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Historically shunned by creditors, **short sales are becoming the resolution of choice** as we make our way out of the crisis.

SHORT SALES GAINING TRACTION

ANATOMY OF A FRAUDULENT SHORT SALE

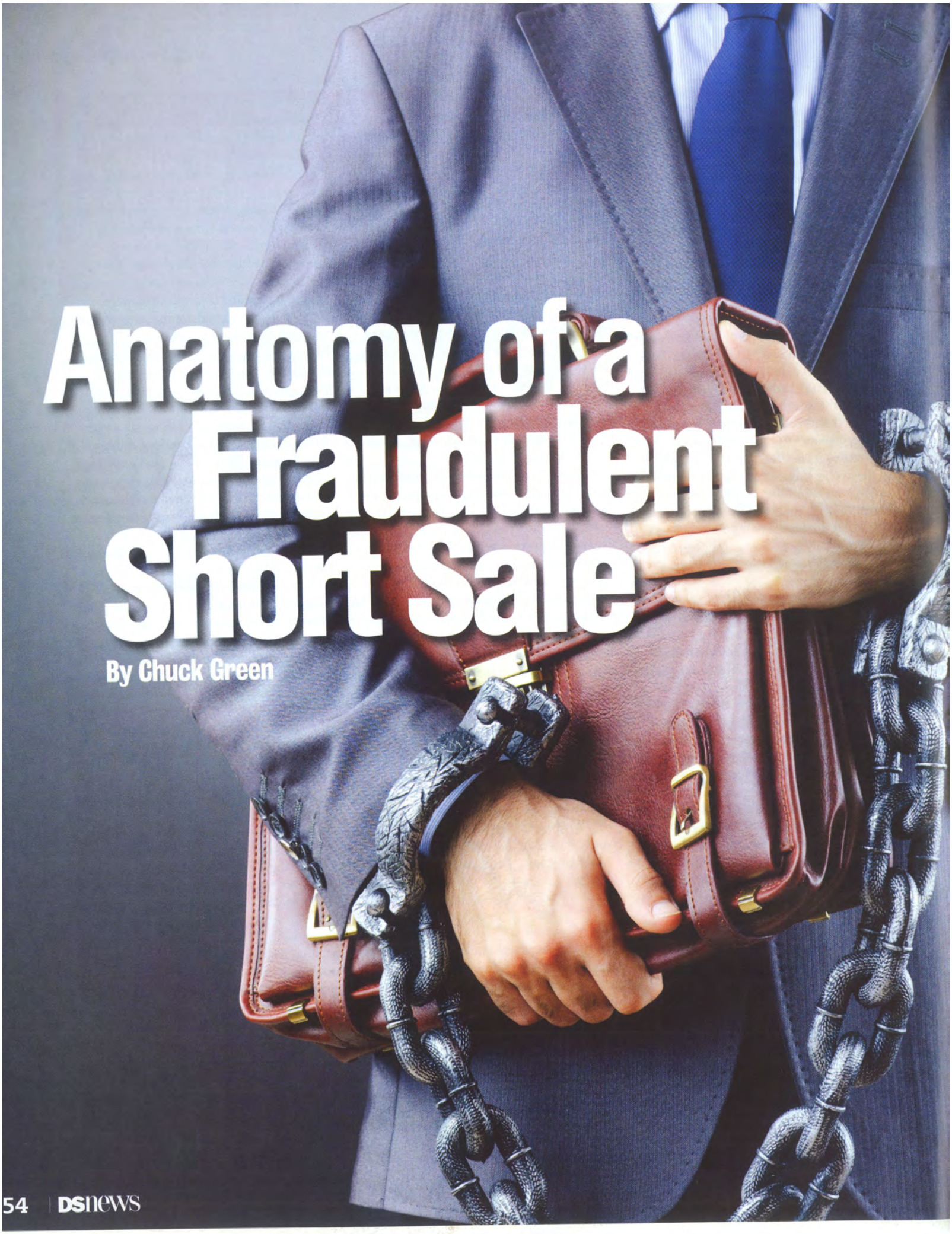
As short sale activity increases, so does the potential for fraud, putting servicers in the precarious position of deciphering between swindles and legitimate flips.

HOUSING PAIN HITS THE POLLS

Recent study reveals a distinct link between foreclosure rates and voter turnout with default-heavy communities posting softer-than-average figures.

SHORT AND SIMPLE

Thanks to new rules aimed at easing the process and procedural steps servicers can take to avert roadblocks, short sales don't have to be a long shot.



Anatomy of a Fraudulent Short Sale

By Chuck Green

With short sale activity up, so is the potential for fraud, but what constitutes a swindle versus a legitimate short sale flip?

A couple purchased a home in California's San Fernando Valley in 2005 for $675,000 but defaulted in 2009. The following year, they completed a short sale of the home for $363,000 to a man of similar ethnicity. At the time, it probably seemed like an innocent coincidence. However, in 2011, the buyer added his wife to the title in a joint tenancy. The thing is, she and the seller shared the same last name and were, in fact, siblings.

It was a dual agency sale, meaning the same agent handled both sides of the transaction. Dual agency is legal in California but not in all states. A neighbor reported that after the house was supposedly sold in 2010, no one moved out and the same people regularly came and went from the property. What's more, the same cars remained parked there. Coincidences only go so far.

Then there was the bachelor who bought a house in Orange County in 2005 for $700,000 and added $300,000 in home improvements. In 2008, he put the property on the market for $1 million. He went through three or four real estate agents and, possibly by design, defaulted in 2010. Several months later, his lender agreed to a short sale for $300,000. The buyer? The bachelor's girlfriend. In 2011, she sold the home for $410,000, ringing up a tidy $110,000 profit.

"That unfolded in a down-market" with the girlfriend making a 37 percent profit in less than 12 months, bristles Monique Bryher, a real estate broker based in Los Angeles.

"The property undoubtedly would have had multiple offers if the man had listed it at $410,000, and the bank, rather than the girlfriend, would have received the money in this non-arm's-length short sale," added Bryher, author of the book *How to Commit Short Sale Fraud . . . and Get Away with It,* from which the cases were culled. An arm's length transaction basically means no family, friends, business associates, or known acquaintances, she explains.

Deception Deficits

Short sale fraud can occur when the parties involved in a transaction—buyers, borrowers, or real estate professionals—fail to disclose affiliations with other parties to rig sales at a low price and hide better offers from the distressed home seller, according to Freddie Mac. By concealing the higher offer, short sale fraud worsens losses to home sellers and taxpayers, the GSE says.

With hundreds of millions of dollars in short sale losses over the past few years, the benefits have never been greater for lenders and servicers to implement short sale monitoring tools and improve their short sale fraud prevention strategies.

Fannie Mae notes that falsifying material information, such as the true value of the property, also constitutes fraud as it prevents the servicer from making an informed short sale decision, and Freddie Mac cites manipulating or influencing the broker price opinion (BPO) as one of the most common short sale fraud schemes.

CoreLogic's fourth-quarter update to its 2011 Short Sale Study examined 685,000 single-family residence (SFR) short sales from the first quarter of 2008 through the fourth quarter of 2011. CoreLogic, a provider of property, mortgage, and consumer data as well as fraud management technology, estimates unnecessary short sale losses due to suspicious transactions topped out at $300 million for the 2011 calendar year. That's down from the $375 million projected in May 2011 but still a hefty chunk of change to leave on the table.

The company anticipates estimated losses will increase slightly in 2012 due to unrealized recoveries in short sale transactions that may be exacerbated by the new Freddie Mac and Fannie Mae regulations, shadow inventory—also known as pending supply overhang—and projected short sale volume increases in the marketplace. As a result, CoreLogic projects 2012 to experience slightly higher losses than the approximately $300 million estimated for 2011.

Shady Activity Clusters

Lender Processing Services reports 160,541 short sales were completed in California during the 12-month period ending June 30, 2012. Florida's short sale tally over the same period was 99,620, and Arizona's was 51,872.

As the volume of short sales continues to grow, California, Florida, and Arizona remain the states with the highest SFR short sale volume and account for some 45 percent of all short sale transactions in the United States. According to recent CoreLogic data, these three states will maintain the same respective positions at the top of the rankings for SFR suspicious short sale transactions through 2012 and heading into 2013 as industry experts anticipate short sale volume in these markets could potentially exceed foreclosure transactions.

Additionally, investment buyers continue to pose a disproportionate degree of risk with the suspicious rate for transactions involving LLCs at around 20 percent compared with approximately 1.5 percent of all transactions in the CoreLogic study. CoreLogic also reports a rising trend in the percentage of suspicious short sales flipped for more than $50,000 profit as more than 60 percent of all suspicious transactions involve a resale for more than $50,000 above the initial short sale price.

"People who commit mortgage fraud are criminal opportunists who take advantage of whatever they can, [like] insider knowledge of lender operations and processes," said Ann Fulmer, an expert in mortgage fraud and investigations and VP of industry relations at Interthinx, a provider of risk mitigation technology solutions. "Mortgage fraud is essentially committing robbery without a gun," she added.

Lackadaisical Attitudes?

Jim Klinge sees "shady dealings," as he calls short sale frauds, at least once a day. Klinge, a broker with Klinge Realty in Carlsbad, California, holds the multiple listing service (MLS) among those at least partially culpable. "I think the problem is that the people who run the MLS refuse to lay out concrete rules on [how to properly conduct short sales]. They don't have specific boundaries, rules, or regulations; they just let it go."

Why? "I think it's because they don't get paid enough to care. Administrators of the MLS are just keeping the store open and doing as little as possible. It's okay with them [if they operate] a mediocre business, something that people can use and abuse at their leisure."

MLSlistings officials did not respond to requests for comment.

Klinge also places blame on the National Association of Realtors (NAR). "I asked them what they're doing to combat short sale fraud, and they wouldn't have anything to do with it. It's a sad testimony to our industry," Klinge said.

However, an NAR spokesperson says the organization's Short Sales and Foreclosure Resource Certification is currently the fastest-growing NAR certification and designation, which underscores the significance of the issue within the association. Nearly one in five Realtors now holds this certification, developed a few years ago. The certification is designed to help Realtors assist sellers in maneuvering the complexities of short sales and help buyers pursue short sale and foreclosure opportunities, the spokesperson explained.

Klinge says banks are at least starting to pay more attention to the issue, albeit to a limited extent. "I think they're doing what their attorneys tell them to do without spending too much money," he said. "They're just worried about the bottom line."

Bryher, though, practically sees red over the role—or lack thereof—she feels many banks generally play in regulating short sales. "For the most part, banks don't care nor does law enforcement. [In fairness], because the bank is at least the primary victim, if they're not willing to do anything, it's harder for law enforcement to [act]," she said. Case in point: When Bryher contacted the bank involved in one of the short sale fraud cases in her book, "I could tell from the conversation that [the information I provided] would go straight into the trash," she recalled.

Yet, Freddie Mac's Robert Hagberg insists the industry pays serious heed to the matter. Freddie Mac implemented controls to help deal with short sale fraud, including being first to mandate the use of a short sales affidavit designed to "hedge off a lot of [short sale fraud] activity," indicated Hagberg, the GSE's associate director of mortgage fraud investigations. While the measures worked, Hagberg admitted, "When you put a control in place, some people will find a way to kind of jump the hurdle."

The affidavit notwithstanding, banks have to follow up and at least conduct random audits "to keep people honest and prosecute those caught," Klinge observed.

Fulmer, however, said today's environment—for both large lenders and servicers—

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"strongly resembles the environment during the boom: big-time pressure to quickly move a lot of bad loans and properties off the books. It encourages everybody to do the minimum amount necessary to resolve cases without necessarily doing the due diligence needed to stop fraud. They're just trying to stop the bleeding."

Wells Fargo and Bank of America wouldn't comment for this article, and JPMorgan Chase didn't respond to a request for information.

Banks are one thing; real estate agents, on the other hand, have no excuses, Fulmer says. She notes the apparent irony of their part in a short sale.

"It's the fox guarding the hen house because in short sales and other distressed sales, brokers aren't required to obtain an actual appraisal. A broker price opinion will suffice and a broker price opinion is prepared by the fox—the real estate agent—at least a few of whom convince banks to accept less than market for a piece of property," she explained.

In fact, some agents go so far as to give short sale properties "token exposure" with a listing service in order to meet lenders' marketing requirements but limit offers, according to Fulmer. "We've seen cases where a property's been listed in the wrong market. It's kind of manipulation," she said.

Legitimate Deals Do Exist

While he can't directly address fraudulent activity, broker Allan Glass proffers a different overall take. "I think a lot of these deals, when you're trying to analyze them from an altitude of 10,000 feet, without understanding their complexities, often look like they could be fraudulent or suspicious but in no way are," said Glass, president of ASG Real Estate Inc. in Los Angeles.

Glass says he, and others, often legitimately complete short sale transactions on the fast track, precipitated by a number of factors, such as the need for families to move into a home quickly for things like school or work.

Gagan Sharma, president and CEO of servicer BSI Financial, offers a similar point of view. "If an investor does his or her research, is good at identifying and buying the right property, and has good contacts to finish [a deal] fast, I don't think that's fraud. If anything, that investment activity is to be encouraged for a quick recovery of the market," Sharma said.

Clamping Down on Cons

Servicers play an important role in trying to tamp down short sale fraud, according to Ed Gerding, senior fraud and risk strategist consultant at CoreLogic. "With hundreds of millions of dollars in short sale losses over the past few years, the benefits have never been greater" for lenders and servicers to implement short sale monitoring tools and improve their short sale fraud prevention strategies, Gerding noted.

He says CoreLogic believes consortium-based tools are an effective component of a short sale fraud prevention strategy. Pre-closing short sale monitoring provides tracking of transactions and pending applications not normally recorded prior to a short sale, "so the lender and servicer can spot potential flipping and flopping and proactively react to stop it," Gerding explained.

While the use of short sale monitoring tools are effective, it's also important for lenders and servicers to provide adequate risk mitigation training that will heighten the awareness of short sale fraud red flags and how to mitigate against them, Gerding notes. "When all else fails, send the high-risk short sale transactions to the fraud prevention team for a full investigation," he added.

Gerding says short sale fraud prevention strategies are gradually beginning to improve but not to the degree he'd like. "It's important to communicate, communicate, and over-communicate about the inherent risk of short sale transactions, how to identify the fraud red flags, and how to respond to these emerging threats," he said.

Hagberg says training loss mitigation staff to recognize the red flags surrounding short sale fraud—like whether the purchase contract on the short sale is an option contract or a customized form rather than the standard state-issued form—"is far and away," the most effective best practice tool lenders and servicers can implement.

"Over the last few years, a lot of users have become much better about ensuring that people who negotiate short sales or loan modifications are familiar with those flags," Hagberg said. "Just because someone doesn't work in the fraud unit doesn't mean they can't identify red flags and flip them over to those who conduct the actual investigation."

To help prevent fraud, Sharma says his company uses property valuations done by an independent source that's not involved in the disposition of the property. "This ensures that we get an accurate estimate of value," he explained. Further, when the deal is going through closing, Sharma says BSI Financial as wells as its investors independently review the property valuation as an additional layer of quality control. BSI also ensures an arm's length transaction and single point of contact.

Still, based on what she's been told, Fulmer says scams are successful because they target servicers since they conduct most negotiations although servicers generally aren't the most qualified to detect or prevent fraud. "Servicers have always functioned basically as back office, collection, and account management kind of people, and they're clearly overwhelmed with volume right now," she said.

Furthermore, they're performing tasks like single point of contact and "basically acting as psychologists and social workers for troubled borrowers—things they've never had to do before," Fulmer noted. "I don't think [combating fraud] is part of their genetic code. People flow in and out of the industry and you get new crops of people who've never experienced this before. They're never been trained to detect or prevent fraud."

Besides, most people don't think like criminals, Fulmer points out. "We tend to trust people, but that creates vulnerability because if you don't think 'how can I gauge this?' you're not able to expose the realities and won't be able to figure out what's going on," she said. That, she noted, creates a "huge opportunity for scammers." DS