



Equity Skimming

An Investor's Guide to Avoid Trouble

In the wake of the Great Recession, many opportunistic investors sought to create profit through innovative real estate ventures in a complex and previously unknown market. The post-recession real estate market was flooded with innumerable underwater properties burdened by subprime mortgages and foreclosures in perpetuity. Some of the bolder and liquid investors began a practice of pinpointing equity-rich properties in turnkey condition with open-minded owners. These investors approached these owners to create mutual ventures whereby the investor acquired the property under some agreement to remunerate the owner while renting the property at profit to third party tenants. Some of these arrangements were good faith business opportunities, while some were downright predatory, targeting desperate owners to defraud them and their lenders of their property rights. The latter practice is known as illegal equity skimming or equity stripping. To facilitate good faith investors in entering the alternative market of purchasing encumbered properties, this article seeks to differentiate illegal equity skimming from legal property investment in encumbered real estate. If you have any questions about property investment and legal risk in real estate ventures, please contact Bernhard Law Firm at abernhard@bernhardlawfirm.com, 786-566-1969, www.bernhardlawfirm.com.

The practice of collecting money through rental of mortgage-encumbered properties without payment to mortgagees may incur criminal and civil liability for equity skimming and related crimes and torts, with risk of criminal prosecution, incarceration, restitution orders, civil fines, injunctions, and damages in federal and state court, subject to the below considerations. This article discusses general rent collection practice in its coincidence with practices prohibited under Florida and federal equity skimming statutes, without addressing any specific rent collection act, agreement, tenant, owner, or property, and is to be read by comparison to actual activity and known practices.



Given the increased rate of federal criminal prosecution after the 2009 creation of the Financial Fraud Enforcement Task Force, any person or company participating in real estate investment on encumbered or indebted properties on any level, including the owners, officers, and employees of companies, should make diligent and documented efforts to avoid practices that could be construed as the removal of equity through rent collection without remuneration to mortgagees. Precautions include: (i) documenting good faith efforts to resolve the encumbrances and unpaid debts; (ii) careful use of mail or wire to avoid equity removal activities thereon; (iii) extra care with properties encumbered by VA and FHA related loans; (iv) increased documentation of funding to make multiple property purchases at a true market price; and (v) increased documentation of signed and acknowledged disclosures of any sale, rental, or loan-related arrangement. The following is a limited and non-exhaustive review of the legal underpinnings to equity skimming prohibitions.

CRIMINAL PROHIBITIONS ON EQUITY SKIMMING ACTIVITIES

The federal and state governments have devised various ways to prosecute property investment and rental practices that generate third party profit without settlement of mortgage debt or remuneration to mortgagees. Where conducted with intent to defraud, these practices may carry strong criminal penalties despite involving non-violent offences.¹ As cited in cases further below, the federal government has been particularly active in prosecuting equity skimming under a diverse range of criminal charges. This high rate of prosecution coincides with President Obama's establishment of the Financial Fraud Enforcement Task Force to "wage aggressive and coordinated investigations and prosecutions of financial frauds and maximize the ability both to recover the proceeds of these frauds and obtain just and effective punishment of those who commit them."² This task force has facilitated and coordinated prosecution for practices approximating equity skimming under theories of loan fraud, mail fraud, wire fraud, tax crimes, money laundering, violation of the False Claims Act, and unfair competition. The following is a non-exhaustive list of criminal statutes generally prohibiting collection of rent from mortgage-encumbered properties without remuneration to mortgagees:



Federal equity skimming – 12 U.S.C. § 1709-2 and 12 U.S.C. § 1715z-19

Federal equity skimming under 12 U.S.C. § 1709-2 is the practice of diverting revenues generated by mortgaged property in default to purposes other than property maintenance or mortgage payments, where the United States government³ has insured the mortgages.⁴ The federal equity skimming statute mandates criminal penalties for “whoever, with intent to defraud, willfully engages in a pattern or practice of (1) purchasing one- to four-family dwellings . . . which are . . . in default within one year subsequent to the purchase and the loan is . . . guaranteed by the [or made by the VA], (2) failing to make payments under the mortgage or deed of trust as the payments become due, regardless of whether the purchaser is obligated on the loan, and (3) applying or authorizing the application of rents from such dwellings for his own use.”⁵ When and where the federal government insures a mortgage, it acquires an interest in the mortgage and thus has standing to civilly sue and criminally prosecute for equity skimming in federal court.⁶ The penalties per offense are up to \$250,000 and five years imprisonment.⁷

The below-cited federal cases show that the federal government has broadly applied and interpreted the equity skimming statute to thwart any diversion of funds from mortgagees. For example, although the statutory language for equity skimming appears to have a purchase element, whereby a defendant must have purchased the property for value, the courts have nevertheless held that the statute does not require a transfer of or for value.⁸ Instead, the courts have held that the statute essentially encompasses any acquisition of real estate by any means whatsoever (except descent).⁹ Further, although the statute appears to require direct engagement in equity skimming, the courts have nevertheless held that associates, colleagues, and other indirect participants in an equity skimming business may also be convicted if the government can establish that underlying equity skimming occurred and that the accused: (1) had specific intent to facilitate the commission of equity skimming by another; (2) had the requisite intent of equity skimming (to defraud); and (3) the accused assisted or participated in the commission of the underlying equity skimming offense.¹⁰ Thus, the statute applies to the purchaser, or a beneficial owner under and business or trust purchaser, or to any officer, director, or agent of any purchaser.¹¹



Activity resulting in federal criminal prosecution

There are plenty of examples of financial and real estate activities that the federal government prosecuted and obtained convictions under equity skimming theories. By way of example, the following activities resulted in equity skimming prosecutions:

1. An investor solicited a homeowner, persuaded him to deed a home title to a trust with the investor as trustee, and signed a rental agreement with an option to repurchase; the investor thereby obtained a portion of rental payments and failed to pay the mortgage;¹²
2. An investor represented to a homeowner that he could prevent foreclosure or protect the owner's credit rating, and thereby had the homeowner move out while renting the property; this eventually resulted in foreclosure.¹³
3. An investor found homeowners in foreclosure, purchased their homes, and intercepted certain equity checks;¹⁴ and
4. An investor offered to refinance homes and obtain money for homeowners, but instead had homeowners sign papers to sell their houses to the investor; the investor then intercepted the sale proceeds and obtained other funds from the homeowners.¹⁵

There appear to be numerous other ways to incur a criminal investigation for diverting rental profit from mortgagees. Thus, an property investor should take care to avoid rent diversion or other circumstantial activity indicating an intent to divert rent proceeds from mortgagees (i.e. intent to defraud).

Circumstantial evidence showing intent to defraud

Proof of intent to defraud for equity skimming may arise by inference from all of the facts and circumstances surrounding a transaction.¹⁶ The evidentiary showing required to establish intent to equity skimming is minimal, and thus, any person involved in real estate investment should be particularly cautious. Here are several examples of circumstances underlying real estate activities that a federal judge or jury has confirmed as sufficient to show the requisite intent to defraud, and thus for conviction of equity skimming:

1. An investor's purchase of a large number of federally insured homes at a time

when the buyer had no capital to do so at a fair market price after consideration for encumbrances;¹⁷

2. An investor's failure to make mortgage payments after purchasing encumbered property;¹⁸
3. An investor's continuous purchase of houses in order to pocket the rents;¹⁹
4. An investor's use of all rental income for personal expenses;²⁰
5. An investor's testimony that he merely hoped to quickly sell the properties he bought;²¹
6. An investor's retaining rental income in excess of reasonable operating and maintenance expenses during any period in which the mortgage is in arrears;²²
7. An investor's establishing post office boxes, opening bank accounts, and filing articles of incorporation using various names; using notices in newspapers to identify real property going into foreclosure; and approaching homeowners to assume title to one of the fictitious business entities;²³
8. An investor's telling investment associates or homeowners that their liens and documents could not be recorded and had no legal effect;²⁴
9. An investor's representations to homeowners of past success in stopping foreclosure, particularly where methods actually fail to work;²⁵ and
10. An investor's matriculation to education courses in real estate and property law.²⁶

In contrast, the following circumstantial evidence would go to show *no* intent to defraud:

1. A documented good faith effort to make mortgage payments;²⁷
2. Lack of a criminal record;²⁸ and
3. Application of at least some of the rents toward payment on the outstanding mortgages.²⁹

Any investor should take care to perform and document these latter acts and circumstances, so as to avoid criminal prosecution and conviction.

Florida state equity skimming – § 697.08, Fla. Stat. (2015)

In 1994, the Florida Legislature enacted Florida Statutes § 697.08³⁰ prohibiting, with intent to defraud, the practice of equity skimming, which the Statute defines as to:

- (a) Purchase, within a 3-year period, two or more single-family dwellings, two-family dwellings, three-family dwellings, or four-family dwellings, or a combination thereof, that are subject to a loan that is in default at the time of purchase, which loan is secured by a mortgage or deed of trust;
- (b) Fail to make payments under the mortgage or deed of trust as the payments become due, regardless of whether the purchaser is obligated on the loan; and
- (c) Apply, or authorize the application of, rents from such dwelling for the persons' own use.³¹

The Florida Legislature has provided that equity skimming is a third degree felony.³² A person convicted of a third degree felony may be subject to imprisonment of up to five (5) years and a \$5,000 fine.³³ A habitual offender may be sentenced to up to ten (10) years imprisonment.³⁴

This firm endeavored to obtain representative cases to illustrate practices construed as and prosecuted under equity skimming.³⁵ This firm found several records of state convictions at the county level.³⁶ For example, in *State v. Nickelson*, the defendant purchased approximately 26 properties with mixed mortgage deals, but only paid an average of two months of mortgage payments while renting the properties for his profit. The prosecution resulted in conviction and imprisonment, and the defendant is still actively appealing his 2007 sentencing. State-level prosecution is thus a reality and should be taken seriously.

Mail fraud – 18 U.S.C. § 1341

Where prosecutors have been unable to obtain evidence to sustain an equity skimming action, or to heighten sentencing and plea bargaining leverage, they have brought charges under mail fraud. To obtain a conviction for mail fraud, the prosecution must prove: (1) the existence of a scheme or artifice to defraud that (2) involves the use of the



mails for the purpose of executing the scheme, and (3) the specific intent to commit fraud.³⁷ Nearly any use of mail in furtherance of equity skimming will suffice a conviction for mail fraud. For example, even distribution of self-addressed envelopes to lessees for the forwarding of their rent checks satisfies mail fraud in equity skimming.³⁸ Thus, property investors should make careful use of mail or wire to avoid equity removal activities thereon.

Wire fraud – 18 U.S.C. § 1343 & 2.

Under 18 U.S.C. § 1343 for wire fraud, it is a violation of federal law for anyone, in a scheme to defraud or for obtaining money or property by false pretenses, to transmit any writing, signs, signals, pictures or sounds, by means of interstate wire for the purpose of carrying out the scheme to defraud. Under 18 U.S.C. § 1349, it is a violation of federal law to conspire to commit these acts. Under 18 U.S.C. § 982(a)(2), the U.S. is entitled to forfeit any property, real or personal, derived from proceeds obtained through wire fraud affecting a financial institution.

The federal government has prosecuted and convicted rent diversion practices in Florida under wire fraud charges. In *U.S. v. Mayer*, 14-cr-190-T-24EAJ, the U.S. government prosecuted a Tampa equity skimmer under 18 U.S.C. § 1343 & 2 for wire fraud affecting a financial institution and 18 U.S.C. § 1349 for conspiracy thereto. In May 2015 a jury found him guilty, sentenced him to over eleven (11) years in prison, ordered him to pay \$3.1 million in restitution to the affected banks, and disgorged an additional \$4.4 million through forfeiture. According to the court records, Mayer used straw buyers to acquire 24 properties in Tampa, and immediately resold them to one of Mayer's LLCs for profit. The LLCs were shell companies formed for buying, holding, and selling the properties. Mayer then fixed up and rented the properties, and continued to flip them, thereby obtaining profit at the lenders' losses. Among other improprieties, Mayer and associates skimmed the extra equity and monthly rent payments to private accounts rather than applying them to cover repairs and mortgages.³⁹ These acts resulted in conviction for wire fraud. Thus, again, property investors should make careful use of mail or wire to avoid equity removal activities thereon.



CIVIL LIABILITY FROM EQUITY SKIMMING ACTIVITIES

The Florida equity skimming statute is amenable to private actions for civil relief.⁴⁰ Private litigators have also sought relief under other financial protection statutes, including the Florida Deceptive and Unfair Trade Practices Act (“FDUTPA” § 501.201, Fla. Stat. (2015)), the Truth in Lending Act (“TILA” 15 U.S.C. § 1601), and the Home Ownership and Equity Protection Act (“HOEPA” 12 C.F.R. 226.32), among others. Less active than private litigators, but still forceful, the Florida Attorney General’s Economic Crimes Division investigates consumer complaints for equity skimming, and has brought recent actions against Florida equity skimmers for unfair and deceptive trade practices, seeking restitution, civil penalties of \$10,000 for each violation, and injunctive relief to prohibit any participants from participating in any real estate, mortgage or credit counseling business again.⁴¹

Very few Florida state appellate courts have rendered an opinion directly mentioning or interpreting § 697.08, Fla. Stat. (2015), the Florida equity skimming statute.⁴² However, in *Citation Mortg., Ltd. v. RC of a Retirement Living Ltd., Series III*, the Court defined equity skimming through reference to the 1992 Colorado Supreme Court decision of *People v. Phelps*, 837 P.2d 755, 756 (Colo. 1992), wherein that court defined equity skimming as “the practice of diverting revenues generated by mortgaged property in default to purposes other than the property maintenance or mortgage payments.”⁴³ Following the trends in state and federal criminal prosecution, Florida civil courts appear to read the statute broadly to encompass any act that diverts rent from mortgagees without a good faith effort to resolve the encumbrances before obtaining personal profit. Any property investor may expect civil action under Florida’s equity skimming statute for any of the above-referenced practices triggering criminal liability.

Further, civil litigants may use federal disclosure laws as inroads to create civil liability for equity skimming. Both the Truth in Lending Act (“TILA”) and the Home Ownership and Equity Protection Act of 1994 (“HOEPA”) are disclosure laws whose purpose is to ensure up-front provision of information to potential borrowers so that they know what they are getting and what they are being charged for getting it.⁴⁴ HOEPA, an amendment to TILA, focuses on holding accountable the financiers of predatory lending arrangements, including for any misconduct by the financiers’ counterparts in the primary mortgage



origination market.⁴⁵ Some plaintiffs and prosecutors have used HOEPA and TILA to attack property investment arrangements where contractors, brokers, and other quasi-lenders act in a predatory fashion to target unsophisticated homeowners and skim equity from them under high-rate, high fee loans.⁴⁶ Under 15 U.S.C. § 1640, a creditor who fails to comply with the HOEPA and TILA fair disclosure requirements is liable for (1) actual damages sustained as a consequence of the creditor's failure; (2) twice the amount of any finance charge made in connection with the transaction, not to exceed \$2,000 in an individual action on a non-open end credit plan; (3) costs including any reasonable attorney's fees incurred in prosecuting a successfully HOEPA action or defense; and (4) an amount equal to all finance charges and fees paid.⁴⁷

Similarly, civil litigants may use state regulations on business practices to civilly prosecute property investment arrangements that divert rent from mortgagees. For example, the Florida Deceptive and Unfair Trade Practices Act ("FDUTPA") prohibits any deceptive or unfair business practices.⁴⁸ FDUTPA specifically renders unlawful (i) unfair methods of competition, (ii) unconscionable acts or practices, and (iii) unfair or deceptive practices in the conduct of any trade or commerce.⁴⁹ While the Legislature did not define what "an unfair or deceptive act" is, it has mandated that FDUTPA to be liberally construed.⁵⁰ Thus, Florida courts have held that a prohibited "deception" occurs if there is any representation, omission, or practice that is likely to mislead consumers.⁵¹ On the other hand, an unfair practice is one that is "immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers."⁵² The Florida Supreme Court has also held that a person may violate FDUTPA by unfairly competing against another business, even where the violation arises from a single unfairly competitive act, to a single party, on a single transaction or contract.⁵³ FDUTPA violations may result in an award of actual damages, declarations of wrongdoing, and injunctions from further activities. FDUTPA provides myriad inroads for mortgagees, tenants, and homeowners to sue property investors who unfairly compete with banks through rent diversion or who mislead homeowners or renters through misrepresentation of home purchase and rental arrangements. Thus, any investor should take great care to make full and documented disclosures of the underlying arrangements, terms, risks, and realities of property transfer and rental.

In sum, a review of the Florida and federal law on equity skimming indicate that any property investor should take care when participating in real estate investment on



encumbered or indebted properties on any level, including the owners, officers, and employees of investment companies and trusts. They should make diligent and documented efforts to avoid practices that could be construed as the removal of equity through rent collection without remuneration to mortgagees. Precautions include: (i) documenting good faith efforts to resolve the encumbrances and unpaid debts; (ii) careful use of mail or wire to avoid equity removal activities thereon; (iii) extra care with properties encumbered by VA and FHA related loans; (iv) increased documentation of funding to make multiple property purchases at a true market price; and (v) increased documentation of signed and acknowledged disclosures of any sale, rental, or loan-related arrangement.

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Notes

1. See, e.g., *U.S. v. Pons*, 795 F.3d 745, 746 (7th Cir. 2015) (sentencing 6.5-year prison term for equity skimming and wire fraud); *U.S. v. Fiorito*, 640 F.3d 338, 343 (8th Cir. 2011) (affirming 22.5-year prison term for mail fraud and equity stripping for defrauding 17 homeowners of over \$400,000).
2. See stopfraud.gov.
3. For example, through the U.S. Department of Housing and Urban Development ("HUD") or its Secretary, the Federal Housing Administration ("FHA"), or U.S. Department of Veterans Affairs ("VA").
4. See *U.S. v. Weaver*, 290 F.3d 1166, 1169 (9th Cir. 2002); *U.S. v. Capano*, 786 F.2d 122, 122 (3d Cir. 1986).
5. 12 U.S.C. § 1709-2.
6. 12 U.S.C. § 1715z-4(b); see *U.S. v. Capano*, 786 F.2d 122, 130 (3d Cir. 1986) (the statute is not intended to proscribe equity skimming except in those mortgages in which HUD had a financial interest); *U.S. v. Livecchi*, 711 F.3d 345, 347 (2d Cir. 2013).
7. 12 U.S.C. § 1709-2
8. See *U.S. v. Weaver*, 290 F.3d 1166, 1171 (9th Cir. 2002).
9. *Id.*
10. *Id.* at 1169 (citing *U.S. v. Gaskins*, 849 F.2d 454, 459 (9th Cir. 1988)).
11. *Id.*



12. *Id.*
13. *Id.* at 1170.
14. *U.S. v. Fiorito*, 640 F.3d 338, 343 (8th Cir. 2011).
15. *Id.*
16. See *U.S. v. Aubrey*, 878 F.2d 825, 827 (5th Cir. 1989).
17. *Id.*
18. *Id.*
19. *Id.* at 828 (“the existence of the scheme or artifice to defraud was clear from appellant’s continuous purchase of houses in order to pocket the rents.”).
20. *Id.* at 826.
21. *Id.* at 827.
22. See *U.S. v. Livecchi*, 711 F.3d 345, 347 (2d Cir. 2013).
23. See *People v. Bell*, 45 Cal. App. 4th 1030, 1039 (Cal. 1st Div. 1996).
24. See *U.S. v. Weaver*, 290 F.3d 1166, 1173 (9th Cir. 2002).
25. *Id.*
26. *Id.* at 1174.
27. See *U.S. v. Aubrey*, 878 F.2d 825, 826 (5th Cir. 1989).
28. *Id.* at 828.
29. *Id.*
30. § 697.08 is located in Florida Statutes Title XL, which regulates real and personal property in Florida, Chapter 697, which regulates mortgage practice.
31. § 697.08(1)(a)–(c), Fla. Stat. (2015).
32. §§ 697.08(2) and 921.0022(3)(a), Fla. Stat. (2015).
33. §§ 775.082(3)(e) and 775.083(1)(c), Fla. Stat. (2015).
34. § 775.084(4)(a)(3), Fla. Stat. (2015).
35. Florida state criminal prosecutions are incredibly difficult to track. There are no apparent appeals of state criminal convictions for equity skimming.
36. See, e.g., *State of Florida v. Christopher Nickelson*, Pinellas Circuit Criminal Case No. 2003CF017342 (convicted in jury trial for equity skimming and scheme to defraud, sentenced to concurrent maximum of five year for equity skimming with 15-year fraud sentence plus \$525,000 restitution).
37. 18 U.S.C. § 1341; *U.S. v. Aubrey*, 878 F.2d 825, 827 (5th Cir. 1989).
38. See *U.S. v. Aubrey*, 878 F.2d 825, 828 (5th Cir. 1989) (“distribution of self-addressed envelopes to the lessees for the forwarding of their rent checks satisfies the mailing element of 18 U.S.C. § 1341”).
39. See April 17, 2014 Compl. ¶¶ 29–31.
40. § 697.08, Fla. Stat. (2015).
41. See, e.g., *Office of the Attorney General, Department of Legal Affairs, State of Florida v. Xolutex, Inc.*, Miami-Dade Circuit Civil 09-77640 CA (entering judgment of \$100,000 in civil penalties, and permanent injunction from real estate business for equity skimming).
42. See *Nickelson v. State*, 30 So. 3d 707 (Mem) (Fla. 2d DCA 2010) (holding court cannot order restitution after equity skimming without evidentiary hearing); *Nickelson-Ippolito v. State*, 17 So. 3d 1257, 1257 (Fla. 2d DCA 2009) (holding court could not award restitution to victims of equity skimming without proper testimony or evidentiary hearing); *Minalla v. Equinamics Corp.*, 954 So. 2d 645 n.2 (Fla. 3d DCA 2007) (referencing the equity skimming statute in the pleadings); *Citation Mortg., Ltd. v. RC of a Retirement Living Ltd., Series III*, 753 So. 2d 777, 779 (Fla. 2d DCA 2000) (holding § 697.08 did not apply to skimming practices through retirement centers and nursing homes, as opposed to family dwellings).



43. *Citation at 779.*
44. *Katline Realty Corp. v. Avedon*, 183 So. 3d 415, 420 (Fla. 3d DCA 2014).
45. *Id.* at 420.
46. *Id.* at 419.
47. 15 U.S.C. § 1640; *Avedon*, 183 So. 3d at 421.
48. § 501.204, Fla. Stat. (2015).
49. § 501.204, Fla. Stat. (2015).
50. § 501.204; Fla. Stat. (2015); *Samuels v. King Motor Co. of Fort Lauderdale*, 782 So. 2d 489, 499 (Fla. 4th DCA 2001).
51. *See, e.g., State v. Beach Blvd Automotive Inc.*, 139 So. 3d 380, 390–91 (Fla. 1st DCA 2014) (finding plaintiff stated FDUTPA cause of action where, notwithstanding markings on documents, auto dealer led customers to believe they would receive their deposits back if they did not purchase a vehicle).
52. *Samuels*, 782 So. 2d at 499.
53. *PNR, Inc. v. Beacon Property Mgmt., Inc.*, 842 So. 2d 773, 774 (Fla. 2003) (finding a FDUTPA violation where a party neglected his contractual duties as part of a generally anti-competitive scheme against other businesses).