

Cash Back Clauses and Mortgage Fraud

A cash back clause refers to a term in a Contract of Purchase and Sale whereby the buyer and seller agree that the seller will refund some specified amount of money to the buyer in cash upon closing. A common use for such clauses is to allow the buyer to obtain cash to carry out some repair or renovation of the property.

Whatever the rationale behind including a cash back clause in a Contract of Purchase and Sale, the use of such a clause is problematic.

Canada Mortgage and Housing Corporation's (CMHC) definition of "mortgage fraud" is quite expansive. According to CMHC, "mortgage fraud occurs when someone deliberately misrepresents information to obtain mortgage financing that would not have been granted if the truth had been known".

Cash back clauses can constitute mortgage fraud. The purchase price of the property is artificially inflated by the cash back clause. Consider the following example:

John Smith has listed his home for sale. He is asking for \$200,000. John receives an offer from Sally Thompson. Sally's offer contains the following terms:

- She will pay the full \$200,000 asking price by way of a \$10,000 deposit and a \$190,000 new mortgage.
- John agrees to refund Sally \$15,000 on closing.

John accepts the offer. Sally's mortgage application will request financing in the amount of \$190,000 on a \$200,000 purchase. In actual fact, Sally is only paying \$185,000 for the property. She has deliberately misrepresented material information and if the lender was aware that Sally was only paying \$185,000 for the house, it would not agree to lend her \$190,000. If Sally does not disclose the refund to her lender, Sally has committed mortgage fraud.

While the lender typically protects its interests by requiring buyers to provide recent appraisals of the property's value, some individuals have successfully used cash back clauses to extract thousands of dollars in cash from a property in which they have built no equity.

According to information on CMHC's website, buyers who misrepresent information to lenders may be held liable for any financial shortfalls in the event of default on the mortgage. In addition to potentially significant civil liabilities, buyers who deliberately misrepresent information on mortgage applications may face criminal charges as well.

As registrants, you are obligated to protect and promote the interests of your clients. In order to do so, it would be prudent to suggest that they seek legal advice as to the risks and obligations involved in such transactions.

Cash back clauses must be disclosed to the lender, even where they arise in an Amendment to the Contract of Purchase and Sale. You should advise your client that lenders view a cash back clause in an Amendment as a reduction in the price of the property. As a result, the lender is likely to reduce the amount of the mortgage it will grant the buyer accordingly.

Cash back clauses may also complicate the determination of the sale price of the property. If you are representing a seller who is considering entering into a contract that includes a cash back clause and the Seller's Brokerage Contract expresses the commission payable as a percentage of the sale price, confusion may arise as to whether the commission is to be calculated on the basis of the purchase price listed in the Contract of Purchase and Sale or the purchase price less the refund the seller will be providing to the buyer. This is a matter that must be discussed with the seller prior to him or her agreeing to a cash back clause.

As a registrant, you must also understand the potential risks you are facing when participating in a cash back scheme.

A Contract of Purchase and Sale that includes a cash back clause may not clearly show the price offered by the buyer as required by The Real Estate Act. A registrant who participates in a trade involving a cash back scheme may be found to have committed professional misconduct.

In 2005, Najeeb Ahmad, who was registered as a salesperson in Ontario, had his registration revoked by the Registrar because of his participation in multiple transactions that involved artificially inflating the prices of properties in order to obtain cash refunds for the buyer. In its decision, the Licence Appeal Tribunal emphasized the risk of harm to lenders whose mortgages would not be adequately covered by the true value of the properties and the far-reaching impact of mortgage value fraud, noting that inflated prices of individual properties can impact the valuation of neighbouring properties.

When an offer you write or receive on behalf of your client contains a cash back clause, you must exercise due diligence to determine whether or not the clause is genuine and if there is a legitimate purpose the cash back is intended to address. If a registrant knows the offer is not genuine and continues to participate in the transaction, the registrant could be found to have committed professional misconduct and may face criminal charges.

Financial institutions rely on registrants to prepare the mandatory Contract of Purchase and Sale accurately and honestly. A registrant's participation in a fraudulent cash back scheme poses a serious risk to the reputation of the industry and the public perception of registrants.