Published on *WBEZ* (http://www.wbez.org)

Venture: Flipping houses in a post-bubble world

As the housing market has tanked, investors have discovered new ways to make quick profits. We examine how some Realtors have been buying and quickly reselling distressed properties, in some cases, possibly to the detriment of taxpayers.

Ashley Gross November 29, 2011

The real estate market is moribund. Prices have plummeted. So who knew that people were still making big bucks from flipping properties?

Turns out, speculators have found new ways to profit amid the wreckage of the housing boom. And some real estate agents are navigating this post-bubble world for large profits - in some cases, at the expense of taxpayers and end buyers.

We stumbled into this world of post-bubble flipping by accident. WBEZ's Susie An reported in July on her own experience as a first-time homebuyer purchasing a house. She found herself as the buyer on the tail end of one of these flips.

In March, An and her husband saw a 100-year-old, Victorian-style house in Chicago's Avondale neighborhood and right away realized it was a lot better than anything else they'd seen.

"When we walked in, I think both my husband and I just had that feeling, that tingle inside that yes, we could live here," An said.

The house was listed for $240,000, but they put in an offer of $250,000. An says it was listed as a pre-foreclosure. Their real estate agent told them that meant it was a short sale.

A short sale occurs when the value of a home has dropped below the value of the mortgage, and the bank that holds the mortgage agrees to take a loss and let the property be sold.

Almost a quarter of U.S. homeowners are underwater, and that has led to a wave of short sales – the housing data firm CoreLogic says the number of short sales has tripled in the last two years.

After they put in their offer, An says she and her husband didn't hear anything for a month.

They started looking at other places, but then they heard back from their real estate agent saying that now an investor was buying the property, and the investor wanted to quickly resell it.

An says they were told if they were still interested, that they should put in their best and highest offer and to do so quickly, because there was competition for the property and the investor wanted to get it done fast.

“A lot of rushing, a lot of rushing, and so we went with $285,000,” An said.

Their offer was accepted. But An still didn’t know what the investor had paid for the property – it hadn’t yet been posted on the Cook County Recorder of Deeds web site.

When she and her husband got to the closing table in late June, they found out in passing from their attorney that the investor had purchased the house for $160,000 in cash. She says at first she didn’t trust her ears – she had the lawyer repeat it and she wrote the amount down.

“We were shocked,” An said.

Housing flips redux

Why would the bank have accepted an offer that was $90,000 less than her and her husband’s offer of $250,000, even if the lower offer was in cash? Granted, real estate agents say that cash deals are often preferred these days because they can be closed quickly. But still, An says that didn’t seem to justify accepting $90,000 less.

And here’s another puzzle – An discovered that the investor she bought the house from, Marcie Schmidt, is a Realtor who works for Exit Strategy Realty, the company that had listed the house.

That raised all sorts of questions.

Because the Realtor and investor work in the same office, it seems like they can get first crack at these properties. And then the other question is: Who is the Realtor really working for if the investor is a coworker? Is the Realtor trying to get the best deal for the homeowner or the investor?

Their interests may not be aligned. But state regulators say there’s nothing that bars Realtors from acting as investors.

After An’s story ran, we got comments from listeners saying the circumstances sounded fishy. We decided it merited a follow-up story. But we emphasize that we didn’t choose to continue the story out of any desire to settle a personal gripe of An’s on the air. We felt that it was newsworthy and wanted to understand how these transactions work.

The mystery deepens

And we soon learned that this wasn’t an isolated transaction. CoreLogic tracks ‘suspicious’ short sales, which it defines as short sales that may have caused unnecessary losses to the lender, because the properties were resold quickly for profit, without allowing enough time to do much rehab to justify a higher price. CoreLogic forecasts that ‘suspicious’ short sales may cost banks as much as $375 million this year.

“There have been a couple of industry surveys of fraud, trying to identify fraud in short sales, and this practice of flipping houses is the practice identified as being most harmful to banks and to the ultimate investors in mortgage loans,” said Diane Thompson, an attorney with the National Consumer Law Center.

I contacted Schmidt as well as the Realtor who listed the property. Neither of them responded to my emails or phone calls. I also contacted the original homeowner, who declined to comment.

I called Citibank, which held the original $370,000 mortgage on the property, to ask why the bank would accept a much lower cash offer than a financed offer.

The spokesman, Mark Rodgers, told me that the bank wasn’t aware of a higher offer and their policy is not to accept a cash offer instead of a higher financed offer. So that deepened the mystery – why was the bank not told of An’s offer?

While trying to understand these transactions, I discovered someone else with Exit Strategy Realty who has done quite a few more of these deals.

His name is Mike Cuevas, and he calls himself the “top short sale agent in the U.S.” He’s a young guy – around 30 – who says he decided early on in the housing crisis to concentrate on short sales. Now he offers training workshops to Realtors all over the country on how to do short sales.

Cuevas presents himself as a white knight, helping people avoid foreclosure by doing short sales. Short sales are less damaging to people’s credit than foreclosures. He says in his online bio that he’s closed almost 1,000 short sales.

“You know how many people send us cookies, hugs, cupcakes? People call us crying,” Cuevas said in an interview. “People say you saved my financial future and my kids are now going to be able to go to college because I can now get the credit to give them a student loan.”

What Cuevas doesn’t talk much about in any of his webinars I watched is his own role as an investor buying and quickly reselling short sales.

According to records on the Cook County Recorder of Deeds web site, Cuevas has bought and quickly resold at least 13 short sales, for combined gross profits of more than $800,000. He didn’t hold them very long. In many cases, the short sale and the subsequent sale were recorded on the same day on the Recorder of Deeds web site.

For example, he purchased a condo at 10 E. Ontario St. in downtown Chicago for $118,500 and then resold it for $185,000. Both transactions were recorded on the same day – Nov. 8, 2010.

He bought a home in north suburban Park Ridge, Ill., for $466,000 and then resold it for $543,000. Both transactions were recorded on Aug. 17, 2010.

Maybe about now you’re saying, so what? So he profited from real estate – isn’t that what investors try to do? That's what Cuevas says.

"That's what capitalism is," Cuevas said. "That's what America is."

But this is a story of winners and losers. In a short sale, someone has to eat the loss. At first glance, it looks like banks are losing out. Naturally, in these days of joblessness, foreclosure and Occupy Wall Street protests, there's not a whole lot of sympathy for banks.

But really, the losers are the investors who hold the mortgages – and here's where this pertains to all of us. In many cases, taxpayers are the ones losing out when a short sale sells for less than it could fetch on the open market.

Fannie Mae and Freddie Mac, which are financed by taxpayers, own or guarantee about half of all home mortgages in the U.S. So when they take an unnecessary loss on a short sale, taxpayers are the ones getting hurt.

Mike Cuevas bought and quickly resold two condos in this building at 10 E. Ontario for a total gross profit of $92,500 (WBEZ/Ashley Gross)

Cuevas says he's helping the market by getting these properties sold as short sales, preventing them from going all the way into foreclosure, which he says would further drag down home prices. He says that as an investor, he's also lost money on short sale transactions.

Cuevas bought and quickly resold this building

And he vehemently defends the role of investors in buying and reselling short sales. He says cash investors provide a service to the end buyer that justifies a premium.

Short sales are notorious for taking a long time to close, because banks are loath to take a loss on a property and also because there are often second mortgages or homeowner lines of credit that need to be settled, and that requires negotiating with multiple banks.

Cuevas says cash investors can better handle these negotiations, in some at 3221 N. Racine for a gross profit of $125,000 last year (WBEZ/Ashley Gross)

cases by paying additional cash to a second lienholder as a way to get them to agree to the short sale. Investors also settle other liens, such as overdue water bills or homeowner association dues. Because of all these extra expenses, Cuevas says his net profit is often a lot less than his gross profit, but he declined to give any specifics.

He says settling all those liens simplifies the process for the end buyer, who can then quickly buy a home with a clear title, instead of having to deal with the short sale rigmarole.

But in An's case, Schmidt's gross profit totaled $125,000, and she specifically sold the property "as-is," with no rehab or renovation. She only held the property for a few weeks. So are deals with such a huge spread legitimate?

If short sale flips are done the wrong way, they can get a real estate agent and an investor in legal hot water. In Connecticut, a real estate agent and an investor, who was also a real estate agent, were convicted of bank fraud last year for a short sale flip. They put in a low offer to the bank that held the mortgage, while at the same time concealing that there was a higher offer for the property.

The bank approved the short sale at the low amount, and then the investor turned around and resold it for the higher amount. He shared the profits with the real estate agent. Both pleaded guilty to one count of bank fraud.

Cuevas says what he does is completely different from what happened in Connecticut. The way he does these deals legally, he says, is that he uses an option contract that he signs with the homeowner. Then, he says he submits his offer to the bank to get the short sale process rolling.

He says the option contract gives him the right to list the property as if he already owns it, so he can line up a buyer for the subsequent sale. He says he has no obligation to give those subsequent offers to the bank as long as his offer was the first one in. Cuevas says what's most important is that he tells everyone – the homeowner, the bank, the end buyer – that he's an investor seeking to profit.

"One, it's plain out in English disclosed on the contract. You must disclose, disclose, disclose to stay within legalities," Cuevas said. "Two, you record your notice of option, so it's public record. Okay, there's nothing hiding here, no one's trying to deceive anybody. It's right there. Third, it should also be disclosed on the listing agreements."

He declined to show me one of the option contracts.

Lawyers I spoke with said without seeing the documents, they couldn't say for sure whether the way he's done these short sales is legal. But they said as long as he discloses to everyone that he is an investor, and as long as he puts his offer in first, before any other offers are on the table, then he's probably done it correctly.

Cuevas says he's done everything by the book.

"Not only by the book, but beyond and above the book," he said. "I'm not hiding anything.

There's nothing funny going on."

But even if option contracts are a legal maneuver to flip short sales, that doesn't mean banks and mortgage holders like the use of such contracts. Freddie Mac, for example, warns banks that an option contract in a short sale is a red flag.

Cuevas bought this property for $345,000 and resold it for $390,000. Both transactions were recorded within a week of each other. (WBEZ/Ashley Gross)

Kathleen Cooke, one of Freddie Mac's fraud investigators, says the problem with many investors who use option contracts is that they don't disclose what the resale price is. She says it's not enough disclosure to just say you're an investor seeking to profit.

Cooke stresses that she isn't making a legal pronouncement, but she says the use of option contracts is something the company doesn't like because it costs them money.

"Freddie Mac considers it to be a deceptive business practice that deliberately omits crucial data to the short sale lender," Cooke said. "Omission of higher offers causes short sale lenders to approve transactions without all the facts and we take a higher loss than we should."

So last year, Freddie Mac started requiring banks servicing its loans to include forms that everyone involved with short sales, including Realtors, has to sign. They must attest that there are no hidden deals and that the sale is an arm's length transaction. Many banks have now followed suit. Some require that the buyer hold the property for 30 days or even 90 days before reselling it.

"The banks got wise, got more restrictive with their language and cut this off," said Greg Braun, a real estate attorney in Chicago.

Because of that, Cuevas says he hasn't done any deals lately. The last one I could find on the Cook County Recorder of Deeds site was from March.

"The spread deals are dead," Cuevas said. "You can't buy and sell property for short-term investors. Any Realtors today who want to work and stay out of trouble, if they're going to work with an investor, they have to sell to an investor who's going to buy it, close on it and be ready to hold it for 90 days."

There's another potential loser when a short sale yields less than it could on the open market – and that's the original homeowner.

A homeowner doing a short sale doesn't make any money off the deal because he or she owes more than the house is worth, so all the money goes to the bank. So the homeowner may think that it doesn't matter what the home sells for.

But, in Illinois, banks have the right to go after the homeowner for the difference between what the house sells for and the mortgage amount. That's called the deficiency.

And Thompson of the National Consumer Law Center says banks are increasingly pursuing homeowners for deficiencies after a short sale.

"It's become a big problem for homeowners because they agree to enter into a short sale because they think it means they'll be able to get out from under the debt and then they can get a debt collector banging on their door six months later," Thompson said.

Cuevas says he never steps in as an investor unless the lenders waive all of the homeowner's deficiencies.

"Any investor that we've ever worked with, our rules are you can buy the property as long as you don't profit at the expense of the homeowner," Cuevas said. "It's that plain and simple."

The homeowners I reached who sold their homes to Cuevas backed that up. They said their deficiencies were forgiven by the banks.

But Ralph Schumann, an attorney who heads the Illinois Real Estate Lawyers Association, says people have to be very careful about promises from Realtors and investors that their deficiencies will be waived.

"I have seen so much fraud in this area, and I guess this is the bottom line, show me the documentation that says the deficiency is waived," Schumann said. "Let me vet it. Let me make sure it's really enforceable and valid and won't be an issue down the line, and then I might be willing to tell my client, 'Oh yeah, go ahead and do it under the circumstances.'"

As for Susie An, she and her husband are settling into their house. They've repainted the walls and ripped out the old carpeting. They're excited to see the magnolia tree in their backyard bloom next spring.

An says no one twisted her arm to make her put in the higher offer, but she says it still rankles her knowing they probably could have bought the place for less. Still, she says it's not her own situation that bugs her the most.

"I think what frustrates me the most is the fact that we have this type of market now, where before the bubble burst, people were taking advantage of how the market was set up, and after the market crashed, people are still finding new ways to take advantage," An said.

But at least for now, this particular profitable niche in real estate has been closed off.

Banks – and the investors who hold the mortgages – are no longer willing to leave money on the table.

Source URL: http://www.wbez.org/story/venture-flipping-houses-post-bubble-world-94309

Links:
[1] http://www.wbez.org/sites/default/files/story/audio/2011-November/2011-11-29/venture-web.mp3
[2] http://www.wbez.org/sites/default/files/story/photo/2011-November/2011-11-29/susie's house_demien.jpg

[3] http://www.wbez.org/story/venture-buyers-market-buyer-friendly-89183
[4] http://www.superagentsummit.com/