

TITLE ISSUES

February 2007

VOLUME 17, NUMBER 1

NEW LEGISLATION AIMS AT REAL ESTATE FRAUD

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The 94th Illinois General Assembly took up the problem of real estate fraud. It enacted, and the Governor signed into law, several measures designed to protect property owners from fraud schemes. These measures, all effective January 1, 2007, may or may not have the desired effect of reducing fraud. Time will tell. This article will describe three of the new laws aimed at reducing real estate fraud.

THE MORTGAGE RESCUE FRAUD ACT

The Mortgage Rescue Fraud Act, **P.A. 94-822**, became effective January 1, 2007, and is codified at 765 ILCS 940/1 et seq. The Act regulates rescue operations—that is, transactions such as sales and re-finances that are designed to “save” a home from mortgage foreclosure or tax deed. The legislation arose in the wake of reports that unscrupulous “rescuers” were making false or illusory promises to owners of distressed property. Despite the promises of rescue, these owners ultimately lost their homes anyway—to the rescuers, or their successors, rather than to the original foreclosing lender or tax purchaser. The Act is intended to reduce the incidence of fraud perpetrated against vulnerable homeowners.

Applicability: The Act only applies to distressed property, defined as residential real property consisting of 1 to 6 family dwelling units that is in foreclosure or at risk of loss for non-payment of taxes. Distressed property (hereinafter DP) also includes residential property (1 to 6 units) whose owner is more than 90 days delinquent on any loan secured by the property. 765 ILCS 940/5. (The owner of DP is hereinafter referred to as DP Owner.)

Transactions regulated: The Act regulates two types of transactions: (1) those transactions conducted by a distressed property purchaser (hereinafter DP Purchaser), and (2) those transactions conducted by a distressed property consultant (hereinafter DP Consultant). The activities of a DP Consultant are beyond the scope of this article and will be discussed only briefly below. See the regulations of DP Consultants at 765 ILCS 940/50(a). This article will concentrate on matters most relevant to real estate attorneys and title companies—the activities of a DP Purchaser.

Who Is a DP Purchaser? The Act defines a DP Purchaser as any person who acquires any interest in fee



in a DP while allowing the DP Owner to possess, occupy, or retain any present or future interest in fee in the DP. The term also includes any person who participates in a joint venture or joint enterprise involving a distressed property conveyance (hereinafter DP Conveyance). 765 ILCS 940/5. The Act defines a DP Conveyance as any transaction in which a DP Owner transfers an interest in the DP to a DP Purchaser who, in turn, allows the DP Owner to occupy the premises and promises to convey back to the DP Owner or grants the DP Owner an option to re-purchase the DP at a later time.

Thus, the Act applies only if all of the following elements occur:

- Residential property (1 to 6 units)
- DP Owner conveys the land to a DP Purchaser
- DP Owner remains in possession (under a lease or otherwise)
- DP Purchaser promises to re-convey to DP Owner or grants DP Owner an option to re-purchase

By way of an unnecessary example, the Act states that it does not apply to any purchaser who acquires DP at a “short” sale, provided the purchaser neither promises to convey the DP back to the DP Owner nor grants the DP Owner an option to re-purchase. *Id.*

The Regulatory Scheme for a DP Conveyance: First, the Act requires a written DP Conveyance contract and sets out requirements for the form and terms of the contract. 765 ILCS 940/25 to 45. The DP Owner has the right to cancel a DP Conveyance contract at any time

until either (1) midnight of the fifth business day following the day on which

the DP Owner signed the contract or (2) 8:00 a.m., on the last day on which the DP Owner has a right of redemption under the Illinois Mortgage Foreclosure Law or the Property Tax Code—whichever, (1) or (2), occurs first. 765 ILCS 940/35. Thus, the Act grants the DP Owner the right to rescind the DP Conveyance contract but not the conveyance. But see below discussion on remedies. In addition, the Act requires the DP Purchaser to record the DP Conveyance contract with the Recorder of Deeds for the county in which the DP is located. The contract must be recorded within 10 days of its execution, provided the DP Owner has not canceled the contract. 765 ILCS 940/40(d).

Second, Section 50(b) of the Act, 765 ILCS 940/50(b), prohibits 12 specific actions by a DP Purchaser. Stated here in paraphrased form, these provisions constitute the statutory rules under which a DP Conveyance must be performed.

(1) The DP Purchaser must verify and be able to demonstrate that the DP Owner has a reasonable ability to pay for the subsequent re-conveyance and to make the monthly or other payments required prior to the re-conveyance. Section 50(e) sets out the minimum standard for determining “reasonable ability to pay,” requiring an analysis of the DP Owner’s debt to income ratio, the DP’s fair market value, and the DP Owner’s credit history.

(2) The DP Purchaser must pay consideration to the DP Owner under the following guidelines:

- (a) at the time of the DP Conveyance, pay consideration in an amount equal to at least 82% of the DP's fair market value, or
- (b) as an alternative
 - (i) at the time of the DP Conveyance, pay consideration only in the amount necessary to clear title;
 - (ii) limit the DP Owner's re-purchase price to no more than 125% of the amount paid to clear title; and
 - (iii) if the DP Owner cannot re-purchase the property pursuant to the DP Conveyance contract, pay consideration to the DP Owner in an amount which, when added to the cost of clearing title, equals at least 82% of the DP's fair market value at the time of the conveyance or at the time when the DP Owner's right to re-purchase expires.

The statute mentions two possible valuation dates under this last provision. This could be a source of conflict, unless a valuation date is fixed in the DP Conveyance contract. Under Section 50(d), "consideration" includes payments to the DP Owner, payments

made to third parties necessary to complete the transaction, and payment of the DP Owner's debts, e.g., clearing title by paying off liens. Consideration does not include amounts characterized as down payments or as fees to the DP Purchaser or its agents. A DP Purchaser may borrow money and place a mortgage on the DP to finance the payment of required consideration.

(3) The DP Purchaser cannot include provisions in the re-purchase agreement that are unfair or commercially unreasonable.

(4) The DP Purchaser cannot hold itself out as a consultant, advisor, or agent of the DP Owner and cannot use phrases such as "save the house" or "buy time."

(5) The DP Purchaser cannot misrepresent its status as a licensed or non-licensed entity.

(6) The DP Purchaser cannot do any of the following until the expiration of the DP Owner's right to cancel the contract.

- (a) accept an executed instrument of conveyance from the DP Owner;
- (b) induce the DP Owner to execute an instrument of conveyance; or
- (c) record any instrument executed by the DP Owner.

(7) The DP Purchaser must re-convey the DP back to the DP Owner when the terms of the DP Conveyance contract have been fulfilled.

(8) The DP Purchaser cannot induce the DP Owner to execute a quit claim deed "when entering into a distressed property conveyance." This provision is ambiguous. Usually, one "enters into" a

contract but “makes” a conveyance. Does the ban on quit claim deeds apply only to the time of entering the contract, or does it extend to the time of closing? Bearing in mind that quit claim deeds are often employed in fraud schemes and that the legislature intended to reduce fraud, we should view quit claim deeds as outlawed altogether in DP Conveyances.

(9) The DP Purchaser cannot “enter into a distressed property conveyance where any party to the transaction is represented by a power of attorney.” Again, the ambiguity should be resolved in favor of outlawing any power of attorney—from any party, whether the DP Owner or the DP Purchaser—at the closing.

(10) Through the closing, the DP Purchaser must extinguish all liens and encumbrances on the DP or assume liability for all liens and encumbrances. The title must be cleared “immediately following the conveyance.” One wonders whether the typical paid but unreleased mortgage will give rise to a violation of the Act or whether title coverage over that mortgage will be sufficient protection for the DP Purchaser.

(11) The DP Purchaser must complete the DP Conveyance “before a notary” in

- (a) the offices of a title insurance company or title insurance agent
- (b) the offices of a bank
- (c) the offices of a licensed attorney.

This section adds the phrase “where the notary is employed” after the word “attorney”. It is possible, however, to construe the phrase as also modifying the references to title companies, title

agents, and banks. An acceptable notary, therefore, should be an employee of any of these institutions.

(12) Subsequent to the DP Conveyance, the DP Purchaser cannot convey or encumber the DP without the knowledge or permission of the DP Owner. Further, the DP Purchaser cannot frustrate in any way the DP Owner’s ability to complete the re-conveyance back to the DP Owner.

Remedies for Violations: Any violation of the Act constitutes an unlawful act under the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 et seq. The Attorney General and States Attorney may file actions to enforce the Act. Consumers (DP Owners) may file civil actions for damages. The Act specifies that this remedy is not exclusive. The DP Owner retains “all other applicable claims including but not limited to, those brought under the doctrine of equitable mortgage.” 765 ILCS 940/55. Thus, while the Act itself does not void any deeds or mortgages (except as noted below), the DP Owner may utilize the concepts of equitable mortgage or common law fraud to set aside a DP Conveyance and subsequent mortgages and deeds. In addition, the Act creates the crime of Criminal Mortgage Rescue Fraud for intentional violations of Section 50 of the Act. 765 ILCS 940/60. This crime constitutes a Class 2 Felony. 765 ILCS 940/65.

COMMENT: TITLE COMPANY EXAMINING AND CLOSING PROCEDURES:

From a title insurer’s perspective, mortgage rescue business is risky business. Complaints by DP Owners against DP Purchasers, based on theories of equitable mortgage or common law

fraud, may lead to court orders voiding the DP Purchaser's deed and mortgage, as well as subsequent deeds and mortgages. If a rescue transaction is declared fraudulent, then a title insurer faces total loss of the insured title. Title insurance companies and title insurance agents may choose to decline rescue business because of the high risk. On the other hand, if a title company or agent chooses to close and insure rescue transactions, it is likely to proceed as follows.

Rights of the DP Owner: If a title company or agent encounters a DP Conveyance contract on the chain of title, it will raise a title exception for:

RIGHT, TITLE AND INTEREST OF
_____(DISTRESSED
PROPERTY OWNER(S)), AS
DISCLOSED BY DISTRESSED
PROPERTY CONVEYANCE
CONTRACT DATED

AND RECORDED

AS DOCUMENT
_____.

This exception will remain unless:

- The DP Conveyance never takes place, e.g., a deed issues pursuant to the mortgage foreclosure or tax deed proceeding, the DP Owner refinances (no conveyance) or the DP Owner conveys but retains neither possession nor a right of re-purchase of any sort.
- During the DP Owner's period of occupancy and right to re-purchase, the DP Owner consents in writing to a conveyance or encumbrance of the land (and vacates the premises in the case of a conveyance)

- After the DP Purchaser acquires title, it re-conveys the property back to the DP Owner

Thus, the exception will remain on final policies insuring the DP Purchaser, its lender, and subsequent purchasers and lenders who acquire the property during the DP Owner's occupancy and right to re-purchase and without the DP Owner's written consent. The exception should also remain on a subsequent purchaser's owner's policy issued during the period of the DP Owner's right of occupancy and re-purchase, even if the DP Owner consents to the conveyance.

In addition, there should also be an exception for the interest of the DP Purchaser under the recorded contract. This exception may be waived from final policies insuring the DP Purchaser, its lender, and its subsequent purchasers.

If the title application, chain of title showing pending mortgage foreclosure or tax deed proceedings, or any other information suggest a rescue operation, (even in the absence of a recorded DP Conveyance contract), then the title company or agent should raise an exception for the rights of the record owners under the Mortgage Rescue Fraud Act. Customers should then furnish information allowing the title company or agent to determine whether the contemplated transaction is regulated by the Act – the key being whether the record owner will, after the conveyance, retain possession and a right to re-purchase the land.

Closing procedures: If a rescue transaction is indicated (whether by recorded DP Conveyance contract, title exception, or otherwise), in addition to normal closing procedures, closers will:

- For any documents notarized outside the closing, verify whether the documents were notarized by an employee of a bank or by an employee in an attorney's office.
- Not accept for recordation any quit claim deed
- Not accept any closing documents executed on behalf of any party to the rescue transaction pursuant to a power of attorney
- Obtain satisfactory clearance for removing the lien of the mortgage in foreclosure or of the tax deed proceeding

Subsequent transactions: The terms of a DP Conveyance contract survive the delivery of the deed. 765 ILCS 940/30. In addition, Section 50(b)(12) of the Act prohibits subsequent sale or encumbrance without the DP Owner's knowledge or consent. Thus, for any transaction subsequent to the DP Conveyance itself, the rights of the DP Owner must be considered. The title exception shown above will appear on any commitment for a subsequent transaction and must be dealt with in the manner indicated.

Distressed Property Consultant: The Act also regulates the activities of a DP Consultant. Those activities will usually lead to a re-finance transaction rather than to a conveyance. In closing such a re-finance, in addition to the usual concerns about closing transactions during the pendency of a foreclosure, the title company or agent must be aware of certain prohibitions in the Act. A DP Consultant cannot take a lien (e.g., a mortgage) on the DP to secure payment of its fee. Such a lien is declared void and unenforceable, 765 ILCS 940/50(a)(3), and cannot be insured. Also, DP Consultants cannot act as the

DP Owner's agent under a power of attorney. 765 ILCS 940/50(a)(6).

DP Consultant activities may not be apparent from the public records. The DP Consultant is not required to record its consultation contract. Therefore, closers will be alert to who is taking mortgage positions and who is acting as an agent under a power of attorney.

Conclusion: The Act imposes a strict regulatory scheme on would-be rescuers. Title personnel cannot know, control, or police everything the Act requires and prohibits. Thus, transactions regulated by the Act pose significant risks to title insurers. In addition, title companies and agents must be alert to the activities of rescuers who choose to ignore the Act. Their rescue transactions and subsequent transactions are also vulnerable to attack on theories of equitable mortgage and common law fraud – perhaps, more vulnerable because these rescuers failed to comply with the Mortgage Rescue Fraud Act.

OTHER ANTI-FRAUD MEASURES: RECORDED INSTRUMENTS

Public Act 94-821, effective January 1, 2007, amends Section 35c of the Conveyances Act, 765 ILCS 5/35c, relating to the requirements for recordable documents. The Act adds a provision requiring that for any deed of conveyance or other instrument to be recorded, the signatures of the parties "making the conveyance" shall be acknowledged by an Illinois notary public or by any officer or court described in Section 20 of the Conveyances Act, 765 ILCS 5/20 (acknowledgements outside the State of Illinois). The Act includes the statement that "failure to comply with this provision shall not invalidate the instrument."

COMMENT: The Act is another fraud prevention measure, but it contains an ambiguity. It refers to deeds of conveyance or other instruments to be recorded but only requires acknowledgement of the signatures of “the parties making the conveyance.” Recorders may interpret the Act broadly and require all signatures on all recorded instruments (deeds or otherwise) to be notarized. Thus, lack of an acknowledgement will not invalidate the document but may prevent its recordation. Recorder practices may vary from county to county.

Public Act 94-823, effective January 1, 2007, adds new Section 3-5046 to the Counties Code, 55 ILCS 5/3-5046, entitled Quitclaim Deed Notification. This new section applies to Cook County only and requires that

whenever a quitclaim deed is recorded, the Recorder of Deeds must mail a notification postcard to the previous owner of record at the address listed on the property records in the Recorder’s office. The notice must state that a quitclaim deed has been recorded on the property and give the date of recording. The notice must also state the address of the Recorder’s office and any other information deemed necessary by the Recorder.

COMMENT: This Act is intended to reduce fraud by providing notice of the recordation of a quitclaim deed—a device frequently used in fraud schemes. While a fraud victim in Cook County may now learn relatively quickly that a forged quitclaim deed has been recorded against his or her property, the Act does not provide any additional remedies.

We welcome your topic suggestions for future Title Issues. If you are interested in submitting your ideas, please e-mail us at: Patrick.quist@ctt.com or complete this form and mail to:



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