

## **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  $95\% \times (\$250,000 - \$200,000)$ .

### **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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