

# Mortgage Fraud and Side Agreements

---

---

## Side Agreements = “Suicide” Agreements

BY OLIVER E. FRASCONA

The use of the term alone should trigger the conscience of most real estate professionals. Why is there an agreement that can not be a part of the contract? There can be no answer other than that the facts expressed in the side agreement are to be concealed from someone who, had they known all of the facts of the proposed transaction, would have reacted in a fashion different from what was intended– also often referred to as “Criminal Fraud on a Federally Chartered or Insured Lender.”

With the exception of such obvious motivations such as keeping a relative or mother-in-law from knowing where you are moving or the purchasing of commercial property as an undisclosed agent, there are very few times when any side agreement is appropriate. This is a good area to avoid. The “If I do not see it, it does not exist” ostrich theory offers no safe haven. Once you know of an irregularity, you are under several often conflicting duties to report to the lender, the government, the seller, the buyer, your board and, always, your broker. Do not be a co-conspirator.

### Case in Point.

*The listing agent, who is a friend of the wife of a client-couple involved in a divorce, agrees to list the property for one commission and rebate a portion of the commission to the wife. The other seller, the husband, has no knowledge of this “side agreement.” Is that not fraud? Are not both the sellers your clients? Could your breach of fiduciary duty to one client result in your refunding the entire commission?*

**Yes.**

*The final straw is the agent’s remark when questioned. He said, “I just wanted to help the wife. You know we have been friends for a long time.”*

*Remember that the fiduciary duty is owed by an agent to all the principals.*

---

---

## 5 Ways to Practice Law Unlawfully

- Changing the wording in a purchase contract except for the section designed to be filled in by a real estate licensee. Even if it’s only a few words, don’t mess with the preprinted portions of a contract form unless permitted to do so by your state’s law.
  - Explaining to your client the meaning of a clause in the contract. Resist the temptation and refer the client to an attorney.
  - Telling a client “not to worry” about a clause in the contract since the seller will not try to enforce it.
  - Signing a document on behalf of your client, even with the client’s approval, unless you have power of attorney.
  - Writing an addendum to the purchase contract. It’s far less risky to include common contingencies as standard clauses and then cross them out if they don’t apply.
- 
- 

**Standard Forms.** *Always use the standard forms proffered by your board or association, real estate commission, and/or by your real estate office. There is no excuse for not starting with these forms. Expediency in preparation is not a good defense. The judge will want to know why you did something different from the standard practice for this particular buyer or seller, especially if some protection is lost.*

---

---

## 10 Signs There May Be Fraud (from Realtor.org March 2006)

The Federal Bureau of Investigation reports that pending **mortgage fraud cases increased by 47 percent** between 2003 and the second quarter of 2005. In its white paper, The Detection, Investigation, and Deterrence of Mortgage Loan Fraud Involving Third Parties, the Federal Financial Institutions Examination Council of Arlington, Va., suggests these **red flags as indicators that fraud may be taking place.**

- **Cash is paid to the seller outside of the escrow arrangement.**
- **Cash is paid to the borrower in a purchase transaction.**
- **No money is due from the buyer at closing.**
- **A difference exists between the sale price on the HUD-1 form and the price on the sales contract.**
- **Related parties are involved in the transaction.**
- **The buyer must use a specific lender.**
- **Funds are paid to undisclosed third parties, indicating that there may be potential obligations.**
- **The sales price is “changed” to fit the appraisal.**
- **The sale is subject to the seller acquiring title.**
- **The loan is based on a buyer’s “stated income” instead of a documented source.**

=====

**Mortgage fraud.** Say the buyers are short of cash for the downpayment, and the salesperson arranges for them to borrow a little extra by fudging appraisal figures. It may seem like an innocent fix, but it’s illegal to trick a lender into lending too much money against an overvalued property. Even if you don’t lose your license in such a scheme, you can jeopardize your livelihood, according to Jon Goodman, a Colorado real estate attorney who answers questions for the state’s legal hotline. The U.S. Department of Housing and Urban Development is known to stop dealing with licensees simply because they were implicated in mortgage fraud, Goodman says.

=====

## Educate Yourself on Mortgage Fraud BY BLANCHE EVANS

With reports of mortgage fraud on the rise all over the country, real estate agents must be on guard for this white-collar crime and go out of their way to make sure they aren’t involved in a fraudulent deal.

Ralph Roberts, a Warren, Mich.-based real estate broker who has created a [Web site \(http://www.flippingfrenzy.com\)](http://www.flippingfrenzy.com) to fight mortgage fraud, says the illegal schemes that have grown more complex over the past several years and are seriously hurting the nation’s communities.

Some 721 cases of mortgage fraud are pending in the United States this year, up from 436 in 2003, according to the FBI. What can you, a real estate practitioner, do about it? You can educate yourself about the common fraud scenarios so you can identify a scheme if you encounter one.

There are more than a half-dozen mortgage *fraud schemes that you should look out for*, the FBI says. In its 2005 Financial Report to the Public, the FBI said these are the most prevalent:

- **Property flipping.** Property is purchased, falsely appraised at a higher value, then quickly resold. This typically involves one or more of the following: fraudulent appraisals, doctored loan documents, and inflated buyer income. Kickbacks to buyers, real estate brokers, appraisers, and title company employees are common.
- **Silent second.** The buyer borrows a downpayment from the seller through a nondisclosed second mortgage, which may not even be recorded. The primary lender believes the borrower has invested his or her own money.
- **Nominee loans/straw buyers.** The identity of the borrower is concealed through the use of another person's identity for the purpose of hiding an applicant's name and credit history when applying for a loan.
- **Fictitious or stolen identity.** May be used on a loan application.
- **Inflated appraisals.** An appraiser acts in collusion with a borrower and provides misleading appraisals to the lender.
- **Foreclosure schemes.** Homeowners at risk of defaulting or whose houses are already in foreclosure may be solicited to transfer the deed to their home. They do so, believing they can save their home. The perpetrator profits by re-mortgaging the property or pocketing fees paid by the homeowner.
- **Equity skimming.** False credit reports and income documents are used to secure loans to purchase property, then the buyer signs the property over to an investor in a quitclaim deed, relinquishing rights to the property and providing no guaranty to title. The investor does not make mortgage payments and rents the property until a foreclosure suit is brought several months later.

### **Tips for Staying Safe From Fraud**

There are many precautions you can take to make sure that you and your clients steer clear of deals involving mortgage fraud. Remember that if a deal seems too good to be true, it probably is.

- **Get referrals.** Encourage clients to get referrals from mortgage professionals and to check the licenses of industry professionals with state regulators.
- **Look out for unusual promises.** Be wary of unsolicited contacts and high-pressure sales tactics. A promise of extraordinary profit in a short period signals a problem.
- **Verify the value.** Check out recent comparable sales of property in the area where you are buying, and other documents, such as tax assessments, to make sure the value of the property is not inflated.
- **Seek out title history.** Review the title history to determine if the property has been sold multiple times within a short period, which could indicate that values were falsely inflated.
- **Know the loan terms.** Understand terms of your mortgage and check that information against information in other loan documents.
- **Protect your signature.** Never sign loan documents that contain blanks. (End of this Article)

# About Real Estate and Mortgage Fraud

by **Ralph Roberts**

Every day, in every city all over the country, real estate industry professionals and consumers and homeowners alike participate in fraudulent real estate transactions. Many are fulfilling a carefully orchestrated scheme, while others are sincerely unaware that their actions could bring them fines, loss of licensure (for the industry professionals), or even jail time. They believe what they're doing is legal and condoned because "so many established people are doing the same thing."

The key to preventing and detecting fraud is knowledge—by understanding what fraud is and how it works you can protect yourself as a homeowner, and if you're a real estate industry professional, you can take important steps to protect your business and your customers.

According to the FBI, real estate fraud is one of the fastest growing white-collar crimes in the United States, and is perpetrated in numerous ways, including:

- Artificially inflating the value of a home to obtain a larger loan.
- Inflating the value of a home so the buyer can receive cash back at closing.
- Submitting false documents to secure financing, including phony paycheck stubs and fake W-2's.
- Taking out multiple mortgages on a property that collectively far exceed the value of the property.
- Selling a home without disclosing to the buyer that it has a tenant.
- Selling the same home to several different buyers.

No matter what your role is in a real estate deal, you have the unique opportunity to affect the validity of the transaction. Each real estate transaction represents an opportunity for an honest experience, and each person you work with has a responsibility to continue that transaction with the same integrity. As a borrower is handed off from REALTOR® to loan officer to processor to underwriter to lender to title and escrow, there are hundreds of occasions for fraud. When you know what to look for (and refrain from infringing on the law yourself), you can have a significant positive impact on the quality of the transaction.

## **Fraud-For-Property**

Although fraud has evolved and become more complex as technology has improved and forgeries have become harder to identify, there are still two basic types of real estate fraud: fraud for property and fraud for profit. In a fraud-for-property transaction, the loan application is completed with falsified information, with the purpose of getting someone into a loan who wouldn't otherwise qualify. For example, a borrower might provide altered pay stubs, "enhance" their credit score, or claim that their down payment was a gift when in fact it was a loan from a third party (also called a "silent second"). Some applicants commit this fraud on their own and may or may not realize the seriousness of their actions, while others are "coached" by their real estate agent or loan officer to distort the facts. It is often (and erroneously) considered a "victimless crime" because the end result is someone getting the home of their dreams. This is a romanticized notion to say the least. When borrowers purchase homes they can't afford, they are at an elevated risk of defaulting and foreclosures. True, maybe one delinquency won't topple the real estate market—but consider that in the last quarter of 2005, the MBA reported a national delinquency rate of 4.44 percent, out of nearly 41 million loans. That's a big hit for the industry to take.

## **Fraud-For-Profit**

Alternately, a fraud-for-profit scam is usually designed to manipulate the lender by conspiring with appraisers, straw buyers, or other insiders. These schemes are more difficult to detect because there are often several people involved, and you may not know who's on the "up and up." This is why it's so important to always work with associates you trust and feel confident in. For Realtors, choosing your appraiser, title company, or other industry partner based on price alone will not help you gauge their values; as in most aspects of the real estate world, strong, reliable relationships are essential.

On the flipside, if you're about to purchase a new or second home, try to get an idea of your Realtor's ethics, procedures, and fraud knowledge. Even if the REALTOR® is an established figure in the industry, don't assume that she/he is immune from fraud. Know your REALTOR® and don't be afraid to tell them when you feel their actions violate the law.

### **Four common schemes to be on the lookout for include:**

- **Appraisal Fraud:** A property is over- or undervalued, often due to pressure from loan originators and real estate agents to alter appraisal reports. This pressure can be negative (yelling or threatening) or seemingly positive (gifts and other illegal kickbacks).
- **Flipping:** A home is purchased and "flipped" or sold immediately for a severely inflated price, often upwards of 30 to 50 percent of the original selling price. That initial transaction is often concealed from the lender. The loan is never repaid and the lender is left high and dry.
- **Identity Theft:** This can range from stealing a customer's identity, to using false names to take out loans, to appraisers using another's name to make false valuations. Identity theft happens swiftly, and finding someone who's real identity you may not know after the loan is completed can be nearly impossible.
- **Straw Buyers:** One person (or company) pays someone else to pose as the home buyer, using their own information and credit score to purchase a property. The scammers then take over the title and mortgage. Essentially, the lenders think they're loaning money to one person, when in actuality, the home will be owned by someone else.

## **Preventing Fraud**

In 2005 there were over 21,994 suspicious activities reports filed within the real estate industry, yet only three percent were ever investigated. Imagine if you only completed three percent of the items on your to-do list—you'd be frustrated, scrambling for resources, and in need of serious help. That's how the Financial Institution Fraud Unit of the FBI feels. Without adequate resources, or an agreed-upon way to fund all of these cases, the FBI and other enforcement officials are left treading water.

So what can you do? Take action when you suspect fraud. Do your due diligence on your REALTOR®, and if you're a real estate industry professional yourself, do your due diligence on every single real estate transaction that comes across your desk to catch false information before a loan closes, whatever the likelihood of fraud. You never know who else is involved in the deal, and what ulterior motives they may have. Check the property's background, look for recent sales, and get a second appraisal if you feel the numbers just don't add up. Ask for back-up verification on any questionable information.

If you know someone has committed fraud, report it. If you let it go, you can bet that person will go on to take advantage of another unsuspecting homeowner or real estate company.

---

---

# Loan Fraud: Say No to Ugly Lending Practices

BY OLIVER E. FRASCONA

It's often done with the best of intentions, but manipulating contracts, appraisals, sources of downpayment, and sale prices to help buyers qualify for a higher loan amount—even if it's suggested by the lender—may make you guilty of loan fraud. Loan fraud occurs when a lender makes an inappropriate loan, because the property is overvalued or the lender has a false picture of the buyer's financial position. Some experts estimate that as many as one in 10 mortgage loan applications contain some misrepresentation.

Here's how it can happen: Sally is a good real estate salesperson. She just wants to close the deal and to make everyone happy. But the seller is desperate to sell, and the buyer needs "just a little help on the downpayment." So Sally writes a contract for \$100,000, contingent on a 90 percent conventional loan. Both parties sign it. The contract includes a clause that reads, "Seller to credit Buyer with \$1,000 for a drapery allowance." So far, Sally looks good. She's written all the terms of the deal—including the payment the seller is making to the buyer—in the contract.

Then the loan officer tells Sally to take the clause discussing the drapery allowance out of the contract and do it as a separate "side" agreement. "If there's any money being given to the buyer for draperies, it shouldn't be in the contract because then the loan won't correspond to secondary market guidelines," he says. "Just bring me a new contract, and I'll pretend I never saw the first one." Sally, who trusts the loan officer, rewrites the contract and gets the parties, who trust Sally, to sign again. The loan officer destroys his copy of the original contract, and the transaction closes with the second contract.

Now the ugly part. The buyer misses a payment. The lender conducts a routine audit and finds out about the "kickback" of funds to the buyer. This payment was part of the transaction but wasn't disclosed on the HUD-1 statement, says the lender. Next thing Sally knows, the FBI is at her door, pointing out that the incentive payment isn't in the contract. The buyer and seller say Sally promised that the side agreement was OK. The loan officer swears he never would've told Sally to leave it out and that he "never saw a prior contract." Sally spends thousands in legal fees, loses her real estate license, and barely avoids criminal charges.

If the buyer in the story hadn't missed a payment, the issue probably never would have come to light. But that doesn't make it legal or ethical. Nor does it lessen your liability if you're the one with the bad luck to get caught.

What are some other types of unintentional mortgage fraud that can creep up on even good real estate practitioners like Sally?

- **The delayed second mortgage.** Since the seller wants to move, he agrees to loan the buyer \$10,000 to complete the purchase. The buyer signs a note to the seller to be recorded after closing and receives \$10,000 from the seller to use as the downpayment. The purchase contract shows that the buyer bought the property for \$100,000 and put \$10,000 down. The second mortgage from the seller isn't mentioned in the contract written by the sales associate.

The lender makes what it thinks is a 90 percent loan of \$90,000 and receives the \$10,000 from the buyer to contribute as the downpayment. Only after the closing does the broker finish the transaction by recording the note as a junior lien on the home.

- **The forgiven second mortgage.** To help the buyer qualify for a higher loan amount, the seller and the sales associate agree to write a second purchase contract, raising the sale price from \$90,000 to \$100,000. The buyer gets an \$80,000 conventional loan. Both the 80 percent conventional loan and the seller-carried \$10,000 second mortgage are included in the contract.

The property appraises at \$100,000, the buyer puts down \$10,000 in cash, and the deal closes. At closing, the seller signs an affidavit that there are no liens on the property other than those stated in the contract. Shortly after the closing, the seller marks the second mortgage paid in full—even though no payments were made—and records a release.

- **The owner-occupant investor.** An investor wants to qualify for the more favorable mortgage terms available to owner-occupants, so he completes a loan application stating that he will live in one of the units in the building. The broker knows the application isn't correct but says nothing.

The practitioners in these stories could've avoided problems if they'd followed these simple rules.

- Put *everything* in the contract.
- If the loan officer tells you to "take it out of the contract" or "do that outside the closing," ask for that direction in writing and keep the document.
- Remember, the loan originator isn't the final arbiter of what's acceptable. It's the lender that finally holds the loan.
- If the parties persist in using illegal loan procedures against your advice, document your advice to your client in writing.

Remember: Your desire to help clients or to get a deal closed could put you on the wrong side of the law and lose you not only a commission, but your license and your reputation.

---

---

## ***Cash Back at Closing: Appealing Arrangement or Sinister Scam***

by Ralph Roberts

Cash back deals are stitched into the very fabric of the U.S. economy. Manufacturers promote their products with cash rebates. Credit card companies offer cash-back on purchases. Even banks dangle cash-back deals to attract new customers. Now, home buyers and con artists are jumping on the cash-back bandwagon, and plenty of our own people -- real estate professionals -- are tripping over themselves to cater to them.

On its surface, cash back at closing seems like a win-win situation. The buyer simply pays a little more for a property than it's worth, and the seller agrees to kick back the surplus cash to the buyer.

For buyers, it can be a savvy financial move, allowing them to pay off outstanding credit card debt or use the extra cash for home repairs and renovations. The seller unloads his house at close to or better than his asking price. The real estate agent gets a bigger commission. The loan officer chalks up another successful loan. And the lender scores a larger loan and stands to earn more interest over the life of the loan. If anything seemed like a win-win situation, cash back at closing is it!

Unfortunately, as with most deals that seem too good to be true, cash back at closing schemes are just another way of scamming someone -- in this case, the lender, who's fooled into making a risky loan.

But lenders aren't the only losers. Buyers are often tricked into buying more house than they can afford. Housing values in the area are artificially inflated, making housing less affordable and raising property taxes. Honest real estate agents lose business to dishonest agents who offer cash back deals. And neighborhoods begin to buckle when homeowners default on the inflated loans and their properties end up in foreclosure. Perhaps that's why cash back at closing schemes are illegal.

### **Illegal?! Yep.**

When I tell colleagues that cash back at closing schemes are illegal, a surprising number of them are incredulous. Agents frequently approach me and describe cash back deals that they were convinced were legitimate.

I was recently talking with a top selling agent in Florida who listed a house for \$600,000. A broker who wasn't from the area had a buyer interested in purchasing the property. Although the broker and buyer had never seen the property, they submitted an offer of \$695,000 -- \$95,000 more than the asking price! The only hitch was that the buyer wanted the seller to kick back the extra \$95,000 to the buyer at closing. The seller just wanted to sell the house, so he had no problem with it. When the agent asked what I thought, I immediately recognized the scam and informed her that the deal was illegal. She explained that the seller really needed to sell the house and that the seller's attorney had informed the seller that nothing was wrong with such a transaction. Unfortunately, the lawyer was under-informed.

The law that governs these transactions is referenced on the 1003, Uniform Residential Loan Application, that every buyer signs when he applies for a loan--Title 18, United States Code, Section 1001. It's part of the small print that lawyers always tell you to read closely before signing anything. To paraphrase Title 18, section 1001, you can't lie on a loan application or any other document related to the transaction. When a buyer, appraiser, agent, loan officer, or another party provides a false statement of the property's value on the 1003 or any other document, they're lying. They're breaking the law.

As real estate professionals, our job is to know the law, act in accordance with it, and abort any deals designed to dupe anyone involved in the transaction. That means we have to shut down cash back at closing scams before they close. The warning signs are readily evident:

- The buyer places an offer on the property that's significantly more than the asking price on the condition that the seller kicks back all or some of the extra money.
- The appraisal is obviously inflated.
- Neither the buyer nor the buyer's agent has ever seen the property.
- The buyer wants to use a different title company than the one that the seller's agent has chosen.
- The buyer or buyer's agent claims that the extra money will be used for home repairs or renovations or paid to a contracting company to handle the repairs or renovations.

The logistics of cash back at closing scams vary, so the warning signs tend to morph over time, but the underlying law that's being broken remains the same. According to real estate lawyer, Rachel Dollar, "Whether it be through seller kickbacks, inflated purchase prices or 'repair' costs, the common thread in these deals is that the lender is not informed of the true nature of the transaction."

Whenever the lender is not informed, in writing, of the true nature of the transaction, the transaction is illegal. And if you go along with the scheme, you become an accomplice, subject to prosecution. So, what should you do when you smell something fishy?

Put a stop to it! Inform all parties that cash back at closing schemes are illegal, and then call the lender immediately. The lender's phone number is on the closing papers, and, believe me, they'll be eager to hear of any pending deals that call for them to loan more money than a property is worth.

=====