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Watching Out for Fraud

Be sure you're doing the proper due diligence on behalf of your clients in a distressed-property sale.

No doubt, you've read reports about intricate fraud schemes designed to bilk distressed property owners out of equity and steal homes. To help your clients avoid scams, pay close attention to your fiduciary duties—and think beyond basic due diligence.

In an example we've seen repeatedly, unsuspecting sellers are told that a limited-liability company—actually a shell corporation created by the fraudsters—is the buyer of their property. Short-sale approval letters are fabricated using a template from a prior bank short-sale approval and forwarded to the sellers in order to induce them to execute a grant deed in favor of the "buyer." Meanwhile, innocent buyers bidding on the property are told the short sale is approved, and those buyers transfer their purchase monies into escrow. The escrow officer, in on the fraud, then transfers the money to his or her coconspirators and provides a false HUD-1 showing that the funds were used to pay off the lender as part of the short sale. The sellers, assuming their loans are paid off, stop making payments, causing the lender to begin foreclosure proceedings. Before long, the innocent buyers learn they've been defrauded.

What if you are the lone unknowing practitioner in a crooked deal like this? Say, for example, you're representing the innocent buyers. With a little extra care, it's possible that you can expose the fraud and prevent it from occurring. Freddie Mac is encouraging practitioners to help prevent fraud by blowing the whistle on questionable transactions; the agency requires all parties to the transaction to sign an affidavit affirming a truly arms-length deal. If you weren't aware of wrongdoing, you won't be held responsible for others' actions. But if your gut tells you that something is off, then do some research. Follow up with escrow or title officers to ensure they've verified the validity of the short-sale agreement. Don't hesitate to ask for copies of communications with the lender regarding the short sale, and make sure you're satisfied that the lender has authorized the short sale to proceed along the lines that it is, in fact, proceeding. Asking tough questions will protect both your clients and you. We know of one case in which a buyer's agent is being sued for failing to conduct due diligence that would have prevented fraud. Sometimes it can be intimidating to ask extra questions for fear of losing a deal and thus the commission, but is that $10,000 commission really worth becoming embroiled in a lawsuit or blemishing your reputation?

Here are some things to look out for:

- When working with another real estate practitioner for the first time, check the person's license status with your state's department of real estate. Never deal with unlicensed agents or unlicensed brokerage companies, and be wary if you encounter agents who are unwilling to meet in person.
- Be sure to pay extra attention if one of the real estate practitioners is a party to the deal, is using a shell company, or mentions "on the side," "outside of escrow" or "after closing."
- Make sure early in the real estate transaction that all the required state and federal disclosures have been made, and be suspicious if other parties claim to represent federal or state agencies or programs.

Also, beware of the "forensic loan audit." According to the Federal Trade Commission, these can be used to exploit financially strapped home owners. In exchange for an upfront fee, so-called forensic loan auditors, mortgage loan auditors, or foreclosure prevention auditors offer to review a home owner’s mortgage loan documents to determine whether the lender complied with state and federal mortgage lending laws. The “auditors” explain, in many instances without any reasonable basis, that the owner can use the audit report to avoid foreclosure or accelerate the loan modification process.

For your part, if you plan to undertake a short sale on behalf of a buyer or seller, be sure you fully understand how a legitimate transaction should play out. Check with colleagues, industry Web sites, and your state regulatory agency. Remember, if it seems too good to be true, it probably is.

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