

# Q3 2011 Mortgage Fraud Risk Report

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

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## Executive Summary

The national Mortgage Fraud Risk Index remains elevated at 143 (n = 100) and has remained effectively unchanged over the last year.

- For the sixth consecutive quarter, the two most risky states are unchanged: Nevada has the highest fraud risk with an index value of 255, with Arizona next at an index value of 243.
- California was particularly well-represented in all the indices. It was the third most risky state overall with an index value of 197, and contained half of the ten most risky metropolitan statistical areas (MSAs), seven of the top ten zip codes, and more than half of the top ten metros in the property valuation and employment/income indices.
- Employment/income fraud risk increased 8.8% from the last quarter, continuing an increasing trend that extends back to Q3 2009. Since that time this index has increased by over 50%, from 77 to 114. This is likely the result of borrower data being misrepresented in the face of stagnant or declining real incomes in order to meet debt-to-income thresholds required by lenders.
- Non-geographic risk profiling suggests that the fraud risk is highest in loans with high loan-to-income ratios (the ratio of loan amount to monthly income). In general, all of the fraud risk indices increase as the loan-to-income ratio increases, so that almost universally the highest indices occur at loan-to-income values close to or greater than 100.

## Mortgage Fraud Risk Hot Spots and Trends

The national Mortgage Fraud Risk Index, while elevated at 143 (n = 100), has remained essentially unchanged for the past six quarters. This index value is down -0.1% from the same period last year, and up +0.9% from the previous quarter. Figure 1 shows the distribution of current mortgage fraud risk in MSAs throughout the United States. The “very high risk” MSAs continue to be distributed throughout the nation. As has happened every quarter since the inception of this report, California, Florida, Arizona, Colorado, and Nevada are well-represented in the “very high risk” category. Additionally, the Chattanooga and Memphis, Tennessee; Salem, Oregon; Charleston, South Carolina; and Atlanta, Georgia metros continue to be classified as “very high risk,” while Bend, Oregon and Myrtle Beach, South Carolina return to this category. The metros of St. George and Salt Lake City, Utah; Burlington, Vermont; Raleigh, North Carolina; and Tulsa, Oklahoma appear in this category for the first time. Although several Ohio and Michigan metros were categorized as “very high risk” in previous quarters, their representation is now limited to the metros of Cleveland and Flint, respectively.

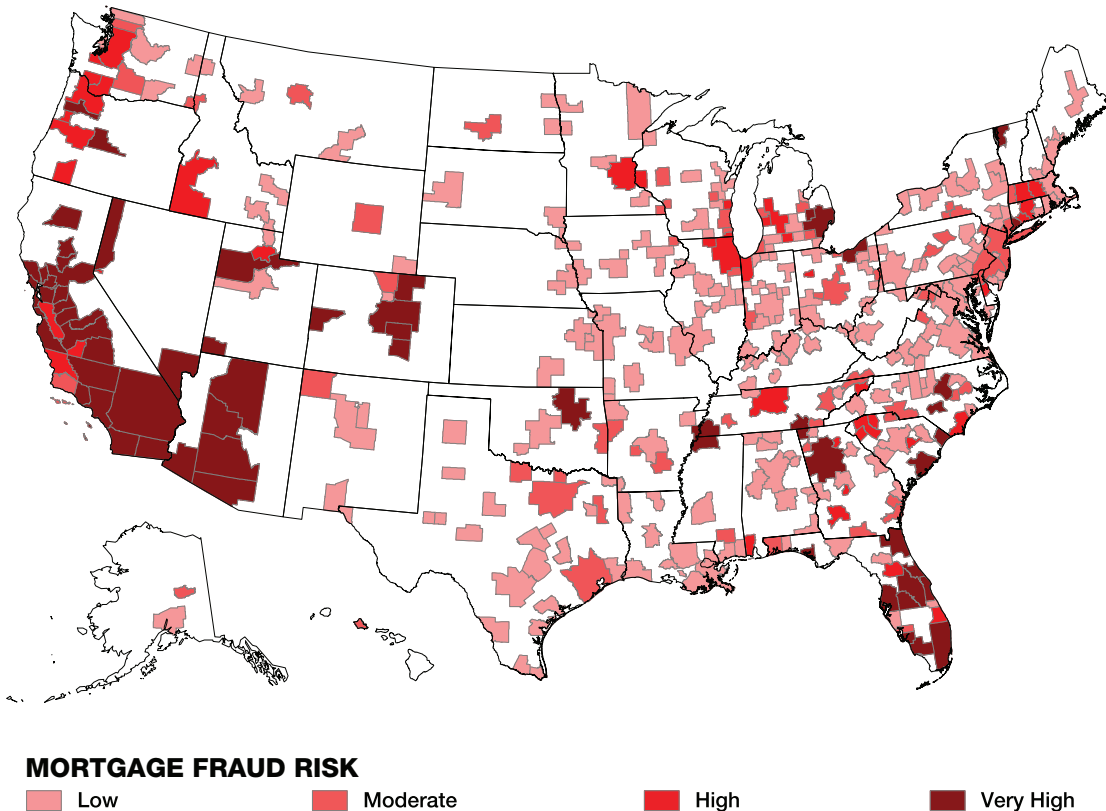


Figure 1: Mortgage Fraud Risk in Q3 2011 by Metropolitan Statistical Area (MSA)

Table 1 shows the ten MSAs with the highest mortgage fraud risk. Stockton, California is the most risky MSA with an index value of 303 – more than twice the national value of 143. Four other California MSAs are also in the top ten: Modesto, Bakersfield, Riverside and Vallejo-Fairfield. The table is rounded out by the Florida metros of Cape Coral and Miami, the Nevada metros of Las Vegas and Reno, and the Phoenix, Arizona metro.

Rank	Metropolitan Statistical Area	Mortgage Fraud Risk Index Q3 2011	% Change Since Q3 2010	% Change Since Q2 2011
1	Stockton, CA Metro	303	23.1%	7.4%
2	Modesto, CA Metro	299	16.1%	11.1%
3	Bakersfield, CA Metro	277	40.5%	21.9%
4	Las Vegas-Paradise, NV Metro	274	0.3%	10.0%
5	Phoenix-Mesa-Scottsdale, AZ Metro	269	16.4%	6.2%
6	Riverside-San Bernardino-Ontario, CA Metro	260	-2.9%	1.0%
7	Vallejo-Fairfield, CA Metro	253	-2.1%	15.3%
8	Miami-Fort Lauderdale-Pompano Beach, FL Metro	243	19.1%	1.9%
9	Cape Coral-Fort Myers, FL Metro	234	-4.5%	-4.4%
10	Reno-Sparks, NV Metro	231	-3.0%	1.0%
<b>United States</b>		<b>143</b>	<b>-0.1%</b>	<b>0.9%</b>

Table 1: MSAs with the Highest Fraud Risk in Q3 2011

Table 2 shows the Mortgage Fraud Risk Index for the ten zip codes with the highest mortgage fraud risk. A whopping seven of the top ten are located in California (versus just one last quarter), with zip code 93304 in Bakersfield having the highest index value at 535 – over three times the national value. Unsurprisingly, most of the highest risk zip codes are located within MSAs that are in the “very high risk” category in Figure 1. Interestingly, zip code 19030, which is the second most risky with an index value of 501, is located in the Philadelphia metro where the overall index value of 141 is less than the national value.

Rank	Zip	City and State	Mortgage Fraud Risk Index 2011 Q3
1	93304	Bakersfield, CA	535
2	19030	Fairless Hills, PA	501
3	89103	Las Vegas, NV	458
4	33169	Miami, FL	457
5	92703	Santa Ana, CA	445
6	93292	Visalia, CA	445
7	91708	Chino, CA	432
8	94589	Vallejo, CA	431
9	92530	Lake Elsinore, CA	423
10	95351	Modesto, CA	421

Table 2: Zip codes with the Highest Fraud Risk in Q3 2011

## Geographic Fraud Risk Migration

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

Figure 2 depicts the Mortgage Fraud Risk Index for the individual states, with the ten highest risk states shown in red. The ordering of the top five is identical to the previous quarter, with Nevada and Arizona leading with index values of 255 and 243 respectively. Both states saw significant increases in their index values: Nevada increased 15 points while Arizona rose by 13 points. This increased the gap between them and the rest of the states, so that there is now a 47 point difference between Arizona in second place and California in third. Florida and Colorado are in 4<sup>th</sup> and 5<sup>th</sup> place, respectively, while Michigan, Georgia, Hawaii, Tennessee, and Connecticut round out the top ten. The District of Columbia fell from sixth position in the previous quarter to 24<sup>th</sup> this quarter after a decrease of 47 in its index value. The ten states with the lowest risk, shown in green, are Kansas, Alaska, Maine, South Dakota, Montana, North Dakota, Iowa, West Virginia, Kentucky, and Mississippi. The four least risky states – Kansas, Alaska, Maine, and South Dakota – all have values less than half of the national value.

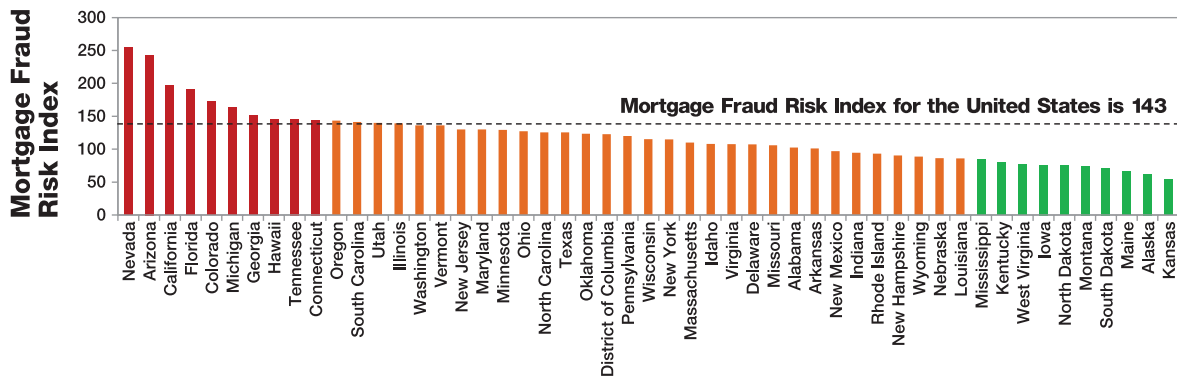


Figure 2: Mortgage Fraud Risk Index in Q3 2011 by State

## Type-Specific Mortgage Fraud Risk Hot Spots and Trends

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

### PROPERTY VALUATION FRAUD RISK INDEX

Property valuation fraud is perpetrated by manipulating property value to create the appearance of equity, or, in flopping, to increase the spread between the artificially depressed acquisition price of a distressed property and its price to an end buyer at or near market value. The difference between the acquisition and disposition price is then extracted from loan proceeds by various means. Table 3 shows the ten MSAs with the highest property valuation fraud risk. All of these metros are within the adjacent states of California, Nevada, and Arizona, with California claiming seven of the top ten spots. Furthermore, the top three metros of Stockton, Modesto, and Bakersfield are all in the California Central Valley region. Bakersfield's index value has increased by over 50% in the last year, which is notable, particularly in the context of the 15% decrease in the national index.

Rank	Metropolitan Statistical Area	Property Valuation Fraud Risk Index Q3 2011	% Change Since Q3 2010	% Change Since Q2 2011
1	Stockton, CA Metro	647	7.2%	9.4%
2	Modesto, CA Metro	646	5.2%	22.3%
3	Bakersfield, CA Metro	613	54.0%	24.8%
4	Las Vegas-Paradise, NV Metro	583	-8.1%	6.1%
5	Phoenix-Mesa-Scottsdale, AZ Metro	575	3.5%	6.3%
6	Riverside-San Bernardino-Ontario, CA Metro	523	-17.1%	0.1%
7	Vallejo-Fairfield, CA Metro	504	-18.2%	19.1%
8	Reno-Sparks, NV Metro	500	-6.2%	1.9%
9	Sacramento-Arden-Arcade-Roseville, CA Metro	480	9.4%	15.4%
10	Salinas, CA Metro	463	4.1%	15.5%
<b>United States</b>		<b>224</b>	<b>-15.0%</b>	<b>1.1%</b>

Table 3: MSAs with the Highest Property Valuation Fraud Risk

## IDENTITY FRAUD RISK INDEX

Identity fraud is frequently used in mortgage fraud schemes in order to hide the identity of the perpetrators and/or to obtain a credit profile that will meet lender guidelines. Table 4 displays the top ten MSAs for identity fraud risk. Many of the metros saw significant increases in this index over the previous quarter, including the top three metros of Burlington, Vermont; San Jose, California; and Bridgeport, Connecticut. Naples, Florida was a standout in this respect, with its index value nearly tripling from last quarter. Despite the 17.7% decrease in the national index, a number of these top-ten MSAs have experienced double-digit percentage increases over the last year, including first-placed Burlington, Vermont (+44.6%).

Rank	Metropolitan Statistical Area	Identity Fraud Risk Index Q3 2011	% Change Since Q3 2010	% Change Since Q2 2011
1	Burlington-South Burlington, VT Metro	368	44.6%	92.5%
2	San Jose-Sunnyvale-Santa Clara, CA Metro	346	16.1%	39.7%
3	Bridgeport-Stamford-Norwalk, CT Metro	312	21.9%	34.4%
4	Miami-Fort Lauderdale-Pompano Beach, FL Metro	299	-16.0%	-4.9%
5	Cape Coral-Fort Myers, FL Metro	297	16.1%	23.2%
6	New York et al, NY-NJ-PA Metro	270	-9.8%	4.0%
7	Naples-Marco Island, FL Metro	262	-14.1%	188.3%
8	Stockton, CA Metro	260	31.5%	38.9%
9	Detroit-Warren-Livonia, MI Metro	256	18.0%	-1.9%
10	San Francisco-Oakland-Fremont, CA Metro	244	-4.0%	21.8%
<b>United States</b>		<b>156</b>	<b>-17.7%</b>	<b>-1.0%</b>

Table 4: MSAs with the Highest Identity Fraud Risk

## OCCUPANCY FRAUD RISK INDEX

Occupancy fraud is perpetrated by investors who falsely claim the intent to occupy the purchased property so as to obtain a mortgage with lower down payments and/or interest rates. Table 5 shows the ten MSAs with the highest occupancy fraud risk. Despite a small decline in its index, the Miami, Florida metro was ranked first, moving up from second last quarter. Another Florida metro – Palm Bay – took the second slot, while Burlington, Vermont jumped to third on a 52.4% increase over last quarter and a 116.5% increase from a year ago.

Rank	Metropolitan Statistical Area	Occupancy Fraud Risk Index Q3 2011	% Change Since Q3 2010	% Change Since Q2 2011
1	Miami-Fort Lauderdale-Pompano Beach, FL Metro	138	-9.5%	-1.3%
2	Palm Bay-Melbourne-Titusville, FL Metro	123	62.1%	10.6%
3	Burlington-South Burlington, VT Metro	118	116.5%	52.4%
4	St. George, UT Metro	118	77.0%	17.2%
5	Modesto, CA Metro	117	36.8%	-11.4%
6	Las Vegas-Paradise, NV Metro	116	-4.5%	27.8%
7	Springfield, MA Metro	113	124.6%	-9.5%
8	Deltona-Daytona Beach-Ormond Beach, FL Metro	109	75.6%	42.8%
9	Charleston et al, SC Metro	109	78.5%	13.8%
10	Chico, CA Metro	106	132.3%	8.0%
<b>United States</b>		<b>70</b>	<b>5.5%</b>	<b>-11.7%</b>

Table 5: MSAs with the Highest Occupancy Fraud Risk

## EMPLOYMENT/INCOME FRAUD RISK INDEX

Employment/Income Fraud occurs when an applicant's income is misrepresented in order to meet lender underwriting guidelines. Table 6 displays the top ten MSAs for employment/income fraud risk. Six of these metros are located in California. Burlington, Vermont, which was also first in the identity fraud index and third in occupancy, is at the top with a value of 209. The metros of Myrtle Beach, Florida and San Diego, California round out the top three, with the former experiencing an increase of 65.5% over the previous quarter's value. All of the metros in the top ten have seen strong gains to their index values from last year, with the smallest gain among the group being Salinas, California's 30.8% rise.

Rank	Metropolitan Statistical Area	Employment/Income Fraud Risk Index Q3 2011	% Change Since Q3 2010	% Change Since Q2 2011
1	Burlington-South Burlington, VT Metro	209	34.7%	-16.4%
2	Myrtle Beach-North Myrtle Beach-Conway, SC Metro	183	111.8%	65.5%
3	San Diego-Carlsbad-San Marcos, CA Metro	177	50.1%	14.6%
4	San Jose-Sunnyvale-Santa Clara, CA Metro	171	56.3%	5.1%
5	Chico, CA Metro	171	40.4%	30.6%
6	Oxnard-Thousand Oaks-Ventura, CA Metro	169	33.4%	25.0%
7	Honolulu, HI Metro	169	36.6%	-7.8%
8	Los Angeles-Long Beach-Santa Ana, CA Metro	167	36.9%	3.6%
9	Wilmington, NC Metro	165	66.3%	10.7%
10	Salinas, CA Metro	160	30.8%	-19.8%
<b>United States</b>		<b>114</b>	<b>21.0%</b>	<b>8.8%</b>

Table 6: MSAs with the Highest Employment/Income Fraud Risk

The national value saw a quarter-on-quarter gain of 8.8%, continuing the upward trend that has been observed since Q3 2009. The employment/income fraud risk index has shown three significant trends over the last six years. First, the index almost doubled from 101 in Q1 2006 to its all-time high of 196 in Q3 2007 as stated income and no- and low-document loan programs were used to inflate borrower incomes in order to attain qualifying debt-to-income ratios at the height of the real estate bubble. The index then dropped by more than half to 77 in Q3 2009 as housing became more affordable and the stated and low-documentation loan programs were eliminated. Since then, the employment/income index has been steadily rising to a value of 114 this quarter – an increase of about 50% over the last two years – as stagnant or declining real incomes again make it difficult for borrowers to meet the debt-to-income thresholds required by lenders.

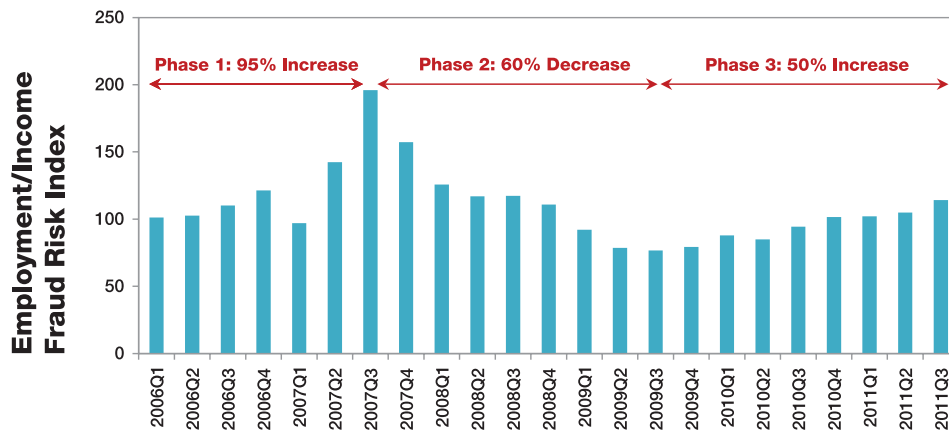


Figure 3: Employment/Income Fraud Risk over time

## Non-geographic Risk Profiling

The last edition of the Mortgage Fraud Risk Report included a section on non-geographic profiling which showed that fraud risk increased with increasing loan value. Fraud risk was also greater for investment loans than for owner-occupied and second home loans. The same trends are observed for this quarter as well.

In this edition, the fraud risk trends with loan-to-income are considered. Loan-to-income is defined as the ratio of loan amount to monthly income. The loan-to-income ratio, while not used for qualification purposes, can serve as a proxy for trends in the commonly-used debt-to-income ratio – though it should be noted that absolute loan-to-income values are not equivalent to absolute debt-to-income values.

Figure 4 shows that in general, all the fraud risk indices increase with increasing loan-to-income ratios, so that almost universally the highest indices occur at loan-to-income ratios close to or greater than 100. The Property Valuation Fraud Risk Index, Figure 4b, increases strongly with increasing loan-to-income up to a ratio of 60, and then is essentially flat with further increases in loan-to-income. Both the Identity Fraud Risk Index, Figure 4c, and the Occupancy Fraud Risk Index, Figure 4d, increase monotonically across the entire range as loan-to-income increases. The Identity Fraud Risk Index trend is particularly strong, increasing from 130 at loan-to-income ratios less than 20, to 315 for loan-to-income ratios greater than 100.

The most interesting pattern is associated with the Employment/Income Fraud Risk Index, Figure 4e. The index first decreases strongly with increasing loan-to-income, from 208 for loan-to-income ratios less than 10, to 115 at loan-to-income ratios between 30 and 40. The trend then reverses and increases strongly to reach 214 for loan-to-income ratios greater than 100. Table 7 shows that the average income decreases monotonically with loan-to-income ratios, and so in general fraud risk would be expected to follow the same pattern. However, the increase in employment/income fraud risk at loan-to-income ratios greater than 40 suggests that even low incomes, if coupled with high loan-to-income ratios, can be subject to high employment/income fraud risk.

All these trends underline that high loan-to-income loans are extremely risky.

Figure 4a

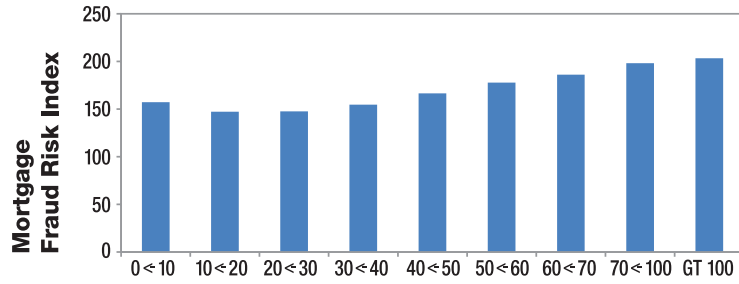


Figure 4b

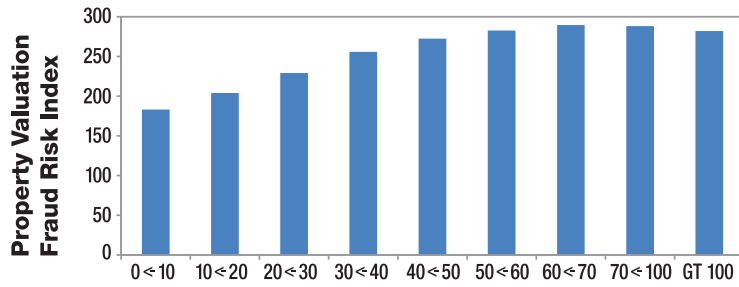


Figure 4c

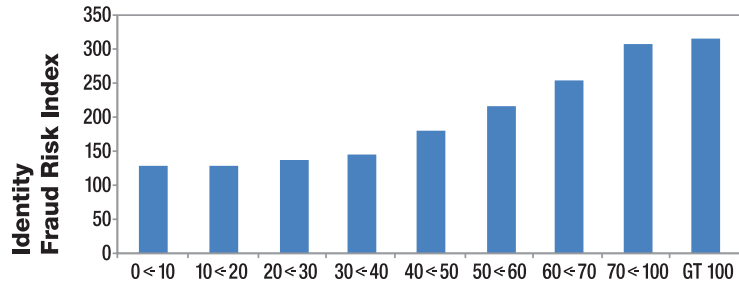


Figure 4d

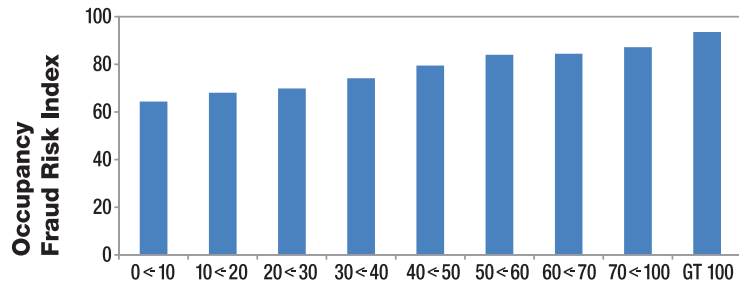
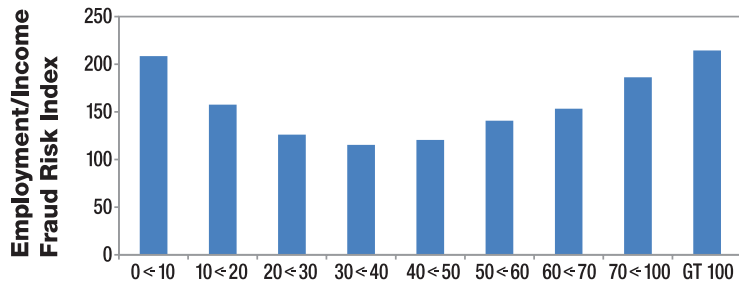


Figure 4e



LTI	Income	Loan Amount
0 < 10	34,031	128,104
10 < 20	11,645	176,295
20 < 30	8,121	202,400
30 < 40	6,490	225,203
40 < 50	5,665	252,207
50 < 60	5,089	277,139
60 < 70	4,662	299,966
70 < 100	3,878	312,960
GT 100	1,860	301,112

Table 7: Average Income and Loan Amount by LTI Band

Figure 4: Mortgage Fraud Risk Indices versus loan-to-income

## Extended Forecast

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

- Nevada and Arizona, which continue in first and second positions for the sixth consecutive quarter with mortgage fraud risk index values of 255 and 243, respectively. No other states have values in excess of 200.
- California, which was particularly well-represented in indices across the board. It was the third most risky state overall, with an index value of 197, and contained half of the ten most risky MSAs as well as seven of the top ten zip codes.
- The Burlington-South Burlington MSA in Vermont, which has the highest Identity and Employment/Income Fraud Risk Indices, and which placed third in terms of occupancy fraud risk.
- Non-geographic risk profiling suggests that the fraud risk is highest across all indices at high loan-to-income ratios.

## About the Interthinx Fraud Risk Indices

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

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

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

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

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

## About the Interthinx Mortgage Fraud Risk Report

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

## About Interthinx

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

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