FHA SETS TEMPORARY EXEMPTION TO "FLIPPING RULE"

FHA's one-year shift is no blank check for fraudsters

You may have read recently that the Federal Housing Administration (FHA) has announced a temporary and partial exemption to their rule prohibiting FHA insurance for "flipped" properties. FHA is not suddenly unconcerned about the predatory practice of flipping mortgage fraud. It is still very much concerned about flipping mortgage fraud.

So, you ask, what is "flipping," in the context of mortgage fraud?

Flipping is a type of mortgage fraud that happens when a property is purchased and quickly resold for a huge profit after the first buyer makes some minor cosmetic improvements to the property and obtains an inflated appraisal from a cooperative real estate appraiser and sells the property to a new buyer for much more than the property is really worth. Sometimes it also involves a cooperative lender who qualifies the new buyer by exaggerating income or other assets. Down the road, the new buyer, who may not be truly able to afford to make the mortgage payments, discovers that the home is not worth anywhere near what he/she paid for it, and foreclosure becomes more likely. That's the ultimate worse case scenario, but it has become a contributor to the foreclosure epidemic in many distressed communities.

FHA recently announced that it is waiving portions of its regulations that prohibit HUD-owned or bank-owned FHA-insured properties from being sold if the homes have been owned by the seller for less than 90 days. Because of FHA anti-flipping rules, foreclosed properties had to remain in the hands of the seller (e.g., the bank) for at least 90 days, because the agency prohibits sale of FHA-insured properties for at least 90 days. By waiving the 90-day requirement, HUD is trying to eliminate one impediment to the resale of the stock of foreclosed properties.

The waiver is only temporary (expiring on Feb. 1, 2011), and there are certain conditions to guard against flipping fraud, such as:

1. Requirement that the sale be at arms length, with no identity of interest between the buyer and seller, or other parties participating in the sales transaction.

2. High margin restrictions. Additional restrictions on the transaction if the sales price is 20% or more above the seller's acquisition cost.

3. No home equity conversion mortgages.

If the property's sale price is 20% or more above the seller's acquisition cost, the lender would have to justify that sale price with adequate documentation, such as a second appraisal and an inspection of the quality of any improvements.

Despite the waiver under FHA rules, mortgage flipping that is conducted in a fraudulent manner to the detriment of the consumer and the community is still a predatory lending practice and not acceptable, with or without FHA insurance.

About Nancy Derr-Castiglione

“Lucy
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Nancy, a Certified Regulatory Compliance
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Previously, Nancy held compliance positions with Bank One Corporation and with United Banks of Colorado.

In addition to serving as a Contributing Editor of ABA Banking Journal, Nancy has served on the ABA Compliance Executive Committee; National and Graduate Compliance Schools board; conference planning committees, and the Editorial Advisory Board for the ABA Bank Compliance magazine. She can be reached at nancycastiglione@comcast.net

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