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'Oklahoma swindle' is just plain real estate fraud

Inflating purchase price on home sale is illegal

What should you do when your real estate agent suggests something that sounds just a bit suspicious? That was the dilemma Mike Westward faced recently, triggered when he read the column on real estate fraud in this space two weeks ago

Westward's e-mail reads:

"I listed my house for sale and my agent said that a client is willing to buy it for \$250,000, if I agree to sign a purchase and sale agreement for \$270,000 and turn over the difference of \$20,000 to the prospective buyer. Apparently, this is a common practice and a creative way of getting around the down payment (the proverbial no money down scheme).

"Now, my question is: Would I face any repercussion if I agreed and proceed with this transaction?"

Westward may be correct in saying this is a common practice and a creative way of getting around the down payment. But it's also illegal for all the parties who participate in it.

The police call it fraud. In the real estate trade, it's known as a variety of the Oklahoma swindle. According to Toronto appraiser Barry Lebow, the Oklahoma is a scheme that involves artificially increasing the value of a property so that the first or second mortgagee is left with security that may be partially or entirely worthless.

Here's an example of how it works:

Let's say Mike's house is worth \$250,000. With the advice of a real estate agent or other party, Mike enters into an agreement of purchase and sale at \$270,000 - \$20,000 more than the house is worth. The agreement says the \$20,000 deposit was paid directly by purchaser to vendor, and not to the real estate agent or the vendor's lawyer, as is customary. That way, it's not traceable.

An amendment to the offer is prepared on Schedule A. It reduces the price from \$270,000 to \$250,000. The front page of the offer says \$270,000, and the amendment says \$250,000.

The purchaser, who is in on the scam, then applies to a bank, trust company or mortgage broker for a high-ratio Canada Mortgage and Housing Corp. mortgage for 95 per cent of the sale price - \$256,500 - on the understanding that the house sold for \$270,000. The bank never sees the amendment.

Now we have a house that sold for \$250,000 and a mortgage on it for \$256,500 (plus a CHMC premium). Since the mortgage is more than the purchase price, the purchaser actually gets a deed to the house or condominium with no money down. Not only that, he or she actually puts some surplus money into his pocket.

In one transaction I saw recently, a condominium in Mississauga sold for \$95,500. An unscrupulous agent prepared an amendment to the offer on a separate page stating that the vendor would give \$7,000 to the purchaser on closing for "renovations." Of course, there were to be no renovations - the \$7,000 was really there to fool the bank into believing the purchaser had a down payment that was \$7,000 higher.

The amendment was not shown to the bank, which agreed to advance a 95-per-cent mortgage on the assumption that the price was \$95,500 rather than \$88,500.

The deal fell apart when the purchaser's lawyer, who also represented the bank, told the purchaser he would have to tell the bank about the amendment. Once the bank found out about the inflated price and phoney down payment, the deal would die.

Why is the Oklahoma illegal?

Section 362 of the Criminal Code makes it an offence punishable by up to 10 years in prison to obtain credit (such as a mortgage) by a false pretence or fraud. Anyone who knowingly assists in the misrepresentation is a party to the offence and subject to the same penalty.

I have often seen crude attempts to carry out this type of mortgage fraud, but in my experience the transactions never close. In order to successfully conclude the scam, so many people have to be in the know, or asleep at their jobs, that the risk of getting caught is very high.

In addition to the real estate agent, a number of others involved in the transaction will sooner or later find out what's going on. Red warning flags will be going up all over the place in the offices of the lawyers for both parties.

The biggest tip-off is that the deposit and purchase price just don't add up to the total purchase price on the final statement of adjustments. This happens because the deposit is fictitious.

The purchaser's bank and the appraiser often discover for themselves that the underlying value of the property does not support the inflated purchase price. Inevitably, the lawyers involved will spot the fraud.

Agents and others who try to create an Oklahoma expect that the lawyers will either close their eyes to the scam or go along with it without telling the bank. It may look good on paper, but in the vast majority of cases, the scam explodes before closing when the lawyer blows the whistle.

Who gets hurt by these scams? A buyer has no down payment and actually gets money back after closing has very little to lose by defaulting on the loan.

Inflated purchase price scams cost millions of dollars to banks, CMHC, the title insurers, the justice system and, ultimately, the public. One title insurer reported recently that 22 per cent of its claims related to fraudulent transactions.

When I e-mailed a reply to Westward, I told him there was nothing wrong with the inflated purchase price idea if the purchaser's mortgage lender is aware of the facts. If not, I wrote, it is fraud.

I suggested that he report the conduct of the real estate agent to the owner of the brokerage, and file a complaint about the agent's conduct to the Real Estate Council of Ontario. RECO licenses real estate agents and has the authority to sanction them for improper activities.

The vast majority of real estate agents are honest, competent and capable. Those who try to create fraudulent purchase deals should not be allowed to retain their licences.

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Please send your inquiries and questions to bob@aaron.ca or call 416-364-9366.