

Wave of Short Sale Fraud Hits Mortgage Industry

January 20, 2010

By Jennifer Harmon

The rise in residential foreclosures around the country has led to a similar increase in short-sale fraud transactions that has particularly serious implications for mortgage lenders.

“What we’re seeing are situations where individuals are unlawfully taking advantage of homeowners and their lenders by engaging in short-sale fraud. The most common scenario is where these individuals secure two appraisals on a property that is about to go into foreclosure, one lower and one higher,” says Chris Thorsen, a partner and financial services industry litigator with Bradley Arant Boulton Cummings LLP in Nashville, Tenn.

“They then use the lower appraisal to buy the property from the mortgage company holding the loan, and the higher appraisal to sell the property on to another buyer. They pocket the difference, which can be as much as several hundred thousand dollars, depending on the property,” says Mr. Thorsen.

Mortgage lenders who have fallen victim to short-sale fraud face an expensive battle in court to recover funds.

“These cases are very fact intensive - who knew what and when - and as a result are expensive to take to trial for the mortgage lender who has been duped, “ says Mr. Thorsen, who currently represents several lenders in litigation related to short-sale fraud.

“Additionally, lenders often face the hurdle of convincing the judge and jury that the short-sale fraud was more than your average property flip for profit,” says Mr. Thorsen.

He says there are steps lenders can take to mitigate risk from short-sale fraud.

“An ordinary short-sale can be advantageous to the lender, if it is careful and puts in some hurdles of its own. For example, they can make the short-sale contingent on the buyer not selling the property for more than a certain percentage more than what they have paid for it, and, if they do, the excess goes back to the mortgage company.”

Lenders should also secure representations and warranties from both the borrower and the buyer that they are not aware of any other appraisals for higher amounts on the property and/or that they have no undisclosed agreements with any third parties to sell the property for more than “X” dollars, he said.

“If language like this is used, a clause can be inserted providing for damages in the amount of the additional resale price of the property to be paid to the lender as well as an agreement to pay attorneys fees and litigation expenses in the event the lender has to file suit for any violations of the agreement.”



BRADLEY ARANT
BOULT CUMMINGS

LLP