Short Sales Part II
By
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Introduction – With an ever-increasing number of homes selling for less than the cost of the total mortgage indebtedness, many brokers and their supervising principal brokers are encountering short sale issues they have never seen before. In legal parlance, some of these issues are of "first impression" – meaning that there is no ready answer because there is no prior precedent to rely upon for guidance. Today, while we all have a basic understanding of what a "short sale" is, there are several steps to successfully completing one. And – since there is no "precedent" to follow – we must forge our way carefully, with an understanding that we may, from time to time, have to revisit, re-evaluate, and perhaps revise, some of our previous assumptions on how they should be conducted.

Basic Assumptions – In short sales there is an entirely new player in the transaction – the lender. And while they are not technically a "party" to the Sale Agreement, the lender's involvement, and ultimately their approval, is essential in order for marketable title to be delivered to the buyer. In the "standard" real estate transaction (i.e. those in which sellers leave closing with money in their pockets) it is normally not necessary to obtain lender consent to the sale, since the seller has a legal right to removal of the trust deed once a full payoff is tendered. In short sales, that is not the case, because the lender is being asked to accept *less* than a full payoff.

As a result of this new dynamic – i.e. the introduction of a nonparty into the decision-making process – some basic Realtor® assumptions no longer apply. One such assumption that does not apply in short sales is that the seller and buyer want the same thing, i.e. to close *this transaction* for a price they both agree is acceptable. In short sales, the seller's primary goal is to sell to the person the lender approves - and this may not be the first buyer who makes an offer acceptable to the seller.

Another basic assumption that no longer applies is that both parties will jointly work toward consummating *this transaction*. In short sales, since it is the lender making the final decision, the transactional process frequently favors the "last and best" offer. This approach is counter-intuitive for most Realtors®, who have always regarded the buyer with the first accepted offer as having a legally enforceable right to purchase the property.

The Seller Contingency. The underlying reason that the short sale concept is foreign to most Realtors® is that they are not used to dealing with a *seller contingency*. In the traditional transaction, virtually all of the contingencies, such as financing, inspection, title, well testing, etc., are intended to primarily benefit the buyer and are generally within the buyer's control to manage and complete. However, in the short sale transaction, lender consent is actually a *seller contingency.* Legally, this means that the seller is not required to sell to a particular buyer until the contingency, i.e. lender consent, is either satisfied, removed or waived.[1]

Further confounding this process is the fact that: (a) Since lenders are not parties to Sale Agreements, they have no contractual obligation to honor any of the transactional terms already negotiated between the seller or buyer; and (b) The lender's decision to consent to the short sale is based upon what is good for the lender, *not* necessarily the seller or buyer. All of this means that the lender can, in their own time and at their own discretion, dictate the terms of the transaction. For example, if they want the sales price to be higher, they can condition their consent upon that change; if they do not agree that the buyer should receive a seller credit for repairs, they can strike the provision. If they want the property to remain on the market for greater exposure, despite the fact that one or more offers are already pending, they can demand it. A seller's and buyer's only option is to terminate the short sale transaction that they have submitted to the lender for consent.[2]

The Quandary. Because a short sale means that the seller is receiving no money out of the transaction, the agents' traditional roles become skewed: The listing agent's goal now becomes obtaining the quickest sale, rather than the best price; and the selling agent's role in locking up the property for their buyer can become futile, since the lender's motivation is to secure the last and best offer. Thus, the entire short sale

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process takes on the appearance of an auction with sealed bids, and no one really knows when the bidding will close.

The quandary for Realtors® involved in short sale transactions is to continue meeting their fiduciary and affirmative obligations in light of the lender's involvement and lender's demands. Oregon licensing law imposes certain duties upon both real estate agents *vis' a vis'* their own clients, *as well as the other principals and agents in the transaction*.[3] Three of these duties are honest dealing, good faith, and the duty to disclose material facts known by one party's agent and not apparent or readily ascertainable to the other party. Additionally, information the licensee knows or should know would constitute fraud if not disclosed, is required to be disclosed, even if it is confidential information.[4]

While all of these general concepts are not particularly difficult for licensees to apply in standard real estate transactions, these obligations can become blurred in short sales. For example:

- What if the seller desperately needs to sell the property quickly - must the lender be notified of all subsequent offers after the first one? What if the seller wants to reject an offer rather than submit it to the lender?
- How much information, if any, does the listing agent need to disclose to the buyer's agent if doing so would enable that agent to submit a better offer than the ones already under consideration by the lender?
- What are the rules, if any, on a buyer's agent going around the seller and listing agent to negotiate directly with the lender – especially where the seller has already rejected the agent's offer?

The reason these types of questions, and others, are not easily answered is because the lender is *not* one of the principals in the transaction and the agents continue to owe their fiduciary duties to their own respective clients. Oregon's licensing laws give no clear direction on handling short sales.

Conclusion. Licensees must proceed carefully in short sale situations. Companies should consider developing office policies, training and protocols, especially among their principal brokers, so that from the top down, there is some uniformity in approach. This way the industry as a whole can develop a “best practices” approach to short sales.

Even though many of these questions do not have ready answers and are ones of first impression, there are certain basic rules that can be followed. First and foremost, it should be remembered that even though the lender is not a party to the Sale Agreement, it will be receiving funds from the closing, and as such is a beneficiary of the transaction. Accordingly, the lender will be relying upon the complete and truthful disclosure of information from escrow, the seller, and the real estate agents. Concealment of material information could create significant civil liability as well as licensing liability to the agents.[5]

Secondly, if the buyer's agent has reason to believe the listing agent is not being complete and forthright in his or her information regarding the lender's requirements – or is not informing the lender of the buyer's offer - he or she should contact their own principal broker for direction and assistance.[6] End runs and back-channel communications with the seller's lender could ultimately backfire and also create potential liability if not handled correctly.

FOOTNOTES

1 And if it is removed or waived without the lender’s consent to the short sale, the transaction still cannot close, since the lender’s trust deed will not be removed from title.

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2 Although the analysis will have to be left for another article, with each day's news of banks and credit markets in trouble, there is mounting evidence that lenders are beginning to understand the need to avoid foreclosures, which only increases their already bloated REO departments.

3 ORS 696.805 and 696.810.

4 "Confidential information" is information communicated to a licensee by the principal, including but not limited to price, terms, financial qualifications or motivation to buy or sell. Excluded from this definition is (a) information the principal instructs the licensee to disclose, and (b) information the nondisclosure of which would constitute fraud.

5 Consider, for example, ORS 696.301(1) which permits the Real Estate Agency to issue sanctions against a licensee who has "Created a reasonable probability of damage or injury to a person by making one or more material misrepresentations or false promises in a matter related to professional real estate activity."

6 While there is a chance the principal broker may not have a ready answer, they are in a better position to find one. For example, the selling agent's principal broker can call the listing agent's principal broker to resolve the matter, call the Real Estate Agency for direction, or call their company attorney for legal advice.

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