

The Ten Commandments For Avoiding A Fraudulent Real Estate Transaction

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Millions of dollars worth of claims are made every year on transactions that could have been avoided (or at least sent to a competing escrow or title company) had the escrow or title officer been more aware. The Ten Commandments set forth below are designed to help escrow and title officers avoid participation in fraudulent real estate transactions.

COMMANDMENT NO. 1: Do not give in to pressure to close before all necessary documents have been submitted.

Some people say that the three most expensive words in the business lexicon are “You can’t lose.” They’re wrong. The three most expensive words are “Recon to come.” While the concern is less immediate when dealing with a well known institutional lender, even the most honest people lose interest in completing the paperwork once the escrow is closed.

Distinguish between the understandable desire to complete a transaction quickly and the seemingly irrational demand that escrow close immediately. Sometimes pressure from the customer goes beyond what is normal. A party may insist on speed to separate the buyer or the lender from its money before facts that would kill the deal come to light (and before the last stage leaves town). To avoid this problem, and the associated problem of paying off the wrong person, obtain the originals of the note and deed of trust, a copy of any servicing agreement, and a fully executed Request for Reconveyance before closing escrow.

COMMANDMENT NO. 2: Do not participate in a transaction that you do not understand.

The escrow officer should not proceed without at least a basic understanding of the structure of the transaction and the motivations of the parties. The escrow company may be able to defend against escrow negligence lawsuits by reciting case law which holds that the escrow’s sole obligation is to follow the escrow instructions. An escrow officer, however, who has no concept of what was going on in the transaction makes a dreadful witness. Escrow officers are often viewed (perhaps mistakenly) as “the experts” who will make sure that the transaction is legitimate. In subsequent litigation, the court will tend to reject the “I-was-just-following-orders” defense if given an opportunity, despite the escrow officer’s innocence and ignorance.

When a transaction is too complicated for mere mortals to understand, watch for problems. Before proceeding with a complicated transaction, the escrow officer should make the participants explain it in simple terms, if necessary, to the branch manager, the underwriter, or the company’s legal counsel. If something does go wrong, the escrow will probably be blamed along with the wrongdoer who has by then fled the jurisdiction.

COMMANDMENT NO. 3: Do not deviate from company procedures in exchange for the promise of future business.

Customers often ask the escrow or title officer to violate company rules or common sense, offering the promise of future business as an inducement. These rules have been established for a purpose. Do not be induced when the customer says, “Trust me, I’m a regular customer and I’ll give you more business.” That kind of business may offer nothing more than an invitation to greater exposure on future claims.

Additionally, even nominal gifts -such as flowers, wine or invitations to social events - from the customer to an escrow officer may be inappropriate. Do not take risks unless they are justified by the single transaction under consideration.

COMMANDMENT NO. 4: Know your customer.

The only way to identify certain scams is to know the reputation and history of developers in the area. For example, there has been a recent spate of mechanic’s lien foreclosures that are prearranged between crooked lenders and developers to defraud subcontractors, suppliers and ultimately the title company. Keep track of past failed projects.

Pay attention if you learn that another title company previously issued a policy on the same project (why are the parties coming to you?) or if the chain of title shows prior mechanic's liens problems or prior litigation. A bad project usually remains a bad project. A bad developer always remains a bad developer.

Also, in terms of knowing your customer, be vigilant when a representative signs on behalf of another person or entity. Even though such transactions are usually legitimate, after an investment has gone sour, disappointed investors frequently litigate the scope of authority of the person signing on their behalf. While powers of attorney (even notarized ones), partnership agreements, loan servicing agreements, and corporate resolutions can be forged, requiring such documents at least provides some protection - both from the commission of a fraud and from honest errors - such as when a power of attorney is expired according to its terms or when the party signing loan documents on behalf of a partnership is only a limited partner.

COMMANDMENT NO. 5: Do not make factual representations.

Every day, escrow and title officers are asked to, and sometimes do, verify facts outside their scope of knowledge, such as the value of real property or the stage of completion of a construction project. One accommodating escrow officer even provided a written verification of her views on these subjects on company letterhead. The escrow officer made these representations to facilitate a loan to a favorite customer from a foreign bank that did not have the slightest idea as to the proper role of an escrow. An escrow or title officer invariably gets in trouble with factual representations where the source of the information is one of the parties to a transaction who is trying to induce the adverse party to rely on that information. The escrow and title officers should avoid this role in the transaction.

Escrow and title officers should refrain from making any representations, unless the facts are specifically within their knowledge, such as representations to a party as to the status of an escrow. In most transactions, even representations regarding the state of title are unnecessary and should be avoided on the theory that the most common title products are not representations as to title - a Preliminary Report is an offer of insurance, and a Policy of Title Insurance is a contract of indemnity. The rare customer who needs a representation as to title should be sold an abstract of title or a title guaranty. Neither the escrow officer nor the title officer should make representations as to title other than by selling a product specifically designed for that purpose.

COMMANDMENT NO. 6: Be skeptical of the unseen buyer or borrower.

Some fraudulent schemes have been perpetrated using non-existent persons, with phony tax returns, forged credit reports, fictionalized appraisals, made-up social security numbers, and/or all of the above. Never under-estimate the creative genius of the fraudulent mind. One tip-off is the request that the escrow officer notarize documents for an absent party (although assistance from an accommodating notary is unnecessary if the notary is forged). Another potential danger sign is when all documents are signed outside the presence of the escrow officer. While it is virtually impossible to recognize a single fictionalized transaction of this type in isolation, patterns emerge when a series of similar transactions are sponsored in rapid succession by a single non-party broker or middleman.

COMMANDMENT NO. 7: Beware of transactions in quick Succession involving the same property.

For better or worse, our society some-times rewards speculation, and the "quick flip" of real estate can be perfectly legitimate. In proper circumstances, even back-to-back escrows are appropriate. However, many fraudulent schemes start with a series of sales between real or made-up parties, or between family members, with the sole objective of increasing the stated price (but not the actual value) of the real property which is then used as collateral for a loan. Invariably, the amount of the loan will far exceed the actual value of the real property, and the escrow and title companies will be blamed when the borrower defaults after a single monthly loan payment or no payments at all. Again, this type of fraudulent scheme is difficult to spot where only one property is involved but becomes more apparent when the "satisfied customer" brings in multiple similar transactions, or when there are several uninsured transfers within a short period of time, often between family members.

COMMANDMENT NO. 8: Avoid accommodation recordings.

An accommodation recording is the recording of a notarized document which does not relate to an open escrow. The escrow officer typically records the document as a favor to a customer in the hope of being engaged for a

future transaction concerning the subject property or some other property. The escrow officer does not charge a fee for the service. Many escrow officers think that, because no fee is charged, there can be no liability. Unfortunately, as more than one court has declared, this notion of simple fairness is simply incorrect.

Accommodation recordings expose an escrow company to claims of “aiding and abetting” a fraud, if one occurs, even without any reward or compensation to the escrow company.

Accommodation recordings result in a disproportionately higher percent-age of claims than transactions where the escrow company opens an escrow as part of a real transaction and charges for its services. Perhaps the best service the escrow can provide is to direct the party requesting an accommodation recording to the County Recorder’s office.

COMMANDMENT NO. 9: Watch out when the buyer receives money from (rather than pays money into) escrow.

If something seems too good to be true, it usually is. This is often the case in a “net cash to buyer” transaction. Many fraudulent schemes, often involving double escrows, reveal a buyer who is acquiring title and simultaneously receiving proceeds out of escrow on a loan that is premised on a fraudulently inflated property value. Since these types of scams usually involve a series of loans from a single lender, the perpetrator needs to get the loan proceeds released to him-self. One giveaway is the instruction on multiple “net cash to buyer” loans (usually in the form of an assignment of proceeds) that the escrow pay the loan proceeds directly from escrow to a single payee who is not a party to the transaction. The payee is probably orchestrating a fraudulent scheme against an unsuspecting lender who has not taken adequate steps to appraise the real property security accurately.

COMMANDMENT NO. 10: Be wary of requests for reports that do not reflect the true current state of affairs.

The purpose of a preliminary report is to facilitate the sale of title insurance, and deviation from this purpose invites trouble. Years ago, customers would sometimes request a report with a specific “as of” date that did not show more recent transactions affecting the property. Such special ordered reports of title were used to memorialize the state of title at a particular time for the purpose of documenting certain tax-oriented transactions.

Unfortunately, backdated reports have also been used to mislead investors or lenders concerning ownership of property that was sold or encumbered after the last date shown on the report. Even if requested by a good customer (see Commandment No. 3), and even if you think you understand the purpose (see Commandment No. 2), do not provide custom-tailored reports that could be used for misleading purposes. To the extent a proper title product is desired to freeze-frame a past state of title for a legitimate purpose, check with the underwriter or legal counsel and, if permitted to proceed, make sure that the report discloses in bold print, in a location where it would be difficult to redact, that subsequent events may have changed the state of title after the last date covered by the report.

CONCLUSION

While nothing can make escrow and title companies “bulletproof” from fraud, the Ten Commandments set forth above may help to alert escrow and title officers to danger signs.