CHICAGO TITLE INSURANCE COMPANY

TOPIC:	SHORT SALE aka SHORT PAY aka PREFORECLOSURE SALE

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In situations in which a modification or deferred payment or other type plan does not work for a distressed borrower, they may seek alternatives – typically a short sale (if a buyer can be found and the current lender(s) will agree to a reduced payoff to release the property) or even a deed in lieu of foreclosure (if the lender will accept title in exchange for a reduction or release of the borrower's personal liability on the note). On November 30, 2009, the Treasury Department issued Supplemental Directive 09-09: Introduction of Home Affordable Foreclosure Alternatives – Short Sale and Deed-in-Lieu of Foreclosure (11-30-09), known as "HAFA", to become effective April 5, 2010, providing supplemental *guidance* to servicers of qualifying loans in situations in which the borrower cannot qualify under the Home Affordable Modification Program (HAMP). However, there are other such programs with individual lenders, and the terms can vary widely. This manuscript is an overview of various concerns for the closing attorney.

DEFINITION

A "short sale" is a transaction in which the potential net proceeds from sale (or refinance) of the property (after payment of costs) will not be sufficient to fully payoff the existing mortgage debt(s) of the seller. The seller (or their agents) must obtain written approval from their lender to release the property for less than the outstanding mortgage balance, under specified terms, typically based on reduced value of the asset (thus, a current appraisal) and the borrower's financial situation taking a turn for the worse.

SHORT SALES - SOME FINANCIAL CONSIDERATIONS

Hopefully, the short sale will produce a market value offer and avoid foreclosure costs thereby decreasing the potential for or the amount of a payoff deficiency by borrower. In addition, the borrower's credit rating may not be as negatively affected (since the property *is* being sold) as it would be with a foreclosure or bankruptcy. (*See* www.myfico.com, the Fair Isaac Credit Score, which indicates, however, that "Credit bureau reports are limited in how they represent foreclosures today, so it's generally not possible to tell from the credit report if a reported

foreclosure is a short sale, deed in lieu of foreclosure, settled account, regular foreclosure, or some other variation. The FICO® score treats all of these descriptions that appear on credit reports as serious delinquencies, so they have an impact on the score similar to the impact from a charge off, tax lien or account included in bankruptcy."

For borrowers who may in the near future wish to purchase a new property and obtain market financing, the Fannie Mae period required to re-establish credit (or for which they are barred from Fannie Mae financing) is significantly less with a "preforeclosure sale" (Fannie Mae's terminology for a short sale), *i.e.*, 2 years after a short sale, as compared to 5-7 years after a foreclosure or 4-7 years after a deed in lieu of foreclosure (Fannie Mae Announcement 08-16 dated June 25, 2008).

Any borrower considering a short sale should still consider consulting with their tax advisor. There may be significant tax consequences from the sale and from the cancellation of indebtedness (debt obligation less property value adjusted for expenses) as compared to foreclosure, especially if the property is investment or business property. Of course, if the lender has preserved its right to seek a deficiency judgment, there is no cancellation of debt income until the debt is compromised or collection statute of limitation expires, presumably. (For more detail, see IRS Publication 544, IRS Publication 4681, IRS Form 982 (on-line at www.irs.gov --> Forms & Publications) and IRS news release IR-208-17 (www.irs.gov/irs/article/0,,id=179073,00.html.)

The antideficiency statute is also a consideration. Typically in a short sale a lender CAN pursue a deficiency if it does not agree otherwise (other than a short sale under the new HAFA as currently set forth). In contrast, a foreclosure may trigger North Carolina's antideficiency protections under N.C. Gen. Stat. § 45-21.38 and *new* 45-21.38A, which cannot be eluded by either a waiver of collateral or a release as that would circumvent the spirit and purpose of the protections. Ross Realty Co. v. First Citizens Bank & Trust Co., 296 N.C. 366, 250 S.E.2d 271, 275 (1979); Barnaby v. Boardman, 313 N.C. 565, 330 S.E.2d 600 (1985). But cf. Wilkinson v. SRW/Cary Associates, 112 N.C. App. 846, 437 S.E.2d 3 (1993) (purchase money antideficiency law does not prevent personal action by seller as holder of unsecured note given by buyer at the time of the real estate sale transaction). In the event a deficiency will be imposed, or even in the event of a potentially significant cancellation of debt (and tax consequences), some commentators recommend that the distressed borrower obtain an independent appraisal of the property value.

QUERY: WHO DOES THE ATTORNEY REPRESENT?

Handling a short sale can be very labor-intensive and may entail significant delays. The buyer's and seller's interests may not always be totally in sync. The seller's goal is to end the transaction without the property *and* without further debt, which can get complicated if there are subordinate liens, significant repairs needed, or the short sale lender insists on a deficiency note. The attorney handling the seller's side of the closing (whether the same as the buyer's or a

separate attorney) will have substantial additional time in the closing caused *solely* because of assuring compliance with the seller's lender's short sale requirements. In addition, even with a binding written confirmation of compliance with the short sale terms, a dissatisfied lender may be difficult to deal with in trying to clear the title as required by the buyer and the buyer's lender.

The buyer may be looking at significant delays (and loan commitment deadlines not met), repairs that must be calculated into their purchase price (usually paid by them), and hoping that no subordinate liens attach in the interim which would prevent the short sale from happening. This might include not just judgments, but owners' association dues, taxes, or even a casualty to the property.

MINIMUM REQUIREMENTS – PRE-CLOSING

Title opinions, commitments, contracts, and the HUD-1 Settlement Statement should accurately reflect the actual current vesting of the seller in title and preferably itemize all conveyances taking place at closing. Many lenders now require that the commitment reflect any changes of ownership within the past 30, 60, or 90 days as an indication to the *new* lender of the possibility of an illegal flip (or violation of FHA Regulations, even with recent temporary waivers, discussed hereafter). However the short sale lender typically relies on the HUD-1 to reflect the actual nature of the sale transaction, to assure that an immediate flip of the property to an ultimate purchaser for substantially more than the short payoff is not involved. (*See* later section on mortgage fraud hereafter.)

Therefore, many title insurers now include a specific requirement in their commitments to address this *pre-closing* disclosure, such as:

> If this transaction involves a "short sale" or "short pay" under which an existing lender has agreed to cancel or release land from a deed of trust for less than the current balance owed on the debt or attributed to the land to be released, certification that (a) all lender requirements are met, and (b) lender's agreement to cancel or release does not include any condition or right to refuse to cancel or release land from said deed of trust or to later void the cancellation or release after receipt of the payment amount specified by lender.

Prior to closing, the attorney must have confirmation from the lender (not just the mortgage broker) that certain conditions outside of their control are confirmed met and the conditions removed such as verification of the appraised or market value of the property, of the distressed seller's financial condition, and that the sale is a bona fide arms-length transaction for sufficient value to meet the short sale lender's requirements. The lender should be provided a copy of the *final* HUD-1 Settlement Statement, whether they will approve it or not, so that the attorney's file will have verification of proof of notice of the terms of the transaction. The lender must know

that innocent third parties, for value, are relying upon this transaction and their exact terms so that they can be met at or before closing.

Since the attorney must assure that *all* requirements for release of the property are met at or before closing, the attorney should not close until (s)he can verify that there are *no outstanding conditions* that render the transaction void, revocable, or allow a right of rescission or avoidance by the lender agreeing to accept the short payoff; especially conditions that can be exercised after the lender has received the payoff funds to which they have otherwise agreed and after a third party innocent purchaser *or lender* has advanced value for the property. All due diligence, proof required, and conditions other than those totally within the control of the attorney (i.e., recording and delivery of the payoff funds in appropriate form) should be met prior to closing.

Even more so than with written closing instructions, the short payoff instructions must be complied with *to the letter* and no assumptions should be made. It is highly recommended that the closing attorney be the addressee to assure that the actual lender (noteholder or servicer, but not mortgage broker) is both aware of their reliance and that they are notified if there are *any* discrepancies or changes. (It is not unheard of that a fax of a copy is either unintentionally or fraudulently inconsistent with the lender's requirements, incomplete, or even changed by those desperate for the transaction to occur.) There is no "standard in the industry" of what the lender (or its investors) will require. Some points of risk or ambiguity include (but are definitely not limited to) the following:

- Promissory note from the distressed borrower for a deficiency balance
- Terms related to escrows such as unearned insurance premiums, property taxes in limbo, or mortgage insurance
- Changes in amounts accrued to be paid to third parties that come due or change in the interim
- Restrictions on payments on subordinate liens
- Repairs required to protect collateral vs. simply to render in condition buyer (or a new lender) will accept
- Restrictions on realtors' commissions
- Recent transfers, transfers into a non-possessory trust (not managed by the distressed borrower), or contemplated transfer at closing (even if legitimate)
- No money back to borrower
- NO straw buyers or flips to third parties already waiting in the wings!
- Any condition that will survive closing, such as a prohibition on conveyance for 30 days thereafter, must be evidenced in the title documents and pre-approved by the buyer, the new lender, and the title insurer if it is to remain outstanding post-closing. (Certain short-term conditions should be discussed with the title insurer to determine if limitations on the buyer's ownership will be sufficient to provide the new lender with affirmative coverage.)
- If the property is encumbered by multiple liens, written enforceable confirmation of conditions, all of which must be handled at closing, must be verified on *all* of the liens, even if from the same lender. The attorney must not assume that the department holding the first mortgage and providing a first mortgage short payoff agreement will be binding

> on a different loan even with the same lender or servicer. And most second mortgage holders are still requiring some payment, even if there is no equity in the property above the outstanding first mortgage balance. So if the first mortgage does not make concessions, the short sale may not be feasible.

Again, the lender who is agreeing to the short payoff should be provided a copy of the *final* HUD-1 Settlement Statement, whether they will approve it or not, so that the attorney's file will have verification of proof of notice of the terms of the transaction. There must be NO EXCEPTIONS from the lender's written requirements unless approved *in writing* by the *lender* prior to closing.

At closing, the payoff must be made at or before the expiration of the short payoff agreement, in the manner (wire or certified cashier's or trust account check via overnight verifiable delivery service) and to the office designated in the letter.

Post-closing, it is more critical than ever that the attorney assure that they follow up to obtain the actual record satisfaction of the debt as soon as possible! Delays can be costly; memories can be short; individual employees disappear; lenders are taken over by FDIC. This is not a situation where there is full satisfaction of the debt -- only contractual and estoppel reliance on a letter agreement.

The North Carolina Bar Association and the North Carolina Association of Realtors® have adopted the Short Sale Addendum (NC Bar Form 2-A-14 attached as an exhibit at the end of this manuscript) addressing closing delays, termination by either party, repairs, backup contracts, foreclosure in the event a short sale cannot be negotiated, and tax consequences.

MORTGAGE FRAUD AND SHORT SALES -- FLIPPING 2010

The federal and state lending regulators take flipping on short sales VERY seriously. *See* Fannie Mae, Mortgage Fraud News: July 2009, "Preforeclosure Sales Abuse." The FBI includes short sale frauds in their 2008 FBI Report (latest on-line at http://www.fbi.gov/hq/mortgage_fraud.htm). The 2008 FBI report describes "Short Sale Schemes":

> Short-sale schemes are desirable to mortgage fraud perpetrators because they do not have to competitively bid on the properties they purchase, as they do for foreclosure sales. Perpetrators also use short sales to recycle properties for future mortgage fraud schemes. Short-sale fraud schemes are difficult to detect since the lender agrees to the transaction, and the incident is not reported to internal bank investigators or the authorities. As such, the extent of short sale fraud nationwide is unknown. A real estate short sale is a type of pre-foreclosure sale in which the lender agrees to sell a property for less than the mortgage owed. In a typical short sale scheme, the perpetrator uses a straw buyer to purchase a home

> for the purpose of defaulting on the mortgage. The mortgage is secured with fraudulent documentation and information regarding the straw buyer. Payments are not made on the property loan causing the mortgage to default. Prior to the foreclosure sale, the perpetrator offers to purchase the property from the lender in a short-sale agreement. The lender agrees without knowing that the short sale was premeditated. The mortgage owed on the property often equals or exceeds 100 percent of the property's equity.

The FBI described the 2009 "Emerging" *Short Sale Schemes – Modified* in which:

> [p]erpetrators across the country are recruiting real estate agents and paying them referral fees for locating and soliciting homeowners undergoing foreclosure. Homeowners are entering into agreements with perpetrators deeding their property to them in the form of a land trust. The homeowner is listed as the beneficiary of the trust and the real estate agent is listed as the trustor. The perpetrators then negotiate a short sale with the lender. After the short sale, the real estate agent sells the property for a profit to another previously identified buyer, but the lender and the homeowner do not know this. In effect, the perpetrator sells the property for less than the mortgage and re-sells the property, often the next day, for a profit.

STORIES AND EXAMPLES

In all of the cases that follow, the fact pattern is basically the same: The current owner is in financial distress, the mortgage arguably exceeds the property value, a flip is contemplated, and an attorney is being asked to represent and obtain title insurance for the proposed ultimate purchaser. In all of these cases, ***the attorney needs to (1) review closely the short sale documents, especially any generic provisions or conditions about notice or undisclosed circumstances, and (2) make full disclosure of ALL transaction details to and discuss with the title insurer prior to closing.*** Typically, the title insurer will require full disclosure to and written approval from the short sale lender in order to assure that they will be obligated to satisfy their lien for less than full payment. In addition, the short sale agreement may have a prohibition on re-sale within a certain period, which may or may not make it into the deed(s) delivered at closing, and can easily be missed in a last minute document delivery. The attorney and the title insurer have an obligation to the ultimate buyer and their new lender to assure that the title is cleared.

Story #1 Option to Purchase:

Owner entered into an **option to purchase** with B when the amount of the outstanding mortgage exceeded the property value. The option would only be exercised if the optionee, B, found a

purchaser. Presumably the exercise of the option and ability of B to exercise it was contingent on having funds from the immediate flip.

(1) First, B did not want us to disclose this arrangement to the (short sale) lender *at all*.
(2) In the alternative, B would allow disclosure of this option to the (short sale) lender, but not disclose the purchase price negotiated between B and the 3rd party purchaser.

Story #2 Multiple Contracts:

Owner enters into a **contract** with purchaser B, which includes a provision deep within the terms that B has the **right to list the property for resale** and states that the borrower intends to resell the property for a profit. Purchaser B assigns the purchase contract to C, as Trustee for the property. Subsequently, C as Trustee, enters into a contract with proposed insured purchaser for a higher price.

Story #3 Fake Sale to Family Member (based on case appearing in Fraud Insights Vol. 4, Issue 11, Nov. 2009):

There are a large number of homeowners realizing they owe more to the bank than their property is worth. They don't want to short sale their home and move out, but they do want to get out from under the tremendous debt. As a result, many homeowners have elected to fake a sale to a family member in order to obtain a lower mortgage payment.

Some property owners have figured out a clever way of reducing their debt while remaining in their home. The property owner enters into a purchase contract to short sale his/her property to a straw buyer, usually a family member. The property owner uses the purchase contract with the straw buyer to negotiate a short sale with the existing lender. In turn, the straw buyer uses the purchase contract to qualify for a new purchase money loan. Once the short sale approval letter and new purchase money loan are secured the transaction closes, but the owner never moves out of the property.

Instead, the original owner takes over the monthly payments from the straw buyer (relative) based on a lower principal amount, lower interest rate and much lower monthly payment. In these situations, the loan investor then suffers losses on both loans. The loan investor accepts a shortage on the existing loan and ends up purchasing the new loan with a borrower who doesn't actually live in the property and doesn't make the mortgage payments. Instead the investor receives payments from the same borrower who just shorted them thousands of dollars.

As a result, some short pay approval letters require the sale transaction be an arms length transaction with no relationship between the buyer and seller. Below is a sample of the requirement language:

> *Any relationships between seller, buyer, agents and escrow/title companies must be disclosed in writing and made known to lender upfront prior to a demand being issued. Failure to do so may result in the demand being declared null and void at any time.*

In some cases the short pay lender will require the buyer, seller, and their real estate agents to sign an Affidavit of Arms Length Transaction under penalty of perjury which states, in part, something similar to the following:

> *The purchase and sale reflected in the Agreement is an Arms Length Transaction meaning the transaction has been negotiated by unrelated parties, each of whom is acting in his or her own self-interest. And that the sale price is based on fair market value of the Property. With respect to those persons signing this affidavit as an agent for either Seller(s), Buyer(s), or both, those agents are acting in the best interests of their respective principal(s).*

Some short pay lenders require the Affidavit of Arms Length Transaction also be signed by the closing attorney as settlement agent acknowledging the parties are not related to one another to the best of the attorney's knowledge.

Red flags!

- Seller and buyer have similar names (or middle initial indicates same family maiden name)
- Driver's license or other documentation show same address for the parties

Story #4 Side Deals for Junior Mortgages (based on case appearing in Fraud Insights Vol. 4, Issue 9, Sept. 2009):

Loan investors such as Fannie Mae and Freddie Mac have guidelines that must be followed by loan servicers when negotiating a short sale letter. Those guidelines often dictate the maximum allowable payment to any junior lienholders. The investor's guidelines take into account that, without a short sale agreement, the junior lienholder would receive nothing. If the first lienholder elected to foreclose rather than enter into a short sale agreement, the second lienholder would receive nothing. Therefore, the first lienholder, in some cases, limits payments to the second lienholder to no more than $1,000 or sometimes $3,000. As a result, second lienholders are trying to force more money out of the transaction by making side deals.

In this down market, we have seen a number of second lienholders trying to "skirt" the maximum amount allowed by the first lienholder by making side deals with the buyer and real estate agents in the transaction. At first, the second lienholders were blatantly including amounts in the footer section of their payoff letter to be Paid Outside Closing (POC) by the

buyer or real estate agents. When attorneys and settlement agents began refusing to close with the POC condition in the letter, the second lienholders moved on to other tactics. Typically these "deals" are made with the seller, the realtor, or others involved in the transaction. *See, for example*, "Big Banks Accused of Short Sale Fraud," by Diana Olick, CNBC.com January 15, 2010; Fannie Mae "Mortgage Fraud News: July 2009.

In one recent transaction, the short pay letter from the first lienholder, "First" Home Loans, dictated no more than $5,000 to be paid to the second lienholder, "Second Mortgagee". The closing attorney received a short pay letter from Second Mortgagee reflecting the same $5,000 amount. We closed the transaction and ten (10) days later they received an e-mail from a loss mitigator employed by Second Mortgagee stating the $5,000 wire was being returned and that the lender would be pursuing foreclosure.

The transaction had already closed 10 days prior insuring free and clear marketable title to a new owner and a first lien position to a new purchase money lender. The loss mitigator stated that the buyer and the short sale negotiator had a "side deal" with Second Mortgagee to send a wire transfer for an additional $9,141.10 on the date of closing. The buyer faxed an instruction to his bank to send the wire on the date of closing as proof of his concurrence with the "side deal." On the date of closing, however, the buyer rescinded his wire and the funds were never transmitted. As a result, Second Mortgagee notified them they were rescinding their short pay letter and initiating foreclosure.

The attorney and insurer had to make demand on Second Mortgage to satisfy, quoting the payoff statutes. Second Mortgagee's loss mitigator forwarded all to the fraud unit for Second Mortgagee. The second mortgage was satisfied, but the ramifications for others involved are still in process.

Moral of the Story

First and foremost, if the parties make you aware of a side agreement, do not proceed to close. Make the first lienholder aware of any side deals and only close when you have conveyed the facts and received the first lienholder's authorization to close.

Secondly, if the lienholder refuses to release their lien post-closing, get the seller involved immediately. In other situations like the one in the above article we have opted to get the consumer involved by having them call the lending institution and inform them of their intent to notify the OCC and other federal regulators of their deceptive practices. Often times, the lender will listen to a consumer over the attorney or settlement agent and will reverse their decision to refuse payment. Also, some states like North Carolina require the lender to release their lien within 30 days or suffer penalties to the consumer for non-timely release of their lien.

Story #5 "Negotiators" Preventing Contact (based on case appearing in Fraud Insights Vol. 4, Issue 7, July 2009):

When the settlement agent finally made direct contact with a payoff lender she had been trying to reach, she found out the short sale negotiator was misrepresenting the transaction. The negotiator had raised the sale price by $12,000, with $8,000 to be given back to the buyer at closing and $4,000 to be paid to the negotiator as his fee.

Once upon a time in the Flathead Valley, short sales were just beginning in the town of Kalispell, Mont. So, when a local settlement agent, Linda, received a request to handle a short sale transaction, she requested a Seller Authorization form and payoff information, began title search (which showed no surprises), and prepared an estimated settlement statement for the payoff lender. The seller had hired a Florida-based "negotiator," named Sam, who was going to be communicating with the lender to obtain the short sale approval. So the draft settlement statement was sent to Sam. A couple of weeks passed without receiving the "payoff approval letter." During that time an addendum was generated, increasing the sale price by $12,000. According to the negotiator, the payoff lender requested the sale price be increased. The buyers were eager to increase the price, as they really wanted the house and thought they were getting a good deal on the property.

The negotiator called to advise he would be collecting a $4,000 short sale fee at closing. Linda told him the fee needed a matching invoice and would be reflected on the settlement statement she sent for approval to the payoff lender. He provided the payee's name and amount and asked Linda to forward a settlement statement to him for submittal, which she did.

Voila! Like magic, the payoff approval letter arrived in the next couple of days and the parties were on track to close. Total amounts due, closing costs, and commissions were all accurate according to the payoff letter – Linda just needed to have the settlement statement approved by the payoff lender.

Linda forwarded the settlement statement to the payoff lender for approval with a copy to Sam the negotiator. Within the hour, Sherry at payoff lender called Linda back, asking where the "seller concession" was reflected on the settlement statement. Linda replied that there was no seller concession and proceeded to verify this with the listing and selling agents to be sure she was not missing any addenda to the purchase contract. The agents confirmed there was no seller concession to be credited to the buyers at closing. The payoff lender was quite upset as the negotiator had advised them there was an $8,000 seller concession to the buyer in exchange for the increased sale price.

What happened? The settlement statement payoff lender had initially received when they provided payoff approval reflected a seller credit. Payoff lender had been faxing approvals and other communication to Linda, but had been given *Sam's phone and fax number*, so they thought they were communicating with Linda when all along it was really the negotiator. Furthermore, they had not approved any type of short sale negotiator fee to be paid. One of the terms and conditions of the payoff letter was that payoff lender receive the settlement statement directly

from Linda. So when payoff lender received the settlement statement directly from Linda it was the first valid communication they actually had with her.

Payoff lender called both agents directly for verification of the purchase contract, demanded that the parties reduce the sale price back to the original offer, and refused to allow Sam to receive any compensation out of the transaction. The payoff lender representative told Linda they were also turning Sam into the fraud division for investigation. Sam was never heard from again.

Moral of the Story

Had Linda closed the transaction based on the terms provided by the negotiator instead of the terms in the payoff letter, we would not have received a lien release from the payoff lender. Since we insured free and clear marketable title to the new buyer, as well as a first lien position to the buyer's new lender, we would have been forced to make payoff lender "whole" in order to clear the lien of record. The terms and conditions of payoff letters on short sales can be complex, but continuing to read and follow them is a duty owed to the attorney's clients.

Story #6 Using Trusts to Force the Sale:

One proposed evasion structure is to convey the property to a trust in which the seller is named as original trustee. But just in case they get cold feet, a third party (affiliate of the short sale negotiator) is named as "successor trustee" with authority to go through with the transaction. The trust will convey to an intermediary corporation for the "short sale" price, but that corporation already has a contract and will immediately sell to the new third party unaffiliated buyer. The sale to the third party buyer will presumably be for a substantially increased price which, of course, is not disclosed either to the short sale seller or the short payoff lender.

Story #7 Unnamed Sellers:

The buyer's short-sale contract named the seller as "Property Owner" and required the short-sale buyer to use a pre-named law firm (stated to be already approved by and representing the short-seller's mortgagee) to insure the short-sale buyer's title and close the transaction for (presumably) the short seller and the mortgagee. Thus, *until it was too late*, the seller did not know about the second leg of the flip which invalidated the short sale, caused reinstatement of the negotiated loan, triggered default, and loss of the benefit of the higher purchase price.

Story #8 Using Trusts to Evade FHA's 90-Day Title-Seasoning Requirement:

Many lenders are now requiring verification in the title commitment of any transfers of title within a certain period *prior to the contemplated closing*, even if there does not appear to be any problem with those conveyances. Simply put, the only conveyance is to a trust and the later transfer is the assignment of the beneficial interest in the trust. The red flag for the attorney is

that the trust names “Joe Seller” but suddenly the trustee is some unknown and previously unnamed and unrelated party, asserting that Joe Seller assigned his interest and no longer has any interest in the property.

Legitimate reasons might be to avoid further liens of the distressed borrower attaching to the property. But typically these are foreclosure avoidance schemes of which a short sale negotiation is only one potential part, and the intermediary (the “new” beneficiary) will take all proceeds from the property without disclosing to the seller or the short sale payoff lender. If they cannot negotiate a short sale or if they cannot find a new buyer, they simply let the property go and leave the distressed seller even further distressed – often taking rental income with them.

Story #9 First Time Homebuyer’s Credit Scam (based on case appearing in Fraud Insights Vol. 5, Issue 1, Jan 2010):

The Mexican custom of using the paternal grandmother's maiden name is used in the United States to circumvent the First-Time Homebuyer's Credit laws.

In Mexico, the father's surname does not suffice on legal documents. Men must include their mother's maiden name. The reason is simple and practical: There are so many Hispanics with the same surnames that they need to include their mother's maiden name to legally separate their identities.

A few months ago, a short sale transaction was closed by Mona for Antonio Sandoval Abrica. Mr. Abrica owned the property as his sole and separate property. He sold the property for $90,000 to an investor. There was approximately $206,500 owed to the current lien holder, but they agreed to a short pay amount of $84,000.

The investor returned a month later and opened a new transaction with Mona for the sale of the same property. The buyer in the new transaction was Maria Aguilar Sandoval, a married woman, as her sole and separate property. She was purchasing the property for $115,000 with a 100% seller carry-back financing. The note was for 30 years, but the investor told Mona that Maria would refinance in a few years and pay him in full. Maria was paying all closing costs, including title and escrow fees. The seller wanted to close by month's end so Maria could claim a First-Time Homebuyer's Credit and receive $8,000 from the IRS. Mona was told the husband's name was Antonio Sandoval. When the gentleman arrived, Mona asked for his identification, which read "Antonio Sandoval Abrica." Mona asked if he went by any other name, he said no just "Sandoval."

She thought he looked familiar and excused herself from the signing room to do a search on the name "Abrica" in her escrow system. Mr. Sandoval was really Mr. Abrica, the previous owner of the subject property. Mona felt too uncomfortable to continue with the transaction and halted the document signing appointment.

Who is harmed in this type of transaction?

1. The short pay lender who took a shortage of more than $122,500 on their payoff.
2. The U.S. taxpayers who would have paid $8,000 to someone who was not qualified to receive the First-Time Homebuyer's Credit.
3. The future refinance lender who should know Maria and her husband defaulted on a previous loan that caused a short sale of the property.
4. Given that this involves potential fraud on a federally-insured mortgage as well as the USIRS, it would have caused serious troubles for the closing attorney and for the title insurer!

What is the definition of a first-time home buyer?

The law defines "first-time home buyer" as a buyer who has not owned a principal residence in the last three years. For married couples, the law tests the homeownership history of both the homeowner and the spouse. For example, if you have not owned a home in the past three years, but your spouse has owned a principal residence, neither you nor your spouse qualifies for the first-time home buyer tax credit! The Sandovals and the investor were attempting to circumvent this law through the use of the paternal grandmother's maiden name.

SHORT SALE ADDENDUM

Property Address:_____

The additional provisions set forth below are hereby made a part of the Offer to Purchase and Contract ("Contract") for the Property between Buyer: _____
and Seller: _____.

1. **Short Sale Defined**. For purposes of this Contract, a "Short Sale" is a sale where: (i) the Purchase Price is or may be insufficient to enable Seller to pay the costs of sale, which include but are not limited to the Seller's closing costs and payment in full of all loans or debts secured by deeds of trust on the Property due and owing to one or more lender(s) and/or other lienholders ("Lienholders"), (ii) Seller does not have sufficient liquid assets to pay the costs of sale, and (iii) the Lienholders agree to release or discharge their liens upon payment of an amount less than the amount secured by their liens with or without the Seller being released from any further liability.

2. **Contingency**. This Contract is contingent upon Seller obtaining Short Sale approval from Lienholders effective through Closing ("Lienholders' Approval") in an amount which will enable Seller to close and convey title in accordance with the Contract. Seller shall use best efforts to obtain Lienholders' Approval and shall reasonably cooperate in the Short Sale process by providing such documentation as may be required. Buyer and Seller understand that Lienholders' Approval may take several weeks or months to obtain, and neither the Seller nor any real estate agent representing Seller or Buyer can guarantee the timeliness of Lienholders' review, approval or rejection. If Lienholders reject the Short Sale, then either party may terminate this Contract by written notice to the other party and all Earnest Money shall be returned to Buyer.

3. **Notice of Lienholders' Approval and Buyer's Right to Terminate.** Seller agrees to provide Buyer with written notice of Lienholders' Approval. Buyer may terminate the Contract at any time prior to receipt of the Lienholders Approval by written notice to Seller, and, in such event all Earnest Money shall be returned to Buyer.

4. **No Guarantee of Lienholders' Approval**. Buyer and Seller understand that:
   - No Lienholder is required or obligated to accept a Short Sale
   - Lienholders may require some terms of the Contract be amended in exchange for approval of a Short Sale
   - Buyer and Seller are not obligated to agree to any of Lienholders' proposed terms
   - **NEITHER THE BUYER, THE SELLER, THE SETTLEMENT AGENT NOR THE BROKERS IN THIS TRANSACTION HAVE ANY CONTROL OVER LIENHOLDERS' APPROVAL, OR ANY ACT, OMISSION OR DECISION BY ANY LIENHOLDERS IN THE SHORT SALE PROCESS.**

5. **No Repairs**. Buyer acknowledges that Seller may not be financially able to make any repairs to the Property that Buyer may request. This acknowledgement shall not affect any rights that Buyer may have under the Contract to terminate the Contract as a result of any election Seller may make not to make repairs.

6. **Other Offers.** Buyer and Seller understand that additional offers may be received by the Seller's Agent, which must be presented to the Seller pursuant to North Carolina law. Such offers may be accepted by the Seller as backup contracts and forwarded to Lienholders for review and approval. Buyer and Seller are advised to seek advice from an attorney to determine their rights and obligations.

Buyer Initials: _____ _____ Seller Initials: _____ _____

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This standard form has been approved jointly by:
North Carolina Bar Association – NC Bar Form No. 2-A-14
North Carolina Association of Realtors®, Inc. – Standard Form 2A14-T

TOPIC: Short Sale aka Short Pay aka Preforeclosure Sale
Last Revised February 1, 2010

7. **Foreclosure.** Seller represents that to the best of Seller's knowledge, a foreclosure proceeding ❑ has not ❑ has been filed with respect to the Property. Further, if during the Short Sale process a foreclosure proceeding is filed, the Seller shall disclose such foreclosure filing to the Buyer. Buyer and Seller understand that if Closing does not occur before the completion of a foreclosure of the Property, Seller will lose all rights and interest in the Property. In such event, the Contract shall be void, and all Earnest Money shall be returned to Buyer. Seller and Buyer acknowledge that if a real estate agent involved in the transaction contemplated by the Contract knows or reasonably should know that a foreclosure proceeding with respect to the Property has been filed, the agent is required by law to disclose it to the Buyer as a material fact.

8. **Tax Consequences and Advice.** Seller is advised to seek advice from an attorney, a certified public accountant or other professional regarding the credit, legal and tax consequences of a Short Sale.

IN THE EVENT OF A CONFLICT BETWEEN THIS ADDENDUM AND THE OFFER TO PURCHASE AND CONTRACT OR THE VACANT LOT OFFER TO PURCHASE AND CONTRACT, THIS ADDENDUM SHALL CONTROL.

THE NORTH CAROLINA ASSOCIATION OF REALTORS®, INC. AND THE NORTH CAROLINA BAR ASSOCIATION MAKE NO REPRESENTATION AS TO THE LEGAL VALIDITY OR ADEQUACY OF ANY PROVISION OF THIS FORM IN ANY SPECIFIC TRANSACTION. IF YOU DO NOT UNDERSTAND THIS FORM OR FEEL THAT IT DOES NOT PROVIDE FOR YOUR LEGAL NEEDS, YOU SHOULD CONSULT A NORTH CAROLINA REAL ESTATE ATTORNEY BEFORE YOU SIGN IT.

Buyer:_____(SEAL) Date_____

Buyer:_____(SEAL) Date_____

Seller:_____(SEAL) Date_____

Seller:_____(SEAL) Date_____

Buyer Initials: _____ _____ Seller Initials: _____ _____

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Acknowledgement

Date:_____
Escrow Number:_____
Property Address:_____
Buyer: _____
_____

Buyer acknowledges and agrees as follows:

A condition of Lender's approval of the short sale is that the Buyer agree that the Buyer will not transfer the property which is the subject of this transaction within 30 days of the close of escrow (or closing). Buyer understands that escrow holder (or settlement agent) has agreed to close this escrow and the title insurer who will be issuing Buyer's New Lender a policy of title insurance without raising an exception for the Lender loan or the terms of this condition contained in the approval has agreed to issue said policy on the basis of the following acknowledgements by the Buyer. Buyer agrees not to transfer the property within said 30-day period and further represents that Buyer will be occupying the premises as Buyer's principal residence. Buyer does hereby agree to indemnify escrow holder (settlement agent) and the title insurer harmless from any loss, costs or damages including, but not limited to attorney's fees, which either may incur as a result of Buyer transferring the property within said 30-day period.

Understood and acknowledged:

Buyer:

_____

_____