

PENN ATTORNEYS

TITLE ALERT

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RE: Title Alert 2008-09

SHORT-SALES

The current economic climate, particularly in the mortgage and real estate markets, has led many homeowners to be at risk of foreclosure. We have previously addressed so-called "Foreclosure Rescue" schemes in Title Alert 2007-25, and we now point out some of the issues with "short-sales"—a sale of property where the existing lender has agreed to accept payment of less than the outstanding balance due on the mortgage and to satisfy the mortgage.

Often borrowers, either by themselves or through the counseling agency, to which the notice of foreclosure directs borrowers, work out the reduced mortgage payoff amount; however there are also those who see a business opportunity in the distressed homeowners' situation, and in an entrepreneurial spirit enter into the short-sale negotiations and transaction. *One must exercise extreme caution when handling a "short-sale" transaction as the potential for fraud is high.*

Short-sales are not illegal or fraudulent in themselves, but like most transaction structures, if they are misrepresented, or improperly documented, a title insurance provider and a settlement service provider can easily be drawn into exposure to risk. There are few absolutes, but some fact patterns should alert us all to the need to inquire further.

WARNING SIGNS

1. Immediate or simultaneous resale of the property at a price above the discounted value.

Yes, buying low and selling high is the American way. The problem here - and the fraud you may be facilitating - is that the coordinator of the short-sale is simultaneously representing that the property is not worth even the outstanding balance of the mortgage while holding a contract for the sale of the property for a significantly higher (true market) price. Both can't be true!

To avoid the risk of our Approved Attorneys being considered accomplices in this type of transaction, all Penn Attorneys Title Insurance Co. Approved Attorneys must make the "old" lender and any "new" lender(s) aware of any flip transactions and the sales price of the end transaction. The lenders must provide a written acknowledgement of the terms of the end sale. This written acknowledgement must come directly from an officer of the lenders, and cannot come from a mortgage broker.

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Under NO circumstances should you, as a Penn Attorneys Approved Attorney, participate in any transaction in which you are asked to fund the first transaction from the proceeds of the second transaction. Every transaction must be funded independently with good funds. **

**See Title Alert 2007-15 at http://www.pennattorneys.com/printable/title_alerts/2007-15.pdf .

2. Multiple Sales Contracts.

Several variations of the short-sale frauds we have seen involve multiple sales contracts at different prices –a low one to show the “old” lender when negotiating a discount and a higher one used for negotiating with the “new” lender. Our Owner Affidavit and Purchase Affidavit already ask if there are any outstanding agreements affecting the property.

3. Requests for multiple HUDs or HUDs that don’t reflect the financial substance of the transaction.

This is always a warning signal of possible fraud and NOT something you can accommodate without becoming a co-conspirator and violating RESPA. Remember that the HUD is a representation of the complete transaction. You cannot have a variety of HUDs that represent the transaction. There is just one and it must be a true and complete representation of the transaction.

4. Payments to the Sellers not disclosed on the HUD – often characterized as payments for the purchase of furniture or other assets.

Many lenders condition their short-sale agreements on the current owner not receiving any proceeds (or only a capped amount of proceeds). Approved Attorneys have been asked to treat the payment as unrelated to the sale of the real estate, as a payment for furniture or other “unrelated” transaction between the parties. The other party to the transaction will argue adamantly that it doesn’t need to be disclosed since it is unrelated. Be assured that this is very related – they would not be buying that furniture “but for” the purchase of the property. If someone does not want to fully disclose the transaction to the lender, it should also be considered a warning signal. Further, handling or simply being aware of such side payments will often be a violation of the written short-sale payoff agreement and instructions on the short-sale.

5. Changes in ownership after the property is in default or foreclosure, without a new mortgage or dismissal of the foreclosure suit.

We have seen several apparently fraudulent structures combining short-sales with equity stripping. Equity stripping often appears under the guise of foreclosure rescue – where the white knight riding to the rescue somehow winds up with all of the borrower’s equity in the property.

These transactions usually begin with a transfer into a trust or into a third party without a refinance transaction, without curing the underlying default and without dismissing the foreclosure action. This fact pattern, whether or not coupled with a proposed short-sale, is frequently indicative of equity stripping; the homeowner in default gives up all the equity in the home unwittingly based on fraudulent promises to “help” bring the mortgage current or “help” to save the home and avoid foreclosure. Even though the ownership change is properly documented, great care must be exercised when faced with such a scenario. These types of transfers can be, and have been, set aside as fraudulently induced and those lawsuits usually involve accusations against everyone involved in the transaction – including the closing agent!

6. Restrictions on Communicating with the Short-Sale Lender.

We have recently come across short-sale coordinators who insist that the closing agent/ approved attorney have absolutely no communication with the short-sale lender – and take their word as to the payoff.

The stated rationale: “We deal directly with the lender's negotiator. We feel that we have developed a special working relationship with these already overloaded work-out officers. We do not want any interference or any additional documents or any requests made to the lender to send you a copy of a payoff statement.”

Not only does this practice raise the risk of a misrepresentation in the short-sale transaction (which is furthered by blocking your communication), but Penn Attorneys has already experienced claims resulting from misrepresented short-sale payoffs. Always communicate directly with the short-sale lender and get your payoffs directly from the mortgage holder/servicer.

BEST PRACTICE

If you have any of these warning signals in a transaction be very cautious. While there are no hard and fast rules, the single best guide in evaluating a proposed short-sale (or any other transaction) is to ask yourself, “Would the lender take this discount (or make this loan) if they knew all of the facts that I do?”

If the answer is “Yes”, there is no harm in disclosing the facts to the lender in writing and awaiting its written approval.

If the answer is “NO”, then your hiding the information may sweep you into a *mortgage fraud conspiracy*. There is no bright-line rule as to how much profit is too much or how long the property should be held before making the profit. **The best practice is full disclosure and written approval by all parties.** If you have questions, don't hesitate to contact us.

Recommended Guidelines for Insuring Short-Sales

- **Prepare and forward to the short-sale lender a proposed HUD statement**, evidencing that the discounted payoff represents the full net proceeds of the transaction, after paying all other expenses of the transaction. Seller proceeds to be “paid outside of closing” or for personal property, etc. must also be disclosed.
- **The Payoff statement and short-sale agreement for the mortgage must come directly from the short-sale lender**. We cannot rely on a payoff received from a third party (realtor, seller, short-sale company). Closely review the details of the lender’s payoff instructions and any agreement between the lender and the borrower. Often, there are requirements that go beyond the normal payoff process, such as additional agreements to be executed by the borrower, a new note, and special affidavits or indemnities. Failure to completely follow such instructions or failure to include any such additional documentation will enable the lender to refuse to accept the short payoff or satisfy the mortgage, or even to repudiate the agreement as null and void.
- If the property is in foreclosure, **the lender’s foreclosure attorney must provide a written confirmation** that, upon receipt of payment by the discounting lender of the amount set out in the lender’s “net” payoff letter, the attorney will withdraw the property from any Sheriff Sale List and satisfy the judgment without the payment of any other fees or expenses.
- **The short-sale must be an arms-length transaction**, the buyer and the defaulting property owner (“Seller”) must not be in any way related, nor may the Seller remain in possession, unless fully disclosed to and approved by the Short-Sale lender and any new lender.
- **You must deal directly with the Seller and they must understand and acknowledge the terms of the transaction** and execute a copy of the relevant HUD closing statement reflecting the entire transaction for the property acquisition and the resale.
- If involved in both ends of a flip transaction that includes a short-sale, **obtain an express acknowledgement from the Seller’s lender of full knowledge** of the end/flip transaction sales price. This letter must be signed by an officer of the lender and absolutely cannot be from a mortgage broker. **IMPORTANT:** You must obtain from the first purchaser and the end/flip purchaser written authorization to inform the discounting lender of the end/flip purchase price. We will require the first transaction to be fully consummated, including the recording of the deed and the recording of the satisfaction of the mortgage. We will not issue a title commitment until the documents in question have been recorded. Also, on Schedule A of the title commitment, we will include the consideration on the last vesting deed, as well as the usual parties, date, and recording information of that vesting deed.

NOTE: In the case of a flip transaction, the loan funding the end purchase may violate FHA and FNMA flip transaction requirements, making the transaction ineligible for resale as an FHA and FNMA loan, particularly if the new loan is within 90 days of acquisition by the seller.

If you become aware that you are insuring the second part of a flip, we will require the first transaction to be fully consummated, including the recording of the deed and the recording of the satisfaction of the mortgage. We will not issue a title commitment until the documents in question have been recorded. Schedule A of the title commitment must include the consideration on the last vesting deed, as well as the usual parties, date, and recording information of that vesting deed.