

“Protecting Real Estate Brokers and Agents in Short Sale Transactions”

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I. PROFILE OF JOHN COOKE

John Cooke is the founding principal of Cooke Law Group. He is a Bay Area native, and a University of California at Berkeley graduate. John received his Juris Doctor degree from the University Of Maryland School Of Law. He possesses over eighteen years of legal experience in the areas of business, real estate, and construction law. John is active in the California State Bar. John is also a trained mediator who mediates business and real estate disputes. He is also on the attorney referral panel for the California Association of Realtors.

II. PROTECTING REAL ESTATE BROKERS AND AGENTS IN SHORT SALE TRANSACTIONS

This presentation assumes a basic understanding of the differences between short sales and other options available to distressed homeowners. The purpose of this presentation is to provide information to assist the broker in protecting his or herself from potential liability in short sale transactions. The term “broker” in this article also includes the agents who work for the broker.

A broker, as an agent to its principal (the seller), owes the seller various duties. Those duties include, among other duties, a fiduciary duty and a duty of reasonable care. This presentation focuses on acting with reasonable care when representing a client in a short sale transaction.

A. Definition of Short Sale

A “short sale” transaction is a transaction in which the lender consents to the sale of the security interest for less than what is owed on the note. The lender may or may not accept the proceeds in full satisfaction of the loan amount. The lender may request a promissory note from the borrower to make up the shortfall or force the borrower to liquidate assets to pay towards the shortfall.

B. Characteristics of Short Sales

Characteristic	Notes
No foreclosure on your credit record.	However, a short sale does have some affect on seller’s credit (possibly 80-100 points). Lenders may report the short sale as being settled for less than the full balance.
Potential adverse tax implications.	Cancelled debt is taxable. Although The Mortgage Forgiveness Debt Relief Act of 2007 may apply. Seller should consult a tax advisor on the tax implications of a short sale.
No deficiency judgment.	In California purchase money loans are not subject to deficiency judgments. But, home equity loans and refinances may be subject to a deficiency judgment in judicial foreclosure.
No eviction.	In a short sale the seller may be able to stay in his or her home until the close of escrow. But, the seller must obtain approval from the bank for an extension of any Trustee sale date until there is a short sale approval.
No cost to borrower.	No out-of-pocket money is usually expected from the borrower in a short sale. The lender is generally responsible for all costs and expenses of a short sale.
The shortfall between the sale proceeds and the amount owed to lender may still be owed after short sale.	While lenders in the past may have forced borrowers to liquidate assets to pay the shortfall amount, lenders now are seeking promissory notes for the shortfall amount.
A “short sale” is not a quick transaction.	The short sale transaction can take up to four months, or longer.

C. A Broker Owes a Duty of Reasonable Care to His or Her Client

A broker must exercise reasonable skill and care in the performance of services for the benefit of the client and is liable for any damages that the client suffers because of

unreasonable delay or negligence. The standard of care is that which would be followed by a competent broker under similar circumstance. In a residential transaction, the standard of care is that of a “reasonable prudent broker,” which is measured by the “degree of knowledge through education, experience, and examination required to obtain a license.” (Civil Code, § 2079.2.) Professional negligence is the failure to exercise the degree of skill or knowledge ordinarily possessed by an average member of the profession. A broker is vicariously liable for the acts of any real estate agents that he or she employs.

D. Acting with “Reasonable Care” when Representing Sellers and Buyers in Short Sales

The following are suggestions for a broker when representing sellers/borrowers and buyers in short sale transactions. These suggestions are intended to help ensure that the transactions will not result in potential liability to the broker.

- Discuss the short sale process in detail with clients. For example, explain to clients that they are potentially liable for the shortfall amount between the sale proceeds and the amount owed to the lender. The borrower may also need to prove financial hardship to lenders in order for the lenders to consent to a short sale.
- Inform client that the forgiveness of debt by the lender could be a taxable event. The seller may also owe capital gains tax on the sale of the property. The C.A.R. Short Sale Listing Addendum informs clients of the potential credit, legal and tax ramifications and advises the clients to seek advice from the relevant professional.
- Inform the seller that a short sale may negatively impact a seller’s credit rating. The C.A.R. Short Sale Listing Addendum advises of the credit impact of short sales.
- Client’s refusal to consult with an attorney. If a client refuses to consult with an attorney and/or tax consultant consider having them sign a document indicating that they are not consulting with an attorney or tax consultant against your advice.
- Don’t tell the client that the short sale is always better than foreclosure in a blanket statement. Have the client consult with a lawyer and/or tax consult to ensure that the short sale is the best option for them based on their particular circumstances. There are other options available to a seller including a negotiated loan modification or forbearance with seller’s lien holder, foreclosure, deed in lieu of foreclosure, and/or bankruptcy.
- Make efforts to ensure that you are not practicing outside of your expertise. If you have not done a short sale before conduct your first short sale by working with an experienced agent.
- Always be mindful of the potential financial and tax ramifications of short sales. Make sure that you have your disclosure checklist checked and doubled checked and initialed by seller.

- Be wary of calling yourself an expert unless you receive specialized training that can objectively qualify you as an “expert.” You may avoid a client potentially arguing after a transaction that he or she was misled into thinking that you are an “expert” if the client is unsatisfied with the transaction.
- Caution “stated income” borrowers about possible lender scrutiny during short sale approval process. Agents who represent sellers/borrowers should warn their clients that if they were not completely honest in stating the amount of income in applying for a “stated income” loan and the lender discovers this fact when reviewing documents in connection with a short sale application (e.g. tax returns); this may put the borrower at risk of potential liability for their dishonesty.
- A listing agent working with a distressed seller should not attempt to negotiate a listing of the property if the lender forecloses on the property. Such conduct potentially violates the fiduciary duty owed to the distressed seller.
- Advise buyers of potential length of short sale process. If you are representing the potential buyer of a short sale property, advise client that the process can take approximately three to four months, or more, to complete and that there is still no guarantee that the lender will approve the offer. You do not want the buyer to have unreasonable expectations regarding the length of the transaction.

E. Good Business Practices for Handling Short Sale Transactions

The following are good business practices to remember when representing clients in short sale transaction.

- Do not engage in the unauthorized practice of law. Writing a broker price opinion or negotiating with lenders in short sales and advising homeowners about a loan modification before they choose a short sale could be challenged as practicing law without a license or acting outside the scope of a sales associates’ license. Accepting a fee for broker price opinions might raise issues for sales associates who accept the fees directly rather than through their broker.
- Check your E&O coverage to confirm that any work on short sales is covered. Similarly, if you handle REOs for a lender, be sure your E&O policy covers property management activity. REO property sales tasks could be characterized as property management functions (turning on utilities, keeping vacant property secure and/or evicting residents).
- When dealing with short sale processing companies carefully read any disclaimers contained in the agreement. Some companies may include indemnification clauses in the agreement that shift all legal costs onto the broker if a lawsuit arises.
- Have attorneys review lender releases of borrower from shortfall from the sale. Since brokers are not licensed to review the terms of the escrow contract with their clients make sure that you have an attorney review any agreements involving a release of the borrower from the shortfall between the sale proceeds and the amount owed to the lender.

- C.A.R. forms regarding short sale transactions are available. Consider using the C.A.R. form SSL (Short Sale Listing Addendum) for listing a short sale property and using the C.A.R. form SSA (Short Sale Addendum) in connection with a purchase agreement.

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