

PRACTICE TIPS:
Recognizing Fraud in Real Estate Transactions

Real estate fraud can occur in a number of different ways. The following is a list of some possible indicators of fraud in residential real estate transactions.¹ The presence of one or more of these indicators in a transaction does not necessarily mean that a fraud is occurring or has occurred in the transaction. This list is not intended to replace the lawyer's professional judgment. Whether a fraud is being committed in the course of a real estate transaction will depend upon the circumstances of the individual matter or transaction.

Recent Property Purchase

- ☐ The client has recently purchased a property on an all cash basis and is subsequently placing a mortgage on the property.
- ☐ The client has a copy of his or her Transfer/Deed but does not have any other documents relating to the property (purchase documents or a survey).
- ☐ The client does not retain the same lawyer who acted in the purchase transaction to act in the mortgage transaction and the client instructs the new lawyer not to contact the former lawyer;
- ☐ The search of title indicates recent transfers of the property at higher prices and the same lawyer acted on each of the transfers;

The Agreement of Purchase and Sale

- ☐ The agreement of purchase and sale contains no hand written amendments;
- ☐ The agreement of purchase and sale contains an amendment which provides for a reduction in the purchase price or a payment to the vendor after closing;
- ☐ The vendor in the transaction acknowledges receipt of deposit monies that are not required pursuant to the agreement of purchase and sale;
- ☐ The deposit is paid to the vendor directly rather than to the lawyer in trust or to the real estate agent;
- ☐ There is no real estate agent involved in the transaction;
- ☐ A real estate agent is listed in the agreement but the lawyer does not receive any communication from the agent (e.g. payment of commission);

The Transaction(s)

- ☐ The client does not have fire insurance on the home;
- ☐ The utility companies are unaware of the vendor owning the home;
- ☐ The client needs to close the transaction very quickly;
- ☐ The client is a new client and promises to refer more transactions to the lawyer;

- ❑ The client arranges the mortgage through a broker and the brokerage fee is unusually high;
- ❑ The client is prepared to pay higher legal fees than normal for the lawyer's services;
- ❑ The purchase price is much higher than the purchase price of recent transfers of the same property;
- ❑ There are large and unusual adjustments in the Statement of Adjustments (e.g. large credit for renovations);
- ❑ The statement of adjustments does not reflect the terms of the agreement of purchase and sale and any amendment thereto.
- ❑ The title indicates a pattern of mortgages being registered and discharged shortly afterwards;
- ❑ All of the funds required to close the transaction come from the institutional lender;
- ❑ The name of the client in the identification produced by the client does not match the name of the client in other documents in the transaction;

Mortgage Proceeds

- ❑ There is a surplus of mortgage proceeds after the closing of the transaction that are to be paid to the borrower or to a third party;
- ❑ The client directs part of the mortgage proceeds to third parties (e.g., off-shore recipients, currency exchange);
- ❑ The client instructs the lawyer that it is unnecessary to prepare written directions authorizing the payment of funds to third parties;
- ❑ The mortgage is a cashback mortgage and the cashback is the full amount of the equity in the property;
- ❑ The client directs the lawyer to rebate a portion of the mortgage surplus to the vendor;

Client is a Facilitator

- ❑ A new client (facilitator) refers a number of real estate files to the lawyer and the client although not a party to the transaction controls the transaction (e.g., gives instructions to the lawyer, arranges for the parties to the transaction to sign documents etc.) and directs the parties in the transaction;
- ❑ The client does not have a personal cheque for the client's pre-authorized debit plan but provides a blank "counter cheque";
- ❑ The lawyer is instructed to pay the excess mortgage proceeds to the facilitator even though the facilitator does not appear to have an interest in the transaction;

Flip Transaction

- ❑ The vendor acquires the property the same day that it is being sold for a higher purchase price (flip transaction);

- ❑ The lawyer is asked to act for both the purchaser and the vendor in the flip transaction;
- ❑ A bank loans money on the strength of the consideration contained in the flip agreement;
- ❑ The client instructs the lawyer not to disclose to the lender that the transaction is a flip or that the lender is lending money on the higher consideration;
- ❑ The Land Transfer Tax affidavit shows the higher consideration. The Transfer/Deed of Land signed by the original vendor containing a lower consideration is manually altered prior to closing to match the consideration set out in the Land Transfer Tax affidavit;

Multiple Transactions

- ❑ A new client begins referring a number of real estate files to the lawyer and the same parties (purchasers and vendors) are involved over and over in transactions;
- ❑ The client indicates that he or she is in the business of renovating homes;
- ❑ The same real estate agency appears regularly on the agreements of purchase and sale;
- ❑ The mortgages arranged in these transactions are usually high ratio mortgages with mortgage insurance;
- ❑ The lawyer is instructed to use the excess mortgage proceeds for the purchase of another property;

Corporations

- ❑ The original minute books for the company are not available or incomplete;
- ❑ The minute books contain irregularities such as the lack of the "pink-stamped" articles of incorporation.



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¹ Some of the items contained in this list of possible indicators were adapted from the following sources: LAWPRO, "The Many Faces of Fraud," June 2004; Law Society of Upper Canada CLE program, Real Estate Fraud: Protecting Your Practice From the Brazen New Breed of Fraudster, January 26, 2004.



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RED FLAGS THAT SHOULD PROMPT QUESTIONS AND DUE DILIGENCE WHEN DEALING WITH REAL ESTATE TRANSACTIONS

To help lawyers recognize potential fraudulent transactions, the Law Society's mortgage fraud investigation team has compiled a list of significant indicators or "red flags" that should prompt further review of any transaction in which they appear.

While this list of indicators is not exhaustive, it summarizes many of the major issues and concerns the team has seen in its investigations of lawyers for mortgage fraud and related allegations.

The fact that one or more of the following red flags appears in any transaction does not necessarily mean that the transaction is improper, or that a fraud is being perpetrated. However, when a real estate and/or mortgage transaction exhibits one or more of these red flags, a lawyer should apply extra diligence.

Lawyers have a duty to advise their clients, including lenders, of any information discovered in the course of the transaction that in the lawyer's reasonable opinion would affect the decision of the client to complete the transaction.

Red Flags

- Two or more Agreements of Purchase and Sale for the same property and closing on the same day or within a few days of one another, at different sale prices.
- Substantial escalation in the sale price of a property over a relatively short period of time.
- Short closings, coupled with excessive urgency to complete the transaction.
- The same lawyer acting for all parties, except the legitimate vendor.
- Instructions and information, such as title information, coming from a third party.
- The purchaser provides no or minimal funds on closing, such that only the mortgage advance is required to complete the legitimate purchase.

- The purchase funds come through a last-minute "gift letter," "promissory note" or second mortgage, or some other source or arrangement and this fact is not known to the lender and is not part of the mortgage commitment and instructions to the solicitor.
- The presence of the same purchasers, vendors, real estate agency and mortgage broker in multiple transactions.
- The lawyer receives an unusual volume of transactions from the same purchasers, vendors, real estate agency and mortgage broker.
- The lawyer is offered higher than usual legal fees for acting on transactions.
- The client does not wish to sign an acknowledgment and direction authorizing the lawyer to electronically sign and register a document.
- Last-minute registrations under Power of Attorney.
- Last-minute transfers contemplating "Trustee" arrangements such as "Trustee to beneficial owner" at NIL consideration followed immediately by the registration of a mortgage and the advance of mortgage proceeds
- The lawyer is instructed to address or send the reporting letter to a third party.
- Agreements of Purchase and Sale, and/or amendments to Agreements of Purchase and Sale in which deposits are payable directly to the vendor and not to the real estate agent or the vendor's Lawyer.
- Additional deposits or other credits to the purchaser contained in amendments to the agreement of purchase and sale and/or not supported by written agreement.
- The net mortgage advance received exceeds the balance on closing on Statement of Adjustments.
- The lawyer receives instructions to pay excess mortgage proceeds to third parties not related to the transactions.

FRAUD IN REAL ESTATE TRANSACTIONS

Fraud in real estate transactions is a growing area of concern. Two of the more common types of fraud are value fraud and identity fraud. In a value fraud the value of the property is inflated and usually a third party advances money on the strength of the higher value. In an identity fraud, the fraudster misappropriates the identity of a third party to facilitate the fraud.

The following are some resources to assist lawyers to recognize fraud in real estate transactions and understand their ethical obligations when engaged in transactions involving real estate fraud:

- Fact scenarios outlining how a real estate fraud may occur;
- Practice tips containing some possible indicators of fraud; and
- Qs and As dealing with practice issues and some of the lawyer's ethical obligations when acting in transactions in which a fraud has been or may be occurring.

Fact Scenarios – How might a real estate fraud occur?

The following fact scenarios are examples of how a value or an identity fraud may occur in the context of a real estate transaction. However, it should be noted that sometimes elements of both of these types of fraud might be present in the same transaction.

VALUE FRAUD

Fact Scenario I - Flip Transactions

A fraudster arranges for a purchaser (Purchaser 1) to purchase a property from a legitimate vendor (Vendor 1). Purchaser 1 and Vendor 1 agree on a purchase price of \$200,000.

The fraudster and/or Purchaser 1 retains Lawyer A to act on the purchase transaction.

The fraudster then arranges for another purchaser (Purchaser 2) to purchase the same property from Purchaser 1 (who becomes Vendor 2 in the second transaction) at a purchase price of \$300,000. Lawyer A is also retained to act for both Vendor 2 and Purchaser 2 in the second transaction.

Purchaser 2 then applies to the Bank for a high ratio mortgage (95% of \$300,000) and the Bank approves Purchaser 2 for a mortgage of \$285,000. The amount of mortgage proceeds received from the Bank on closing is greater than the amount required to close the first transaction.

Both transactions close on the same day or within a short time period of each other. Where the transactions close on the same day, Vendor 2 and Purchaser 2 instruct the lawyer to change the Deed delivered by Vendor 1 to show the higher consideration of \$300,000. On closing, a portion of the mortgage proceeds is used to complete the first transaction and the balance or excess is paid to the fraudster, Purchaser 1 and/or Purchaser 2.

After closing, the fraudster and/or Purchaser 2 may reside in the property for a period of time and make the mortgage payments or alternatively the fraudster may rent out the property and use the rental monies to make the mortgage payments. At a certain point Purchaser 2 or the fraudster stop making the mortgage payments. The Bank sells the property under power of sale and the bank is unable to realize the full amount owing on the mortgage because it over-advanced approximately \$95,000.00, being 95% x (\$300,000 - \$200,000).

Fact Scenario 2 – Misrepresentation of the Sale Price

A fraudster agrees to purchase a property from a legitimate vendor. The fraudster and the vendor agree on a purchase price of \$250,000. The parties sign an agreement of purchase and sale indicating a purchase price of \$250,000.

The parties then sign a one page amendment to the agreement indicating that the purchaser will be given a credit of \$50,000 on closing to effect repairs to the property. The fraudster does not disclose the amendment to the Bank.

The fraudster applies to the bank for a high ratio mortgage. The fraudster is approved for a mortgage of \$237,500 being 95% of \$250,000.

On closing, some of the mortgage proceeds are used to close the transaction and the balance of proceeds are paid to the fraudster.

After the closing, the fraudster makes mortgage payments for a period of time and then stops. The Bank sells the property under power of sale and is unable to realize sufficient monies to cover the full amount owing on the mortgage because it over-advanced approximately \$47,500.00, being 95% x (\$250,000 - \$200,000).

IDENTITY FRAUD

Fact Scenario 3 – Theft of Owner's Identity

A fraudster (imposter) appropriates the identity of an owner of real property and applies to the Bank for financing. The imposter supplies the Bank with a false letter of employment and other false information or documents.

The Bank approves the financing.

The imposter retains a lawyer to act on the mortgage transaction and the Bank retains the same lawyer to act on its behalf in the mortgage transaction. The lawyer does a title search and finds that there are no encumbrances against the property.

The lawyer completes the transaction and pays the mortgage proceeds to the imposter. After closing, the imposter makes mortgage payments for a period of time and then stops.

The lawyer discovers after closing that the imposter is not the owner of the property but an imposter who forged the signature of the owner on the mortgage document.

Fact Scenario 4 – Theft of Corporate Identity

A fraudster (imposter) targets a real property owned by a corporation. The fraudster creates minute books for the corporation and either appropriates the identity of one of the controlling individuals of the corporation or creates a new identity to act as the controlling individual of the corporation. The fraudster applies to the Bank for financing. The fraudster supplies the bank with false corporate documentation and false financial information.

The Bank approves the financing.

The imposter retains a lawyer to act on the mortgage transaction and the Bank retains the same lawyer to act on its behalf in the mortgage transaction. The lawyer does a title search and finds that there are no encumbrances against the property.

The lawyer completes the transaction and pays the mortgage proceeds to the corporation and/or fraudster. After closing, the lawyer discovers that the identities of the corporation and of the individual controlling the corporation were stolen and that the mortgage documents were signed by an imposter.

Fact Scenario 5 – Theft of Lawyer's Identity

A fraudster enters into an agreement of purchase and sale with a legitimate vendor.

The fraudster appropriates the identity of a lawyer who is in good standing with the Law Society. The fraudster creates letterhead using the lawyer's name but containing a false address, telephone number and fax number. The fraudster establishes a trust account using the lawyer's name.

The fraudster applies to the Bank for mortgage financing and is approved. The fraudster then provides the Bank with the lawyer's name and the false address, telephone number and fax number. The Bank retains the same lawyer to act on its behalf in the mortgage transaction.

The Bank sends mortgage instructions to the lawyer at the address provided by the fraudster and forwards funds payable to the lawyer in trust. The mortgage proceeds are deposited into the trust account established by the fraudster. Prior to closing, the fraudster steals the mortgage money and disappears and the transactions do not close.



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