OPENING STATEMENT OF

SENATOR SUSAN M. COLLINS
CHAIRMAN

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

HUD's GOVERNMENT INSURED MORTGAGES:

THE PROBLEM OF PROPERTY "FLIPPING"

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During the next two days, the Permanent Subcommittee on Investigations will examine a type of mortgage fraud commonly known as "flipping." Flipping is a complex fraud that involves the purchase and then resale of property at greatly inflated prices. This fraudulent scheme increasingly plagues our nation's cities and victimizes first-time homebuyers. Indeed, the evidence gathered by the Subcommittee during its nine-month investigation suggests that flipping is spreading like a virus that, if left unchecked, could reach epidemic proportions.

Property flipping generally involves con artists who purchase dilapidated homes at bargain prices, usually in economically distressed parts of the city. These properties are then quickly resold at a tremendous markup – often 100% or more. It is not uncommon for "flippers" to buy and sell the same property within a few months, or even days.

In flipping schemes, the sellers frequently make cosmetic repairs to the property such as carpeting over damaged wood floors or painting termite damage so that it is not visible. They then sell the home to an unsuspecting purchaser, usually targeting low-income, first-time home buyers. The targeted buyers are normally unsophisticated people who have little, if any, experience with financial transactions, much less the real estate market. Through high pressure tactics, the sellers persuade these buyers to rely on them completely. They arrange for the buyers to obtain a mortgage loan, often by doctoring the buyers' financial and credit information. To support the grossly inflated sales price, the sellers usually obtain dubious appraisals from unscrupulous appraisers who are part of the scam.

After the buyers move into their new homes, they soon discover that the "total rehab" they were promised is little more than a crumbling relic. The dream of homeownership turns into a nightmare for the victims of flipping schemes. Our investigation found that many buyers are left with homes that are virtually uninhabitable. Others are forced to make costly repairs that they can ill afford. In addition, because the homes are sold at exorbitant markups, the buyers are saddled with mortgage payments that often exceed their ability to pay. The end result for these homeowners is often default and eventually the loss of their homes through foreclosure. While the property flippers walk away from the sale with a huge profit, the buyers are often left with no house, broken promises, and a tarnished credit rating.

During our extensive investigation, the Subcommittee staff interviewed scores of low-income home buyers who had been duped by property flippers. The tragic story of Gladys Hall, a 54-year old Chicago resident, illustrates how these scams work and testifies to the emotional and financial toll that results from this fraud.

In early 1996, Ms. Hall contacted a local real estate agency in response to a flyer that had been circulated in her neighborhood, urging her to "rent to buy." After speaking with a sales agent, she was persuaded to purchase a home owned by the real estate agency that was located in the South Austin area of Chicago.

At the time, Ms. Hall was unemployed, and her only source of income was Supplemental Security Income ("SSI"). Even though Ms. Hall had very limited means, the seller arranged for her to obtain an FHA-backed mortgage to purchase the house for $122,000. Property records indicate that the real estate agency had purchased the property twenty-two months earlier for only $11,000 – a markup of over 1,000 percent.

At the time of sale, the real estate agent assured Ms. Hall that his agency would thoroughly rehabilitate the home. Soon after she moved into the house, however, Ms. Hall discovered that the structure was leaning noticeably, the roof leaked, and the plumbing didn't work. In addition, even though the sales agent assured Ms. Hall that her monthly mortgage payment would be about $500, it soon skyrocketed to almost $1,000 because it was an adjustable rate mortgage. Ms. Hall told Subcommittee staff that, at the time of sale, she didn't know what an adjustable rate mortgage was, and that she did not understand that her mortgage payment could increase dramatically if interest rates rose.

Not surprisingly, Ms. Hall soon fell behind in her mortgage payments. In 1998, the lender foreclosed, obtained payment on the insurance from FHA, and returned the property to the Department of Housing and Urban Development ("HUD"). Ms. Hall is now living in a public housing project in Chicago. When HUD sold Ms. Hall's home in April of this year, it received only $24,990. FHA's insurance fund picked up the difference, incurring a loss of over $90,000. The Subcommittee staff sought to question the principals of the real estate agency that sold this property to Ms. Hall; however, those individuals asserted their Fifth Amendment rights and refused to answer questions.

Unfortunately, Ms. Hall's experience is not unique. We will hear testimony today from three witnesses who were victimized by flipping schemes similar to the one perpetrated on Ms. Hall. Moreover, HUD's Office of Inspector General reported in its report to Congress dated March 31, 2000, that it had uncovered "massive fraud schemes surrounding the origination of single family loans insured by HUD." Six months ago, a federal grand jury in Los Angeles charged 39 persons with fraudulently obtaining more than $110 million worth of FHA-insured loans through the execution of multiple flipping schemes that typically inflated the value of properties as much as $150,000.

And, two weeks ago, federal prosecutors in Fort Lauderdale, Florida, charged ten persons with fraudulently securing more than 200 FHA insured loans valued in excess of $17 million. One of the defendants has apparently told authorities that they targeted first-time home buyers in predominantly working-class, minority neighborhoods. The fraud ring followed a familiar formula: buy properties in distressed conditions at very low prices, perform minor, cosmetic improvements, and then resell the homes at drastically inflated prices to unsophisticated buyers.

I find it very troubling that so many citizens in our nation's cities have been victimized by the predatory practices of unscrupulous real estate agencies, appraisers, and lenders. But, what I find most appalling is that the federal government has essentially subsidized much of this fraud. HUD, through FHA, insures many of the mortgages that finance these fraudulent transactions, but the Department has been slow to act to curtail this fraud. A series of audits and reports over several years warned HUD repeatedly of the vulnerability of its mortgage programs to fraud.

When a lender forecloses on Gladys Hall and other flipping victims, it is fully compensated for underwriting the bad loan because FHA paid the insurance claims. Therefore, these flipping schemes often result not only in financial ruin for the buyers and their families, but also undermine the integrity of the FHA insurance fund by passing the tab for the fraud on to the federal government.

The unfortunate irony, of course, is that victims of property flipping are often the very people whom the HUD is supposed to help attain the American dream of home ownership. They depend on HUD to protect them from the predatory sales and lending practices that the Subcommittee's investigation uncovered. After all, without HUD's help, they would not have been able to obtain conventional mortgages to buy their homes; their access to the housing market depended on obtaining FHA loan guarantees. Surely, HUD has a duty to protect the unsophisticated home buyers who are the targets of these fraudulent sales and lending practices as well as to safeguard the integrity of the insurance fund.

The purpose of these hearings is to get to the bottom of this disturbing trend in mortgage fraud. In addition to examining the flipping schemes and the havoc that they wreak on families and neighborhoods, we will consider whether HUD should be held accountable for the recent growth in the mortgage fraud that has beset the single family loan program. We will also seek to determine what HUD and Congress should do to put a stop to these predatory practices which threaten the stability of many urban neighborhoods, and rob the FHA insurance fund.

I look forward to hearing the testimony of our witnesses. At this time, I would like to recognize the distinguished Ranking Minority Member, Senator Levin, for his opening statement.

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