

Short Sale Fraud: Upfront Fees

1. Introduction
2. What constitutes an upfront fee?
3. The Official Position of the Distressed Property Institute
4. What does this mean for CDPEs?
5. CDPE Plan of Action
6. Summary
7. Endnotes

Introduction

Short sale fraud has increased greatly since 2007 and may come in several forms. However, the upfront fee may be the most noticeable and in many cases the most preventable type of short sale fraud. There has been debate in the real estate community regarding the charging of upfront or non-commission fees. The Distressed Property Institute is positioned firmly against charging a distressed homeowner any upfront fees for consulting on, listing or negotiating a short sale, as such practice is largely unethical and in some states illegal. The Distressed Property Institute reserves the right to revoke the CDPE Designation of members charging their short sale clients any non-commission fees.¹

What constitutes an upfront fee?

An upfront fee is any fee charged by the agent and paid by the seller to list a distressed property or negotiate a short sale. The agent does not have to guarantee that the sale will close for the fee to be considered a fraudulent transaction. In some states, including California² and Florida, charging upfront fees is illegal:

The foreclosure-rescue consultant is prohibited by law from accepting any money, property, or other form of payment from you until all promised services are complete. If for any reason you have paid the consultant before cancellation, your payment must be returned to you no later than 10 business days after the consultant receives your cancellation notice.³

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In a short sale, the lender or buyer pays the agent's commission at the close of the sale. If the short sale is conducted through the Home Affordable Foreclosures Alternative Program (HAFA) program, then the lender must pay the agent's commission. Because agents derive income from commissions upon closing, additional upfront fees are unnecessary for negotiating a short sale. In the case of distressed homeowners, an upfront fee compromises an agent's fiduciary responsibility to those homeowners.

Agents should also consider that handling short sales means dealing with homeowners enduring real financial hardships. It is our position that to charge an upfront fee of someone undergoing financial hardship is unethical, regardless of the size or condition of the fee. While there may be many who charge such fees, the frequency of an act has little relevance to whether or not it is ethical. Some agents assume that because they have not been held accountable yet, they will not be held accountable at all. We do not believe this to be the case.

The Distressed Property Institute believes that agents dealing with homeowners facing foreclosure should seek out the best possible solution for each individual homeowner, even if it does not result in a sale. If a distressed homeowner can qualify for a mortgage modification or other foreclosure alternatives, such alternatives should be pursued before signing a listing agreement. Often a short sale is the best option, but we suggest agents perform due diligence in advising distressed homeowners of all foreclosure avoidance options.

Official Position of the Distressed Property Institute

It is the official position of the Distressed Property Institute that charging a distressed homeowner any kind of upfront fee for consulting on, listing or negotiating a short sale is unethical and in most cases constitutes fraud. Furthermore, the Distressed Property Institute does not condone the charging of cancellation fees of distressed homeowners. We believe such activity to be a breach of an agent's fiduciary responsibility.

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 collecting and using such funds will an exception be made. In such cases, it is wholly incumbent upon the agent to produce substantial proof, to be defined by the Distressed Property Institute, of full compliance with the law.



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What does this mean for CDPEs?

While some agents may be concerned with client retention and lost time and/or expenditures for listing cancellations, we believe that agents performing due diligence at the outset will avoid these issues. CDPEs are trained in the methods for qualifying potential listings, and understand how to determine seller commitment before a listing agreement is signed.

Because of CDPE methodology and the ethical ambiguity associated with the upfront fee, the Distressed Property Institute condemns the use of upfront fees by any of our members, unless in full compliance with state laws and regulations. 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 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 in jurisdictions where the charging of upfront fees is contrary to the law.

CDPE Plan of Action

The Distressed Property Institute advises the following course of action for members and non-members alike in avoiding situations involving upfront fees in short sales:

- Do not charge any upfront fees of a distressed homeowner whose property you are listing, regardless of amount or whether such fees are refundable.
- Advise any sellers, agents and brokers that charging an upfront fee of a distressed seller is unethical at best, and illegal in some states.
- Advise clients that upfront fees are unethical and that you do not charge them, but are paid a commission by the lender or buyer at closing.
- Avoid transactions in which you know such fees have been charged.
- Notify the authorities when you know such fees have been charged in states in which such fees are illegal.

Summary

Unfortunately, due to the severity and longevity of the current housing crisis, fraudulent activities against distressed homeowners are becoming more and more prevalent. The Distressed Property Institute condemns and is committed to eradicating fraud in all its forms by educating its members and the real estate community at large on the various types of fraud involving distressed properties and sellers. Understanding upfront fees and why they are largely unethical is the first step in avoiding this type of fraud. Through education and agent involvement, the



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Endnotes

¹ Unless in full compliance with state laws (some states may allow advanced fees if approved by the state DRE, placed in an escrow account and handled as “client trust” funds—see the California Department of Real Estate *Consumer Alert Warning Regarding Residential “Short” Sales*, April 2010).

² California State Senate, SB 94.

http://info.sen.ca.gov/pub/09-10/bill/sen/sb_0051-0100/sb_94_cfa_20090327_152419_sen_comm.html

³ Florida State Senate, CS/HB 643.

http://www.flsenate.gov/cgi-bin/view_page.pl?Tab=session&Submenu=1&FT=D&File=hb064303er.html&Directory=session/2008/House/bills/billtext/html/



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