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Beware of the "Cash Back at Closing" Scam

You have probably seen all sorts offers on television and in the mail offering you "cash back" on your purchase. These are very popular advertising techniques, especially with car companies and credit card companies. Have you ever heard of getting "cash back at closing" on a home purchase? That phrase probably sounds familiar, but unfortunately, while such offers work in other areas of consumer spending, they are illegal in the mortgage world. This is a scam worthy of criminal punishments for those involved.

This is the way a "cash back at closing" deal might play out. The buyer agrees to pay more than the house is worth. In return for giving the extra amount back to the buyer, the seller gets to negotiate a true selling price that is as good as his asking price. Both the real estate agent and the lender profit from the bigger loan, as the agent gets a larger commission and the lender gets more in interest repayments.

The problem is that this is illegal under U.S. law. There is a section of fine print on the Freddie Mac/Fannie Mae 1003 Uniform Residential Loan Application (a form used by all lenders,) under the heading of "Acknowledgement and Agreement" that states that false representation in the transaction is illegal. The form reads as follows, "Each of the undersigned (the borrowers) specifically represents to Lender and to Lender's actual or potential agents, brokers, processors, attorneys, insurers, servicers, successors and assigns and agrees and acknowledges that the information provided in this application is true and correct as of the date set forth opposite my signature and that any intentional or negligent misrepresentation of this information contained in this application may result in civil liability, including monetary damages, to any person who may suffer any loss due to reliance upon any misrepresentation that I have made on this application, and/or in criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Sec. 1001, et seq…"

The basic idea is that it is illegal to lie on your application. If you buy the property for more than it is worth, you are inflating the price and dishonestly representing the real value of the home. This is lying.

The problem with this scheme, even though it appears to benefit everyone involved, is that it makes the loan riskier than it would otherwise be. When one person buys a home for an inflated price, it can raise the price of other homes in the areas without a real increase in value to back it up. Higher home prices mean higher property taxes and lower affordability in the area. Buyers may find themselves in trouble with "cash-back" loans when money gets tight and they are unable to keep up with their larger-than-normal mortgage payments. Because they borrowed so much for the extra cash back at closing, they will have a very hard time selling the home at the price they bought it and may have to sell at a loss or go into foreclosure. Foreclosure leads to ruined credit for the borrower and lost money for the lender.

So if any real estate agent, home seller, or mortgage lender ever offer you a cash-back deal on a home purchase, realize that the deal is really a scam and could get you into a lot of trouble, including possible jail time and fines! Sadly, sometimes things that sound too good to be true really are too good to be true.