The Solari Report

March 7, 2019

Your Mortgage: Financing Your Home Without Falling for Fraud with Marie McDonnell

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C. Austin Fitts: Ladies and gentlemen, welcome to The Solari Report. Today we have something very enlightening for you. Marie McDonnell who I've known for several years, joins me today. She is the President and CEO of McDonnell Analytics, sometimes called McDonnell Property Analytics, which is a firm in Massachusetts. She is a Mortgage Fraud And Forensic Analyst, a Certified Fraud Examiner, and a Master Analyst In Financial Forensics.

She has over 32 years of experience in mortgage and transactional analysis, mortgage auditing, and mortgage fraud investigation. She helps individuals who want to make sure that their mortgage is properly originated. She provides services for attorneys nationwide on mortgage-backed securities and foreclosure forensics, and she also advises and performs services for county registers of deeds, attorneys general, courts, and other governmental agencies.

Basically, I will tell you that if you are involved with mortgage litigation, you had better have her on your side. I would not want to be opposing counsel and see Marie walk in and sit down on the other side. I would truly be afraid.

Marie McDonnell, welcome to The Solari Report and we are so glad that you are joining us today.

Marie McDonnell: Thank you, Catherine and I really appreciate that introduction. It makes me laugh because frequently we hear from the attorneys that we are working with that they are so glad we are on their side.

Fitts: It's unusual because I thought that I had seen more mortgage fraud than just about anybody. But, of course, I saw it from the point of view of somebody running a $300 billion portfolio. The things that I've seen, the fraud is so bad, and it's so amazing and so over the top and nonstop.

I always say, "No one will ever understand it." Then I see you and realize, "Oh, no. You've seen far more than I have!"

It's psychologically relieving to be with you. I should point out that in our discussion, we are going to be talking about your mortgage and financing your home without falling for fraud.

I really believe that you are on the side of the people, and I am so thrilled to have you here to help us understand how to originate a mortgage without getting 'taken to the cleaners'.

Let's just dive in. The three areas where we can be defrauded on a mortgage are: 1) In the process of applying, 2) In the process of closing, and 3) The next 30 years before we pay it off.

Tell us how you would like to begin.

McDonnell: First, I think that it is important for your listeners to understand how I came about doing this work. It all began in about late 1986 or early 1987 when I decided that I wanted to understand the creation and retention of wealth. Living on Cape Cod in Massachusetts, real estate seemed to be a natural subject to study for that purpose.

I became a real estate salesperson, and I interned for one year before I could get my real estate brokerage license, which I did. I decided to undertake a very aggressive education in order to really qualify myself to work in this area.

Within the first few weeks of 1987, I took a week-long intensive course sponsored by the National Association of Realtors. It's their graduate realtor institute designation program. On day two they taught a class, 'The Financial Calculator'. That really changed my life.

From then on, I began to look at the amazing power of owning and controlling real estate and how over time the 'eighth wonder of the world', which is 'the power of compound growth', could really build wealth. But I realized that if you are going to understand how the laws of compounding can create wealth, you need to understand how the laws of compounding can be used against the property owner to deplete that wealth.

Of course, that led me immediately to want to study real estate financing and compound interest and how that interest portion of your monthly mortgage payment can consume 100% based on the current mortgage products that have been introduced over the last 15 years or so.

In any event, that was one thing. I wanted to understand the financing side of a real estate transaction. But then I also realized, "If you are sitting down at the real estate mortgage closing table, and look around the room and review your HUD-1 Settlement Statement, which has all the accounting for the transaction, and you see who is getting paid, it is everyone on the other side of the transaction from the buyer/ borrower".

I realized that even if a consumer hires a real estate attorney to help them through a real estate and mortgage closing, they don't understand the financing transaction. When I looked around to see who was helping consumers with this, there was no one.

I decided that I needed to do something about that. I made a bargain with myself back in those days –in early 1987. I thought, "Once my children are on their own, I could move to Boston and use my skills and knowledge to become involved in very sophisticated real estate transactions and financing transactions, or I could figure out what every homeowner's problems are, figure out how to solve those problems, and maybe one day, millions of people would pay a small sum to learn what I know." That was the bargain that I made with myself back then.

So, I undertook the study of real estate and real estate financing with a view from the consumer's standpoint. Also, what was motivating me as a mother and a single mother raising three children on my own, was that I realized how fundamentally important 'home' is to a family. I could see what was going on around me, and how the very fabric of society was unraveling through various legislation and political factors.

The culture was changing, and I understood that one way a family is broken up is through facing a sustained financial pressure that involves losing the roof over your head. I really wanted to do something about that.

Foreclosure intervention and prevention was very much a part of my mission from the very beginning. At that time-in the late 1980s-and as I looked back at the mortgage loans that people had obtained over the last few years, this was all in the midst of the savings and loan crisis. So, I really studied that period of time because there were some very important legislative changes in the early 1980s that created a paradigm shift in the mortgage lending business that the average person had absolutely no knowledge of.

In 1982 there was a very important piece of legislation passed by Congress under the Garn-St. Germain Act. One of the things that legislation did was to create a new breed of Federal housing creditor who could make mortgage loans. So just imagine up to that point in time, your local bank and even the national banks, could only make mortgage loans within their depository base. But with this legislation in 1982, they could create mortgage subsidiaries and lend anywhere in the country.

This really was the beginning of this major paradigm shift in the mortgage lending business. Of course, another part of that legislation was the Alternative Mortgage Transaction Parity Act. This allowed a variety of different types of creative mortgage products that created an artificial economy for the consumer so that they could qualify for more expensive loans.

Until that point, the 30-year fixed rate mortgage was the standard. When you introduced an adjustable rate mortgage product or a graduated mortgage product where you could lower the monthly payment for a period of time by offering an introductory 'teaser rate', then suddenly the consumer – although their income has not changed or increased – could qualify for a lot more money.

You can see then how these mortgage products helped to facilitate the boom in housing. I actually did the statistical analysis in Massachusetts for the decade of the 1980s, and from the beginning of that decade until the end, real estate prices in Massachusetts tripled. This was at a time when wages were stagnated.

In any event, I observed that these types of sophisticated mortgage products, which were not well understood by consumers at the time, as they began adjusting up to market rates that would trigger a mortgage default. Why is that? Because their income hadn't changed and as interest rates adjusted up to market, the monthly payment was just unaffordable.

In 1991 I decided to change my business focus from Marie McDonnell Real Estate Counselor to 'The Mortgage Counselor'. As I introduced that business through a free public seminar – where I had standing room only attendance – I began focusing on auditing mortgage loans. Of course, nothing like that really existed formerly. So, I had to teach myself how to do this and how to really analyze these mortgage products so that I could understand every single element of the terms expressed in the mortgage note.

Because there was no off-the-shelf software available for me to actually mathematically analyze these loans, I figured out how to program the various types of mortgages in an Excel spreadsheet. I have evolved that into an analytical tool for every single type of mortgage in existence today. They are tried and true, and this has allowed me to really analyze a mortgage transaction throughout the life of the loan.

This brings me back to your introduction and what we do here. So, the thing that we like to help people out with first and foremost, is if they are considering buying a home and taking out a mortgage to help to fund the that home, we like to counsel with them ahead of time so that we can show them what is truly going to be affordable for them.

We also want to follow the paperwork from the loan application process through to the actual closing of the real estate transaction and make sure that the type of loan and the terms of the loan that they have applied for are what they end up getting at closing. So often we find that there was a bait-and-switch on the loan terms by the time consumers get to closing, and they can end up signing paperwork that represents a much more expensive and risky mortgage product than what they had bargained for.

So, it's very important to analyze that transaction from the application to the closing. Then, of course, much of the industry has been developed to help people get to a real estate and mortgage closing. You have the real estate industry and the mortgage industry now populated with all kinds of mortgage brokers and mortgage companies – these Federal housing creditors. You also have your local community banks, of course, and your national banks.

In any event, there is a lot of help for the consumer in getting to a real estate and mortgage financing closing, and almost no help for the rest of the 30-odd years that the consumer is going to be paying on that mortgage loan. So, we also help people through that process.

One of the other big changes that has taken place over the last 30 years or so in terms of the evolution of the mortgage lending and origination industry, is that the mortgage loans are no longer being held by the bank or the lender who originated the loan; they are being sold and securitized – and I will explain securitization shortly. This results in a third party being introduced into the situation when the loan is sold off into the secondary mortgage market. That is the servicer. The borrower has absolutely no control over who services their loan.

Many of the servicers who are out there in the market these days have made mistakes, or in some cases they have created a new profit center out of manufacturing defaults that would trigger a late payment that they get to keep. When a loan goes into default – when people start falling behind in their mortgage payments – there are a number of types of fees that the mortgage servicer will begin to impose. This can create a big problem when the consumer tries to figure out how best to pick up those payments or when they challenge the payments.

One of the things that we do here at McDonnell Property Analytics is examine that mortgage transaction, figure out what went wrong and why and whose responsibility it is, and then we will oftentimes intervene with the mortgage servicer and try to help them straighten out the problem.

In any event, that is just a little about what we do here and the types of problems that consumers can face as 'life goes on' from month to month and they make those mortgage payments.

One of the things that I really want to impress upon your listeners and viewers, is how important it is for homeowners/borrowers to preserve their loan origination documents.

Fitts: I need to stop you because I will tell you – having been through more than a few mortgage closings in my life – that the documentation is overwhelming if you've never done a mortgage before. It is incredibly important that you know what all the documents are. I think that it is incredibly important you have somebody review them.

The next time that I do it, I am hiring you. I've always had an attorney or someone who is an expert who is reviewing and making sure that the documents are correct.

I want to point out that you provided us with a document checklist. It's going to be in the subscriber links, and it is excellent. I have to say that all the resources that you have provided are going to be in the subscriber links there.

I 'beat the drum' about this all the time on how important it is to have your documentation.

There is a document custodian checklist for the closing file in the links. If you are doing a mortgage closing, you want to familiarize yourself with what all the documents should be. Then you want an expert to review them. Then you absolutely want to make sure that you have the file and that you keep this file up to date.

You may have this mortgage for up to 30 years, and if you have perfect documentation, then most of the fraud that can happen can't touch you- but you have to have the documentation.

McDonnell: You are so right. My ability to assist a homeowner in trouble with their mortgage loan is going to be in direct proportion to the documentation that they can provide to me. I know that the process of applying for and closing a mortgage loan can be extremely stressful. Once people get through that process, most of them never want to see that paperwork again!

This is part of the mortgage counseling. When I am talking to people and ask them, "Do you have those original loan documents that you received at closing?" they will say, "No, I haven't seen those in a long time."

I tell them, "You need to look in the basement, look in the attic, look in the garage, and look anywhere you can. Those are so important."

They will do that, and often after I coach them and try to trigger their memory as to where those might be – voila- they turn up. I can tell you that sometimes there is just one piece of paper and a stack of documents that gives me the ammunition that I need to do some very powerful things.

Fitts: I'm going to tell my story now. I did a mortgage- not my current mortgage, but a mortgage I did before. I bought my house for cash, and then later did a mortgage to finance the business. They would transfer that mortgage to a new servicer anywhere from every two to six months – maybe two to eight months. The reason was that they had a much better chance of defaulting me if they could transfer.

It was transferred to try to induce a default. Then when they couldn't induce a default, it would be transferred again.

I can't tell you how many times they transferred that mortgage. I had an attorney and a bookkeeper, and was set up with a checklist to make sure they couldn't default me.

We used to authorize them to get the payment electronically, but we would also send them a check so that they had two forms of payment and they couldn't say that we hadn't paid. Of course, we would send things Priority Mail with tracking, and we would have multiple copies. They were up against a team of people.

Finally, the last time that they tried to do it, I was on the phone with the person working for the servicer. I was laughing because she had no idea who and what she was up against. I said, "You have to tell us how much you get? What is your commission for defaulting a person?"

We started to laugh, and I think that she finally realized, "Oh my God! I'm up against some experienced talent here." You could tell that she started to be afraid.

If you look at how much brainpower they have to try to intentionally harm you, you realize that it's like going into war without weapons. Your documents are your weapons. You are in a war zone, and you have to be very, very careful. You can't afford to take a mortgage out and not have the documentation, and you certainly can't rely on them.

I have seen cases where they make a fake document. So, you have to have the original documentation.

McDonnell: Everything that you are saying is so true. We have the war stories here to articulate how that happens in any number of ways to our clients.

You often talk about how humanity is really being harvested. Well, definitely that is absolutely what is happening with these mortgage finance products. This is why you have to be very careful about what you sign onto. The way that the court is going to look at it is: Well, you signed the document. You are expected to know what is in these documents. And you got money, didn't you?

On the other hand, I can tell you that some of the more sophisticated mortgage notes that were devised and really fueled the ramp-up in the housing bubble at the turn of this millennium are so complex that even you could not read that note and understand how it would function. You can't and you have to be able to do the math.

Fitts: That is what I usually do. I have to convert it to an algorithm and look at the mathematics.

Many people don't want to spend the time to do that. Once you understand that you can't trust the process, then if you don't do it, you get somebody who can.

Let's go back to the origination versus closing. I do think that it is possible for any person who is entering into a mortgage to hold themselves to the discipline of finding a reputable mortgage firm.

In other words, you can screen out a lot of 'bad guys' by making sure that you are doing business with someone who is highly reputable regarding the origination. You may not be able to do that in terms of the servicing carriers because the institution that you are working with may sell the mortgage, or the institution could be sold. So, even if I go to a community bank that is going to hold the mortgage on the balance sheet, I could end up with that mortgage being sold or the community bank being sold.

Certainly I as the consumer, can do a great deal to make sure that at least the origination process and the initial closing is with reputable players. Wouldn't you say that that is true?

McDonnell: Yes it is very important. Also among our war stories, we have many cases where our clients will tell us that their mortgage broker was a relative or a friend. These are the people you expect to be able to trust, and yet some of the situations that friends and family have placed people in are just horrendous.

The consumers have to discipline themselves. You have to be a bit of a 'don't wanter'. In other words, much of this whole process of buying a home and obtaining the financing to make that dream comes true or refinancing your home, perhaps to take out some cash equity, is very emotionally driven.

It is important to have the type of discipline that one would need to be able to go on a diet. You just have to resist.

Fitts: Do you know what it is? You have to budget the time to learn about how to do this.

McDonnell: Absolutely.

Fitts: It's more time-consuming than you would think, but you just have to budget your time.

One of the links that you have provided is a glossary of terms. I find the key to understand a mortgage or a set of closing documents is to understand the terms used and you have a great glossary of terms. I think that having definitions of all the different terms used in a mortgage is 'step one' to understanding how they work.

In one of the documents that you provided, you analyzed the key mortgage origination documents. We are not going to do that here, but I am going to provide that documentation so that somebody can walk through them.

Before we go on to pitfalls, is there anything that you would want to point out about the key mortgage documents?

McDonnell: Yes, I would. There are a few things that people are unaware of, even if they have had mortgages in the past.

For example, the most important consumer protection act enacted by Congress that relates to the mortgage loan origination process is the Truth in Lending Act. Those are lovely words, however, these days there is very little 'truth' in lending.

Depending upon when you took out your mortgage, there was a standard form that had to be used to disclose the cost of the credit for which the consumer applied.

It was called a Truth in Lending Disclosure Statement. As a result of the Dodd-Frank Consumer Protection Act of 2010, a new type of disclosure now exists as of October 2014. So, if someone has taken out a loan very recently, they are going to have a different type of form, which is a Truth in Lending Act and Real Estate Settlement Procedure Act combined disclosure. The acronym for that is the TRID disclosure. Most of the older transactions will have this Truth in Lending Disclosure Statement.

There are four Federal boxes at the top that give you critical information about the mortgage loan. One is the annual percentage rate and then there is the finance charge, which is how much interest and points you are going to be paying as a dollar amount over the life of this loan. The amount financed is going to be the principal amount of the loan that you borrowed minus your upfront points and interest expense. Then, of course, there is the total of payments that can be two, three, or more times the amount of money you originally borrowed, which is frightening.

It will also have the schedule of payments. So, if you have a fixed rate loan that will be quite simple. It's a level monthly payment throughout the entire term of the loan. But if you have some sort of an alternative mortgage transaction – like an adjustable rate mortgage loan, an interest only loan, or a pay-option adjustable rate mortgage with a negative amortization feature- you are going to see the schedule of payments change from time to time. That is a very, very important document.

One of the reasons it is so important is that in situations where the homeowner is refinancing their primary residence, most people will know that they have a three-day 'cooling off period' or right to rescind that transaction. That is to provide a bit of a breather so that if the consumer signs those loans documents at the closing and then changes their mind because there is something about that transaction that they don't like, they can cancel it within three to five days after the closing.

What most people never find out about is that the three-day rescission period can be extended up to three years under certain circumstances. Consider for a moment if you take out a loan, and there has been a bait and switch at closing, and suddenly you find that you have a higher interest rate, the monthly payments are going to be unaffordable, but you feel trapped, and you don't rescind the loan within the three business day rule. Let's assume that two to three years later, the monthly payments have increased to an unaffordable level, and you are about to default, or maybe you are in default, and you are trying to figure out what rights you might have to deal with that situation.

When I examine a loan in that situation, the first thing I will do is conduct a Truth in Lending Analysis where I look at the original Truth in Lending Disclosure Statement and the HUD-1 Settlement Statement, which has the breakdown of costs, and I will also review the three-day Notice of Right to Cancel the transaction. I will examine those three documents that had to be given to the consumer at the closing; and if there are certain defects in those documents which, if they exist, would trigger a right to rescind for up to three years from the date the paperwork was signed.

Some of those defects could be the Notice of Right to Cancel-which is a form to actually rescind the loan-and was not properly dated, or you were not provided with two copies of the Notice of Right to Cancel for every borrower who signed the mortgage. Since I'm very mathematically focused, I also look at the Truth in Lending Disclosure Statement. In defense to a foreclosure, I would only need to find a $35 understatement in the finance charge, and that would trigger that three-year right to rescind.

For a consumer facing foreclosure, if a defect exists in those loan closing documents, they have a very powerful right. Once the loan has been rescinded, it voids the transaction from the inception and it extinguishes all of the finance charges.

For example, let's assume you took out a $100,000 loan. Let's say that over two and a half or three years you've paid $30,000 in mortgage payments with very little going to principal, and most of it going to interest.

If you have a three-year right to rescind because of defects in those documents, you file the notice that you are rescinding the transaction, and within 20 days the lender has to return all the money that you paid in, and they have to file a discharge of that mortgage. Once they do that, you then have the obligation to pay back the money that you borrowed. But if you net out $30,000 from $100,000, now you only need to pay $70,000.

The important thing is that you are out of that bad transaction.

So maintaining these loan origination documents is absolutely vitally important, and we recommend that people also make electronic copies of their loan origination package. The paper documents are so important.

Here is an example: I have a client right now in Aspen, Colorado. I will be flying there in a couple of weeks to sit for a deposition. Litigation is ongoing there because I am going for that deposition. He is challenging who really owns his mortgage loan.

The mortgage servicing company filed with the court what they claimed to be the original wet ink promissory note that my client signed at closing. We are challenging that on a couple of different bases. I have one document that my client received from the closing that has his original blue ink signature on it, and he has a copy of his HUD-1 Settlement Statement that was signed by the closing agent, my client, and his wife.

I will now compare that document and his wet ink signature with the note that is filed with the court. There are a number of reasons I believe that what has been filed with the court is a digitally altered forgery. The fact that I now have a document that has his original signature signed with the same pen would allow me to first of all, compare it using some magnification device, but we could also send both to an ink chemist who would be able to determine with certainty whether or not that note is original.

Also, the paper is very important. The copies that the borrower took from the closing should have been printed on the same paper quality as the original note, the mortgage, and so forth.

It is really those original documents that help us to distinguish whether or not a forged note is being presented to the court either in a foreclosure action or civil litigation over some dispute.

It's vitally important and in addition of course, to maintaining those loan origination documents, we really want people to keep every single monthly mortgage statement. They should keep their real estate tax bills, their homeowner's insurance premiums, and everything connected to the servicing of the mortgage loan, and keep those from year to year in a file. We encourage people to keep it in a paper file as well as an electronic file. The reason for that is because if there is a dispute over whether or not the servicer credited the borrower's mortgage payments, we can look back at those original computer-generated authentic records to understand where the mortgage loan accounting stood at any given date, whereas what is being produced these days by mortgage servicing companies as a 'payment history' can be manipulated.

The borrower has to become their own document custodian.

Fitts: They really do. I can't tell you how often I've heard from you and from a variety of attorneys that they will ask for the basic documents – not just the documents issued at origination or at closing, but the last ten years of payments, etc.

What the consumer doesn't realize is that whether it's the courthouse, whether it's the mortgage company, or whether it's the servicer, nobody else is keeping records. They are reserving the right to say, "After three years, we dispose of them," or whatever.

If you don't have them, you can't depend on any other party to have them, even if they are not fraudulent. If they are fraudulent, they can't make it up.

Before I called you, one of my colleagues and I were just laughing about the stories of people who have had their houses foreclosed on even though they didn't have a mortgage on their house. They had to prove that this fraudulent mortgage is nonexistent. It's ridiculous.

Let's move to the pitfalls. We are going to do it briefly, but I want to go through all the different kinds of frauds that exist. There is Application Fraud. I'm assuming that is when I apply, but the lender cooks up my application. Is that what you are thinking of?

McDonnell: We have so many cases where we are looking at the loan origination documents. We are looking at the original loan application, and we are talking to our client who, perhaps, is working in the hospitality business or the cleaning business or something like that. We look at the application in terms of what is being represented as their monthly income, and we see $20,000 a month.

The disparity between a reasonable wage earner in a particular classification of industry versus what we see on some of these applications is just outrageous.

Fitts: Nobody should sign an application that they haven't read, and they shouldn't sign it until they know that everything is true and correct.

McDonnell: Exactly. Many of our clients have presented their W-2 statements and their tax returns as verification of their income, but a bait and switch happens, and they end up unknowingly signing an application as part of the loan closing package that has very different figures on it.

The application can be altered by the mortgage broker or even by the underwriting department of the lender to get the loan approved. Sometimes we see assets appear.

Fitts: Have you ever seen a situation where the borrower signs the application and the application is true and correct, and then it is changed without them knowing or having an opportunity to re-sign it? In other words, it has been changed in a fraudulent way.

McDonnell: Yes, absolutely.

Fitts: How do you catch that? Is there any way it can be caught at closing?

McDonnell: Yes. It's important for consumers to know that under Federal law, within three days of your submitting a mortgage loan application to a lender, that lender is required to send you (within three business days) early disclosures.

Prior to the change in 2014, you would see a good faith estimate of settlement of costs, and a Truth in Lending disclosure statement. If you applied for anything other than a fixed rate loan, you would receive loan program disclosures explaining how that loan was going to work.

It's very important to keep those early disclosures and bring those early disclosures to closing. That gives you an immediate opportunity to compare the good faith estimate with your HUD-1 Settlement Statement, to compare your early or preliminary Truth in Lending disclosure statement with the final version, and to compare your original application with the final application that you are being asked to sign at closing.

If there are significant discrepancies between the early disclosures and the final disclosures, you need to stop the process immediately.

That is something that the borrower has control over. They need to take their early disclosures to the closing and compare them before they start signing those documents.

Fitts: The next pitfall is Appraisal Fraud. Is it typical that appraisal fraud occurs without the borrower realizing that the appraisal is being 'cooked up'?

McDonnell: Yes. I would say that most of the time that would be true.

The appraisal fraud can either be inflating the value of the property in order to maximize the amount of money the borrower can apply for, or I also have other cases where the appraisal came in too low. That resulted in them squeezing the borrower because they couldn't borrow as much money as they actually needed, for example, to start construction. It would seemingly justify putting them into a higher priced loan because the loan to value ratio is too low.

Appraisals fraud can either inflate or reduce the true fair market value of the property to achieve certain objectives of the lender who is controlling the appraiser.

Fitts: Next are the Bait and Switch Schemes.

McDonnell: We talked about it a little earlier. That is where the borrower applies for one type of mortgage product, like a fixed rate mortgage at a certain interest rate on certain terms, and then at the closing find out that they are being placed in a high-priced adjustable rate mortgage that is considerably more expensive, has higher points, and so forth.

There are all kinds of versions of the bait and switch schemes that we see, but essentially the expectation of the borrower who applied for a loan on certain rates and terms is surprised at closing with a completely different product which, of course, is never more beneficial to the borrower. It is always less beneficial.

Fitts: Next is Breach of the Implied Covenants of Good Faith and Fair Dealing.

McDonnell: That would go along with a Bait and Switch or where early disclosures represented a certain loan amount financed at a favorable interest rate and on favorable terms. Those early disclosures have to be offered in good faith. So if, in fact, the lender will not approve you for the loan that you applied for initially, it has a duty to send the borrower a letter of declination saying, "Sorry. We can't approve the loan that you applied for," and give the borrower an opportunity to resubmit an application on different terms.

When, in fact, you've applied in good faith, the lender does not deny your loan application, but then at the closing produces a completely different product. Well, that isn't good faith and there would be a breach of duty that is implied in every contract, "To act in good faith."

Fitts: Equal Credit Opportunity Act Violations.

McDonnell: This is another Federal statute that requires the lender not to discriminate against an applicant on the basis of race, color, or a litany of other issues. It's not only whether or not they are going to approve that mortgage loan application, but what we see frequently – and this is very-well documented in various studies – is that African-American consumers of a certain credit quality, when compared to a Caucasian individual, will receive a loan priced at higher rates and on less favorable terms.

The Equal Credit Opportunity Act can be very powerful. Often those claims are brought as class action suits.

Fitts: Forged Loan Documents is the next one. This is the one that scares me the most, especially if they are forging them around you and behind your back.

McDonnell: There are all kinds of stories that we can tell about forged loan documents. There are some cases we have come across where the homeowner never took out a mortgage loan, but someone else – possibly a relative or another fraudster – impersonated the property owner and obtained a mortgage loan on their property. The homeowner never knows about it until they are in foreclosure.

So, that is one type of mortgage fraud where loan documents have been forged.

What we are seeing most often though, is when a loan goes into default and is placed in foreclosure, whether in a state that allows for non-judicial foreclosure or in a judicial foreclosure state, the note that is presented to the court is not the authentic, genuine, original promissory note. We see this all the time.

What is actually happening in most instances is that the foreclosing attorney who brings the action on behalf of the mortgage servicing company is going to get copies of the loan documents from the mortgage servicing company. The mortgage servicing company only has access to an electronic file of scanned images of the mortgage loan documents. For the most part, they are using those copies as the basis for bringing the foreclosure action.

Consumers should challenge their foreclosure and require that the original note be produced and examined by a board-certified forensic document examiner.

Of course, they are doing this as a business decision because most people do not have the financial resources to properly raise their defenses to a foreclosure action.

Fitts: I don't know if you've seen the great videos that Marcy Kaptur, a Congresswoman from Ohio, did.

McDonnell: I love Marcy!

Fitts: Isn't she great? She made them produce her notes.

McDonnell: Absolutely, and she was so right.

Fitts: I believe that one of the reasons the former Assistant Secretary couldn't produce the note was because they were using that note on 20 different mortgages.

Let's get to my all-time favorite, which you know is my favorite: Fraudulent Inducement.

McDonnell: Yes! Fraudulent Inducement essentially is when the borrower is being enticed to apply for a mortgage by a mortgage broker or a loan officer. The terms of the loan are represented to them as very, very favorable. Probably one of the best examples of fraudulent inducement is using a negative amortization payment option ARM loan.

What they will say is, "Look, we are going to offer you a $500,000 mortgage loan at an interest rate of 1.5%. How can you beat that?"

The monthly payment is going to be based upon whatever will amortize $500,000 at 1.5% over 30 years. It's going to be very low. I've even seen situations where the mortgage broker will say to the homeowner, "Sure, you're going to use this mortgage loan, take out more money than you actually need to refinance your underlying mortgage, and you can take the extra money and you can invest it in a mutual fund. The interest that you are earning on the mutual fund is going to offset the 1.5% interest that you are paying on the mortgage loan, and you are going to end up being rich."

That looks very attractive because the real estate agents and mortgage brokers know that if they keep the borrower focused only on the monthly payment and ignore all the other terms of the loan, that is an easy sell. So, we have many consumers who went for that deal only to find out later, usually when they are facing foreclosure or when the monthly payment jumps up three to four times what it was initially, that they didn't understand the negative amortization feature of that loan, or that the true interest rate was really 7.5%, not 1.5%.

They were taught to sell those negative amortization loans based on the 'initial teaser rate' that lasts only for the first month, and then it jumps up to its full market rate, i.e. 7.5%. Now your monthly payment will not even cover your interest, and that extra interest being earned is going to be added back to the principal amount of the loan. So, you are making your monthly payments, but your loan balance is increasing from month to month. So, that is a good example of Fraudulent Inducement.

Fitts: I would say that all the mortgages between 1996 and 2006 in the country had been fraudulently induced except for mine. Imagine if there is a town with a plant, and the bank in that town is working with the plant to finance their move to Asia. In the meantime, the bank encourages people who work at the plant to take out larger mortgages, but the bank realizes that the people are all going to lose their jobs. The people don't know that the plant is leaving. I believe that is fraudulent inducement. They are encouraging people to borrow, knowing full well that they have a material adverse event coming. They know it, and you don't.

In fact, if you look at the housing bubble after 1996, that is essentially what the financial institutions were doing. They were in the business of financing companies moving all the manufacturing abroad, knowing that a large number of people were going to have a flat income or lose their income. They proceeded to encourage them to take out bigger and bigger mortgages, knowing that the squeeze on income was upon us.

I think the Fraudulent Inducement is one of the worst.

Let me keep going: Home Ownership and Equity Protection Act Violations.

McDonnell: The Home Ownership and Equity Protection Act is also a Federal statute enacted in about 2001. This was created to combat very aggressive predatory lending practices. It creates certain benchmarks for restraining how many points can be charged on a mortgage loan and how high the interest rate can be.

Of course, as soon as this act was enacted, they no longer made loans that would exceed those thresholds, but they devised other workarounds. It's very interesting. As I analyze loans for predatory lending, I can see and financially document the workarounds that they invented after that Act went into effect.

Fitts: Illegal Kickbacks.

McDonnell: This happens a great deal between the various participants in the real estate financing transaction.

It might be a real estate agent who refers the homeowner to a particular mortgage broker who gets something on the backside of that or certain affiliated business arrangements. For example, it might be between the closing agent and the title insurance agency that provides the title insurance. Often there are kickbacks, and these kickbacks are prohibited under the Real Estate Settlement Procedures Act.

Fitts: Misrepresentation of the Terms of the Loan.

McDonnell: This is where we often see that the preliminary Truth in Lending disclosure statement describes a certain loan on certain terms and that your monthly payments will be level monthly payments, perhaps for a fixed rate loan over a 30-year period of time.

But then you go to the closing and see that it is not the loan that you got, and the terms have been switched. Essentially, some of these pitfalls that we are talking about have an interplay with one another.

Fitts: It's another part of the Bait and Switch.

Next is Predatory Lending Practices.

McDonnell: Predatory Lending Practices are legendary. Despite all the state and Federal laws enacted to restrain predatory lending, it really hasn't. The inventions of schemes that work around these statutes are legion. We see all kinds of predatory lending practices.

A loan will be predatory if it is knowingly and intentionally made to a borrower when the lender knows that they do not have the ability to pay.

Many people were induced into their subprime loan of choice that really belied the mortgage meltdown of 2007, which triggered the financial crisis of 2008. It was an adjustable rate loan product that began with a two- or three-year fixed interest rate period and then it would adjust, usually every six months based upon the six-month LIBOR rate.

The key to pricing an adjustable rate loan, just so your subscribers know, is to look at the margin that is going to be added to a particular index. This will be spelled out quite clearly in your adjustable rate note.

The pricing structure goes like this: If your margin is under 3% above the index, which is the underlying base rate, that would be considered a prime rate loan. If it is 3% or over, that would fall into the subprime category. But if that margin is 5% or more, that is absolutely in predatory lending territory.

Fitts: I'm just going to quickly list the other ones, and these are going to be found in your exhibit: RESPA Act Violations, Reverse Redlining as an Asset Stripping Scheme, Serial Refinancing not in the Borrower's Interest, Steering, and all sorts of Truth in Lending Violations, Unconscionable Contract, Unfair and Deceptive Acts and Practices, and Yield Spread Premium Fraud.

It's amazing how many different ones there are. I think it's very important that whenever you do a mortgage: 1) You budget the time to really spend to learn what you are doing and how you are doing it, 2) You have to work with reputable firms, 3) You need an expert to check this information, and 4) You need to get all your documents.

Let's go on to recognizing when a fraudulent situation is coming up. You said something that I really believe, and that is the first rule of self-defense is to trust your intuition.

Why do people not do that? What I've found is that it's incredibly important for any consumer to realize that all the experts are there to serve them. If they don't feel right, and if they don't understand it, they need to say, "Stop. I'm the boss here. You have to help me get comfortable. You have to teach me what I need to know."

How can we start to feel like we don't need to be bullied by experts?

McDonnell: That's a really important point. I have to say that virtually all of our clients who end up running into trouble and who look back and recall how they felt when they signed those loan documents knew that something was wrong. So why did they go forward anyway?

There are two answers, and maybe they are one and the same. The first one is these mortgage transactions and real estate transactions that involve the purchase of a property are emotionally driven. What is going to overcome our common sense? It is going to be when you have an emotional involvement in the situation.

For some people, if you are buying a property, you have the moving trucks lined up, you have thousands of dollars in a deposit on this piece of real estate, and you show up at closing and see that you have a Bait and Switch. You know that something is wrong, but now the second kicker hits, and that is fear.

So between the emotion and the fear, "I am going to lose my deposit. I will be out on the street without a place to live because I've surrendered my apartment."

People will be driven, and the people involved in this Bait and Switch scheme count on that. They count on the fact that you are not going to pull out of that deal no matter how bad it is or how costly it is because you just need to get the job done.

Right now I have clients in Dallas who filed for bankruptcy. They were able to sell their property in California, and that money is now sitting in bankruptcy court based on a dispute with the lender.

Our clients have described in detail what their closing was like. It was a purchase, and they thought that they were only going to be reviewing an appraisal and looking at early disclosures. No, it was actually a closing of the transaction.

So husband and wife are there, they are being asked to sign all these documents. The wife was actually an operating officer of a mortgage company in the past, but she had never dealt with pay-option ARM loans. Suddenly she is realizing, "Wait. This promissory note doesn't say what it should say. We applied for a fixed rate loan."

So, they signed all the loan documents, and took their Notice of Right to Cancel, which is their rescission notice, and they signed, "We are rescinding this transaction."

They told the closing agent, "We are not comfortable with this. We are cancelling the transaction," and then they left.

Of course, they left their paperwork there because they thought they were done with it.

The next day they followed up with the closing agent and the mortgage broker, and found out that their loan was funded, and now they were trapped. And by the way, in that situation, – which is a good case study – because they had excellent proof of payment records, I was able to establish that on this $1.5 million mortgage loan that $83,000 they paid in mortgage payments were never applied to their loan. That is my next expert case that I have to jump into.

It's just astonishing what can happen. Your records are like gold.

Fitts: Let's talk about case studies. I know that in the material we provided there is one case study that you described as a way of describing some of these frauds. Is there one that you can just walk us through quickly?

McDonnell: I describe a Bait and Switch scheme that involves a client in Massachusetts. She is a woman of color. She was a single mom at the time, and was living in the projects in Cambridge, Massachusetts.

Her son had gotten himself into trouble, and an eviction was underway. By the way, she worked – and continues to work – at the Cambridge Police Department as a typist. She is just a 'salt-of-the-earth' lovely woman.

She realized that she has a good-paying steady job with a good track record. She said, "Why don't I see if I can actually buy a home?"

Back in that time around 2006, there were many advertisements on television and in the newspapers saying, “Why rent when you can own?”

She went to a real estate agent in Boston and began looking around in the suburbs for a house to buy. She was a perfect candidate for an FHA-insured first-time homebuyer mortgage loan. That is what she should have been directed to. Instead, she was steered – in another one of these pitfalls – to apply for a loan with a mortgage broker for New Century Mortgage Corporation, which was one of the most predatory subprime lenders out there back then.

She was induced to apply for the type of subprime loan of choice that I just described, which was fixed for the first two years at a rate of 8.25%. After that two-year period it was going to adjust up to its fully indexed interest rate, which was 10.75%.

Fitts: Wow!

McDonnell: Oh yeah! You knew from the beginning that this loan is designed to implode.

The margin that she was given was 6.25% above the six-month LIBOR rate. So, it was clearly in the predatory lending category.

By the way, her preliminary Truth in Lending Disclosure Statement indicated that she was applying for a fixed rate loan and that her monthly payments would be just under $2,500 a month. However, when she went into closing she got a completely different loan – this subprime adjustable rate mortgage product that had monthly payments that would increase until the fully indexed interest rate was achieved.

Not surprisingly, after a couple of years she fell behind in her mortgage payments, and her loan was foreclosed upon. She happened to live in the city of Lynn, Massachusetts that had enacted an ordinance requiring mortgage servicing companies to mediate before they could complete an eviction.

She applied for that program, and she was able to stay in her home. She is still residing in her home years after the actual foreclosure. The City of Lynn program was challenged as unconstitutional, so that program is no longer operative.

She hired an attorney to represent her in order to prevent the ultimate eviction, and that attorney has worked with me on a number of cases. He referred her to me, and I audited her loan. It was absolutely shocking because I figured out that her subprime adjustable rate mortgage loan was actually more expensive than if she had taken out a high interest rate loan that would have violated the Home Ownership and Protection Act.

So, this is an example of how New Century did a workaround that Federal legislation to create a type of mortgage loan that was even more costly than a HOPA (Home Ownership and Protection Act) loan. So, I wrote an expert report.

As a matter of fact, soon I am going to Salem, Massachusetts to attend a hearing on the eviction matter. Hopefully the judge is going to see that this loan was quintessentially predatory in nature. In other words, New Century knew from the inception that this loan – the way that they structured and priced it – would be impossible for this borrower to pay.

Then you look at all the risk, including using a 40-year amortization period to balloon it out in 30 years. It's just very, very egregious.

Fitts: I think that if the penalties were proper-with the lenders who do this kind of thing-you could organize this so that the risk would not be worth their taking. I think that all this incredible predatory lending – whether it is in the mortgage area or any of the other areas – is a disgrace. The politics is allowing it to exist and be perpetrated.

It is one of the many ways that the leadership is used to centralize control of capital and I think it's just harvesting.

The reality is that many of us are going to originate mortgages and we are going to deal with servicers, and we need to make sure that the pathway we take has competent and honest people on the other side. We also need to know that this whole area is a war zone, and we need to be prepared to do it correctly and to maintain the documentation correctly and be prepared for it to go wrong.

If you are prepared and it goes wrong, you are going to be fine. If you are not prepared and you don't have your documentation, it may not go fine. I am sure that you have seen that happen.

McDonnell: There are two things that people should understand about how a mortgage loan can be used for human engineering.

First of all, when a loan – like the one I just described – is made to a borrower without the ability to pay, knowing that a foreclosure is going to result, it's an asset-stripping scheme, but it is also a land grab.

Statistically you can see that home ownership rates are lower than the 1970s – or around that time. It also can be designed to geo-engineer a location.

Let's assume that you have some very valuable property in the inner city that is populated by 'deplorables' and you want to reengineer that sector for high-rise luxury condominiums and businesses and so forth. One way to do this slowly, over some years so as not to be too conspicuous, is to only promote mortgage loans that you know are going to default, and you can put ownership in there to basically control that property.

Fitts: Before we close I have to tell you one story. In the 2018 Annual Wrap we did a piece called 'Caveat Emptor' where I discussed the Federal credit. I told a story from 1989, and I want to tell it again to give the subscribers a sense of how wild this area is. It really is the Wild West.

I arrived at FHA and it was before I was confirmed. The first thing I did was read the law, and the law said that our single-family mortgage fund had to be self-supporting. So, the premiums we charge for the FHA insurance had to cover foreclosures and our operating expenses.

I had to get the accountants moved over to report to me before I could find out how much money we were making or losing. It turned out that we were losing $11 million a day.

McDonnell: Oh my gosh!

Fitts: To say that it was financially out of control was an understatement. It was unbelievable.

This was a $300 billion portfolio losing $11 million a day. I had four deputies, and one of them ran the single-family area. So, I needed to find a deputy for single-family.

I went through all the resumes with the transition to send over, and I found a person named Ronnie Rosenfeld who I knew because he was on one of the boards at Wharton with me. Ronnie had a very successful career in real estate and home building and was an attorney by training.

I interviewed him, and after the interview and about a week later, I took him out to lunch. I said, "I wanted you out of the building to ask you the tough question: Why does somebody who has been this successful in real estate and construction and homebuilding willing to come in and do a very tough job? Turning this thing around is going to be tough."

He said, "Look, my family came to this country with nothing, and we have been wildly successful. I want to give back. I've made my money."

He sincerely wanted to give back. So, I put forward his nomination to the Secretary. The process was that I interviewed and then recommended them to the Secretary for his approval. If he approves, then the White House gives its blessing, and that is the person who goes in after completing a background check.

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He sincerely wanted to give back. So, I put forward his nomination to the Secretary. The process was that I interviewed and then recommended them to the Secretary for his approval. If he approves, then the White House gives its blessing, and that is the person who goes in after completing a background check.

She stuck her finger up to my face, she used the 'F-word', and said, "F you! I'm going to have you fired!"

McDonnell: Oh my gosh!

Fitts: I said, "You probably can, but by the time you have me fired, I'm going to have this place in sound financial condition."

So, she started screaming, and was literally spitting into my face. I picked up the phone and called down to the security desk on the first floor. I said, "I need an armed security guard. I need someone evicted from the building."

Then she just completely lost it. The executive director realized that the situation had become dangerous, so he literally dragged her out of the office and down the hall and into the elevator where I could still hear her screaming.

The fellow that she had running the single-family area had been processing land development deals through the department for her, and she was making a lot of money. That program was making a fantastic amount of money.

Before Ronnie even got there I had that program shut down, so they were really after me. But one of the reasons we were losing $11 million a day was because nobody was home; they were too busy processing land development deals to be able to watch the store.

When people say, "Oh, it can't possibly be this bad," that was in 1989. Of course, the creativity and ingenuity around mortgage fraud has just continued.

I thought that it would have been cleaned up in the 2006-2012 financial crisis, but not on your life! It's still going strong.

I don't mean to 'scare our subscribers to death', but the reality is that there are honest businesses in the mortgage area. You can originate a decent mortgage. It can make tremendous sense to do that. We all need a home, and it is a matter of going about this on the right pathway and doing business with the right people, and then making sure that you have everything nailed down during the servicing period. That comes back to having your documents and, of course, going through a process.

I also think that it really helps to have an expert. Henceforth, if I ever do another mortgage, you are going to check it over.

McDonnell: It would be my privilege, of course!

Fitts: I'm going to have all the exhibits up, and I really encourage everyone to take a look at the materials. I think that this is a fantastic package.

Tell everybody how to find your website and how to find you if they are going to proceed with a mortgage and want to get your help.

McDonnell: Thank you very much for that and I do appreciate it.

The first and most important thing is to spell my last name properly. It's McDonnell. You can google Marie McDonnell or go to McDonnell Analytics or McDonnell Property Analytics.

That will take you to my website which is www.McDonnellAnalytics.com. So, if you get the 'McDonnell' right, you are in good shape.

Of course, my website will have my telephone number, and that number is 774-323-0892.

You can also do some keyword search terms like 'mortgage fraud' or 'mortgage auditing' or 'Truth in Lending audit'. Things like that will no doubt bring up my website and perhaps news of things that I have done.

Fitts: I am going to include your resume with a list of many of your different achievements. It's really remarkable.

Let's assume that I already have an existing mortgage, but I am concerned about something or I am having trouble or I don't feel comfortable and I want to get an audit. Should I go to an attorney, or will you look at existing mortgages and help people without going through the attorney?

McDonnell: That is a wonderful question. First of all, these real estate mortgage transactions involve contracts that are legal in nature. So ultimately, if there were an issue, the homeowner would want to seek an attorney. But here is the situation that I find all the time: The attorneys will not know what to do until we first analyze the transaction and figure out what is going on. Then we can brief the attorney on what our findings are.

We are a great first stop on the road to homeownership.

Fitts: They are going to need an attorney at some point?

McDonnell: It depends. There are some problems that certainly can be solved without the need of an attorney, but if someone finds themselves actually facing foreclosure or they are just not able to get any resolution to a dispute with their mortgage servicer, then they will probably need an attorney.

We can do a great deal to help our clients rectify situations if they are not in the midst of an urgent foreclosure matter. And actually, even if they are, that is a large part of our work here. You can't solve a problem unless you understand it. So, that is my operating principle, and that is what we do: Mortgage analytics. We really try to get to the root of the problem so that we can educate our clients and provide the proper litigation support to their attorneys.

Fitts: I had a pastor in Washington who would always scream, "God does not bless a mess." I have to tell you that the US mortgage market is a mess – or too much of it is a mess.

One thing that our tagline at The Solari Report says is, 'Live a free and inspired life.' It is very important to me. Hopefully your pathway to mortgage financing is going to be a good one, but if it ends up being messy, I really appreciate the effort that you have made to try to help people who are willing to spend the money and take the time to avoid that mess or get out of that mess.

I appreciate you and what you are doing, and I really appreciate your taking the time to join us on The Solari Report. We will put all the documents up on the Solari Report

If people post questions, we will keep you informed and encourage you to answer them, or we will encourage them to contact you directly.

Keep doing what you are doing. If there is anything that we at The Solari Report can ever do to support your work, I hope that you will keep us in mind. I am hoping that we will get you back on a quarterly basis.

McDonnell: That would be wonderful! I would really enjoy that and would really love to know what people are concerned about and what their questions are or what their experiences are.

The system is truly broken. None of these institutions are functioning in a way that really supports long-term sustainable home ownership. It is very much dehumanized. It is very difficult for people to apply for a loan modification and get through that process, but help is on the way. Thank you so much and I greatly appreciate it.

Fitts: We will see what the majority of questions are, and that is how we will decide what we do in the 2nd Quarter.

Marie, have a wonderful day. Thank you again very much, and thank your assistant, Stephanie, for me as well.

McDonnell: I will do that, Catherine. Thank you so much and goodbye for now.

MODIFICATION

Transcripts are not always verbatim. Modifications are sometimes made to improve clarity, usefulness and readability, while staying true to the original intent.

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