to prevailing market conditions. Changes in type-specific fraud indices in Q2 reflect a shift to schemes that exploit distressed borrowers and the glut of bank-owned properties. Federally funded economic stimulus and stabilization programs that target foreclosure prevention are also contributing to the current shift to schemes involving defaulted and foreclosed properties.

- **The Property Valuation Fraud Index** is up 56% from the same period in 2008, reflecting the shift to schemes involving short sales, REO inventories, and refinancings by borrowers whose equity has been impaired by falling real estate values.
- **The Occupancy Fraud Index**, which is closely correlated to schemes involving speculative investments, declined 25% due to consumers' reduced economic circumstances and the generally depressed market for residential investment and rental properties.
- **The Employment/Income Fraud Index** decreased 33%, due to lenders' increased use of Internal Revenue Service data to verify income and to a reduced need for misrepresentation of income as housing generally becomes more affordable.

FORECLOSURE FORECAST

The Interthinx Fraud Indices act as leading indicators of foreclosure activity. Therefore, Interthinx projects that regions with high Fraud Indices in 2009 are likely to experience high foreclosure rates going forward even if economic conditions begin to improve. Interthinx also projects that the Fraud Index will continue to rise through 2011, reflecting a coming wave of ARM interest rate resets that will peak in early 2012.

Mortgage Fraud Hot Spots and Trends

Figure 1 shows the distribution of current mortgage fraud risk in MSAs throughout the United States as indicated by the Interthinx Mortgage Fraud Index. Many of the very high risk MSAs are concentrated in California, particularly in the state's Central Valley region, which experienced a surge of new construction and population inflows during the real estate boom as first-time homebuyers fled the coastal regions in search of affordable housing. This region is now at the center of current foreclosure activity. Other very high risk MSAs are located in Las Vegas and Reno, Nevada; Phoenix, Arizona; in and around Denver, Colorado; along the Florida coast; and in the economically-devastated rust-belt regions in and around Detroit, Cleveland and Cincinnati. In the years preceding the mortgage meltdown, these areas experienced either booming economies with historically high levels of real estate activity and new construction, or serious economic dislocation. These factors indicate that fraud flourishes in unstable housing markets, regardless of whether prices are rising or falling.

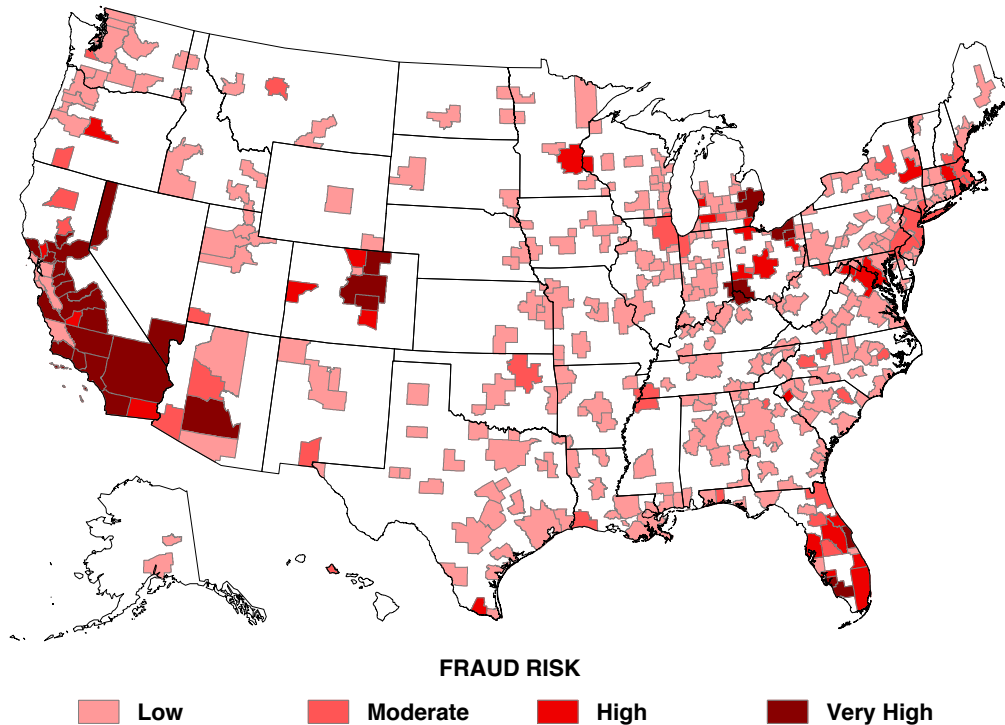


Figure 1: Mortgage Fraud Risk in Q2 2009 by Metropolitan Statistical Areas (MSAs)

Table 1 shows the Mortgage Fraud Index for the 10 MSAs with the highest fraud risk. All ten are located in California and Nevada. California's risk is concentrated in the inland regions of the state; Stockton ranks worst nationally with a Fraud Index value of 257. The risk in Nevada is concentrated in its major population centers.

Rank	Metropolitan Statistical Area	Mortgage Fraud Index Q2 2009	% Change Since Q2 2008	% Change Since Q1 2009
1	Stockton, CA Metro	257	72.3%	19.9%
2	Las Vegas-Paradise, NV Metro	255	96.4%	-8.9%
3	Modesto, CA Metro	245	68.9%	20.4%
4	Reno-Sparks, NV Metro	232	85.9%	-7.8%
5	Riverside-San Bernardino-Ontario, CA Metro	231	79.4%	19.7%
6	Bakersfield, CA Metro	214	59.3%	-0.8%
7	Fresno, CA Metro	204	37.5%	12.5%
8	Salinas, CA Metro	203	63.2%	6.6%
9	Sacramento-Arden-Arcade-Roseville, CA Metro	202	55.9%	13.6%
10	Vallejo-Fairfield, CA Metro	197	46.0%	21.5%
United States		130	6.9%	-4.2%

Table 1: MSAs with the Highest Mortgage Fraud Risk in Q2 2009

Table 1 also shows the Fraud Index change from Q2 2008 and Q1 2009. The United States Fraud Index declined 4% from Q1 2009 but increased by 7% from a year ago. The year over year increase reflects a surge in fraudulent activity in Q3 2008 that coincided with significant increases in unemployment as the economic crisis continued to deepen. A substantial increase in the Property Valuation Fraud Index was offset by significant declines in the Occupancy and Employment/Income Fraud Indices, an indication that type-specific frauds shifted in response to overall economic and market conditions. (See page 9).

Geographic Fraud Migration

Mortgage fraud migrates geographically to take advantage of local market conditions. This section examines the geographic migration of mortgage fraud within the 50 States and the District of Columbia over the last year.

Figure 2 depicts the Fraud Index for the individual states, with the ten highest risk states shown in red. Four of the top ten states – Nevada, California, Arizona, and Colorado – are in the West. Nevada has the highest mortgage fraud risk by far, with a Mortgage Fraud Index value of 245. California has the next highest risk at 176; Ohio, Florida, Minnesota, Massachusetts, Michigan and Maryland round out the top ten. Index values exceed the national value of 130 in an additional 4 states: New York, Hawaii, the District of Columbia, and Rhode Island. New Jersey’s value is at par with the national value; it ranks 15th in this Index.

The ten states with the lowest risk, shown in green, are West Virginia, Alabama, Mississippi, Kansas, Maine, Iowa, Louisiana, Montana, Arkansas, and Indiana. Note that West Virginia, Alabama, and Mississippi have index values of less than half the national value.

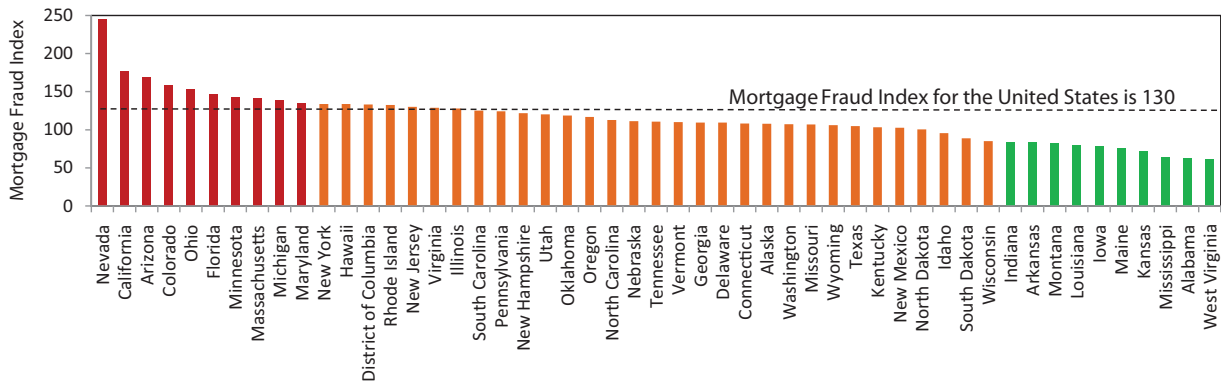
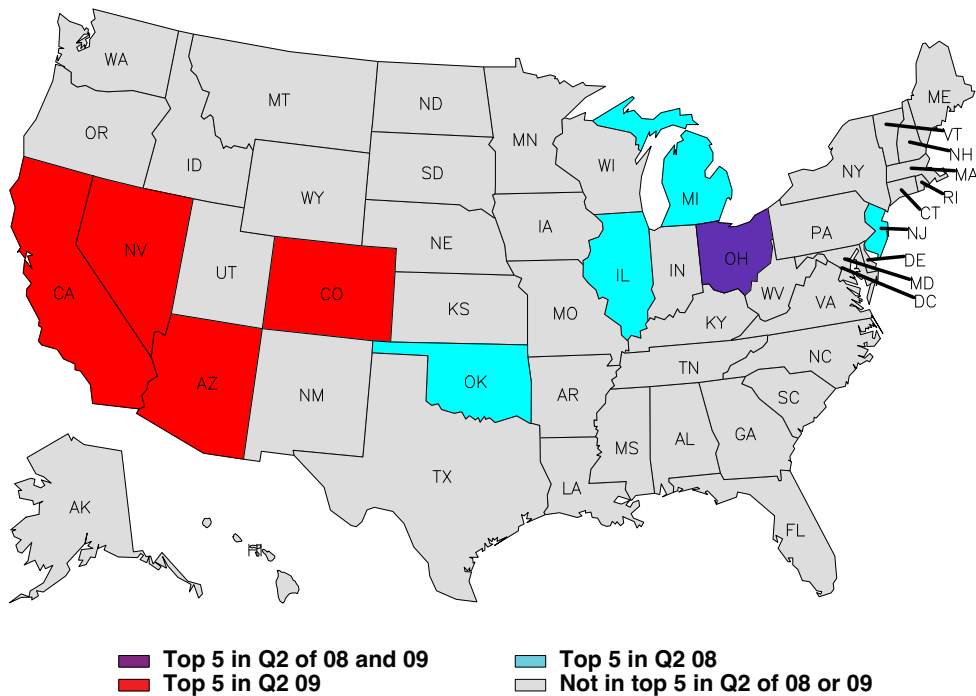
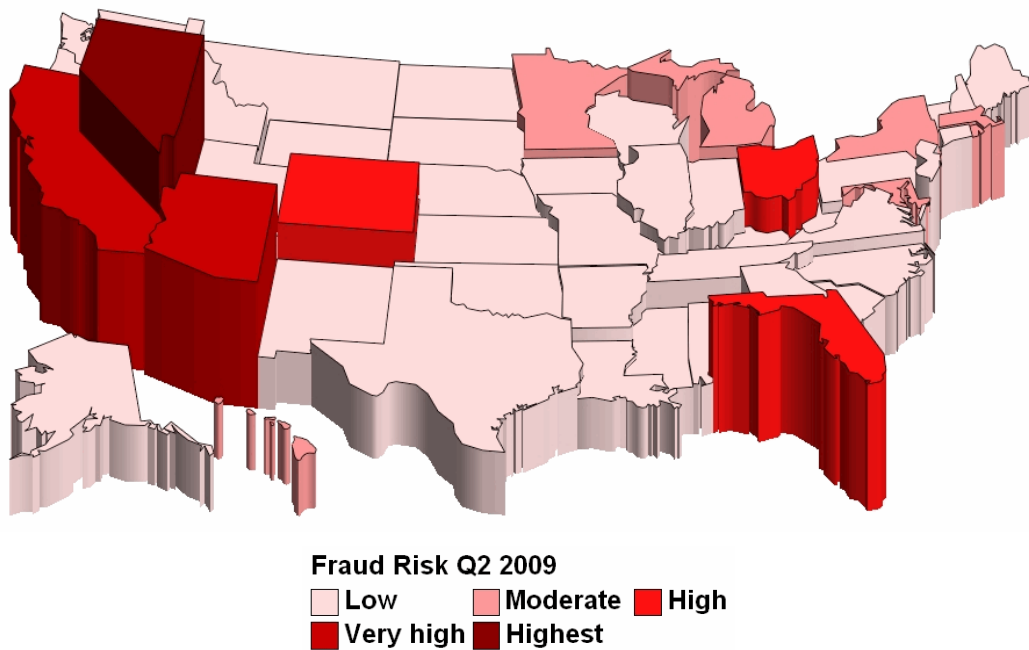


Figure 2: Mortgage Fraud Risk in Q2 2009 by State

There has been a significant geographic redistribution of the states with the highest mortgage fraud risk over the last year. Of the five states with the highest risk a year ago, only Ohio, which had the second highest index value, is still in the top five. The map in Figure 3 highlights the five highest risk states from Q2 2009 and from the corresponding quarter a year earlier. It shows a strong westward migration of high mortgage fraud risk from predominantly rust-belt states to predominantly sun- and sand-belt states. The average increase in the 4 high-risk western states –Nevada, California, Arizona and Colorado– is +43%, while the average decrease in the rust-belt states –Michigan, Ohio, Illinois and New Jersey– is -8%. This suggests that the redistribution is mainly due to the large increase in fraud risk in the Western states, not the decrease in the rust-belt. Also worth noting are the increases in fraud risk in Minnesota and Massachusetts, which now rank 7th and 8th on the Mortgage Fraud Index, up from 32nd and 26th respectively from a year ago.



The westward migration of mortgage fraud risk is associated with the high foreclosure rates in Western states. Figure 4 shows a strong correlation between the levels of mortgage fraud risk in Q2 2009 and foreclosure activity in 2008.¹ The darker colors depict elevated fraud risk; higher relief indicates a higher level of foreclosure activity. The strong correlation between regions with mortgage fraud risk and foreclosure activity is consistent with the increase in fraud schemes that seek to take advantage of opportunities presented in distressed markets, such as “flopping” (deflating short sale values in order to generate a profit margin on a subsequent flip at an increased value), builder-bailouts, and foreclosure rescue-related schemes.²



Relative three-dimensional elevation of states represents foreclosure activity in 2008 (from Reference 1)

Figure 4: Nationwide Foreclosure Activity 2008 and Mortgage Fraud Risk Q2 2009

Mortgage Fraud Risk as a Leading Indicator of Foreclosure Activity

Mortgage fraud risk is a leading indicator of foreclosure activity. Peak values in the Indices tend to precede peaks in foreclosure activity by one to three years, depending on the type of schemes that were prevalent when the loans were originated. While there is an extremely high correlation between fraud at origination and first- and early-payment defaults, the majority of fraudulently originated loans perform for at least one year in order to avoid the scrutiny that comes with premature defaults. In schemes involving investment properties and fraud for housing, the loans may perform for two to three years because the borrowers are trying to protect their credit ratings.

The predictive interaction between mortgage fraud risk and foreclosure activity during the past economic cycle is best illustrated by looking at Nevada over the past few years. Figure 5 shows the quarterly mortgage fraud risk in Nevada between 2003 and 2009 in terms of the Mortgage Fraud Index, as well as the annual foreclosure rates between 2005 and 2008.

In 2004, the Fraud Index for Nevada reached the highest levels ever seen in an individual state, peaking at 368. Figure 5 shows that Nevada subsequently experienced a sharp rise in foreclosure activity in 2006, while unemployment levels were near historic lows, and reached unprecedented levels of foreclosure in 2007, prior to the seizure of the credit markets in mid-year. Unemployment levels rose sharply in 2008 along with continued deterioration in economic conditions, exacerbating the foreclosure crisis and providing additional inventory for the current foreclosure-related schemes.

Figure 5 also shows that Nevada's Mortgage Fraud Index increased again in the latter part of 2008 and continued to be high into 2009, primarily due to a surge in the Property Valuation Fraud Index. Interthinx expects to see a new wave of foreclosure activity in Nevada in 2011 as today's fraudulently originated loans "season" into default. This trend will be compounded by the large number of adjustable rate mortgage resets that will occur between now and early 2012.

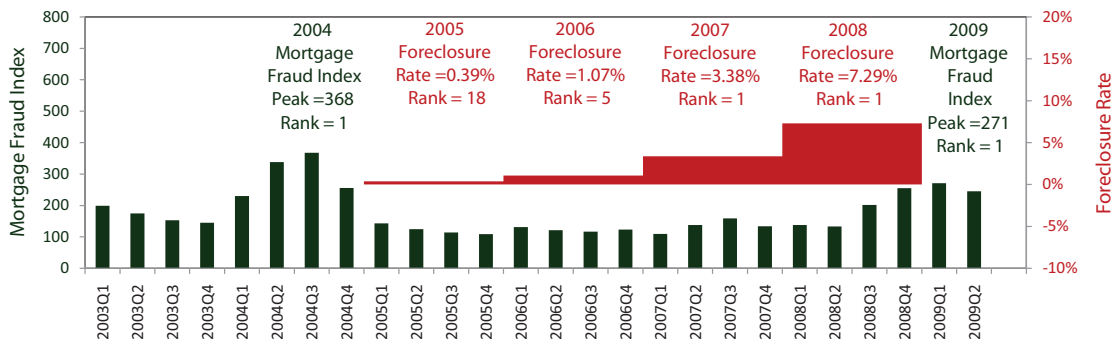


Figure 5: Mortgage Fraud Risk and Foreclosure Activity in Nevada.

Type-specific Mortgage Fraud Hot Spots and Trends

The dynamic nature of fraud is also seen in changes in fraud type. Interthinx tracks four type-specific fraud indices: Property Valuation Fraud Index, Identity Fraud Index, Occupancy Fraud Index and Employment/Income Fraud Index. This section examines the hot spots and trends for these type-specific fraud risks.

PROPERTY VALUATION FRAUD INDEX

Table 2 shows that the Property Valuation Fraud Index for the United States increased 56% over the last year as housing prices continued to tumble.³ This finding is consistent with the tendency for property valuation fraud to peak when housing prices are unstable. The five MSAs with the highest property valuation fraud risk, all located in Nevada and California, are also shown in the Table 2. These are also the states with the largest declines in home prices from their peak.³ In keeping with the large increase in the national index, the five riskiest MSAs all have extremely high index values above 500; by comparison, the United States value is 227. All top five MSA Property Valuation Fraud Index values have increased 250% or more.

Rank	Metropolitan Statistical Area	Property Valuation Fraud Index Q2 2009	% Change Since Q2 2008	% Change Since Q1 2009
1	Stockton, CA Metro	625	299.5%	66.4%
2	Modesto, CA Metro	603	267.3%	58.6%
3	Las Vegas-Paradise, NV Metro	559	416.2%	16.8%
4	Riverside-San Bernardino-Ontario, CA Metro	539	416.8%	73.1%
5	Bakersfield, CA Metro	503	442.2%	29.6%
United States		227	55.6%	15.8%

Table 2: MSAs with the Highest Property Valuation Fraud Risk in Q2 2009

IDENTITY FRAUD 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 Index increased by 9% during the last year. Table 3 displays the MSAs with the highest identity fraud risk, all of which are in high foreclosure areas. In particular, Stockton, Las Vegas and Fresno were respectively the MSAs with the 1st, 2nd and 12th highest levels of foreclosure activity in 2008¹. Nevada and California have the majority of the highest risk MSAs; the top five MSAs are rounded out by Grand Junction, Colorado, which is located in the state with the 5th highest foreclosure rate in the nation.

This data underscores the shift in fraud to markets with highly unstable property values.

Rank	Metropolitan Statistical Area	Identity Fraud Index Q2 2009	% Change Since Q2 2008	% Change Since Q1 2009
1	Las Vegas-Paradise, NV Metro	281	85.5%	-23.2%
2	Reno-Sparks, NV Metro	279	108.3%	-21.5%
3	Grand Junction, CO Metro	201	44.2%	-4.1%
4	Fresno, CA Metro	199	-9.7%	1.5%
5	Stockton, CA Metro	192	-1.9%	-4.5%
United States		136	9.1%	-4.7%

Table 3: MSAs with the Highest Identity Fraud Risk

OCCUPANCY FRAUD INDEX

The Occupancy Fraud Index decreased by nearly 25% over the last year, consistent with decreasing housing prices and more stringent underwriting guidelines, both of which work to discourage many would-be investors.

Despite this large decrease, there are significant hot spots of occupancy fraud. The three riskiest MSAs, all of which saw index values increase by more than 20%, are again in California and Nevada. Detroit, where extremely high REO inventories and extremely low property values have reduced or eliminated investors' need to obtain mortgages, saw a 22% decline in Index value. Ranked as the highest risk MSA last year, it dropped to 4th place in Q2 2009. The fifth most risky MSA, Miami-Ft. Lauderdale-Pompano Beach, also has an extreme oversupply of foreclosed properties. A significant portion of that inventory, particularly in the condominium market, is a legacy of the speculative frenzy and fraud in investment properties during the real estate boom. Florida's elevated fraud risk is persistent; it has ranked in the Top Ten in the Interthinx Annual F.R.A.U.D. Report every year since 2004.

Rank	Metropolitan Statistical Area	Occupancy Fraud Index Q2 2009	% Change Since Q2 2008	% Change Since Q1 2009
1	Stockton, CA Metro	156	20.6%	-25.1%
2	Reno-Sparks, NV Metro	144	49.6%	-22.9%
3	Riverside-San Bernardino-Ontario, CA Metro	144	22.9%	-11.9%
4	Detroit-Warren-Livonia, MI Metro	130	-22.1%	-29.3
5	Miami-Fort Lauderdale-Pompano Beach, FL Metro	125	-10.2%	-11.1%
United States		76	-24.5%	-19.9%

Table 4: MSAs with the Highest Occupancy Fraud Risk

THE EMPLOYMENT/INCOME FRAUD INDEX

The Employment/Income Fraud Index is also down sharply, by 33% (Table 5), reflecting an increase in housing affordability⁴ and the elimination of no- and low-documentation loan programs. Lenders' increasing reliance on income verification through tax transcripts obtained from the Internal Revenue Service, a change widely known to loan originators and other industry participants, also likely plays a role by discouraging potential perpetrators from attempting to misrepresent employment and income.

The decrease in the Employment/Income Fraud Index is evidenced by the “moderate” Index risk levels for the top five MSAs, which experienced only small increases or moderate decreases from the same period last year. These MSAs are in states with the highest (Michigan) and third highest (California) unemployment rates in the nation.⁵

Rank	Metropolitan Statistical Area	Occupancy Fraud Index Q2 2009	% Change Since Q2 2008	% Change Since Q1 2009
1	Madera-Chowchilla, CA Metro	147	17.2%	26.8%
2	Holland-Grand Haven, MI Metro	138	-21.4%	7.2%
3	Modesto, CA Metro	131	15.9%	-2.3%
4	Flint, MI Metro	121	-17.6%	19.7%
5	Monroe, MI Metro	121	13.3%	4.5%
United States		79	-32.8%	-14.6%

Table 5: MSAs with the Highest Employment/Income Fraud Risk

Extended Forecast

The Interthinx Fraud Indices have proven to be a leading indicator of foreclosure activity. For example, in the lead-up to the current mortgage crisis, the Mortgage Fraud Index for Nevada reached 368 in Q3 2004, far and away the highest level in any state. Nevada's foreclosure rate began to climb in 2006, during a period of nearly full employment and prior to the collapse of the credit markets. Nevada subsequently reached the nation's highest rate in foreclosure activity during 2007 and 2008.¹ Therefore, the regions that currently have high Fraud Indices are likely to have high foreclosure rates going forward, particularly if housing prices continue on their downward trajectory. Based on the Fraud Indices, regions that bear close scrutiny going forward include:

- Nevada: the Mortgage Fraud Index is fast approaching the previous highs of 2004 (Figure 5).
- California: which has 8 of the 10 MSAs with the highest Mortgage Fraud Indexes, most of which are concentrated in the inland regions of the state.
- Minnesota and Massachusetts: large increases in overall fraud risk boosted their Index rankings to 7th and 8th place respectively, up from 32nd and 26th place a year ago.
- Colorado: the North-South corridor, centered on Denver, which contains a number of high risk counties.

Interthinx also projects that while interest rates remain low, the predominant fraud type will continue to be related to property valuation as consumers attempt to refinance their mortgages despite reduced equity in their properties. Interthinx also expects the Fraud Index will continue to rise through 2011, reflecting a coming wave of ARM interest rate resets that will peak in early 2012.

About the Interthinx Fraud Indices

The Fraud 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 Indices consist of the Mortgage Fraud 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 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, 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.⁶ The time lag between origination and the SAR report can be several years. For this reason, the Interthinx Fraud Indices’ top fraud geographies and type-specific findings may differ from FBI and FinCEN fraud reports.

About the Interthinx 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 Indices. It is published quarterly, on the last day of the month following the end of quarter. As part of the Fraud Risk Report, Interthinx will report on the geographic regions with the highest Mortgage Fraud Index as well as those with the highest Property Valuation, Identity, Occupancy, and Employment/Income Fraud Indices. The Interthinx Fraud Indices track these risks in all States, Metropolitan areas, Counties and county equivalents, throughout the United States.

Questions or comments? Please contact Rick Grant and Associates to schedule an interview with an Interthinx fraud expert.

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About Interthinx

Interthinx, Inc., an ISO business, is a leading provider of proven risk mitigation and regulatory compliance tools for the financial services industry. Used at every point in the mortgage lifecycle to prevent mortgage fraud, compliance violations and to assess risk, Interthinx is relied upon by more than 1,100 customers, including 15 of the top 20 mortgage lenders and three of the top five largest financial institutions. With technology that earned Mortgage Technology Magazine's prestigious 10X Award as "a diagnostic and corrective solution of the highest order," Interthinx expertise in predictive analytics, data mining, and risk scoring sets the industry standard and directly increases the value of client portfolios. For more information, visit www.interthinx.com or call (800) 333-4510.

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