

## UNDERWRITING DIRECTIVE No. 1

**TO:** All Delaware Agents  
**FROM:** Dwight E. Edwards  
**SUBJECT: Flip Transactions and Other Closings**  
**DATE:** September 08, 1999

In recent months, we have been hearing more and more about real estate transactions that are commonly known as "flips". The typical transaction involves three basic players:

"A", the seller of the property in question  
"B", the purchaser from "A"; and  
"C", the ultimate purchaser of the property

The fourth player is of critical concern, C's lender.

There are several scenarios under which a transaction involving A, B and C might take place. The two most common are:

- The contract or agreement between A and B is closed with A conveying the property to B. Thereafter, the contract or agreement between B and C is closed and B conveys the property to C.
- The contract or agreement between A and B is properly assigned to C, and the closing takes place under that agreement with A conveying to C.

Variations of these two scenarios create a great deal of difficulty for the closing office and underwriter. Occasionally, under the first scenario, a closing takes place where all the money necessary to close the transactions actually comes from C, and there are no other funds available to close the transaction between A and B. In these situations, the HUD-1 closing statements cannot and do not match up with the actual checks disbursed. When the HUD-1 is false, the closing agent is extraordinarily exposed, both criminally and civilly.

Another problem scenario involves a lack of disclosure among the parties and it often develops that property values are excessively inflated. C's lender may be unaware of the conveyance and, more importantly the sales price, between A and B. Failure to notify the lender of that transaction may very well be a violation of that lender's general closing instructions. Many lenders require that they be notified if there has been a recent conveyance (often within the last year).

**PLEASE PLACE IN THE STATE SPECIFIC MATERIALS SECTION OF YOUR  
UNDERWRITING PRACTICES MANUAL**

The purpose of this Directive is to enumerate those circumstances under which the Company is willing to underwrite "flip" transactions. You are authorized to issue a title insurance commitment or policy on this Company involving these types of transactions **only** under the following circumstances:

1. The approved transaction is closed under the first scenario set forth above with A conveying to B and B conveying to C, provided that the transaction between A and B stands on its own with B providing the necessary funding for that transaction as reflected in a proper and complete settlement statement. Likewise, the second part of the transaction between B and C must be properly documented. The second commitment must show title vested in A and require a conveyance from A to B as well as a conveyance from B to C. All disclosures required by any lender involved must be made and must be clearly documented in the agent's file.
2. Alternatively, the approved transaction must be one as reflected in the second scenario above, whereby the contract between A and B is properly assigned to C so that C now owns the contract. The requirement for an assignment of contract must appear in the commitment. This transaction must be properly documented by way of the settlement statement, and that statement must reflect all deposits and payments, including the payment due to B on the Assignment of Contract. Again, necessary disclosures to the lenders and other appropriate parties must be made and documented.

In each of the situations immediately described above, the settlement statement(s) must accurately reflect the transactions. Canceled checks must match the disbursement items shown on each closing statement.

Concurrently with our review of "Flip" transactions, we are seeing other situations arise that also cause us concern. Please note the following:

Occasionally, mortgage brokers demand that (1) the exercise of a lease/purchase option or (2) the consummation of an installment sale contract be treated as a refinance transaction when new financing is involved. In both instances, it is essential that the commitment accurately show the fee owner vested in title and that it require the deed from the current fee owner.

Recently our Company was asked to insure an owner and lender where the owner signed a contract to buy a home for \$100,000. The purchase price was to be paid with an institutional first mortgage from a lender of \$80,000 and a second mortgage to the seller for \$20,000. The first mortgage lender approved the second mortgage but was not told that the parties had agreed to cancel the second mortgage after closing. The end result was that the purchase price was misrepresented so that the buyer could obtain 100% financing. Obviously, the first mortgage lender was not told of this scheme. We decline to insure any such transaction when the lender is not fully informed of all the details of the transaction and the HUD-1 is not a true reflection of the transaction.

Additionally, we have noted an increase in the number of lenders whose general closing instructions require notification if the borrower has held title for less than a specified period of time, often one year. Lenders are imposing this requirement in an effort to identify properties with artificially inflated values. Please help avoid potential claims by working closely with your searchers and closers to assure complete compliance with lenders' instructions.

You might wish to include a statement in the certification accompanying the HUD-1 Settlement Statement that would include: "I (we) certify that the items listed on this statement are legitimate expenses, debts and payments and that there is no agreement with any party to this transaction regarding the enforceability or the legitimacy of the charges, debts or expenses shown hereon or that is not accurately reflected hereon."

Should you have **any** reason to believe that a transaction is not bona fide or is in any way being misrepresented or not fully disclosed to a party to the transaction, you should not issue this Company's commitment or policy without approval from the State Office.

Should you have any questions or wish to discuss these issues further, please contact an Officer of the Company.

DEE/sb