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Information and Risk Management Ideas for Real Estate Professionals

FULL DISCLOSURE NEEDED WITH SHORT SALES

Practitioners handling short sales face substantial risks if sellers conceal their financial instability.

WHETHER you've handled six or 60 short sales, your risk of liability is significant if you're involved in a deal that goes sour. But you can take measures to protect yourself by following two core principles: Know the sellers' financial condition and disclose up front to potential buyers that the transaction will ultimately need to be approved by the lender.

While the importance of knowing the sellers' financial condition may seem obvious, it's not unusual for practitioners to find themselves dealing with clients who don't fully disclose their financial instability. Sometimes the listing agent doesn't know there's any problem at all until the closing officer says the sellers need to bring \$12,000 to the table. In such a situation, because the sellers never shared their financial situation, their agent wouldn't have known when the buyers presented their offer to disclose that lender approval would be required. Nonetheless, this can lead to a claim of negligence or misrepresentation.

How to Protect Yourself

Going forward, here's what you can and should do to reduce the chance of surprises happening to you.

During your initial interview with the sellers, ask: "Is there anything, other than the condition of the house that might affect your timeline for selling?" Or, "Have you netted out the mortgage, or the mortgage and taxes, from the listing price?" Document this

conversation. If you're not getting a straight answer, then make your next statement a bold one: "If there are any financial constraints related to this proposed listing, it's best to talk about them now."

Once you decide to work with the short-sale sellers, take the conservative approach to listing the property: Complete the comment block in the MLS honestly by disclosing that lender approval is necessary. It may result in a slow sales trajectory, but you've done what you need to do.

Meanwhile, recommend that the sellers meet with an accountant or financial adviser to discuss the impact a short sale can have on their credit rating and whether debt forgiveness would have tax implications. Also, urge them to find out what short-term credit strategies are available.

Sellers also should be made aware that if an offer comes in and the short pay would be substantial, the lender may not agree to waive the sellers' personal liability for the debt even though the property is resold. (On this issue, though, there's an important caveat. If the lender is participating in the federal program for helping troubled borrowers—the Home Affordable Modification Program—lenders may be prohibited from going after sellers with a deficiency judgment later.)

Once you receive an offer from a buyer, make sure sellers are clear that

they can't accept the offer without disclosing that the acceptance is "conditioned on the lender's approval of the sale price."

Who Negotiates the Deal?

As you proceed with a transaction after a short sale offer is submitted to the bank, do not contact the lender on the sellers' behalf. If you do, you can be viewed as negotiating the loan and modifying contract rights and remedies. The risk here is that you can potentially expose your clients to personal liability if the lender is unwilling to walk away from sizeable debt. Plus, a disgruntled seller may sue you if the lender pursues a deficiency judgment, and you can assume this isn't a claim your errors and omissions insurance will cover.

Instead of negotiating with the lender, respond to any offers using the necessary language that the acceptance is subject to the lender's approval, and then secure written authorization from the sellers allowing the closing officer to begin direct dealings with the lender.

Short sales are making up a growing share of business today for real estate practitioners. As you build your expertise in this area, don't forget about the legal liabilities you can face throughout the transaction.

Resources for Short Sales

For those agents and brokers that are unfamiliar with the short sale process, there are tools and resources available to help understand these transactions.

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National Association of REALTORS®
(NAR)

NAR offers a wealth of resources for agents and brokers getting involved with short sales. Go to www.realtor.org/realtors/short_sales_tips_tools to find the information best suited to your office. For those needing a crash course in short sales, go to www.realtor.org/realtors/basics_short_sales.

Home Affordable Foreclosure
Alternatives Program (HAFA)

Published in 2009, this program was introduced by the Treasury Department for homeowners that could not keep their homes through the Home Affordable Modification Program (HAMP). This program ends at the end of 2012. Guidelines and forms can be found at www.hmpadmin.com/portal/programs/foreclosure_alternatives.jsp. For a brief rundown on HAFA provisions, visit the NAR website at www.realtor.org/government_affairs/short_sales_hafa.

Risk Management Reporter thanks Stacey Vernallis, Esq., of the Goehring, Rutter & Boehm law firm, for permission to use this article: Frick Buidling, 437 Grant Street, 14th Floor, Pittsburgh, PA 15219-6107, email: svernallis@grblaw.com, phone: 412-281-0587.

Why is the number of short sales rising?

Due to the recent economic crisis, including rising unemployment, and drops in home prices in communities across the nation, the number of short sales is increasing. Since a short sale generally costs the lender less than a foreclosure, it can be a viable way for a lender to minimize its losses.

A short sale can also be the best option for a homeowners who are "upside down" on mortgages because a short sale may not hurt their credit history as much as a foreclosure. As a result, homeowners may qualify for another mortgage sooner once they get back on their feet financially.

What challenges have short sales presented for REALTORS®?

The rapid increase in the number of short sales, and the short sales process itself, present a number of challenges for REALTORS®. Major challenges include:

1. Limited experience

Many REALTORS® are new to the short sales process; a difficulty which is compounded by many lenders' lack of sufficient and experienced staff to process short sales. Even if the REALTORS® are experienced, most servicers are under-staffed and still not adequately trained, making negotiating a short sale particularly difficult.

2. Absence of a uniform process and application

Until HAFA guidelines were established, both short-sales documents and processes were lender-specific, making it very difficult and time-consuming for REALTORS® to become knowledgeable and efficient in facilitating these transactions.

3. Multiple lenders

When more than one lender is involved, the negotiations are much more difficult. Second lien holders often hold up the transaction to exert the largest possible payment, in exchange for releasing their lien, even though in foreclosure they will get nothing.

As a result of these challenges our members have reported difficulties with:

- unresponsive lenders;
- lost documents that require multiple submissions;
- inaccurate or unrealistic home value assessments; and
- and long processing delays, which cause buyers to walk away.

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