



*First American
Title Insurance Company*

CONFIDENTIAL BULLETIN

To: Agents and Offices of First American Title Insurance Company
From: Underwriting Department
Date: 26 September 2007
Bulletin No: FL-531 & SE/MA Division
Name: Insuring “Short Sale” transactions

The housing market is presently in distress. This has caused an increase in a particular type of transaction known as a “short sale” --a sale of property where the lender has agreed to accept less than the outstanding balance of the mortgage and to release the property from the mortgage.

The seller of these properties generally has no equity or negative equity. These properties are often in foreclosure or one is looming near. Some lenders may opt to pursue a deficiency judgment against the mortgagor as to the difference, and the seller may owe taxes on the amount of debt forgiven, but those issues, while important to the borrower, do not affect the title to be insured.

One must exercise extreme caution when handling a “short sale” transaction as the potential for fraud is high.

“Short sales” are not illegal or fraudulent in themselves, but like most transaction structures, if they are misrepresented, or improperly documented, a title agent can easily cross the line into fraud. There are no “absolutes” here, but some fact patterns suggest possible fraud and the need for the closing agent to inquire further. This is especially important after the October 1 effective date of Florida’s Mortgage Fraud statute which in many cases criminalizes “looking the other way.”

Fact patterns of concern include:

- 1. Immediate or simultaneous resale of the property at a price above the discounted value**

Yes, Buying Low and Selling High is the American way. The problem here -- , and the fraud you may be facilitating -- is that the coordinator of the short sale is simultaneously representing that the property is not worth even the outstanding balance of the mortgage while holding a

contract for the sale of the property for a significantly higher (true market) price. Both can't be true! To avoid the risk of our agents being charged as accomplices in this type of transaction, all First American Title Insurance Company agents and direct offices must make the "old" lender and any "new" lender(s) aware of any flip transactions and the sales price of the end or flip transaction. The lenders must provide a written acknowledgement of the terms of the end or flip sale. This written acknowledgement must come directly from an officer of the lenders, and cannot come from a mortgage broker.

It is always a red-flag in this type of situation when the intermediate buyer proposes to use the funds from the end or flip sale purchase to fund the short sale purchase. There is nothing wrong with this practice IF it is fully and properly disclosed and the second buyer approves the use of their funds to close the underlying transaction and acknowledges that the end, or flip, transaction is contingent upon the completion of the short sale transaction. As with the Flip itself, the use of the second buyers' funds should be disclosed in writing to both lenders and acknowledged.

2. Multiple Sales Contracts.

Several variations of the short sale frauds we have seen involve multiple sales contracts at different prices – a low one to show the "old" lender when negotiating a discount and a higher one used for negotiating with the "new" lender. Knowingly making, issuing, delivering, or receiving dual contracts – only one of which shows the true purchase price – is a crime in Florida and a major red flag for fraud. See §877.10 Fla. Stat.

3. Requests for multiple HUDs or HUDs that don't reflect the economic substance of the transaction.

This is always a red-flag for possible fraud and NOT something you can accommodate without becoming a co-conspirator and violating RESPA. Remember that the HUD is a representation of the complete transaction. You cannot have a variety of HUDs that represent the transaction. Just one, and that must be a true and complete representation of the transaction.

4. Payments to the Sellers not disclosed on the HUD – often characterized as payments for the purchase of furniture or other assets.

Many lenders condition their short sale agreements on the current owner not receiving any proceeds (or only a capped amount of proceeds). Agents have been asked to treat the payment as unrelated to the sale of the real estate, as a payment for furniture or other "unrelated" transaction between the parties. The other party to the transaction will argue adamantly that it doesn't need to be disclosed since it is unrelated. Be assured that this is very related – they would not be buying that furniture "but for" the purchase of the property. Any time someone does not want to fully disclose the transaction to the lender, that is a major red flag. In addition, handling or just being aware of such side payments will often be a violation of the written closing instructions on the short-sale.

5. Changes in ownership after the property is in default or foreclosure, without a new mortgage or dismissal of the foreclosure suit.

We have seen several apparently fraudulent structures combining short-sales with equity stripping. Equity stripping often appears under the guise of foreclosure rescue – where the white knight riding to the rescue somehow winds up with all of the borrower’s equity in the property. These transactions usually begin with a no-doc stamp transfer into trust or into a third party without a refinance transaction, without curing the underlying default and without dismissing the foreclosure action.

This fact pattern, whether or not coupled with a proposed short-sale, is frequently indicative of equity stripping -- where the homeowner in default gives up all the equity in the home unwittingly based on fraudulent promises to “help” bring the mortgage current or “help” to save the home and avoid foreclosure. Even though the ownership change is properly documented, great care must be exercised when faced with such a scenario. These types of transfers can, and have been, set aside as fraudulently induced and those lawsuits usually involve a lot of finger-pointing at everyone involved in processing the transaction – including the closing agent.

While there are no hard and fast rules, the single best guide in evaluating a proposed short-sale (or any other transaction) is to ask yourself -- “Would the lender take this discount (or make this loan) if they knew all of the facts that I do?” If the answer is yes, there is no harm in disclosing the facts to the lender(s) in writing and awaiting their written approval. If the answer is NO, then your hiding the information may sweep you into a mortgage fraud conspiracy. There presently is no bright-line rule as to how much profit is too much or how long the property should be held before making the profit. As such, it is best to contact underwriting when faced with this scenario.

6. Restrictions on Communicating with the Short-Sale Lender

We have recently come across short-sale coordinators who insist that the closing agent have absolutely no communication with the short-sale lender – and take their word as to the payoff.

The stated rationale: “They deal directly with the Lender’s negotiator. They feel that they have developed a special working relationship with these already overloaded work-out officers. They do not want any interference nor additional documents nor requests to send us a copy of a payoff statement.”

Each of these factors is a major red-flag for possible fraud. Not only does this practice raise the risk of a misrepresentation in the short-sale transaction (which is furthered by blocking your communication). But, First American has already experienced claims resulting from misrepresented short-sale payoffs.

Always communicate directly with the short-sale lender and get your payoffs directly from the mortgage holder/servicer.

If you have any of these Red Flag’s in a transaction be very cautious. The safe position is full disclosure and written approval by all parties. If you have questions, don’t hesitate to contact your local First American underwriter.

Recommended Guidelines for Insuring Short Sales

1. Prepare and forward to the short-sale lender a proposed HUD statement, evidencing that the discounted payoff represents the full net proceeds of the transaction, after paying all other expenses of the transaction. Above we indicate that some lenders will permit the borrower to retain a small amount of proceeds. Seller proceeds to be “paid outside of closing” or for personal property, etc. must also be disclosed.
2. The Payoff statement for the mortgage must come directly from the short-sale lender. We cannot rely on a payoff received from a third party (realtor, seller, short sale company).
3. If the property is in foreclosure, the lender’s foreclosure attorney must provide a written confirmation that, upon receipt of payment by the discounting lender of the amount set out in the lender’s “net” payoff letter, the attorney will file a dismissal of the foreclosure action and the necessary order(s) vacating the judgment and discharging the lis pendens will be entered without the payment of any other fees or expenses.
4. The short sale must be an arms-length transaction, the buyer and the defaulting property owner must not be, in any way, related unless that relationship is fully disclosed to and approved by the Short-Sale lender and any new lender
5. You must deal directly with the defaulting property owner and they must understand and acknowledge the terms of the transaction and execute a copy of the relevant HUD closing statement reflecting the entire transaction for the property acquisition and the resale.
6. On a flip transaction, obtain an express acknowledgement from the defaulting property owner’s lender of full knowledge of the end/flip transaction sales price. This letter must be signed by an officer of the lender and absolutely cannot be from a mortgage broker. **IMPORTANT:** One must obtain from the first purchaser and the end/flip purchaser written authorization to inform the discounting lender of the end/flip purchase price. NOTE – in the case of a flip transaction, the loan funding the end purchase may violate FHA/FNMA flip transaction requirements, making the transaction ineligible for resale as an FHA/FNMA loan.
7. A full judgment/lien search for the defaulting property owner as well as the first purchaser in a flip transaction is required.