Mortgage Fraud News: July 2009

Preforeclosure Sales Abuse

Fannie Mae has become aware of a new variant of property flipping involving preforeclosure (short) sales.

The trend we have observed involves a perpetrator who submits a short sale offer to purchase a preforeclosure property at a price less than the current indebtedness. This perpetrator locates a second buyer, who may not be arms length, to purchase the property at a higher price simultaneous with the short sale or in rapid succession, concealing the second (higher) transaction from the lender approving the short sale. The second transaction may involve a new loan based on an inflated appraisal.

In some cases, the perpetrator convinces the homeowner to deed the property into a land trust, with the perpetrator (or his accomplice) as trustee.

Example:

Homeowner is in default on $140,000 mortgage.

The perpetrator offers to assist the homeowner in avoiding foreclosure. The perpetrator instructs the homeowner to put the property into a land trust, with the perpetrator (or his accomplice) as trustee.

The perpetrator submits a short sale offer for $106,000 to the homeowner's lender, and simultaneously secures a second purchaser to buy the property from the perpetrator for $145,000.

The lender agrees to the short payoff of $106,000, not knowing that the perpetrator has another contract that would have satisfied the mortgage obligation. Two simultaneous transactions take place: short sale from homeowner (land trust) to perpetrator for $106,000, then from perpetrator to second purchaser for $145,000.

We have been advised of instances where the perpetrator is the listing agent, and the agent presents his/her short sale offer as the "best" offer, even though the agent has received other, higher, arms length offers.

As this trend has gained momentum, some title companies have begun to refuse to close the simultaneous transactions. As a result, a second version of this scheme has evolved in which the closing involves only one transaction: from the homeowner to (the perpetrator's) ultimate purchaser. The perpetrator is paid out through or outside of closing. Some of the tactics observed include a second mortgage filed by the perpetrator against the property immediately before closing, and inflated real estate commissions.

These flips can potentially be identified and thwarted by either the pre-foreclosure lender or the lender financing the second (inflated) transaction. Fannie Mae recommends the following best practices in assessing preforeclosure sale activity:

- ✓ Confirm the ownership status of the property:
  - o Is the title held in trust? Was it an allowable transfer? (Servicing Guide, Section III, Chapter 4)
- ✓ Review marketing efforts such as the MLS listing
- ✓ Condition approval on disclosure of all contracts pending on the property prior to mortgage payoff
- ✓ Validate the purchaser's loan approval, deposit and funds to close
- ✓ Condition approvals for preforeclosure sales on review of the final HUD-1 Settlement Statement
  - o Review the sales price and payouts against the purchase offer

Fannie Mae recommends the following best practices to avoid financing inappropriate property flips:

- ✓ Validate the purchaser's deposit and funds to close
- ✓ Use reliable appraisal valuation sources
- ✓ Review the final HUD-1 and do not allow excessive seller concessions to be paid to the purchaser
- ✓ Question excessive sales commissions
- ✓ Validate that the seller holds clear marketable title to the property

Fannie Mae partners with a wide variety of industry groups, with law enforcement, and with our customers in mortgage fraud education and prevention efforts. If you have any questions or suggestions about this information, please contact Fannie Mae's Mortgage Fraud Program or your Customer Account Manager.