

CDPE Brief

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Short Sale Fraud: Short Sale Flip Fraud

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Introduction

Since 2007, fraud involving distressed properties has increased greatly, none more aggressively than short sale flips. A growing trend of short sale flipping has Freddie Mac and the FBI investigating various cases where lenders, distressed homeowners, and/or end-buyers are being defrauded. CDPE-designated agents should be aware of this trend, and how they and their clients can avoid becoming a victim of or party to fraudulent transactions. The Distressed Property Institute is positioned firmly against agents acting in violation of their ethical and fiduciary responsibilities and reserves the right to revoke the CDPE Designation of members involved in committing short sale flip fraud.

What Constitutes Short Sale Flip Fraud?

Freddie Mac's definition of short sale flip fraud is: "Any misrepresentation or deliberate omission of fact that would induce the lender, investor, or insurer to agree to the terms of a short payoff that it would not approve had all facts been known." ¹

Short sale flip fraud usually involves an original short sale homeowner, an investor and an end-buyer, and is often referred to as an "A-to-B/B-to-C" transaction. In this example, the short sale homeowner (A) sells to an investor (B), who simultaneously or quickly sells at a higher price to an end-buyer (C). Often, the investor creates a disproportionately advantageous position by presenting an option contract. Option contracts are agreements where the buyer has purchased (usually for a nominal fee) the right to buy a property for a specified amount of time. If the lender approves the option contract, the seller is contractually bound to sell to the investor without any



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real obligation from the investor to buy. The investor already has or will secure a buyer who will pay a higher sales price before exercising the option. The investor does not disclose the buyer's higher purchase price because most servicers would not approve such an offer. This process also clouds title until the property in the "A-to-B" transaction closes, which has prompted many title companies to stop insuring title in these types of transactions.

Although many types of short sale flip fraud have been committed, the following is an example where the *agent* is committing fraud:

A seller (delinquent borrower) owes \$200,000 on a property with a market value of \$180,000. The listing agent negotiates with the lender to accept a \$170,000 offer to purchase the property made by another *investor* client (In several instances, Freddie Mac has seen that this offer will be made directly by the listing agent or through an entity under his/her control). The lender accepts the offer for \$170,000.

The listing agent neglects to disclose to the lender that there is another offer on the property for \$195,000. The listing agent negotiates and accepts the second, higher offer on behalf of his investor client, who is now acting as the seller. Both transactions close on the same day with the net difference being pocketed by the facilitator and increasing the lender/investor's net losses, and the list agent receiving commissions of \$21,900 for both transactions.²

Here, the agent has acted as dual agent and violated the fiduciary responsibility he had for his distressed client. The Distressed Property Institute will not tolerate this kind of fraudulent activity and any CDPE-designated agent associated with such behavior or any variation thereof will lose his/her designation, and the associated privileges.

It is important to note that not all short sale flips are fraudulent, or even unethical. In some instances, all parties to the transaction provide full disclosure, and the transaction is in accordance with local laws and loan servicer requirements. These transactions most often involve an investor making material changes or improvements to the property before selling.



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It is estimated that lenders—the majority of which are Government Sponsored Enterprises (GSEs)—stand to lose \$310,000,000 in 2010 because of short sale flip fraud.³ When GSEs lose money, so do American taxpayers. Neighborhoods already decimated are losing further value due to these transactions, pushing more and more homeowners into a negative equity status. In addition to risking one's license, an agent who commits fraud affects the lives of individuals and communities across the nation.

Official Position of the Distressed Property Institute

It is the official position of the Distressed Property Institute that intentionally deceiving a client or another party in a real estate transaction with the intention of personal gain is highly unethical and a direct violation of fiduciary responsibility. Furthermore, the Distressed Property Institute does not condone the actions of agents working with the knowledge that their client intends to commit fraud. We believe such behavior to be merely a collusion of the fraudulent act.

Such activity by any CDPE-designated agent will be grounds for revocation of membership and all rights and privileges therein. If an agent is in violation of the law, the Distressed Property Institute will notify the proper authorities. Only if the agent is in full compliance with the law when executing a short sale flip will an exception be made. In such cases, it is wholly incumbent upon the agent to produce substantial proof, to be defined by local authorities and/or the Distressed Property Institute, of full compliance with the law.

What Does This Mean for CDPEs?

Executing a short flip with required disclosure may seem counter-intuitive to some investors. It may also seem justifiable for the agent to act in questionable ways because of the length of time and amount of work it takes to close a short sale. We believe agents acting in their clients' best interests, and with the tools the CDPE training provides, will be able and willing to act ethically and effectively when executing any short sale transaction. It is never right to deceive a client or another party to the transaction in any real estate sale, much less one that involves the misfortune of a distressed homeowner.

Because of CDPE methodology and the ethical dilemma of deceiving others in a short sale flip, the Distressed Property Institute condemns acting fraudulently—or with knowledge of others acting fraudulently. The Distressed Property Institute maintains that such activity does not reflect the values or ethics of our company and membership organization. Should such activity by members



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be made known to the Distressed Property Institute, we reserve the right to revoke membership of those CDPE-designated agents immediately. Furthermore, the Distressed Property Institute will report any such activity to the proper authorities.

CDPE Plan of Action

A CDPE-designated agent should be wary of the following circumstances involved in receiving an offer from a buyer/investor:

- The buyer of the property is an entity.
- The purchase contract has an option clause to resell the property.
- The buyer makes it known that they intend to sell quickly.

Note: Immediately notify Freddie Mac if you are aware of a second purchase contract for a higher price.

A CDPE should also be diligent regarding all short sale documents:

- Review all short payoff documentation carefully, including the sale contract. This helps determine if there is an option clause to resell the property at a higher price without notifying the lender.
- Draft a short payoff arm's-length affidavit/disclosure notice for all parties involved in the short payoff to help avoid any hidden contracts, or side agreements. The parties involved should be, but are not limited to: the buyer, seller, listing agent, selling agent, short payoff negotiator(s)/facilitator(s), and closing agent. (CDPE: reference *Affidavit of an Arm's Length Transaction* in your CDPE Resource Folder.)
- Solicit information from your borrower.
- Inquire if the borrower is aware of any other parties involved with the short payoff other than real estate professionals.⁴

Summary

For CDPE-designated agents, fiduciary responsibility and ethical behavior is expected and the Distressed Property Institute will be vigilant in making sure that the reputation of the Designation and CDPE membership organization will not be marred by fraudulent activity. CDPEs work with both distressed property owners and investor buyers on a consistent basis, and the Distressed Property Institute expects that CDPEs will always act in the best interest of their client, and act ethically when dealing with all parties involved in their transactions. They will also protect themselves and their clients from those who would commit fraud.



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With diligence and knowledge, the CDPE-designated agent will be able to traverse challenges such as short sale flip fraud, maintaining their integrity and that of the Distressed Property Institute and its members.

Endnotes

¹ http://www.freddiemac.com/singlefamily/news/2010/0412_payoff_fraud.html

² <http://www.freddiemac.com/singlefamily/preventfraud/flipping.html>

³ CoreLogic Study: *The Cost of Short Sales*, P. 6

⁴ <http://www.freddiemac.com/singlefamily/preventfraud/flipping.html>



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