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Short Sale Fraud

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[I. GENERAL OVERVIEW](#)

Just as REALTORS® struggled with loan fraud during the subprime heyday, they now face the rampant growth of short sale fraud in the subprime aftermath. Short sale fraud comes in many shapes and sizes to wreak havoc on the unsuspecting sellers, buyers, and agents, often at the most inopportune time.

This legal article provides legal and practical guidelines for REALTORS® and their clients for dealing with short sale fraud. This legal article also describes certain types of short sale scams, and explains how REALTORS® and their clients can distinguish between legitimate and illegal short sale activities.

Q1. *What is short sale fraud?*

A Short sale fraud is a loose term for describing fraud, deceit, or trickery in connection with a short sale transaction. As background, a short sale is a sales transaction where: (1) the sales price is less than the seller's existing mortgage loan balance, other liens, and costs; and (2) the existing creditors agree to a payoff of less than what's owed. Short sales help homeowners to avoid the stress and stigma of foreclosure. Short sales also help mortgage lenders by avoiding the costs of foreclosure, including the burden of maintaining and reselling properties acquired through the foreclosure process.

Q 2. *What are some examples of short sale scams?*

A Like other types of scams, short sale fraud can take many forms. At one end of the spectrum, a short sale scam can be part of large, well-organized fraud ring, and at the other end, it can be one isolated incident.

Examples of short sale fraud include, but are not limited to, the following:

- Fraudulent short sale flips (see Questions 9 to 13);
- Short sale negotiator scams (see Questions 14 to 19);
- Short sale package scams (see Questions 20 and 21); and
- Improper payments (see Questions 22 to 25).

Q 3. *How could a homeowner fall victim to a short sale scam?*

A Short sale transactions are highly susceptible to scams. A typical short sale is complicated, difficult, and can drag on for many months. Yet, short sale sellers are often too financially strained to hire experts to advise them on the complicated financial, legal, tax, credit, and other issues raised by their situations. Sellers are also likely to be anxious to finalize their short sales quickly to avoid the possibility of losing their homes through foreclosure. On top of the stress and stigma of a looming foreclosure, short sale sellers may be dealing with other financial and emotional hardships, such as job loss, death of a loved one, divorce, or illness. Given these circumstances, the sellers can easily succumb to a scam artist's lure of a guaranteed quick fix. As one victim of a foreclosure rescue scam said, "When you're down and out you'll believe anything."

Q 4. *Can someone other than a homeowner fall victim to a short sale scam?*

A Yes. Homeowners aside, real estate agents, appraisers, mortgage lenders, escrow companies, title insurers, and others involved in the short sale process are also vulnerable to scams, especially considering the financial strain brought about by the downturn in the real estate market. Some real estate agents and other service providers merely get caught in the crossfire between the scam artist and homeowner. Others are reeled in by design because their participation may facilitate or lend legitimacy to the fraudulent schemes.

Real estate agents, in particular, can be targeted by scammers for their leads as they are often the first point of contact for a homeowner in distress. Agents may also be sought out by scammers for their ability to list and market properties. Agents may also get tricked into paying for phony short sale lead generators, farming lists, marketing tools, training seminars, coaching services, and other bogus short sale products and services.

Q 5. *Is there an easy way to detect a short sale scam?*

A No. Short sale scams may not be easy to detect, but see Questions 6 and 7 for helpful guidelines. Outwardly, scam artists do not act or appear dastardly. On the contrary, the typical scam artists look nice and clean-cut, and they seem kind, helpful, patient, and trustworthy. Their purported companies are likely to appear well-established, reputable, and qualified to do the tasks at hand. The companies may even have names that sound altruistic, such as Community Short Sale Services or Short Sale Advocates. Some outfits may appear to be related to the government, such as administered by or an agency of the government. For instance, a scammer may pretend to offer a short sale under the U.S. Treasury's Home Affordable Foreclosure Alternatives (HAFA) program, knowing that most people are unfamiliar with the details of this new government-subsidized program. On March 30, 2011, the U.S. Treasury amended the HAFA program to allow loan servicers to approve a short sale to a non-profit organization for the purpose of renting or reselling the property to the borrower as specified (see Making Home Affordable's Supplemental Directive 11-02). This amendment may give rise to unscrupulous entities posing as non-profit organizations with the intent of preying on unsuspecting homeowner, and even soliciting real estate agents to pay for certification or membership with their organizations in exchange for leads or listings.

Scammers come from all walks of life, including, but not limited to, appraisers, accountants, attorneys, bank officers, landlords, tenants, friends, and colleagues. Scam artists may engage in "affinity marketing" tactics to attempt to lure people into their fraudulent schemes. Affinity marketing tactics involve scam artists who are, or pretend to be, members of the same racial, religious, social, or other group as their victims. For example, a scam artist may claim to be in the military, and use military terms and mannerisms, in an attempt to befriend someone in the military. Or a scammer may join a church to gain the trust of other members of that church before attempting to defraud them.

Q 6. *What are the red flags for detecting a short sale scam?*

A REALTORS® and their clients contemplating or engaging in short sale transactions should be aware of the different types of scams (see Questions 9 to 25). In addition, they should be wary when dealing with someone who does any of the following:

- Makes an offer that sounds too good to be true;
- Gives an unqualified promise, such as to obtain short sale approval, stop foreclosure, or other assurances;
- Is unconcerned about the sales price, possession of the property, and other significant terms of sale;
- Is unconcerned about the short sale seller's financial situation;
- Is involved in a sales transaction where the seller is not the current owner of the property;
- Is involved in a sales transaction where a notice of default has been filed against the property;
- Is involved in a sales transaction under the Home Equity Sales Contract law (see C.A.R.'s legal article at <http://www.car.org/legal/2008articles/home-equity-sales-contracts/>);
- Is involved in a sales transaction where the property owner has purportedly given someone an option to purchase;
- Represents that the buyer is an entity (such as a trust or LLC), rather than an individual person;
- Creates more than one sales contract for the same property;
- Asks for the payment of money upfront before providing any service;
- Asks for payment only in the form of cash, cashier's check, or wire transfer;
- Asks for something to be done immediately without delay;
- Asks for a power of attorney;

- Asks for a transfer of title or an interest in the property outside of escrow;
- Asks for signatures on a grant deed or deed of trust;
- Asks for signatures without giving a lot of time to review the documents;
- Asks for signatures on a document that has lines left blank;
- Fails to provide copies of documents signed;
- Refuses or fails to provide written confirmation of an oral promise;
- Instructs the seller, listing agent, escrow officer, or someone else not to contact the short sale lender;
- Instructs a client not to discuss his or her situation with a housing counselor, banker, accountant, attorney, family, friends, or others;
- Has an answer for everything; and
- Engages in "shop talk" that sounds glib, but doesn't in fact make sense.

Q 7. *What should sellers, buyers, agents, and others do to protect themselves against short sale scams?*

A The basic rule is "if it sounds too good to be true, it probably is." In addition to watching out for the red flags in Question 6, affirmative measure to take to protect against scams include, but are not limited to, the following:

- Before doing business with someone, check the legitimacy and qualifications of both the individual person and business entity. Check whether the individual person and business entity are properly licensed (see Questions 26 to 38). Ask for references and check out those references. Also check someone's background, credentials, and reputation. Search the Internet and check public records and trade group memberships. Remember, however, that even if someone has the proper credentials or comes highly recommended, the risk of a scam is less, but is not eliminated entirely.
- Do not panic. Do not make any rash decisions. It's precisely when your chips are down that you must keep a clear head.
- Before entering into an agreement or arrangement, understand every aspect of what it entails. Read documents carefully and thoroughly before signing. If you do not understand a document or the consequences of a document, seek the advice of an attorney, accountant, or other professional as appropriate. If you do not speak the same language as the person you're negotiating with, don't use that person's interpreter or translator -- bring your own instead.
- Do not sign your name to any false statements or documents with spaces left blank, especially if you're told that signing will be harmless or inconsequential.
- Get as much information as you possibly can before making a decision. Ask questions. Conduct as much research and investigation as you can upfront. Look into different options and their financial, legal, tax, and other ramifications. Ask for advice and help from trusted family, friends, and professionals if appropriate.
- Always try to stay a step ahead of scam artists. As society comes to know one type of scam, con artists will attempt to catch their victims off guard by devising new schemes. For example, with greater public awareness not to pay upfront for a short sale negotiator's fee, scam artists may shift to structuring a short sale to include a buyer's credit to pay the fee.

Q 8. *Isn't it true that no one really gets caught for short sale fraud?*

A No. Although it seems as though scam artists rarely get caught, law enforcement activities against foreclosure-related scams are on the rise. The current housing crisis caused in part by greed and wrongdoing during the subprime heyday is a national issue that has grabbed the public's attention.

Reports show that law enforcement authorities are investigating and prosecuting foreclosure-related scams, and that, more and more, lenders and government-sponsored enterprises Fannie Mae and Freddie Mac are monitoring their files for improprieties, such as fraudulent short sale flips.

On the federal level, reports indicate that, as of 2010, the FBI devotes over 350 of its 13,000 agents to mortgage fraud. On the state level, the Department of Real Estate (DRE) has reportedly revoked, suspended, or accepted the surrender of 886 real estate licenses from July 2009 to June 2010, which is a 60 percent jump over the preceding three years. As of August 2010, the DRE reportedly had about 5,400 open investigations, including scams involving short sales. Since 2006, the DRE has issued about 600 desist and refrain orders to unlicensed people.

Furthermore, regardless of whether the mastermind of a scam ever gets caught, other people involved in a short sale scam can easily get caught. Let's say, for example, a scammer solicits the help of a real estate agent in a short sale flip (see Question 9 for a discussion of short sale flips). After escrow closes, the scam mastermind absconds with the money. That fact does not prevent the seller, buyer, lender, or law enforcement authorities from pursuing civil and criminal claims against the real estate agent who may have been only peripherally involved in the fraudulent scheme (see Question 11). Possible claims could include, among other things, a civil lawsuit brought by the seller for breach of fiduciary duty, a civil lawsuit brought by the short sale lender for mortgage fraud, a criminal case brought by the district attorney for aiding and abetting in a fraudulent scheme, and a disciplinary action taken by the DRE for dishonest dealings, negligence, and incompetence. For any of these situations, arguing that the real estate agent was only peripherally involved in the scam may prove to be a weak defense for the agent.

II. TYPES OF SHORT SALE FRAUD

An excellent way to detect and avoid short sale fraud is to familiarize oneself with the common scenarios. For REALTORS®, making sure that your own business practices steer clear of the these fraudulent activities will help ensure that you do not create for yourself the legal problems associated with these schemes.

A. FRAUDULENT SHORT SALE FLIPS

Q 9. *What is a short sale flip?*

A A "short sale flip" or an "AB-BC transaction" usually involves a resale of a property either simultaneously or soon after a short sale. First, for the AB transaction, Seller A sells the property to Buyer B, subject to the approval of Seller A's short sale lender. Second, for the BC transaction, Buyer B resells that same property to Buyer C, typically for more money.

With full disclosure, among other things, a short sale flip is not necessarily illegal. However, in practice, scam artists often use various illegal and improper tactics to close these types of transactions. These schemes typically involve attempting to dupe Seller A's short sale lender into believing a property is worth less than it is, and yet, simultaneously selling the property for a higher price and pocketing the difference. The scammers use the time waiting for the short sale approval to look for a new Buyer C to buy from Buyer B at the higher price.

At times, Seller A, Buyer B, and Buyer C, among others, are aware of the property flip but the scammers convince them that the plan is legal, or give them money for their cooperation.

Buyer B, in particular, could be, among other things, a trust, a limited liability company (LLC), or a straw buyer, who could be in cahoots or a victim of identity theft. The scammers may also use an option agreement for the AB transaction.

For the legal claims that may be raised in a fraudulent short sale flip, see Question 11.

Q 10. *How does a real estate agent get mixed up with a fraudulent short sale flip?*

A REALTORS® should stay vigilant, because scammers often seek out real estate agents to carry out their fraudulent short sale flips. Scam artists may, among other things, enlist the help of real estate agents to list properties for sale, either to show the short sale lender that the property has been advertised in an open market or to find Buyer C.

Q 11. *What are the legal problems with a fraudulent short sale flip?*

A Depending on the specific circumstances, the legal claims that may be raised a fraudulent short sale flip include, but are not limited to, the following:

- **Mortgage Fraud:** Sellers, buyers, agents, and others who misrepresent or actively conceal a short sale flip may be liable for, among other things, mortgage fraud, common law fraud, misrepresentation, and unlawful business practices. Under federal law, mortgage fraud includes anyone who knowingly makes a false statement for the purpose of influencing a federally-insured mortgage lender or other financial institution as specified (18 U.S.C. § 1014). A violation of federal mortgage fraud law is punishable by 30 years imprisonment, plus a \$1 million fine (18 U.S.C. § 1014). For example, concealing the BC transaction from Seller A's short sale lender or concealing the AB transaction from Buyer C's mortgage lender may constitute mortgage fraud, among other things.
- **Breach of contract:** Sellers, buyers, and agents who make false statements in lenders' short sale agreements may be liable for breach of contract. For example, in a lender's short sale agreement, Seller A may falsely certify that the sales transaction is for fair market value, no other offers have been received, and the seller has no hidden understandings or secret proceeds. Those types of false assertions could be grounds for a breach of contract claim against the seller in a civil lawsuit seeking monetary damages or rescission.
- **Breach of fiduciary duty:** Agents involved in fraudulent short sale flips who fail to exercise due care may be liable to their clients for monetary damages suffered. If, for example, a listing agent both convinces Seller A to sell to Buyer B for \$300,000, and facilitates Buyer B's simultaneous resale to Buyer C for \$350,000, the listing agent may have serious difficulty explaining why the seller only deserved the \$300,000 Buyer B, not the \$350,000 Buyer C procured during the listing agent's listing period (see also Question 12).
- **Licensing Violation:** Agents involved in a fraudulent scheme could also face license revocation or other disciplinary action taken by the DRE (Cal. Bus. & Prof. Code §§ 10176 and 10177).
- **Other Criminal Violations:** In addition to mortgage fraud, illicit short sale flips may expose sellers, buyers, and their agents to other criminal claims, such as perjury (Cal. Penal Code § 118), conspiracy, and aiding and abetting a criminal scheme.

For legal claims that may be raised against short sale negotiators, see Question 16.

Q 12. *If a seller (Seller A) receives no sales proceeds in a short sale anyway, how does a short sale flip harm the seller?*

A Regardless of whether a seller receives any sales proceeds, the seller's involvement in a fraudulent short sale flip exposes the seller to criminal and civil liability. Furthermore, the sales price in a short sale may have financial, legal, tax, credit, and other implications for the seller. For example, obtaining a higher sales price benefits the seller if the lender requires the seller to repay the shortfall or the lender reserves its right to pursue the seller for the shortfall. Also, a higher sales price benefits the seller if the lender forgives the shortfall and the seller is not exempt from debt relief income tax consequences. Also, a seller may benefit from a higher sales price if transferring the seller's property tax base to a replacement property under Propositions 60 and 90.

Q 13. *How do I do a legitimate short sale flip?*

A Legitimate short sale flips may be structured in many different ways. Some factors to consider to help ensure that an AB-BC short sale flip passes legal muster through the judicial process include, but are not limited to, the following:

- How close the sales price for the AB transaction is to fair market value.
- How well the property is listed and marketed to find prospective buyers.
- Whether Seller A and Buyer C are well represented by their own real estate agents, attorneys, accountants, and other professionals as appropriate.
- Whether the parties negotiated an arms-length transaction.
- Whether the different aspects of the transaction, including the profit to be made, are fully disclosed in a meaningful manner to, and approved by, the parties and lenders involved.
- How much time lapses between the close of escrow of the AB transaction and the close of escrow of the BC transaction.
- The extent of repairs, renovations, and improvements that Buyer B makes to the property.
- How much money Buyer B invests to purchase, maintain, repair, renovate, improve, and resell the property.
- Whether the profit Buyer B makes is reasonable under the circumstances, including existing housing market conditions.
- Whether the parties comply with licensing, agency, RESPA, and other laws.
- Whether compliance with these factors is in writing and well-documented.

The above list is an illustrative, not exhaustive list of factors to consider for a legitimate short sale flip. Compliance with all these factors does not guarantee that a short sale flip is legitimate. Similarly, not complying with one or more factor does not necessarily mean, depending on the specific circumstances, that a short sale flip is illegal, as ultimately decided by a judge, jury, arbitrator, or DRE Commissioner.

B. SHORT SALE NEGOTIATOR SCAMS

Q 14. *What is a short sale negotiator?*

A A short sale negotiator is generally someone who negotiates and facilitates a short payoff with a seller's mortgage lender. Because short sales often involve very thick short sale packages and frequent attempts to contact the short sale lender, a legitimate short sale negotiator can facilitate and expedite the short sale process. A short sale negotiator can be the listing agent, someone else in the listing office, or someone in another office.

With full disclosure, among other things, hiring and paying for a short sale negotiator is not an illegal activity. However, certain scam artists impersonate or use short sale negotiators in furtherance of their improper and illegal schemes.

Q 15. *What are some examples of short sale negotiator scams?*

A As with any profession, some short sale negotiators are reputable, legitimate, and qualified to negotiate and facilitate short sales, whereas others are not. Scammers may lure homeowners and their agents into their schemes by promising to expedite the short sale process and obtain approval from the short sale lender. What scammers in fact do include putting together and submitting bogus short sale packages to the short sale lenders (see Questions 20 and 21), performing little or no service (see Questions 24 and 25), or engaging in other wrongdoing.

Some scams revolve around the payment of the short sale negotiator's fee. A seller's short sale lender may disapprove payment to a third-party short sale negotiator, so the scammer makes a secret agreement for the seller, buyer, agent, or someone else to pay that fee, usually outside of escrow. As one variation of the scheme, the purchase agreement may indicate that the seller will give the buyer a credit, but a secret agreement is made for the buyer to use that credit to surreptitiously pay the short sale negotiator fee.

For legal claims that may be raised in a fraudulent scheme involving a short sale negotiator, see Question 16.

Q 16. *What are the legal problems with unscrupulous short sale negotiator?*

A Depending on the specific circumstances, the legal claims that can be asserted against a short sale negotiator scam include, but are not limited to, the following:

- **Licensing Violation:** Short sale negotiator, short sale facilitators, and other individuals negotiating the short sale with the seller's lender should generally be licensed by the DRE (see Questions 26 to 33). Furthermore, agents involved in a scam could face license revocation or other disciplinary action taken by the DRE (Cal. Bus. & Prof. Code §§ 10176 and 10177).
- **Mortgage Fraud:** Sellers, buyers, agents, and others who misrepresent or actively conceal a short sale negotiator fee from a seller's short sale lender may be liable for, among other things, mortgage fraud, common law fraud, misrepresentation, and unlawful business practices. Under federal law, mortgage fraud broadly includes anyone who knowingly makes a false statement for the purpose of influencing a federally-insured mortgage lender or other financial institution as specified (18 U.S.C. § 1014). A violation of federal mortgage fraud law is punishable by 30 years imprisonment, plus a \$1 million fine (18 U.S.C. § 1014). As an example, deliberately waiting until the last minute to insert the short sale negotiator fee into the final HUD-1 Statement may not suffice as a meaningful disclosure to the short sale lender.

- **Breach of contract:** Sellers, buyers, and agents who make false statements about short sale negotiators in the lenders' short sale agreement may be liable for breach of contract. For example, if a seller certifies in a lender's short sale agreement that there are no hidden terms, a secret agreement to pay a short sale negotiator may constitute a breach of contract.
- **Breach of fiduciary duty:** A short sale negotiator who creates an agency relationship with a seller or buyer and fails to exercise due care may breach his or her fiduciary duty to do what is in the client's best interest. Additionally, the listing agent or buyer's agent in a transaction who fail to exercise due care with respect to a third-party short sale negotiator may also be liable to their clients. For example, a listing brokerage attempting to collect short sale negotiation fees to pad its own pocket with no regard for the seller's best interest may be in breach of its fiduciary duty to the seller. Also, absent the seller's consent, a listing agent's refusal to present a buyer's offer to the seller unless the buyer agrees to pay the short sale negotiator fee may also constitute a breach of the fiduciary duty the listing agent owes to the seller.
- **RESPA Violation (HUD-1 Statement):** Omitting from a HUD-1 Statement any short sale negotiator charges paid at settlement by either a buyer or seller may violate the Real Estate Settlement Procedures Act (RESPA) (Appendix A to 24 C.F.R. Part 3500). RESPA generally pertains to transactions of one-to-four residential units with a federally-related mortgage loan (12 U.S.C. § 2602(1)).
- **RESPA Violation (Unearned Fee):** Charging or accepting a short sale negotiator fee without performing any actual service may violate RESPA (12 U.S.C. § 2607(b); see also *Martinez v. Wells Fargo Home Mortgage, Inc.*, 598 F.3d 549, 554 (9th Cir. 2010) (holding that RESPA's prohibition against unearned fees does not extend to overcharges)). RESPA generally pertains to transactions of one-to-four residential units with a federally-related mortgage loan (12 U.S.C. § 2602(1)).
- **Other Criminal Violations:** Depending on the circumstances, improper short sale negotiator activities may expose sellers, buyers, and their agents to other criminal claims, such as perjury (Cal. Penal Code § 118), conspiracy, and aiding and abetting in a criminal scheme. Additionally, anyone who pays an unlicensed person for performing licensed activities is guilty of a misdemeanor punishable by a \$100 fine (Cal. Bus. & Prof. Code § 10138).

Q 17. *How do I check whether a short sale negotiator is legitimate?*

A Factors to consider to help ensure that a short sale negotiator is legitimate include, but are not limited to, the following:

- Whether the negotiator and the negotiator's employing broker if any are both properly licensed with the DRE or registered and bonded as a foreclosure consultant (see Questions 26 to 38).
- Whether the negotiator is qualified to perform short sale negotiation services.
- Whether the negotiator actually performs services to facilitate and expedite the short sale process.
- Whether the negotiator's fee is fully disclosed in a meaningful manner to, and approved by, the parties and lenders involved.
- Whether the negotiator's fee is reasonable, based upon, among other things, the negotiator's qualifications to conduct short sale negotiations and the fee charged by other negotiators.

- Whether the individual paying for the negotiator's services voluntarily agrees to pay for those services, and is given an opportunity to consult with a real estate agent, attorney, accountant, or other professional as deemed appropriate.
- Whether the negotiator does not get paid until after the negotiator fully completes each and every service the negotiator promises to perform.
- Whether the negotiator complies with agency laws, RESPA, laws against fraud, and other laws and MLS rules.

The above list is an illustrative, not exhaustive list of factors to consider for a legitimate short sale negotiator. Compliance with all these factors does not guarantee that a short sale negotiator is legitimate or qualified. Similarly, not complying with one or more factor does not necessarily mean, depending on the specific circumstances, that a short sale negotiator is a scam artist, as ultimately decided by a judge, jury, arbitrator, or DRE Commissioner.

Q 18. *How do I personally provide legitimate short sale negotiator services?*

A Providing legitimate short sale negotiator services can be done in many different ways. Use the guidelines in Question 17 to help ensure that your short sale negotiator services will pass legal muster through the judicial process.

Q 19. *Can a seller require that the buyer pay for a short sale negotiator's fee?*

A It depends. As a term of negotiation in the sale of real property, a seller's requirement for the buyer pay for a short sale negotiator's fee is, by itself, legal. Of course, the buyer may refuse to pay, and go buy another property instead. However, if in addition to requiring the buyer to pay, the seller also requires the buyer to, for example, help conceal the negotiator's fee from the short sale lender or pay the negotiator's fee outside of escrow, the payment may now constitute, among other things, mortgage fraud, common law fraud, and a RESPA violation (see Question 16).

C. SHORT SALE PACKAGE SCAMS

Q 20. *What is a scam involving a short sale package?*

A A short sale package scam generally involves intentional misrepresentations made in a short sale package for the purpose of obtaining a short sale lender's approval. These misrepresentations may be made in the original short sale package submitted to the lender or in subsequent dealings with the lender. Knowing a short sale lender's general requirements, a scam artist will manipulate the truth to improve the chances that a short sale package will be approved by the lender and the deal will close escrow.

Some of the improper tactics that may be used include, but are not limited to, misstating the truth, making up stories, concealing pertinent facts, submitting false documents, and forging signatures. More specifically, examples of improper tactics involving short sale packages include, without limitation, the following:

- Fabricating a seller hardship and creating bogus supporting documentation, when in fact the seller does not have a hardship that satisfies the short sale lender's requirements.

- Making a sales transaction appear to be an arms-length transaction, such as using a straw buyer (e.g., a relative with a different last name), when in fact the seller is selling the property to a related person in contradiction of the short sale lender's requirements.
- Making a property appear to be owner-occupied to improve the chances of a short sale approval, when in fact the property is being rented out to, and occupied by, a tenant.
- Making it appear as if a property has been actively listed for sale in an open market for many months and sold for fair market value, when in fact the sale is a prearranged sale to a straw buyer for a price below fair market value to effectuate the AB sale in an AB-BC short sale flip.
- Making it appear as if the property has been sold in good faith to a buyer for fair market value, when in fact the scammer used improper means to ascertain the lowest price the short sale lender would approve and simply wrote that price into the sales contract.
- Making it appear to the short sale lender that the sales documents are the sum total of the agreement between the seller, buyer, and others, when in fact other arrangements have been secretly made for money to exchange hands (see also Questions 22 and 23).

For a discussion of the legal claims that may be asserted against fraud in short sale packages, see Question 21.

Q 21. *What are the legal problems with fraudulent short sale packages?*

A Illegal or improper tactics used in a short sale package may give rise to a host of legal claims. Most notably, submitting false information in a short sale package to a short sale lender may constitute mortgage fraud. As discussed above, mortgage fraud is broadly defined to include anyone who knowingly makes a false statement for the purpose of influencing a federally-insured mortgage lender or other financial institution as specified (18 U.S.C. § 1014). A violation of federal mortgage fraud law is punishable by 30 years imprisonment, plus a \$1 million fine (18 U.S.C. § 1014).

Depending on the specific circumstances, other legal claims that may be asserted against submitting false information in short sale packages includes, without limitation, breach of contract, common law fraud, RESPA, and perjury. Depending on the extent of a real estate agent's participation in a scheme, these civil and criminal claims may be raised against the agent, who may also be subject to license revocation or other disciplinary action taken by the DRE.

D. IMPROPER PAYMENTS

Short sale scams often involve the improper payment of money, such as undisclosed payments (see Question 22 and 23) and upfront fees (see Questions 24 and 25).

Q 22. *What is a scam involving undisclosed payments in a short sale transaction?*

A An undisclosed payment in a short sale transaction involves the payment of money or other things of value without the knowledge of an interested party, such as the seller's short sale lender or buyer's lender. The undisclosed payment is typically paid outside of escrow in an attempt to escape the purview of interested parties.

One common scenario is when a short sale seller's senior lender authorizes a payment of, for example, \$3,000 to extinguish a junior lien, but the junior lender demands that the buyer or someone else pays an additional \$9,000 outside of escrow. Concealing this additional payment from the senior lender may constitute mortgage fraud as discussed above (18 U.S.C. § 1014). Furthermore,

omitting from the HUD-1 Statement any charges paid at settlement by either a buyer or seller may violate RESPA (Appendix A to 24 C.F.R. Part 3500).

Another common scenario is when a scam artist uses monetary incentives to lure a seller into participating in a fraudulent scheme. A scam artist may arrange for money to be paid to the seller by the scam artist, buyer, buyer's agent, listing agent, or someone else. Sometimes the arrangement is simply for the payment of money, whereas other times the payment is presumably for the purchase of the seller's furniture, for the seller's moving expenses, or for other reasons. Oftentimes, the payment is made outside of escrow to escape the purview of the short sale lender. Again, this type of undisclosed payment may constitute, among other things, mortgage fraud and a violation of RESPA.

Undisclosed payments may also violate other laws and regulations, and depending on a real estate agent's participation in the scheme, these civil and criminal claims may be raised against the agent, who may also be subject to a breach of fiduciary duty claim, as well as license revocation or other disciplinary action taken by the DRE.

Payments made outside of escrow have other risks and consequences as well. For example, absent the safeguards provided by escrow as a neutral third-party, someone who receives cash outside of escrow could abscond with the money without performing on the sales contract.

Q 23. *Why is it problematic for the buyer of a short sale property to pay cash for the seller's furniture outside of escrow?*

A In a short sale scam situation, funds are paid to the seller outside of escrow to conceal that arrangement from the short sale lender. Oftentimes, a scam artist will urge others into a fraudulent scheme by claiming that a payment for the seller's furniture or similar arrangement need not be disclose to the short sale lender because it is unrelated to the real estate transaction, when in fact it is related. Additionally, such payment directly contradicts a short sale lender's requirement, if any, for the seller to certify the absence of any hidden arrangements or receipt of funds. If the short sale lender knew that the buyer had, for example, \$5,000 for the seller's furniture, the lender would likely want that money for itself to lessen its own loss.

Q 24. *What is a short sale scam involving an upfront fee?*

A In this type of scam, the scam artist offers to negotiate with the short sale lender or perform other short sale services in exchange for an upfront fee. Also known as phantom help, the scammer will in reality perform little or no service at all and eventually absconds with the money. Whatever services the scam artist does provide, the scam victim typically could have done on his or her own. The victim ends up not only losing the money, but often loses valuable time to make other short sale arrangements before foreclosure.

To dupe unsuspecting victims out of their money, a phantom help scam artist usually knows exactly what to offer, how to pitch the offer, and what twists to add to lend credibility to the scheme. For example, a scammer posing as a short sale negotiator may guarantee a short sale lender's approval in two weeks, which may be precisely what a homeowner facing foreclosure wants to hear. To bolster the claim, the scammer may explain that, as a close relative of the loan officer or loss mitigator, the negotiator has special access to an inside track at the bank.

Q 25. *What are the legal problems with an upfront fee in a short sale situation?*

A The law generally prohibits anyone who negotiates, attempts to negotiate, arranges, attempts to arrange, or offers to perform a loan modification or other form of mortgage loan forbearance, from claiming or demanding any upfront compensation (Cal. Civil Code § 2944.7(a)). This rule, which is likely to encompass short sale negotiations, pertains to loans secured by one-to-four residential units (Cal. Civil Code § 2944.7(d)). This rule will remain in effect until January 1, 2013 (Cal. Civil Code § 2944.7(e)).

The statutory prohibition against upfront fees applies to both real estate licensees and attorneys, among others. Advance fees for real estate licensees are further regulated under Cal. Bus. & Prof. Code § 10026.

III. LICENSING GUIDELINES

In the subprime aftermath, legislative authorities have beefed up regulations protecting consumers against unscrupulous practices. Checking someone's legitimacy and qualifications to conduct short sale activities should include looking up real estate licenses, and foreclosure consultant registrations if applicable.

A. REAL ESTATE LICENSEES

Q 26. *What are the licensing guidelines for detecting short sale fraud?*

A Using licensing guidelines to help detect short sale fraud is a two-step process. First, you must determine whether the individual person and business entity in question are engaging in activities for which a real estate license is required (see Question 27). Second, if the person or business entity is engaging in real estate licensed activities, you must check whether that person or business entity is properly licensed with the DRE or other licensing agencies (see Question 29).

Q 27. *What short sale activities are deemed to be real estate licensed activities?*

A The scope of real estate licensed activity is very broad. An individual representing a party to a short sale transaction must generally be a licensed real estate broker or salesperson working under a broker.

More specifically, unless exempt, a real estate broker's license is required for someone who, while acting for compensation, engages in, among other things, any of the following acts on behalf of another:

- Solicits prospective sellers or buyers or negotiates the sale or purchase of real property (Cal. Bus. & Prof. Code § 10131(a)). Examples generally include, without limitation, listing agents, buyers' agents, and dual agents.
- Negotiates loans secured by real property, including negotiations with a short sale seller's lender (Cal. Bus. & Prof. Code § 10131(d); see also "Short Sales – An Overview and Warning to Licensees Re: Fraud, Legal and Ethical Minefields," DRE Real Estate Bulletin, Spring 2010, page 2). Examples generally include, without limitation, short sale negotiators, short sale facilitators, short sale processors, short sale coordinators, and debt negotiators.
- Performs services for borrowers or lenders in connection with a loan secured by real property (Cal. Bus. & Prof. Code § 10131(d)); or

- Solicits borrowers or lenders for loans secured by real property (Cal. Bus. & Prof. Code § 10131(d)).

For exceptions to the licensing requirements, see Question 28.

Q 28. *What are the exceptions to the real estate licensing requirement for representing a party in a short sale transaction?*

A Exceptions from the real estate licensing requirements include, but are not limited to the following:

- A homeowner acting on his or her own behalf;
- An individual acting without compensation or expectation of compensation (Cal. Bus. & Prof. Code § 10131), such as housing counseling agencies who offer free assistance to distressed homeowners. A list of HUD-approved Housing Counseling Agencies in California is available at <http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm?&webListAction=search&searchstate=CA> or call (800) 569 4287. Also the non-profit organization Homeownership Preservation Foundation has a 24/7 toll-free Homeowner's HOPE Hotline at (888) 995-HOPE or visit its website at <http://www.995hope.org>.
- An attorney if certain conditions are met (see Question 34).

For other exemptions to the licensing requirements, C.A.R. has a legal article entitled Licensing Chart for REALTORS®, available for members at <http://www.car.org/legal/2007articles/licensing-chart/>.

Q 29. *How do I check to see whether someone is properly licensed with the Department of Real Estate?*

A You can check the license status of an individual person or a business entity on the Department of Real Estate (DRE) website at www.dre.ca.gov under "Real Estate License Look-up" or contact the DRE at (877) DRE-4LIC. Be sure to check, among other things, the following items:

- License Type: An individual person must generally be either: (1) a broker; or (2) a salesperson working for a properly licensed employing broker. A salesperson with NBA or "No Broker Affiliation" is not properly licensed. For a business entity, it must generally be either: (1) a licensed corporation; or (2) a DBA of a properly licensed individual broker.
- Expiration Date: The applicable license should generally be current, not expired, at the time the person or business entity is engaging in any real estate licensed activities.
- Place of Business: The employing broker must have a definite place of business and, under the Real Estate License Look-Up, that place of business should be stated as the broker's Main Office or Branch Office (Cal. Bus. & Prof. Code §§ 10162 and 10163).
- License Status: The license status generally states the word, "LICENSED," and nothing else to indicate a valid, unrestricted license.
- Comment: Indicates any disciplinary action taken against the licensee, such as whether the license has been revoked, suspended, conditioned, or restricted. Contact the DRE for more information about any disciplinary action taken against a licensee.

Q 30. Why should I check to see whether someone is properly licensed with the Department of Real Estate?

A Checking whether someone who is performing real estate licensed activities is properly licensed is one of the best ways to detect a scam (see Question 31). Furthermore, it is a misdemeanor for anyone to pay an unlicensed person for performing licensed activities (Cal. Bus. & Prof. Code § 10138). Additionally, a real estate licensee who violates this rule may be subject to license revocation or other disciplinary action taken by the DRE.

Q 31. How do the DRE licensing guidelines protect against short sale fraud?

A The licensing guidelines play a big role in detecting short sale fraud. The purpose of the DRE licensing guidelines is to protect the public from dealing with incompetent or untrustworthy real estate practitioners (California Employment Stabilization Commission v. Morris (1946) 28 Cal.2d 812, 817).

Many short sale scams can be fettered out because they involve individuals or business entities that are not properly licensed with the DRE. After all, the typical scam artist would not want to come within the purview of any governmental regulatory agency. They would not want to do many of the things needed to obtain and maintain a real estate license, such as submitting personal information to the DRE, submitting fingerprints to the DRE, undergoing a criminal background check, and being subject to DRE scrutiny and disciplinary action for any wrongdoing.

Q 32. How do unlicensed scam artists get around the licensing requirements?

A A common tactic used by unlicensed scam artists is to make bogus excuses as to why they do not need a real estate license. Some of the false claims that may be made to justify the lack of a real estate license when conducting short sale negotiation are as follows:

- “I don’t need to be licensed to help the seller negotiate debt forgiveness.”
- “We have an in-house attorney who will negotiate the short sale” (see Question 35).
- “We’re merely processing the paperwork.”
- “I’m negotiating the short sale on my own behalf as the buyer of the property.”
- “Everyone else is doing it.”

Another common tactic is for unlicensed individuals to work for a licensed company. For example, let’s say an unscrupulous and unlicensed individual, John Doe, purports to work for Short Sale Advocates, Inc. doing short sale negotiations. If the client asks for licensing information, John Doe would just show the client that Short Sale Advocates, Inc. is properly licensed, and not reveal to the client that John Doe himself is not but should also be licensed to conduct short sale negotiations through Short Sale Advocates, Inc. John Doe may also not reveal to the client that Short Sale Advocates, Inc. is just a shell company that could be here today and gone tomorrow.

Q 33. What are the penalties for real estate license violations?

A Any person acting as a real estate broker or salesperson without a license is guilty of a crime punishable by six months imprisonment in the county jail, plus a fine up to \$20,000 (Cal. Bus. & Prof. Code § 10139). Anyone who pays an unlicensed person for performing real estate licensed activities

is guilty of a misdemeanor punishable by a fine up to \$100 for each offense (Cal. Bus. & Prof. Code § 10138). Additionally, if a real estate licensee engages in misrepresentations, fraud, dishonest dealings, or improperly pays an unlicensed person, the licensee may be subjected to license revocation or other disciplinary action taken by the DRE (Cal. Bus. & Prof. Code §§ 10138, 10176 and 10177).

B. ATTORNEYS

Q 34. *Is an attorney engaged in short sale activities exempt from the real estate licensing requirements?*

A It depends. An attorney rendering legal services to a client is exempt from licensing requirements if the attorney is not using or attempting to use the exemption for the purpose of evading the licensing laws (Cal. Bus. & Prof. Code § 10133(a)(3)). Furthermore, when negotiating loans, the attorney exception only applies if all of the following conditions are met:

- The attorney is licensed to practice law in California;
- The attorney renders services in the course of his or her practice as an attorney;
- The attorney is not actively and principally engaged in the business of negotiating loans secured by real property;
- The attorney's disbursements are not charges or costs and expenses regulated by or subject to the limitations for Article 7 loans (commencing with Cal. Bus. & Prof. Code § 10240); and
- The attorney's fees and disbursements are not shared, directly or indirectly, with the person negotiating the loan or the lender.

(Cal. Bus. & Prof. Code § 10133.1(a)(5).) As an example, a law firm called Short Sale Legal Services could be a group of attorneys properly licensed by the State Bar of California, but if the firm principally engages in short sale negotiations, a DRE license may also be required.

Q 35. *Can someone circumvent the licensing requirements by affiliating or associating with an attorney?*

A No, in most cases. REALTORS® and their clients should be wary of people who claim that their affiliation or association with an attorney enables them to practice real estate without a license.

One common scenario is someone working for a short sale business enterprise who claims that neither the individual nor the company need to be real estate licensees because they have an in-house attorney or an affiliation with an attorney or law firm for negotiating short sales with the sellers' lenders. In truth, however, an individual person or short sale business is not exempt from the real estate licensing requirements merely because that person or business is affiliated or associated with an attorney or law firm. Furthermore, attorneys and law firms are not exempt from the real estate licensing requirements unless certain parameters are met (see Question 34). Another common problem with these types of arrangements is, among other things, attorneys and law firms are generally prohibited from "fee splitting" or sharing legal fees with non-attorneys (Cal. Rules of Prof. Conduct Rule 1.320(A)).

Q 36. *How do I check to see whether someone is properly licensed as an attorney?*

A You can check the attorney status and disciplinary records of an individual on the State Bar of California website at <http://members.calbar.ca.gov/fal/MemberSearch/QuickSearch>.

C. FORECLOSURE CONSULTANTS

Q 37. *What is a foreclosure consultant?*

A A foreclosure consultant is an individual who provides, or offer to provide, foreclosure-related consultation services, such as helping certain homeowners stop or postpone a foreclosure sale, or obtain any forbearance from a lender (Cal. Civil Code § 2945.1(a)). The foreclosure consultant law generally pertains to properties that are owner-occupied with one-to-four residential units and an outstanding notice of default recorded (Cal. Civil Code § 2945.1(f)).

Foreclosure consultants are strictly regulated under California law. They must be bonded and registered with the California Department of Justice (Cal. Civil Code § 2945.45). They must have written service contracts (Cal. Civil Code § 2945.3). They cannot, among other things, collect an upfront fee, take a power of attorney, or take a lien on real property (Cal. Civil Code § 2945.4).

Real estate agents are generally exempt from the foreclosure consultant law (Cal. Civil Code § 2945.1(b)(3)).

For more information about Foreclosure Consultants, C.A.R. has a legal article entitled Foreclosure Scams and the Foreclosure Consultant Law, available for members at <http://www.car.org/legal/2008articles/foreclosure-scams/>.

Q 38. *How do I determine whether a foreclosure consultant is properly registered with the California Department of Justice?*

A To check whether a foreclosure consultant is properly registered with the California Department of Justice, look up the person's name at <http://ag.ca.gov/loanmod/index.php>.

IV. ADDITIONAL INFORMATION

Q 39. *To whom should a short sale scam be reported?*

A The following is a list of government enforcement agencies and other organizations for reporting fraud activities. Some of these agencies and organizations are also excellent resources for obtaining more information about short sale fraud.

Office of the Attorney General
California Department of Justice
Attn. Public Inquiry Unit
P. O. Box 944255
Sacramento, California 94244-2550
(916) 322-3360
(800) 952-5225 (in California only)
<http://ag.ca.gov/consumers/general.php> (For filing consumer complaints)

California Department of Real Estate
P. O. Box 187000
Sacramento, California 95818-7000

(916) 227-0864

http://www.dre.ca.gov/cons_complaint.html (For filing consumer complaints)

http://www.dre.ca.gov/cons_alerts.html (Consumer alerts)

State Bar of California

180 Howard Street

San Francisco, California 94105

(800) 843-9053 (Attorney Complaint Hotline)

<http://www.calbar.ca.gov/Attorneys/LawyerRegulation.aspx> (For filing complaint)

Federal Bureau of Investigation (FBI) Headquarters

J. Edgar Hoover Building

935 Pennsylvania Avenue, NW

Washington, D.C. 20535-0001

(202) 324-3000

Or contact your local FBI field office

<https://tips.fbi.gov/> (FBI tips and public leads)

Department of Housing and Urban Development (HUD) Headquarters

HUD Office of Inspector General Hotline (GFI)

451 7th Street, SW

Washington, D.C. 20410

(800) 347-3735

Or contact your local HUD field office

<http://www.hud.gov/offices/oig/hotline/> (Office of Inspector General hotline)

Federal Trade Commission

Consumer Response Center

600 Pennsylvania Avenue, NW

Washington, D.C. 20580

(877) 382-4357

<http://www.ftc.gov/ftc/contact.shtm>

Better Business Bureau

The Council of Better Business Bureaus

4200 Wilson Boulevard, Suite 800

Arlington, Virginia 22203-1838

Contact your local bureau

<http://www.bbb.org/>

Q 40. Where can I obtain more information about short sale scams?

A Some of the agencies and organizations listed in Question 39 are good resources of short sale scams. Additional resources are available as follows:

- DRE's Consumer Alert: Warning Regarding Residential Short Sales, available at http://www.dre.ca.gov/pdf_docs/ca/ConsumerAlert_ShortSales.pdf.
- DRE's Short Sales – An Overview and Warning to Real Estate Licensees Re: Fraud, and Legal and Ethical Minefields, available at http://www.dre.ca.gov/pdf_docs/Article_ShortSales03_2010.pdf.
- DRE's Update to DRE Issued Consumer and Industry Alert(s) Regarding Short Sales Fraud,

and Related Issues (September 2010), available at http://www.dre.ca.gov/pdf_docs/Article_ShortSales03_2010.pdf.

- Fannie Mae's Mortgage Fraud Program, available at <https://www.efanniemae.com/utility/legal/antifraud.jsp>.
- Freddie Mac's Mortgage Fraud Prevention is at <http://www.freddiemac.com/singlefamily/preventfraud/>
- Freddie Mac's Emerging Fraud Trends: Short Payoff Fraud available at http://www.freddiemac.com/singlefamily/news/2010/0412_payoff_fraud.html

Q 41. *Where can I obtain more legal information?*

This legal article is just one of the many legal publications and services offered by C.A.R. to its members. For a complete listing of C.A.R.'s legal products and services, please visit car.org.

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CALIFORNIA ASSOCIATION OF REALTORS®
Member Legal Services
525 South Virgil Avenue
Los Angeles, CA 90020

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