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At What Point Do Sales Incentives Become Illegal?

Many lenders are finding that desperate sellers will resort to unethical tactics to sell homes. As the hot real estate market cooled, developers found that new inventory was languishing and was not selling at price-points allowing them to break even. The problem was that the gap between excess supply and insufficient demand had grown too large to justify projected sales prices; and some developers were unable to drop sales prices, or otherwise sweeten the deal enough to move the inventory. Sales incentives required to attract purchasers were larger than developers' profit margins could absorb at market prices. It is at this juncture that the widely-accepted practice of offering sales incentives can become problematic.

The solution that some property sellers employ is to increase the sales price to cover the sales incentive, and then use an inflated appraisal to obtain financing. We have seen property values increased for give-aways including cars, boats, two years rental income (credited to landlord-purchasers), and as much as four years mortgage payments. These practices (sometimes referred to as Builder Bailouts) deceive lenders into granting higher loan amounts than would otherwise be available.

In most cases, the property seller goes to extreme measures to conceal or disguise the sales incentives from the lender, sometimes disguising the incentive on the settlement statement as disbursements for items such as fictitious property improvements. A recent development is the addition of cash incentives to the real estate commission, with a side agreement with the real estate agent to pass along these additional funds to the purchaser after closing.

This trend has become particularly prevalent in condominium developments, both in newly constructed condominiums and in apartment-to-condominium conversions. Fannie Mae is investigating condominium developments employing excessive sales concession schemes throughout the U.S., with concentrations in Arizona, Nevada, Illinois, and Florida.

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