

SHORT SALES

GENERAL POINTS:

- (1) Short sale defined: A short sale transaction is a transaction in which the seller's sale proceeds will be less than the outstanding indebtedness secured by the property being sold – that is, outstanding mortgage balance(s) are for more money than the seller will clear on the sale after transaction costs. The short sale lender agrees to accept a payoff of less than the amount owed on the note.
- (2) Who negotiates the short sale: The seller may negotiate with their lender, or the seller may employ a consultant or “short sale specialist” to negotiate the short sale with the existing lender. Practical point: when a consultant or specialist, other than the listing agent, has been employed to negotiate a sale, be careful to determine what the consultant or specialist will be invoicing to the transaction. Past incidents of conflicts as to consultant's fees and listing agent's commission suggest this may present an escrow issue.

SETTLEMENT AGENT'S PREPARATIONS FOR SALE

- (1) Preliminary settlement statement: It is likely the agent will be asked to prepare a preliminary settlement statement for the existing lender. Agents should exercise extra care in this regard as the short sale may be delayed by subsequent changes to settlement expenses and should be aware that unusual charges or credits may cause the lender to decline to proceed. All fees should be accurately characterized; any misleading characterizations may be basis for the short sale lender to rescind the sale and reinstate its lien.
- (2) Payoff letter: The settlement agent should always obtain a written payoff letter from the existing lender. Since sellers have often negotiated a short sale agreement, including a payoff amount, well in advance of the transaction, the settlement agent may receive a payoff addressed to the seller. It is preferable that the settlement agent obtain a payoff letter from the lender that is specifically addressed to their agency; a consent from the seller allowing for the settlement agent to request such a payoff may be necessary. Short sale payoffs may be set out in letters or agreements from the short sale lender but regardless of the form, the settlement agent must find three elements in the payoff: a specified amount the lender will accept, a time period for which the payoff amount is valid, and the lender's agreement to release its lien upon satisfaction of the payoff/agreement.
- (3) Junior lien holders: Settlement agents should not overlook junior lien holders. Any junior mortgages or other liens should be released or shown as exceptions to title insurance

policies issued for the transaction. The settlement agent must be careful to resolve any inconsistent instructions of the junior lien holder(s) that conflict with the first lien holder's instructions for the short sale. Do not make any payments to junior lien holders outside of closing – any such payments must be reflected on the settlement statement and approved by the short sale lender.

(4) Pending foreclosure: It is common that foreclosure of the short sale property is imminent. The settlement agent should be particularly vigilant as to this possibility when a recent appointment of substitute trustee appears of record and in these cases, would be prudent to review the pending foreclosure list for the county where the property is located. When foreclosure is pending, the settlement agent should establish good communication with the foreclosing law firm in order to verify that all foreclosure expenses will be met and that the foreclosure sale will be halted upon receipt of the specified payoff amount.

(5) Multiple sets of documents from the short sale lender: The settlement agent should expect that the short sale lender may furnish a preliminary letter or agreement made between the lender and borrower as to general terms of the short sale. These agreements are often followed by specific instructions and further documents from the short sale lender. Practical point: It is always preferable to confirm short sale letters or agreements and in particular payoff amounts with the lender directly where the letter or agreement has been furnished to the settlement agent by the seller or seller's representative.

LENDER INSTRUCTIONS

(1) Common provisions:

(a) No proceeds to seller: It is usual for instructions to reflect that the seller is to receive no proceeds from the sale. Practical point: In cases where the sale later generates refunds that would otherwise go to the seller, the settlement agent should carefully consider whether the lender's instructions would dictate that the lender receive refunded monies. A common example would be duplicate payments of ad valorem taxes toward year's end, resulting in a tax refund.

(b) Reduction in consultant fees and/or realtor commissions: Settlement agents may expect to see a percentage limit on realtor commissions and hard limits on fees paid to consultants or "short sale specialists" employed by the seller. Settlement agents should not make payments to short sale negotiators outside of closing – any such disbursements must be reflected on the settlement statement.

(c) Lender approval of the documents: Even where this provision is not a part of the short sale instructions, it is prudent to obtain written approval of the settlement statement from the short sale lender prior to closing. The short sale lender may also require but should otherwise be notified and make written approval of any changes to the sale contract.

(d) Unsecured promissory notes: The lender may require that the seller execute a promissory note for the loan balance that is not collected at closing. This is not an insurance issue necessarily but may be a requirement to the release of the short sale lender's lien.

(2) Gotcha! clauses: Settlement agents should always look for any condition set out in the lender's instructions that provides the short sale lender justification to rescind the sale and reinstate the lender's lien. Conditional provisions in lender's instructions are generally not acceptable and should be reviewed with underwriting counsel.

(a) Fraud: Instructions may contain a general statement that indicates the short sale will be voided and the lender's lien reinstated if the property was acquired by any means of fraud. Freddie Mac defines fraud as "Any misrepresentation or deliberate omission of fact that would induce the lender, investor or insurer to agree to the terms of a short payoff that it would not approve had all facts been known." As a variation on this theme, the instructions or seller's affidavit may require the transaction be "arm's length". The buyer and seller should be unrelated; if the settlement agent learns that they are related parties, the sale should be halted.

(b) Rental of property by the Seller: "Rent-back" agreements allowing the seller to rent the property back from the buyer are typically prohibited.

(b) Subsequent transfers: Look for restrictions on resale in the short sale lender's instructions, affidavit(s) to be signed by the buyer, and/or the deed for the transaction. The settlement agent must make an owner's policy exception for any such resale restriction. In particular, as of November 1, 2012, the Federal Housing Finance Agency (FHFA) has directed Fannie Mae and Freddie Mac to implement a deed restriction which reads as follows:

"Grantee herein is prohibited from conveying captioned property for any sales price for a period of 30 days from the date of this deed. After this 30 day period, Grantee is further prohibited from conveying the property for a sales price greater than \$[insert 120% of short sale price] until 90 days from the date of this deed. These restrictions shall run with the land and are not personal to the Grantee."

PROBLEM AREAS

(1) Flip transactions: Short sale seller sells to an intermediary party, who then sells to a third party. The intermediary profits from the difference in the price paid for the property on the short sale and the price paid for the property by the third party purchaser.

(a) May indicate that the appraisal supporting the resale may be inflated.

(b) May violate subsequent transfer restriction.

(c) Requires complete disclosure; beware of privacy concerns.

(d) The settlement agent should not apply funds from the final purchase to the intermediate transaction.

(2) Land trusts: Short sale seller transfers the property to a trust, and seller is a beneficiary of the trust. Short sale seller is then paid to sell the beneficial interest to an intermediary. Finally, the land trust, now under control of the intermediary, sells to a third party. The intermediary benefits from the difference in the amount paid for the beneficial interest and the price paid for the property by the third party purchaser. This is problematic because the profit to the intermediary is concealed from the short sale lender (and third party's lender, if any).

(3) Bankruptcy: When the property is a part of the bankruptcy estate, the settlement agent may not rely on a motion to lift automatic stay in order to allow the short sale lender to proceed to foreclose as sufficient to allow a short sale transaction. The settlement agent should require a bankruptcy order specific to the pending short sale transaction or an order of dismissal or discharge of the bankruptcy. The settlement agent should review instructions carefully, as a bankruptcy filing may void the short sale approval.

(4) Affidavits

(a) Contain statements that will likely be beyond the settlement agent's knowledge ex. relationship between parties, side agreements for purchaser to remain in premises, no agreements not disclosed to lender

(b) Contain indemnification and reliance language creating liability for the settlement agent and title insurance underwriter

(c) Freddie Mac updated guidelines to allow waiver where state law prohibits settlement agent from signing, effective January 1, 2012, but settlement agent must agree not to close a subsequent transaction involving the property for one year from the date of the short sale closing

(d) P-35 prohibits many of the statements contained in the affidavits, affirmed by Texas Commissioner of Insurance by order March 19, 2012

(5) Payoffs to collection agencies: The short sale lender may have employed a collection agency to handle payoff of the loan. Remember, the scope of the collection agency's authority, and its involvement in the transaction, is only to the limit of the agency's arrangement with the short sale lender. It may be prudent to tender a cashier's check payable to the short sale lender to the collection agency where no assignment of the lender's lien to the agency is found of record.

(6) Post transaction: Agents are not to insure a resale within a restriction on resale period. When an agent finds there has been a recent deed conveying property to the seller for a pending transaction, and the seller is evidently an investor (a known area investor or an obvious investment entity e.g. 1234 Broadway, LLC) it may be prudent to wait to close the sale for more than 120 days from the date of recording for the vesting deed. Alternatively, the agent may obtain a copy of the owner's title policy issued for the prior transaction to determine whether exception was made for a resale restriction. It is preferable that agents find releases of lien for evident short sale lender liens relating to immediately prior transactions.