



Flip fraud schemes:

When all that
glitters is not gold

When we first wrote about real estate flips and how easy it was for lawyers to become pawns in this type of fraudulent activity, we believed we had seen the worst of it.

Three years later, it appears that we were wrong: Real estate scams today are both more sophisticated and prevalent, despite efforts by LAWPRO to educate lawyers about these frauds through warnings and education efforts, and despite efforts by financial institutions to refine their instructions to lawyers.

Evidence appears to be emerging that in some cases lawyers are masterminding the schemes that have left financial institutions “holding the bag” when their mortgage security is little more than a vacant lot, worth far less than the principal amount of the mortgage. Fraud, which once involved primarily real estate agents and financial advisors, is now being stick-handled by lawyers themselves.

This article updates the material published in LAWPRO's Special Report on Fraud, first published in 2001.

The lawyer as mastermind

One type of scheme involves a lawyer seeking the assistance of another lawyer in processing mortgages, because the “mastermind” lawyer is allegedly “too busy” to handle the transactions on his own. He enlists the help of other lawyers to prepare the mortgage document, obtain title insurance, and register the mortgage. Lawyer B is told that the mastermind will do all the title searches and that he/she need not concern him/herself in that regard.

As part of the scheme, the mastermind lawyer sends Lawyer B the Agreement of Purchase and Sale, the title documents and various directions which require the lawyer to process a transaction in which:

- (a) the vendor listed on the Agreement of Purchase and Sale is not the same person who appears on the title search as the last registered owner;
- (b) the consideration set out in the Agreement of Purchase and Sale is significantly higher than the consideration set out in the title search documents in respect of the last transfer;

- (c) the bank lends money on the inflated purchase price set out in the Agreement of Purchase and Sale;
- (d) a series of directions require payment of the mortgage proceeds to persons and entities who appear to have no connection whatsoever to the parties listed on the Agreement of Purchase and Sale.

Some financial institutions have attempted to eliminate the incidence of these flip frauds by requiring their lawyer to:

- (a) obtain photo identification of the mortgagor/purchaser;
- (b) advise the financial institution of any significant change in the apparent value of the property or of any other matter that might affect the value of the property; and
- (c) advise the bank if the vendor on the Agreement of Purchase and Sale is different from the last registered owner on title.

However, these frauds continue as the lawyers processing the transactions are either careless in their work or, it seems, complicit in or wilfully blind to the fraud being perpetrated on their lender clients. Although the promise of a stream of files and high fees is enticing to any lawyer, it is important to be diligent in ensuring that all that glitters is, in fact, gold.

The lawyer as “pawn”

In this scenario, a lawyer with too much time and too little work on his hands finds himself face-to-face with a golden opportunity: a new contact who is a real estate agent, a financial advisor, or just someone who seems to have a lot of connections.

The lawyer has never met this person before, but is told this person has the ability to bring in a lot of business, either directly or through another person the lawyer may or may not ever get a chance to meet. This person is the “mastermind”.

The lawyer wonders only briefly why a sole practitioner in his position would be chosen by this client, but his concerns are soon allayed when promises of high fees in exchange for quick processing of real estate transactions are presented.

The real estate deals start coming to the lawyer directly from the mastermind. They may appear somewhat unusual in that they

The issue of liability coverage

LAWPRO has become involved in some fraud situations when the financial institutions seek to hold their lawyer responsible for the shortfalls. Our involvement starts with the retention of coverage counsel to determine whether the lawyer was a willing participant in the fraudulent scheme, wilfully blind to it, or merely an innocent dupe when processing the transactions involved. There is no coverage under the LAWPRO professional

liability policy for situations in which lawyers were complicit in fraudulent activities.

These fraudulent schemes can be very costly to the profession.

So the next time you are sitting in your office on a rainy day, keep in mind that if an opportunity presents itself that seems too good to be true, it just may be.

appear to all have short closing dates that require immediate processing, often without time to conduct proper searches. Often there is a flip involved, in which the financial institution has agreed to lend money on the higher purchase price of the flip agreement. The lawyer often acts for all parties. But all directions and information come from one party: the mastermind.

Typically, the scam works like this: Jane Doe is a legitimate vendor with property for sale. The mastermind of the fraudulent scheme submits an offer to purchase the Doe property with Mr. Smith posing as the purchaser.

A purchase price is agreed on, as is a closing date for the transaction (the “original agreement”). The mastermind then prepares a second agreement of purchase and sale whereby:

- Smith sells to Black for a price in excess of the original purchase price (the “flip agreement”); or
- Doe sells to Black for a price in excess of the original purchase price (the “fake agreement”).

In situations where there is a flip agreement, both the original agreement and the flip agreement are sent to the lawyer for processing.

In situations where there is a fake agreement, the bank is usually provided with a copy of the fake agreement as part of an application to obtain mortgage financing on the basis of the higher consideration.

In both cases, the bank lends money on the strength of the higher purchase price contained within the flip or fake agreement.

In that regard, the mastermind also provides the bank with false information about the proposed borrower Black, such as false letters from employers allegedly verifying Black’s income, false social insurance numbers, and false addresses, etc.

Once the mortgage funds have been paid out by the bank, and the mortgage has been registered on title, the mastermind rents out the property and makes the monthly mortgage payments presumably using the rental proceeds.

It is believed that both Smith and Black are “straw men” posing as vendors and/or purchasers, and that the true purchaser is the mastermind.

The police and some of the financial institutions involved have been alerted to these fraudulent schemes, and have conducted their own investigations into the matters.

As a result of these fraudulent transactions, a number of financial institutions have been left “holding the bag” when the mastermind stops making the monthly mortgage payments and the property is sold under power of sale for significantly less than the principal amount of the loan.

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value fraud

Value frauds can be fairly complicated transactions with enough twists and turns to keep even the most conscientious lawyer on his or her toes. When identity mortgage frauds are coupled with value fraud, where a fraudster buys and then flips the property at a higher value to an accomplice – who can be a fictitious person or an imposter – the picture gets more interesting still.

The following are some of the most telling indicia of these types of frauds, some of which have an identity fraud component, as noted by LawPRO examiners, coverage counsel and adjusters who examined files involving fraud and potential fraud. While it is not fair to assume that every deal is fraudulent, the presence of some of these flags in a transaction should put every lawyer on alert.

Client characteristics

- A new “client” starts to send the lawyer numerous real estate files, many of which are “flip” deals.
- The client – the scheme’s mastermind – appears to be in control of the files:
 - he/she sends the Agreement(s) of Purchase and Sale to the lawyer;
 - he/she is the primary contact for any issues that arise prior to closing;
 - he/she provides the particulars such as who is to take title to the property; the date of birth of the transferees, and so on;

- he/she often arranges insurance on the property;
- he/she arranges the “sign up” meeting with the vendor/purchasers;
- the “sign up” meetings often take place in odd locations.
- The client does not have a personal cheque for his/her pre-authorized debit plan and uses a bank “counter cheque.”
- The client tells the lawyer s/he is in the business of renovating homes.

Transaction characteristics

- The Agreement of Purchase and Sale contains no handwritten amendments: It is too clean.
- No real estate agent is listed on the agreement; or
- A real estate agent is listed, but you receive no communication from the agent, particularly with regard to his/her commission. Apparently the vendor has made a private deal with the agent so that no commission is payable or the “deposit” exceeds the commission; or
- The same real estate agency appears regularly on a number of Agreements of Purchase and Sale.
- The lawyer is consistently told to act for the ultimate purchaser on the flip agreement (and/or, in some cases, the vendor and purchaser on the flip agreement).
- The transactions often involve short time frames, last-minute changes in meetings, dates and documents.

“Client” communication

- The lawyer is never contacted directly by his/her so-called “purchaser (or purchaser and vendor) clients” to discuss the transaction, arrange a closing meeting, request an extension, discuss mortgage particulars, etc.
- When and if the lawyer actually meets his/her purchaser (or purchaser and vendor) client, it is apparent that this so-called purchaser (or purchaser and vendor) is very much being directed by the mastermind.
- There is often an absence of written directions for matters, such as funds, in the files, and the lawyer is persuaded by the fraudster that such written directions are unnecessary.
- The mastermind often convinces the lawyer that he or she need not contact the lender about the flip or the fact that the lender is loaning money on the higher consideration.

Search, inquiry findings

- The same purchasers and vendors often reappear time and time again on various transactions.
- Signatures on closing documents often do not match signatures on the corresponding Agreements of Purchase and Sale.

- Your search of title indicates several deeds and transfers of the property recently, in each case with significantly higher prices. The same lawyer may have acted on all of these “transactions”.
- The title discloses a pattern of mortgages being registered, discharged shortly thereafter, and new mortgages being put on, all for successively higher amounts to suggest legitimate increases in value.
- The Land Transfer Tax Affidavit for the subject transaction shows the higher consideration.
- The mortgages are usually insured by a mortgage insurer.

Monetary aspects

- The deposit is paid to the vendor and not to a real estate agent or lawyer in trust.
- There may be an amending agreement to the Agreement of Purchase and Sale giving the purchaser a credit, discount or abatement. The vendor’s statement of adjustments may provide for a large abatement or reduction in the purchase price or credit for monies exchanged between the parties (e.g. a private note or a further deposit). In these cases, invariably, little or no money is exchanged on closing other than the amount provided by the lender which is also an amount that was advanced on a much higher purchase price.
- When calculating how much money the purchaser has to bring in to close the deal, there is a surplus owing to the purchaser.
- There is a vendor-take-back mortgage instead of cash on closing, the amount of which covers all of the equity in the property over and above the new first mortgage. No money other than the lender’s money changes hands.
- The funds to close the transactions often come only from the bank, which is lending money on the strength of the higher consideration in the flip agreement.
- If the purchaser does provide any closing funds, those funds are minimal and usually are not drawn from the purchaser’s bank account (i.e. often there are money orders or cash payments involved).
- The lawyer is often instructed by the mastermind to pay the excess mortgage proceeds to the mastermind, despite the fact that he/she has no apparent interest in the transaction.
- In some situations, the mastermind instructs the lawyer to use the mortgage proceeds for another purchase.
- In some instances, the lawyer is paid premium legal fees for each transaction.

– Compiled from materials provided by Mirilyn R. Selznick and Robert J. Potts of Blaney McMurtry LLP, and Sidney Troister of Torkin Manes Cohen Arbus LLP.