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Looking for new loopholes

To bypass banks, some attorneys add questionable riders to sales contracts

By SARAH GROSS

In order to complete real estate transactions in New York's still-tough lending climate, some lawyers are turning to creative loopholes that have them operating in an ethical gray area, industry insiders say.

Boilerplate contracts — once the norm in residential transactions — have been scarce for several years now as lawyers come up with deals “tailored” to the specific needs of buyers and sellers. But some lawyers are now going even further to avoid strict lending rules, adding contract riders that are not submitted to banks. Other buyers and sellers simply make private side agreements that are not mentioned in any of the closing documents.

“People often do this as a way to encourage lenders to lend more money than they ordinarily would have,” said Aaron Shmulewitz, an attorney at Belkin Burden Wenig & Goldman who has represented more than 250 cooperative and condominium boards in New York. “It gets close to bank fraud sometimes.”

For example, the value of concessions that sellers can throw in to sweeten the deal for buyers is limited by Fannie Mae, Freddie Mac and the Federal Housing Administration, the entities that insure most home loans in the U.S. For FHA loans, the value of these concessions — from drapes and furniture to prepaid maintenance — cannot exceed 6 percent of the sale price. For Fannie and Freddie, the amount ranges from 3 percent to 9 percent, depending on how much the buyer puts down.

But in today's difficult market, sellers anxious to unload their property often want to give more. In many cases, they feel they can't simply slash the purchase price, because banks will decrease the loan amount and co-op boards won't accept deals they fear will devalue the building.

Lawyers and brokers have devised ways to skirt these obstacles. As the website BrickUnderground.com reported, one such way is to state a sales price on the contract that is higher than what the buyer has actually agreed to pay. Then, the seller agrees to refund a chunk of the money back to the buyer at closing. The contract price is recorded by the city, even though

the real price is lower once concessions are factored in.

Some consider this practice ethically dubious, since future buyers and appraisers rely on publicly recorded sales prices for comparables, but it is legal as long as both the co-op board and the lender know about it.

But sources say that lawyers and brokers are now more likely to push the boundaries even further. In order to allow sellers to give larger concessions, they are leaving some credits and concessions out of the official mortgage documents (including the HUD-1 Settlement Statement, a document that lists all closing costs and gives each party a complete list of their incoming and outgoing funds) and instead listing them in riders that banks don't see.

“The [lending] rules are tough, but the agents and brokers who want to survive ... do try all sorts of things.”
Attorney Nathan Erlich

Lenders would have a problem with [these concessions], especially if it affects the consideration being paid,” said attorney John Serpico. Nonetheless, “parties make all kinds of agreements all the time that [are] not necessarily in the main contract.”

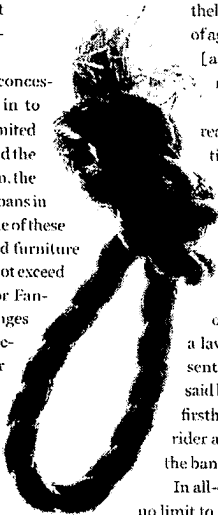
Lenders, for obvious reasons, frown on this practice.

“If they throw in something even as a credit, it must be done properly and declared on the HUD and reflected on the contract of sale,” said Nathan Erlich, a lawyer who has long represented lenders like HSBC and said he has not seen the practice firsthand. “[If] they put it in a rider and they don't declare it to the bank, that's called fraud.”

In all-cash transactions, there is no limit to seller's concessions, so attorneys have more freedom for creative deal-making. By contrast, lenders often view concessions as “trying to dupe them into lending you more money,” explained Sandy Schwartz of Manhattan law firm Schwartz, Levine and Kaplan. “It smells a lot worse if there's a bank involved.”

And when the buyer is paying in cash, co-op boards can pose challenges to concession-giving. Buyers and sellers are technically supposed to inform the co-op board of any concessions, but most don't, for fear of

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getting rejected, industry sources said.

Schwartz said he recently had a deal die because the board found this kind of financial sleight of hand distasteful, even though it was an all-cash transaction.

He was representing the seller of a Midtown apartment when the board rejected the buyer.

"The broker suggested it may have been denied because of the purchase price," Schwartz said. "So we superficially increased the purchase price by throwing in a \$30,000 renovation fee."

The idea was that the buyer would pay the fee to make the purchase price appear higher, then get their \$30,000 back at closing in the form of a credit for their renovation.

At first, Schwartz said he wasn't sure if he was doing the right thing. "I had some qualms about doing this and I had to do some due diligence and soul-searching," he said. But when he found out it was an all-cash deal, "my concerns were alleviated."

Still, the board caught wind of the plan and denied the application again. "[They] came back and they said they were insulted by the application," Schwartz said.

Buyers and sellers find countless other ways of structuring deals. For example, in order to reduce the flip tax (which is calculated as a percentage of the sale price), some sellers create side agreements with purchasers.

Steven Wagner, an attorney who specializes in co-op and condominium law, said a common trick he's seen is

"to sell personal property, the proverbial Ming vase, in a side letter, and to have the purchase price of the apartment listed at a lower price."

Sometimes buyers and sellers even exchange verbal agreements to avoid being detected, Shmulewitz said.

It's not clear how often this sort of tailoring happens, Wagner said, since it's done out of view of the co-op and therefore not frequently litigated. Just in case, when he drafts flip-tax provisions for co-op boards, he said he's careful to "make sure that people can't use that trick."

A disapproving Erlich said he is nonetheless surprised to hear about these incidents. "The [lending] rules are tough, but [it seems that] the agents and brokers who want to survive... do try all sorts of things." **TRB**