

## **DELAWARE UNDERWRITING DIRECTIVE No. 7**

**TO:** All Delaware Agents  
**FROM:** Kate Blake-Endicott  
**DATE:** June 16, 2008  
**SUBJECT:** Short Sales

In this market of declining real property valuations, it should come as no surprise that Old Republic Title has seen a marked increase in the number of short sale transactions.

The potential for a short sale transaction begins when the current owner owes more on the outstanding mortgage or mortgages than the property is currently worth. If the owner cannot make the mortgage payments, the owner is in a financial vice. The property does not appraise out at a sufficient value to allow a refinance, so the owner is forced to either sell the property or face foreclosure. Neither option is attractive as the property generally cannot sell for a sufficiently high price to pay off the mortgage and foreclosure would negatively affect the owner's credit rating.

The lender is also faced with issues if they are forced to foreclose on property which is not worth the amount of their mortgage. They end up with an asset on their books worth less than the outstanding principle. Further, once the lender obtains title through foreclosure, the economics of maintaining the property pending a subsequent sale (i.e. paying taxes, insurance, upkeep, realtor commissions) makes foreclosure an even less appealing option.

Accordingly, both borrowers and lenders are seeking alternatives to extricate themselves from their current situations. A substantial number of borrowers and lenders are turning to short sales. A short sale is defined as a transaction where the current mortgagee agrees to accept less than the outstanding principal balance of its mortgage in exchange for a release of the real property from the lien of the mortgage.

A short sale allows the borrower to sell the property and allows the lender to get the loan off its books without the expense and burden of foreclosing and spending additional funds carrying the property until sale.

The independent title agent has been faced with unique and complex issues relating to these transactions. There have been scores of foreclosure "rescue plans" involving short sales. Unfortunately, many of these involve fraudulent practices and it is often difficult for the unwary title agent to recognize the legitimate from the fraudulent. It would be impossible to address every situation we have seen, however, this Directive will advise you of the most common fact situations used for short sales and address some of the major, recurring issues involved in each.

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## **TYPICAL SHORT SALE SCENERIOS:**

**(a) The Foreclosure Rescue Company:** There are currently numerous companies marketing an expertise in saving the mortgagor from the impending foreclosure. These companies can be legitimate investors or, unfortunately, scam artists that prey on the vulnerable mortgagor. How they function varies, but generally these companies undertake the short sale negotiations with the current lender. While these negotiation companies provide a valuable service, they can also create potential problems for the title agent. Although the foreclosure rescue company controls the short sale pay off negotiations, it is essential that the title agent maintain control of the closing transaction. For example, it is not acceptable to rely upon an estoppel letter from the current short sale lender that was acquired by and sent to the foreclosure rescue company or investor. As with any other closing, it is up to the title agent to have direct communication with the short sale lender and to have the estoppel letter addressed to and received directly by the title agent. Further, in most short sale transactions, the short sale lender requires a copy of the HUD-1 to confirm that the mortgagor is receiving no proceeds from the sale and there are no unauthorized disbursements. The transmittal of the HUD-1 to the short sale lender must be accomplished by the title agent, not an intermediary (i.e. the foreclosure rescue company).

This raises yet another critical issue. It can be a delicate balance trying to separate the actions which are appropriate functions of a licensed title agent from the actions which may constitute the unauthorized practice of law. The licensed title agent should not undertake an advocacy role by negotiating the short sale payoff. This is distinguished from merely being a conduit of information whereby the agent's activity is confined to the appropriate closing role of obtaining requested information from the lender or borrower or sharing information necessary for the protection of the integrity of the transaction (i.e. HUD-1 and commitment).

**(b) The Flip:** Another common short sale situation we encounter is the investor flip. There are a number of variations on this theme, but essentially it involves "investors" who step in to "save" the mortgagor by negotiating a favorable sales price for the property that requires the current mortgagee to accept a short payoff. In these situations, the investor generally purchases the property for the favorable price and then re-sells it at a profit. Alternatively, the investor contracts to purchase the property at the favorable price and then assigns the contract to the ultimate purchaser and collects an assignment fee. These transactions are not inherently improper but, due to the significant fraud exposure, they must be closed in strict compliance with our previously published guidelines on flip transactions. See attached DE Directives 1 and 3.

**(c) The Trust:** While scenarios may vary, the basic situation involves an investor purchasing the property through a trustee of a designated trust of which the investor is the initial beneficiary. Shortly after the closing, the beneficial interest of the trust is then sold to the end purchaser. This may be done in an effort to hide from the short sale lender the fact that there is a subsequent sale. Since the assignment of a beneficial interest is an off record transaction, the short sale lender would not have notice of the final sale to the end purchaser. These transactions should be recognized as flip transactions and handled accordingly. We recommend that any information transmitted that was not generated by your agency should contain a disclaimer indicating that your agency is merely the transmitter and does not guarantee or warrant the accuracy of the attached information.

**(d) The Lease Purchase:** Some rescuers have devised a scheme whereby the mortgagor conveys their property to the rescuer who then leases the property back to the mortgagor, with an option to repurchase. These are suspect transactions and not to be insured without the prior written permission of underwriting counsel.

## **SIGNIFICANT ISSUES:**

Central to all of the above referenced fact situations are the flow of dollars and the instructions contained in the estoppel letter from the short sale lender. As in all real estate transactions, the HUD-1 must speak the truth as to disbursements made through your escrow account. This requirement is heightened in a short sale transaction since the standard caveat in most estoppel letters from short sale lenders prohibit any monies going to the mortgagor and also prohibit any subsequent sales of the property. These prohibitions come worded in a variety of ways but purportedly permit the short sale lender to rescind a recorded satisfaction if it was obtained due to a fraudulent inducement in obtaining the short payoff.

This is a major concern to Old Republic and its agents. It is absolutely essential that our insured be a bona fide purchaser or lender for value. To accomplish this, it is vital that the insured not be involved in any activity that violates the factual representations given to the short sale lender. Specifically, the insured cannot pay any proceeds outside of closing or any monies not shown on the HUD-1. If the estoppel letter prohibits a subsequent sale of the property and the agent is aware of such a sale (or an assignment of a beneficial interest in a trust), the agent must obtain a written approval from an officer of the short sale lender. This is true, even if the agent is not closing the subsequent transfer. The title agent must also pay close attention to the closing instructions of the lender of the ultimate purchaser. For example, if the closing instructions require the seller to be in title for longer than 6-12 months, the title agent must obtain revised instructions if this requirement will not be met.

## **UNDERWRITING GUIDELINES:**

- No proceeds from the sale may be paid to the seller/mortgagor unless approved in writing by the short sale lender.
- The sale must be an "arms-length" transaction (i.e. there can be no relationship between any of the sellers/buyers in the transaction).
- In a flip transaction, both legs of the transaction must stand on their own (i.e. the purchaser under the first leg must bring sufficient funds to close.)
- In a flip transaction, the short sale lender and the ultimate purchaser must sign an acknowledgment of the initial sale and the initial sales price. The acknowledgment must be signed by an officer of the lender (i.e. vice president or above). A form of acknowledgement is attached as Exhibit "A".
- In a flip transaction, the short sale lender must sign an acknowledgment of the subsequent sale and the sales price for such sale. The acknowledgment must be signed by an officer of the short sale lender (vice president or above). A form of acknowledgement is attached as Exhibit "B".
- The terms of the estoppel letter from the short sale lender must be strictly followed.
- The title agent must be in direct contact with the short sale lender and the estoppel letter must be requested and received by the title agent.
- Any requested documentation (i.e. the HUD-1) by the short sale lender must be sent directly from the title agent, not through an intermediary (i.e. foreclosure rescue company).

If done correctly, short sales are legitimate sales transactions. In fact, in the current market they may be a significant portion of some agents' business. The main thing to keep in mind when closing short sales is that all documentation must accurately reflect the transaction and the instructions from the short sale lender and the new lender must be followed.

If you have any questions, please do not hesitate to contact an Officer of the Company.

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**EXHIBIT A**

ACKNOWLEDGMENT

Loan Number: \_\_\_\_\_  
Borrower: \_\_\_\_\_  
Lender: \_\_\_\_\_  
Property Address: \_\_\_\_\_

The undersigned hereby acknowledges the following:

- (1) The subject property is being conveyed from Borrower to \_\_\_\_\_ for \$\_\_\_\_\_ and in connection with said sale, the undersigned has agreed to accept \$\_\_\_\_\_ to release the above-referenced property from the \_\_\_\_\_ lien of the above-referenced loan.
- (2) Following said purchase, \_\_\_\_\_ will convey the property to \_\_\_\_\_ for \$\_\_\_\_\_.

Said conveyance is acceptable to the undersigned and does not violate the estoppel letter provided to {Name of Title Agent} in connection with this transaction.

{Name of Short Sale Lender}

By: \_\_\_\_\_, its \_\_\_\_\_ president

**EXHIBIT B**

**ACKNOWLEDGMENT**

LOAN NUMBER: \_\_\_\_\_  
BORROWER: \_\_\_\_\_  
LENDER: \_\_\_\_\_  
PROPERTY ADDRESS: \_\_\_\_\_

The Undersigned acknowledges the following in connection with the above-referenced loan:

- (1) \_\_\_\_\_ The property was recently conveyed, or is about to be conveyed  
from \_\_\_\_\_ to \_\_\_\_\_ for  
\$ \_\_\_\_\_.
- (2) \_\_\_\_\_ is then going to convey the subject property  
to Borrower for \$ \_\_\_\_\_, and the Undersigned is giving \_\_\_\_\_ the  
above-referenced loan and getting a mortgage on the subject \_\_\_\_\_ property for  
\$ \_\_\_\_\_.

The undersigned acknowledges that the above does not violate the undersigned's closing instructions and authorizes {Name of Title Agent} to close the above-referenced loan.

{Name of New Lender}

By: \_\_\_\_\_  
It's \_\_\_\_\_ president

## 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).

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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.

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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

### **UNDERWRITING DIRECTIVE NO. 3**

**TO:** All Delaware Agents  
**FROM:** Dwight E. Edwards  
**DATE:** January 04, 2002  
**SUBJECT: Mortgage Fraud/Predatory Lending**

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HUD has identified property “flipping” as a major example of predatory lending and has published a proposed rule in the September 5, 2001 Federal Register to amend HUD’s FHA single family mortgage insurance regulations by establishing new 24 CFR part 203.37a. If adopted as proposed, the new rule would make any property sold within six months of its acquisition, ineligible for mortgage insurance.

Property flipping occurs when a recently acquired property is resold for a considerable profit with an artificially inflated value, often involving a lender’s collusion with an appraiser. And it usually involves a rapid resale in which the final purchaser’s loan is used to finance all aspects of both transactions.

HUD is not alone in addressing the issue of property flipping and other forms of mortgage fraud. Many lenders provide in their written closing instructions that their transactions may not be closed unless the borrower has been vested in title for a minimum specified period of time (usually six months or a year) before a closing is conducted. Non-compliance with such instructions could lead to claims if a closing protection letter has been issued.

Lenders closing instructions may also prohibit simultaneous transactions and restrict the source of non-mortgage funds to the borrower or third parties approved by the lender. Typically, written authorization from a specified senior officer of the lending organization is required in order to deviate from closing instructions. Generally, this is not the mortgage broker who originated the loan.

While a quick and profitable resale of a recently acquired property is not necessarily illegal and may not be mortgage fraud, we want to alert you to some of the potential pitfalls involved in these situations. It should be obvious that title commitments and the HUD-1 Settlement Statement should always reflect the facts as you know them. Commitments that do not reflect your analysis of the public record you have examined should not be issued. The HUD-1 Settlement Statement should be completed in accordance with the instructions contained in RESPA Regulation X.

Do not issue a HUD-1 Settlement Statement or title commitment with inaccurate information as an accommodation to any party to the transaction. If you are requested to accommodate a transaction by providing an inaccurate HUD-1 or title commitment, you should refuse to comply with the request and contact your state office.

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