Maine Association of REALTORS®
E-NEWS Legal Update – September 2004

Mortgage Fraud. Back in 2001, Will Lund, Director of the Office of Consumer Credit Regulation, wrote an article for the MREC Newsletter raising serious ethical, legal and regulatory concerns about various "mortgage schemes" being used in residential real estate transactions. The typical scheme involved increasing the contract purchase price to make it look like the buyer was making a larger down payment with the seller taking back a second mortgage for the difference. The second mortgage was immediately discharged after closing and no actual money changed hands. More recently, it appears that a practice of "side deals" is being employed which, while appearing more innocent, may raise the same ethical, legal and regulatory concerns. Mr. Lund has summarized the problem in a draft newsletter article as follows:

"Often buyers and sellers of residential real estate will agree to "side deals" in which money changes hands to cover the cost of needed repairs or defects discovered on the property. However, if these adjustments are substantial enough to affect the value of the residence being used as security for a loan to the buyer, and if the side deal is not reflected in the HUD-1 closing statement, then all parties to the transaction (including the settlement agent and the real estate agent) should carefully review their participation to determine whether legal or ethical principles are being violated.

For example, in any FHA-insured loan, the buyer, seller and settlement agent each sign statements attesting to the accuracy of the figures being used; *see* "FHA Addendum to HUD-1 Settlement Statement." (The settlement agent's certification is the most precise, indicating that the individual attests that the HUD-1 is a "true and accurate account of the funds which were received or paid outside closing.") Knowledge of a substantial side agreement not reflected in the HUD-1 would almost certainly violate these representations. *See also* federal law regarding false statements made in the loan process, 18 USC Secs. 1010, 1014 and 1344(A).

Maine law does not contain specific provisions prohibiting side agreements, such as one enacted in Alabama which states that a real estate agent may lose his or her license for "misrepresenting or failing to disclose . . . the true terms of a sale of real estate" (Ala. Code, sec. 34-27-36(a)(21)). However, parties to Maine transactions should not assume that the absence of a state law here means that such deals are permitted on mortgages headed for the secondary market, especially when the loans will be held or guaranteed by government or quasi-government entities."

The situations described in Mr. Lund's draft article are often made more difficult by the fact that the originating lender or mortgage broker involved in the transaction is indicating that everything is fine and that the side deal needs to be handled outside of closing and cannot be shown on the closing statement. Since these parties or entities are normally not the institution that will end up holding the mortgage, their representations will not necessarily be a defense to a claim of mortgage fraud raised by the lender that ends up holding the loan. Do not assume that simply following the instructions of the originating lender or mortgage broker means that everything is fine and that anyone involved in the transaction will be protected.