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The High Cost of Too Good to Be True

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AS the red-hot California real estate market sizzled in recent years, National Consumer Mortgage looked like just another residential mortgage company successfully riding the boom. It had lush offices in downtown Orange; the former baseball great Steve Garvey promoted its products in radio spots; and its founder, Salvatore Favata, a former local baseball hero himself, lived in a \$1.7 million mansion in tony Yorba Linda and zipped around in a Mercedes roadster. An annual “Favata Fest” at the founder’s home featured live music and photo ops with Mr. Garvey.

The little mortgage company was also ambitious. N.C.M. ran an investment arm that offered high-yielding notes to preferred clients, promising to use customers’ funds to make short-term, high-interest loans to individuals and companies that needed money quickly. For customers like Bryan F. Downey, a 41-year-old father of three, it was a tantalizing pitch. Mr. Downey had a \$125,000 inheritance that he wanted to put to work, and his younger brother had already invested his inheritance with N.C.M.

In April 2005, Mr. Downey invested the entire \$125,000 in N.C.M. notes guaranteeing annual interest payments of 12.5 percent for two years. After the contracts were signed, Mr. Downey recalls, Mr. Favata, 46, tan and trim, glided into the conference room, which had a view of Angel Stadium, nearby in Anaheim. Mr. Favata greeted him like an old friend and shook his hand, saying, “Welcome to the family.” It’s a relationship Mr. Downey now wishes he could disown.

Earlier this spring, Mr. Downey, along with more than 200 others living mostly in California and Colorado, found out they were victims of a long-running Ponzi scheme that pulled in about \$30 million before N.C.M. sought bankruptcy this spring, according to a Securities and Exchange Commission civil complaint and filings in a federal criminal case, both filed in United States District Court for the Central District of California in Santa Ana. Rather than using the money to make loans, authorities say, Mr. Favata wagered away about \$10 million of it in Las Vegas and plowed through much of the rest in his business dealings and lavish lifestyle.

The N.C.M. scheme, of course, is hardly novel. It is not even all that big by recent standards. But it bears all the hallmarks that have made financial scams possible for generations: naïve trust, a speculative market offering seemingly easy riches, and gilded lures hitched to people’s unending desire to keep up with the Joneses. So why is it that year after year, century after century, certain people fall for financial

dodges, regardless of their provenance?

“You would think living in an information age it would be easier for people to sort out the fact that these schemes exist,” says James H. Burrus, assistant director with the [Federal Bureau of Investigation](#) in Washington. “But so much information is available and coming at people at different ways that the fraudsters are much better at adapting to the environment to defraud the victims out their money.

“People believe their next-door neighbor is investing in property, flipping it and getting rich quick,” Mr. Burrus added. “Everybody seems to be doing it. Fraudsters take advantage of those types of cycles.”

But con artists don't use greed alone. Analysts say a variety of factors come into play when scams are afoot, many of which revolve around a fear of financial and emotional vulnerability — concerns about not having saved enough to send your children to college; the isolation and loneliness of the elderly; the stress that accompanies career changes; or the loss of a loved one.

MONEY, especially fast money, offers a buffer of sorts in an uncertain world. And con artists are only too happy to wear the guise of the market sage or guardian angel.

“The best scams start with a kernel of truth that are ripped right out of the headlines,” explained Joseph P. Borg, director of the Alabama Securities Commission and president of the North American Securities Administrators Association. “Oil prices are up. There's a war in Afghanistan and Iraq. Tainted spinach. All of these can spawn frauds.”

Faced with the opportunity to invest on the ground floor of something completely plausible and, better yet, exclusive, some jump in with both feet. “It's a combination of greed and a feeling of, ‘If somebody is going to make money, why not me?’ ” Mr. Borg said.

The inner workings of the N.C.M. scheme, which snared wealthy professionals as well as retirees on fixed incomes, suggest that the common perception that only the elderly, less sophisticated or less well-off investors can be duped may be flawed — that a large cross-section of society can be swindled out of large sums.

Mr. Favata used existing investors, to whom he was faithfully making interest payments, to recruit their friends and family members. The promised returns were not so outsize as to raise the suspicions of more sophisticated investors. Payments, which came monthly or quarterly, lulled many into believing that their investments were safe and solid — at least for a while.

“They were really slick in how they presented themselves, how they looked, even where the building was located,” recalled Mr. Downey, who attended college for two years and now licenses consumer products for a private company. “They looked like they were making lots of money and that they had lots of good investors.”

Mr. Favata, who struck a plea deal with prosecutors in the federal district court in Santa Ana, declined to comment. “Mr. Favata has fully accepted responsibility for his actions,” said his lawyer, Nathan J. Hochman, from Beverly Hills. “He is completely cooperating with federal and state authorities and will devote the rest of his life toward paying back the people he has taken money from.”

Regulators have not accused Mr. Garvey of wrongdoing, and he does not appear to have invested in the scheme. Messages left for him with his agent were not returned.

Experts say that for those caught up in financial scams, especially schemes similar to the one Mr. Favata has acknowledged engineering at N.C.M., the early stages are exhilarating and therefore magnetic. Indeed, until the moment investors finally absorb the fact that they may have been duped and their money gone forever, speculating on a “sure thing” has all of the warm and fuzzy benefits of a freewheeling joy ride.

In its purest form, being involved in a bogus get-rich-quick scheme is like a trip to [Disneyland](#), says Anthony Pratkanis, a psychology professor at the [University of California](#), Santa Cruz, and co-author of “Weapons of Fraud: A Source Book for Fraud Fighters.” Professor Pratkanis equates being taken in by a fraud to riding the Pirates of the Caribbean attraction.

“You’re experiencing the ride, singing, ‘Yo ho ho! It’s a pirate’s life for me,’ but you never see any of the trappings of the ride itself,” he said. “Criminals call it, ‘putting the victim under the ether.’ ”

In other words, once they have taken the bait, victims typically stop asking questions. While there are various estimates of how many people are taken in by cons and how much money they lose, experts and law enforcement authorities acknowledge that their best guesses are just that. The F.B.I., for instance, believes that more than \$1 billion was lost to mortgage fraud last year. While that number seems substantial, experts note that it represents a minute fraction of the \$3 trillion in mortgages issued last year.

There may never be a comprehensive tally of fraud, in large part because it is one of the most underreported crimes, authorities say. Some victims deny, even to themselves, that they have been defrauded, while others are simply too embarrassed to tell anyone. No demographic group is immune to fraud, and sophisticated con artists tailor their pitches to their audience.

A younger victim may be motivated by a rich payday, while the elderly appear to fall for schemes that claim to involve the government or a charity, said Sid Kirchheimer, author of “Scam-Proof Your Life,” a book published by [AARP](#).

“None of them say they wanted to get rich,” Mr. Kirchheimer said of the elderly he counsels through his work at AARP. “They tell me that their grandson wants to go to college and they wanted to help him — at least that’s what they tell me.”

Fraud operators are also deft at using middlemen to become associated with a community group or religious organization. The authorities label these schemes “affinity frauds,” because they take in people who have a common interest.

“Whether in a religious group or any other community-based organization, all you may need to do is scam one person very aggressively, in hope that this ‘centerpoint’ will start peddling the scheme to other members,” said John Reed Stark, chief of the office of Internet enforcement at the S.E.C. “The centerpoint may not even profit or be at all complicit in the scheme, but he or she nonetheless becomes an important part of the overall con.”

ONE investment pitch under investigation occurred in Indianapolis and involved Robert Penn, who owned several property management and real estate businesses and cut a charming figure in the community. Mr. Penn has been accused in a lawsuit — filed in Marion County Circuit Court in Indianapolis by the mortgage giant [Countrywide Financial](#) and other lenders — of orchestrating a scheme to use straw buyers to file hundreds of fraudulent mortgages worth upwards of \$40 million.

In a response filed in court, Mr. Penn denied the allegations; he and his lawyers did not return phone calls seeking comment. Countrywide is contending that Mr. Penn and his associates sold it overpriced mortgages they took out in the names of his investors. Federal prosecutors are looking into the allegations.

Mr. Penn came across as savvy and self-assured, yet always concerned for the well-being of those around him, recall people who worked and invested with him. One of those people was Cynthia K. Hancock, who met Mr. Penn through her former colleagues in 2003.

Ms. Hancock, then an aide at an animal research lab at the [Indiana University](#) School of Medicine, describes herself as unsophisticated about finance and real estate. “I don’t carry a Coach handbag; I have never had a manicure,” she said. “I have just worked all my life and paid my bills. That’s why I had such a great credit score. I thought for once my credit score could help me get a little ahead.”

Ms. Hancock said Mr. Penn told her — as well as many individuals in rural Virginia, where his sister lived and his mother served as a lay minister to a small congregation — that their credit scores could help them make money the way rich people do: in real estate.

To Ms. Hancock and the others who heard the stories of easy money in real estate or read them in newspapers, it was a credible pitch. All they had to do was put their names on multiple mortgage applications, thereby “investing” their credit scores, they said Mr. Penn told them. The borrowers saw little downside; they were not asked to put any money down. They said Mr. Penn told them that he and his business associates would do that on each borrower’s behalf.

When some received a check for several thousand dollars, it seemed that the investment was paying off as it was billed. Then, they said, they discovered that they were on the hook for hundreds of thousands of

dollars in inflated mortgages taken out on homes in Indiana, some of them in rundown neighborhoods. Ms. Hancock, who worked at Mr. Penn's property management company for a year and a half, owned five homes. Her daughter — a law student — was named as the buyer for four homes. All of the homes have been foreclosed on, and Ms. Hancock and her daughter are considering filing for bankruptcy protection.

IN hindsight, it is easy to see where Mr. Penn's investors made their mistakes: they were hurried through paperwork and did not read what they were signing. No one asked to see the properties they were buying or pressed for confirmation that rents were being collected and mortgages were being paid. And the investors said Mr. Penn also tapped into key vulnerabilities, particularly those among the largely African-American, working-class investor group in Virginia. By investing in real estate, they said he told them, they could start to close the financial gap between them and white middle-class investors.

Many investors also dropped their guards because Mr. Penn's family, and his mother in particular, were viewed as religious leaders in the area. Spirituality and predatory practices never intermingle, investors believed.

“The whole basis of church affiliation is a sense of morality,” Mr. Kirchheimer said. “Your natural resistance, your armor will probably be a little less because you are assuming people there are more moral.”

Establishing — and ultimately violating — a bond of trust is at the heart of many frauds, whether it comes through a religious affiliation or a longstanding business relationship.

If there was one person whom Melissa A. Miller of Parker, Colo., thought she could trust, it was Robert O. Bryant, a friend and her insurance agent for 10 years. When Ms. Miller sold her dental practice in 2005, she said, she was not sure what to do with her money.

A fairly conservative investor, she said she was skeptical when Mr. Bryant first told her about Mr. Favata's private notes. She talked with her friends in the real estate business as well as her father, who owned rental property and had experience with similar instruments, eventually concluding that the notes were a safe bet because the properties served as collateral.

Ms. Miller, 39, and her husband, Sam, an airline pilot, who have three daughters and a son, invested \$575,000 in N.C.M. notes. She recruited her father, Denny R. Becker, and he invested \$250,000. Aside from the few interest payments they received, the father and daughter believe that most of that money is lost.

“Yes, I am embarrassed,” Ms. Miller said. “I am ashamed that I got my family involved in this. But it could absolutely happen to everybody.

“They seemed so trustworthy,” Ms. Miller said of Mr. Favata and Mr. Bryant, “which is what got

everybody.

“They were knowledgeable,” she added. “They had every answer to every question you could ask about this scheme.”

OR almost every answer. John P. Brincko, a management consultant advising the creditors committee in N.C.M.’s bankruptcy, said that none of the investors, to his knowledge, asked to see the deeds of trust that ostensibly backed their investments. Ms. Miller said that she asked to see them several times, but that Mr. Bryant rebuffed her with excuses: the deeds would be available after the loans had been made; he would pick up the deeds when he visited Mr. Favata next; and, just before the scheme collapsed, he said he had forgotten to bring them back from California.

Mr. Bryant has not been charged with any crime. He did not respond to an interview request and is listed in N.C.M.’s bankruptcy filing as having lost close to \$1 million of his own money.

In October, Mr. Favata agreed to plead guilty to one count of mail fraud in exchange for a five-year sentence, a \$250,000 fine and repayment of more than \$20 million to the victims, all of which is still to be approved by a judge. But it is unclear whether the victims will receive much beyond pennies on the dollar. His mansion in Yorba Linda will be sold to pay victims, but he appears to have few other hard assets, the authorities say. The Mercedes roadster and a Lincoln Town Car that he drove, for instance, were leased by N.C.M.

Brent G. Tabacchi, an assistant United States attorney based in Santa Ana, said the investigation was continuing but that the prosecutors had decided to settle with Mr. Favata because, among other reasons, he turned himself in, gave up his assets and agreed to a restitution plan.

But for the victims of fraud, there are some losses that can never be repaid.

“I lost a lot of faith in human beings — I will really not trust someone with my money now,” said Mr. Downey, who regrets losing his father’s money. “He worked hard to become middle class, he left us a nice home that we sold, and we all got taken in by a clown in Orange County.

“I foolishly fell for this because I went into their beautiful building that was overlooking Angel Stadium,” he added. “They even promised me box seats.”

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