Legal Times
WEEK OF DECEMBER 4, 2006 • VOL. XXIX, NO. 49
ALM

A Special Report
Real Estate

Beware the Predators

Unsophisticated owners can lose their homes in refinance schemes.

By Patricia A. Brannan
and Sharese M. Pryor

In every neighborhood in which property values have increased substantially, predators known as "mortgage investors" or "mortgage rescuers" are waiting. They are waiting to take advantage of unknowing and often financially unsophisticated homeowners, especially those facing financial hardships and possible foreclosure.

These predators offer promises of mortgage refinances that will allow homeowners to save their homes from foreclosure, take cash out from the equity they have built in their homes, and lower their interest rates, at almost no cost. Predators' signs are visible in American cities at major intersections, bus stops, and grocery stores. You've seen them: "Good Credit, Bad Credit—We Can Refinance You!" and "Save Your Home From Foreclosure With Just One Call!"

In reality, the goal of many of these entrepreneurs is to put in their own pockets the wealth, in the form of equity, that a homeowner has accumulated through long years of ownership and mortgage payments. Many unsuspecting homeowners have made phone calls to the posted numbers seeking a lifeline, only to find themselves in legal messes.

Consider the case of Lillie Mae Wynn-Tobler and Joe Tobler. Faced with a pending foreclosure, Lillie Mae and Joe, African-American homeowners who reside in the city of Opa-Locka, Fla., sought assistance from various businesses specializing in mortgage-refinance products and entered into a very strange transaction to save their home.

The result of the "assistance" they received from the mortgage lender they chose was a transfer of title in their home—and the equity they had built—from the Toblers to the wife of the lender's agent. Eventually, the Toblers' mortgage broker sought to evict them and their two minor children from the home. Hogan & Hartson, through its pro bono program, filed an action on behalf of the Toblers, challenging the lender's practices as violating the federal Fair Housing Act and various Florida consumer-protection laws. A second team of lawyers from Hogan & Hartson, along with the AARP Foundation and Legal Counsel for the Elderly, have been vigorously litigating similar actions in the District of Columbia since 2004 on behalf of elderly D.C. residents who were lured into signing away their homes to "mortgage investors" for a nominal value.

Three Typical Schemes

A 2005 report published by the National Consumer Law Center, "Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure 'Rescue' Scams," described the three typical "mortgage rescue" schemes as the "phantom help" scam, the "bailout" scam, and the "bait and switch" scam.

In the phantom help scheme, a business or individual promises a distressed homeowner either assistance in navigating the often-complex foreclosure process or representation in the foreclosure proceeding, in exchange for outrageous fees. In the end, the homeowner usually receives neither and loses the home.

The bailout scheme is characterized by an "investor's" promise to bring the homeowner's mortgage current, which may mean the payment of just a few months of overdue mortgage payments. In return, the mortgage investor requires the homeowner to transfer title to him or a third party. Homeowners are often led to believe that the investor or third party has better credit and can obtain a mortgage with a more favorable interest rate, which would lower the homeowner's monthly payment. The homeowner is then given a specified time, perhaps a year, to buy back the deed to the property. All too often, the investor eventually seeks to evict the homeowner in order to sell the home for a sizable profit.

The third scheme, arguably the most deplorable, is characterized by a greater level of fraud. The mortgage investor generally lures the homeowner into the scam with the promise of a refinance. Instead of refinance documents, the investor presents documents to the owner that transfer the title but leave the homeowner on the hook for the mortgage. The homeowner becomes a renter in the home, with the mortgage supposedly to be paid in the future by the investor.

This scheme is accomplished through various means: inundating a homeowner with piles of documents to sign; rushing the homeowner to sign quickly; and making false, incomplete, or misleading statements about the nature of the transaction. The investor may say the documents are just for the sake of form or accomplish results different than their terms. As troubling is the potential for victims of the "bait and switch" mortgage-foreclosure scam to violate their obligations to their original mortgage lenders. In order to protect their security interest in property, mortgage lenders typically require a loan to be paid in full upon a transfer of title. A scheme to transfer title without paying off the loan and without the knowledge or consent of the mortgage lender could constitute a breach of obligations to the mortgage lender.

Who's the Target?

Potential targets for mortgage-foreclosure-rescue scams are easy to find. Foreclosure proceedings are announced in public records. Mortgage "investors" can easily obtain lists of homeowners, their addresses, and other important information in court or other public documents. Victims are often vulnerable due to illness or other setbacks in life, and predators try to rush them to sign documents when they are frightened and on the brink of becoming homeless. These "investors" tend to favor in-person approaches with minimal, if any, time or opportunity for homeowners to review documents or have them reviewed by family members or legal services providers. Mortgage "rescuers" have been known to target minorities, low-income consumers, and the elderly with predatory and often discriminatory practices. Homeowners facing foreclosure should be very wary of companies and individuals that offer to "save" their home. Offers that sound too good to be true generally are.

Lawyers and social service providers in contact with likely victims should be alert to these schemes, discuss them openly with those they assist, and insist that any client considering signing anything regarding their home find legal help any way possible. In fact, attorneys might even consider offering basic information programs on homeownership, mortgages, and legal interests in real property, which can be very valuable and are good pro bono projects for lawyers with relevant expertise. Even individuals of very low income may have a home that is of significant value. The more these consumers know about their interests and obligations, the better armed they will be to protect themselves.

Another danger area involves potential homeowners. Over the past few years, homeownership among Americans has increased, but so has the incidence of mortgage foreclosures resulting from subprime and unconventional loan financing. Banks and other mortgage lenders have developed creatively structured (although sometimes aggressive) mortgage products such as alternative adjustable-rate mortgages. These loans allow buyers who otherwise might not qualify to become homeowners, but they are usually more difficult to maintain in a challenging economic climate.

With such mortgages, many homeowners are able to purchase homes with lower monthly payments than they could afford using more traditional mortgage-loan products. A turn in the housing market and the interest-rate environment, however, can cause payments on the newer adjustable products to skyrocket out of the range of affordability for many homeowners. Homeowners unable to pay the increased payments and unable or unwilling to sell their homes early in their time of financial hardship often find themselves facing foreclosure and thus vulnerable to mortgage-foreclosure-rescue scams. It is estimated that one in five homeowners placed into subprime mortgage loans may lose their homes.

Not all foreclosure-rescue businesses are as ill-intentioned as those described above, of course. It is possible that the unsophisticated investor, much like the innocent homeowner, does not understand that various federal and state laws come into play in any transaction that could be characterized as a loan or refinance. In fact, a separate entrepreneurial venture has emerged from the mortgage-foreclosure-rescue scam market—courses designed to teach the techniques and tactics of the foreclosure rescue. Eager entrepreneurs, often looking for ways to purchase property with little or no money down, are taught to profit from the foreclosure and pre-foreclosure market. Real estate entrepreneurs are entering into a highly regulated environment with considerable legal risk when they loan money to save homes from foreclosure. They need sound legal advice before considering any venture that profits from homeowners in or facing foreclosure.

Lawyers should also be extremely wary about closing or otherwise assisting in transactions in which the documents are not consistent with oral representations or the pieces of the deal just don't hang together. Lawyers and other professionals involved in these closings have found themselves facing lawsuits. Ethics proceedings and criminal prosecution are not outside the range of potential consequences for professionals who assist in the fraudulent transfer of title to a home.

It is hard to believe that no lawyers have been complicit in many of these schemes, fully understanding that the homeowners were being duped. At best, some lawyers may be trying to stay ignorant of the representations being made to the homeowners and the federal and state laws implicated by these transactions. Those laws are complex and important, and they include state deceptive-trade-practices laws, loan-shark laws, consumer-credit protections, federal civil rights laws, and even the Racketeer Influenced and Corrupt Organizations Act. Lawyers should be on high alert for these transactions and should refuse to assist when the deal is just too good to be true for the lender and too bad to be true for the homeowner terrified of foreclosure.

Mortgage-foreclosure-rescue scams have become a new form of economic injustice. Mortgage "investors" who exact titles to the homes of vulnerable citizens cause considerable harm to homeowners facing homelessness and to society as a whole. The social and economic advantages associated with homeownership are critically undermined by these types of scams. Moreover, the effects of these malicious schemes tend to fall the hardest on the homeowners and communities that can least afford it.

Society simply cannot afford to take little action to protect homeowners. Most importantly, however, homeowners cannot afford to be uninformed. Homeowners should cautiously proceed with any deal that sounds too good to be true—because it usually is.

Patricia A. Brannan is a partner and Sharese M. Pryor is an associate in the D.C. office of Hogan & Hartson. Brannan is the partner in charge of the firm's community services department and Pryor is a member of the firm's community services, litigation, and communications practice groups.