

Short sales: what to avoid

By now most REALTORS® are acquainted with the notion of a “short sale.” Generally, this involves a situation where the amount secured by liens on the seller’s property and unavoidable closing costs exceed any realistic selling price for the property. Instead, a sale could only occur if the lenders holding the liens agree to discount the amounts of the liens on the property. The level of frustration of REALTORS® representing sellers and buyers in short sales seems to rise monthly. One of the major reasons for the rising level of frustration is due to the inability to obtain a timely response from a lender to an offer submitted by a buyer. As the weeks go by with no response from the lender, the frustrated buyer simply looks elsewhere.

In response to this frustration, there are entities who now offer short sale services to REALTORS®. It may well be that some of these entities can positively facilitate short sales for the benefit of REALTORS® and their clients. However, a couple of the methods offered by some of these entities appear to be potentially detrimental to REALTORS® and their clients. It is easiest to describe the potential problems through the use of a hypothetical situation.

Assume that the Smiths have two mortgages on their property, one in the amount of \$150,000 and a second in the amount of \$50,000. A REALTOR® determines that she can work with the two lenders toward a short sale and can potentially obtain a purchase price of \$190,000 for the Smiths’ property. However, it has been her experience in prior transactions that these lenders are extremely slow in responding to any offer she or a cooperating broker may obtain for a property. She thus engages Acme Short Sale Services to facilitate her listing and selling of the property.

Acme Short Sale Services has a program by which it eliminates the need for a buyer to wait on the lender’s approval of a proposed short sale. Acme Short Sale Services immediately procures a straw buyer for the property for \$170,000. This offer is submitted to the lender, and the short sale process begins. In the meantime, the REALTOR® continues to market the property at a sale price of \$200,000. Ultimately, Acme Short Sale Services obtains the lender’s approval for the sale to the straw buyer for the price of \$170,000. Both lenders are willing to take the necessary haircuts on the indebtedness secured by their mortgages. Thereafter, the REALTOR® finds an actual buyer for the property in the amount of \$185,000. The seller then accepts

the actual buyer’s offer without conditioning it upon approval from the lenders, as Acme Short Sale Services has already obtained the agreement of the lenders to accept the \$170,000.

In order to culminate these transactions, a “closing” is held with the straw buyer for \$170,000, at which time mortgage discharges are obtained from the two lenders. Immediately following that closing, the closing with the actual buyer occurs, netting an additional \$15,000 in proceeds. The proceeds from the second closing are used to pay closing costs, including Acme Short Sale Services’ fees.

The sellers are happy, as their property has sold, and the lenders have forgiven the shortfall in the amounts owed them. The buyers are happy because they have obtained the property for what they believe was a reasonable price. The REALTORS® are happy, as they have received their commissions. Acme Short Sale Services is happy, as it has received its fees from the second closing. Is there anything wrong with this picture?

Yes. Assuming the lenders were never advised that the first buyer was a straw buyer, and that the property would actually sell for an additional \$15,000, a claim could be made that fraud occurred in inducing them to accept lesser funds in consideration for the discharge of their mortgages. Representations were made to the lenders that the property had a market value of \$170,000, and in fact, an actual offer was produced to substantiate that fact. There are those who would claim that these representations violate federal law which prohibits statements which are false which are deemed to have induced a lender to attach a specific value to property.

The second scenario in which REALTORS® must be diligent is essentially the same as the above hypothetical, with one major difference. In this second hypothetical, Acme Short Sale Services advises the REALTOR® and the sellers that it can only effectively provide its services if the sellers convey their property to Acme Short Sale Services by way of a quit claim deed. A representation is made that when an actual buyer is found for the property, Acme Short Sale Services will transfer the property back to the sellers by a quit claim deed. There are a number of reasons given by Acme Short Sale Services as to why it is beneficial to the sellers and the listing REALTOR® to convey the property to Acme. None



of these reasons appear to justify this action.

Obviously, when the sellers convey the property to Acme Short Sale Services by quit claim deed, the sellers and listing REALTOR® lose all control over the sellers' property. Neither the sellers nor the listing REALTOR® have the power or right to timely require Acme Short Sale Services to re-convey the property to the sellers in order to close with a buyer. Further, assuming the REALTOR® has placed the sellers' property in the MLS, the REALTOR® has done so while not representing the actual owner of the property.

There are numerous entities out there offering REALTORS® assistance with short sales. Obviously, some offer truly valuable services to offer to REALTORS® and their clients. However, REALTORS® should take great care to examine the services offered by these entities prior to committing their sellers and themselves.

Representing buyers while values fall

A recent lawsuit generating publicity in California has raised concerns among REALTORS® in Michigan. While we have not been able to obtain copies of the pleadings in the case, it is apparent from news reports that buyers are contending that they paid too much for their home through the fault of their buyer's agent. It appears that they claim their buyer's agent did not reveal two comparable sales in the same neighborhood which would have demonstrated that they were paying far too much for their home. Thus, these buyers believe that their buyer's agent breached two of the fiduciary duties he owed to them, i.e., the duty of complete disclosure and the duty of complete loyalty. A nationwide search does not reveal any similar cases previously occurring in the United States. This is probably due in part to the fact that this is the first period of widespread declining property values since buyer's agency became commonly used in residential sales.

In the 1980s, MAR's Legal Action Committee was involved in a case whereby a seller contended that his agent caused him to sell his property for too low of an amount. The property was a vacant lot which had been on the market for a couple of years listed at \$100,000. After no activity for all that time, an offer for \$60,000 appeared. The seller accepted the offer.

Thereafter, interest rates fell dramatically, and a second party appeared who offered \$100,000 for the property. The seller accepted the second offer. The first buyer sued and obtained specific performance at a sale price of \$60,000. The seller then sued the listing REALTOR® for the difference, i.e., \$40,000. The seller's claim was defeated both at the trial court and the Court of Appeals. Both courts determined that a REALTOR®, in listing property, discharged all duties owed to the seller with respect to the price by simply creating a market whereby a willing buyer would make offers to a willing seller.

In preparing REALTORS® for the beginning of widespread residential buyer's agency in Michigan, REALTORS® were advised of the potential for claims by buyers that they paid too much for property based upon faulty advice from their buyer's agents. Further, REALTORS® were advised that the defense used to defend REALTORS® against sellers who claimed they accepted too little for their property, i.e., that the REALTORS®' job was simply to "create a market," would probably not be available in the event of a claim by buyers that they paid too much. It is difficult to argue that a buyer's agent's sole responsibility is to "create a market" around a buyer. REALTORS® were, however, advised that there was a simple, effective defense to any claims by buyers that they paid too much.

It should be noted that in the California case, it is reported that there was no written contract in place between the buyers and their buyer's agent. Thus, it is certain that the buyers were not required to agree in advance to a disclaimer that the buyer's agent is not an appraiser and makes no representations as to the fair market value of any property considered by the buyers. MAR prepared buyer's agency agreements which contained, and to this day still contain, such a disclaimer. The truth in 1994 remains the same today. In order to fully protect themselves from these types of claims by buyers, REALTORS® need to use a written agency agreement which contains a disclaimer that the REALTOR® is not an appraiser and that the buyer may want to seek the services of an appraiser with respect to the value of a potential purchase by the buyer.

There are many, many reasons why REALTORS® who represent buyers should use written buyer agency agreements. This latest California case is simply an illustration of one of those reasons. **MAR**

Michigan REALTORS® can stay informed of legal issues with updates through our Legal Lines.