

CONTRACT ISSUES ON FORECLOSED PROPERTIES

While real estate and contract law has not changed due to the foreclosure crisis, certainly the processes by which foreclosed properties are sold can involve new legal issues which never arose in conventional transactions – *i.e.*, where buyers borrowed money and purchased a home from a seller that occupied the property. This article will cover some of those issues.

LENDER ADDENDUMS

Many REALTORS® represent any number of prospective buyers who are looking for the ultimate bargain in the purchase of a home. Typically, the targets of these prospective buyers end up being foreclosed properties, *i.e.*, properties now owned by a bank. Most REALTORS® are aware of the practical problems when dealing with bank-owned properties. Most prospective buyers are not. This is particularly true with first-time home buyers. Thus, REALTORS® working with first-time home buyers seeking to purchase a bank-owned property must be sensitive to the anticipated addendum or counterproposal that a bank will submit in response to any offer and, as importantly, must prepare their first-time home buyers for this document.

There is no “typical” bank addendum or counterproposal to an offer on bank-owned property, but there are some common provisions. First, the bank’s counterproposal will typically provide that there will be no seller concessions or that there will be extremely limited seller concessions with respect to closing costs and required repairs.

Second, the counterproposal may contain a provision in which the buyer is required to acknowledge that the seller may receive offers after the receipt of the buyer’s offer and may accept or reject any such offer in its sole discretion. All of this appears reasonable on its face, except that certain lenders interpret these provisions as permitting the lender to accept the buyers’ offer, but thereafter, terminate that offer if it receives a better offer prior to closing. Obviously, this type of provision has to be closely flyspecked by the buyers’ agent.

Third, the counterproposal may contain a provision stating that because the property was obtained through foreclosure or a deed in lieu of foreclosure, the purchase agreement with the buyers may be subject to approval by a private mortgage insurer or a re-purchase of the property by a prior mortgage servicer or insurer. Again, if this provision is in the counterproposal, the buyers must be made aware of the fact that their binding purchase agreement with the seller could be terminated up to the date of closing.

Fourth, the counterproposal may contain a provision that the buyers agree to accept the property in its “as is” condition at the time of closing. Again, this looks like a perfectly reasonable provision. However, many lenders interpret this provision as shifting the risk for the condition of the property to the buyers from the time of the execution of the counterproposal. In other words, if between the time the buyers accept the counterproposal and closing, the pipes in the home burst and there is substantial water damage, the damage would be deemed the responsibility of the buyers who would be required to accept the property in its damaged condition.

Fifth, the counterproposal may contain a provision that if the property has been winterized, it will be the responsibility of the buyers, at their expense, to have the property

dewinterized by a licensed plumber for the purposes of the buyers' inspections. The inspection provision typically goes on to provide that the buyers will fully indemnify and hold the seller harmless from any and all claims for damages arising from inspections made by the buyers. Again, this provision appears reasonable until a home is dewinterized for purposes of an inspection and there are various leaks in the plumbing and substantial water damage to the property.

Sixth, the counterproposal may contain a provision regarding negative sale proceeds. In other words, if unforeseen judgment liens or assessments result in negative sale proceeds to the seller, the seller reserves the right to cancel the purchase agreement and return any earnest money deposits to the buyers. This provision is the flip side of the usual marketable title provision, *i.e.*, a seller will take whatever appropriate steps are necessary to provide marketable title, regardless of whether it results in net negative sale proceeds.

Seventh, the counterproposal may contain a tax proration provision that benefits the lender, which is inconsistent with the local practice and the method that is set forth in the purchase offer. Obviously, the counterproposal will supersede the tax proration provisions in the purchase offer.

Eighth, the counterproposal may contain a provision stating that the seller will deliver insurable title and will pay for a buyer's policy of title insurance from a named title insurer. The buyers are usually also offered the right to purchase title insurance from a different title company at their own expense. The counterproposal typically does not specify the type of title insurance that will be provided to the buyer. Thus, some buyers receive title commitments from these seller/lenders that are nothing more than a title search from the date of the foreclosure sale or a title commitment for title insurance subject to all encumbrances whether of record or not. In other words, the buyers will not receive title insurance anything like what we have traditionally seen.

Finally, the counterproposal may address the issue of the total amount of commissions which may be paid on the transaction and the computation of those commissions. For example, the provision may cap all commissions at six percent (6%) of the net purchase price. The net purchase price would be the net of any and all seller concessions. In turn, seller's concessions could include closing costs, lender required repairs, the cost of any home warranty and the cost of any other negotiated repairs with the buyers. The buyers' agent will want to scrutinize this provision very closely.

Unfortunately, the dynamic of preparing and presenting an offer and acceptance of the offer by the seller/lender does not always result in close scrutiny of a counterproposal. The buyers' agent and the buyers have spent a great deal of time preparing the purchase agreement and are satisfied with its terms. However, a failure to understand the interaction between the purchase agreement, counterproposal and any subsequent addenda can result in substantial disagreements and failed closings.

Hopefully, the following hypothetical will demonstrate the potential problem. Assume that REALTOR® Brown is acting as a buyers' agent for the Smiths. REALTOR® Brown prepared an offer for the Smiths to purchase the bank-owned property located at 123 Elm Street. The property has been vacant for a substantial period of time and it is extremely important to the Smiths that they have an inspection contingency and that any necessary

repairs be paid for by the lender/seller.

REALTOR® Brown submits the offer to the listing REALTOR®. It is “accepted” by the lender/seller, subject to the buyers’ acceptance of the bank’s standard form “counterproposal.” The Smiths, who are excited about purchasing 123 Elm Street, quickly review (or don’t review) the “counterproposal” and sign it.

REALTOR® Brown then arranges for an inspection of 123 Elm Street by an inspector selected by the Smiths. The property must be dewinterized for the inspection. The Smiths use a licensed plumber to dewinterize the property in anticipation of the inspection. When the inspector appears at the property, there is water damage from several leaks in the plumbing within the home. The Smiths obtain an estimate from the plumber for the necessary repairs. REALTOR® Brown prepares an addendum which describes the problems caused by the leaks and calls for the seller to pay \$1,500 to repair the leaks. The seller accepts the addendum. The plumber undertakes the repairs and the \$1,500 cost is reflected in the HUD-1 settlement statement.

The night before the closing, the seller/lender advises that it will not pay the plumbing costs which the Smiths believe that it expressly agreed to pay in the addendum. The seller/lender advises further that it will not close unless the plumbing costs are removed from the HUD-1 settlement statement. Could there be any legal justification for the seller’s refusal to do exactly as it agreed to do in the addendum? Unfortunately, in a similar situation reviewed very recently this author, there was.

In the actual transaction, when signing the addendum, the lender/seller had used a very small stamp above its signature which stated “subject to seller’s counterproposal.” The stamp was so small that it is hardly noticeable. The “counterproposal” referenced was the counterproposal previously provided by the seller/lender, which expressly provided that the seller will make no repairs to the property prior to closing. Since the addendum was signed “subject to the counterproposal,” the terms of the counterproposal controlled. By making the “acceptance” of the addendum “subject to the counterproposal” the seller/lender in effect negated the whole purpose of the addendum itself – *i.e.*, that the seller be required to pay for the repairs listed. While the actions of the seller do not appear either honorable or ethical, they certainly appear to be legal. In many instances, the listing REALTOR® and cooperating REALTOR® end up picking up the costs in these types of situations in order to complete the closing.

In sum, buyers submitting offers on foreclosed properties should be made aware of the fact that a counterproposal will almost certainly be forthcoming from the seller. The counterproposal must be closely scrutinized by buyers and their buyers’ agent. Further, if there are subsequent developments by which the buyers wish to change the terms of the purchase agreement, any addendum prepared on their behalf must clearly modify the existing contract. When a buyers’ agent receives an “accepted” addendum back from a seller/lender, the agent should examine the addendum very carefully and make certain that there has been no language change and that the “acceptance” is not made “subject to” any other document.

NEW FEES AT CLOSING: A CONTROVERSY

Based upon calls to the MAR Legal Hotline and information received by our office, it is apparent that there is a continuing controversy as to when a buyer or a selling

REALTOR® may be compelled to pay a fee to the listing REALTOR® at closing. While I have tried to address this issue in the recent past, it is apparent that the information is not getting out.

The issue of whether a buyer or selling REALTOR® must pay a fee to a listing REALTOR® generally comes up in one of three different factual scenarios.

In the first scenario, the selling REALTOR® submits an offer to the listing REALTOR®. The listing REALTOR® then tenders back a counteroffer that includes a provision stating that the buyer will pay the listing REALTOR® a fee of “x” dollars at closing. If the buyer accepts the counteroffer, then the buyer is obligated to pay the fee to the listing REALTOR® at closing. As a side note, we have not yet run into the situation where the counteroffer signed by the buyer requires the buyer’s agent to pay the listing REALTOR® a fee at closing. If this situation should arise, a strong argument could be made that the buyer would not have the legal authority to bind the buyer’s agent to pay a fee to the listing REALTOR®.

In the second scenario, an offer is submitted on a property and an addendum is delivered back to the selling REALTOR®, which requires either the buyer or the selling REALTOR® to agree to pay the listing REALTOR® a fee at closing. The addendum typically requires only the signatures of the buyer and the selling REALTOR®. Further, in many instances, the execution of the addendum by the buyer and the selling REALTOR® becomes a condition for the listing REALTOR® to submit the offer to the seller. If the buyer and the selling REALTOR® sign the addendum, then they are legally bound to pay the fee at closing pursuant to the terms of the addendum. The addendum need not be signed by the seller or the listing REALTOR® for it to be enforceable.

Many times the selling REALTOR® is of the belief that the seller has not authorized, and is unaware, of the requirement that the addendum be signed as a condition to an offer being submitted to the seller. Hopefully, this is never the case, but if it is, then there are both ethical and licensing issues.

Standard of Practice 1-6 of NAR’s Code of Ethics provides:

REALTORS® shall submit offers and counter-offers objectively and as quickly as possible.

Administrative Rule 339.22307(2) provides:

A licensee shall promptly deliver all written offers to purchase to the seller upon receipt.

Assuming the listing REALTOR® will not present the offer to the seller until the addendum is signed by the buyer and selling REALTOR®, it seems fair to assume that there will be some delay in the presentation of the offer to the seller. If the seller has, in fact, authorized the listing REALTOR® to impose this fee upon the buyer as a condition of submitting offers to the seller, then a strong argument could be made that no delay has occurred in violation of either the Code of Ethics or the Administrative Rules. On the other hand, if the seller has not authorized the listing REALTOR® to impose a fee or to withhold offers from the seller until the buyer or selling REALTOR® agrees to the fee, then the delay

caused by the listing REALTOR®'s insistence upon execution of the addendum could become the basis for an ethics complaint and/or a complaint with the Department of Energy, Labor and Economic Growth. The easiest way for a listing REALTOR® to protect himself from these claims is to enter into a listing agreement with the seller which specifically authorizes the listing REALTOR® to impose the fee and to withhold the presentation of offers to the seller until the buyer and selling REALTOR® sign the addendum agreeing to the fee.

It should also be noted that a court could easily conclude that the imposition of the additional fee on the buyer or selling REALTOR® could make a property less attractive and more difficult to market. If the attempt to impose the fee was done without the knowledge or consent of the seller and the imposition of the fee was shown to materially affect the marketability of the property, a court could then conclude that the listing REALTOR® had breached its fiduciary duty to the seller.

Finally, the third scenario occurs when a listing REALTOR® places a comment in the private remarks section of the MLS stating that the "buyer shall be required to pay listing broker a processing fee of \$250 at closing." Ultimately, a buyer is procured for the property and at closing is presented with a settlement statement that indicates the buyer shall pay the listing broker \$250. The buyer then refuses to pay the \$250, as he/she did not know of any obligation to the listing broker. In this scenario, the buyer has absolutely no obligation to pay the fee to the listing broker as he/she has not agreed to do so by way of counteroffer, addendum or other document.

As a final note, we have been advised that on occasion, listing REALTORS® have demanded that a buyer or a selling REALTOR® pay a fee to the listing REALTOR® at closing by reason of the fact that in the listing agreement the seller has agreed that the listing REALTOR® may charge such a fee. In this situation, the buyer and selling REALTOR® would have absolutely no obligation to pay the listing REALTOR® a fee at closing, as neither the buyer nor the selling REALTOR® is a party to the listing agreement.

MULTIPLE OFFERS REVISITED

As part of last year's legal update, we briefly touched on the practice of multiple offers being submitted to sellers' lenders in the context of a short sale. Since that time, this practice has expanded and taken on different forms. Thus, we are briefly revisiting the subject.

The practice of submitting multiple offers to a seller's lender has taken on three basic forms. First, as offers are submitted to a seller, the seller accepts the offer by signing it with a counter that the agreement is subject to the seller's lender's approval. The seller may sign and accept any number of offers, all of which are then submitted to the lender. Assuming that a seller has accepted four offers subject to the seller's lender's approval, the seller has entered into four (4) binding purchase agreements for the sale of its property. Obviously, the seller cannot sell the property to four different buyers. The seller is counting on its lender to approve the "best offer" with the resulting failure of the other three (3) purchase agreements due to non-approval by the seller's lender. If the seller's reliance on the lender approving only one of the accepted offers is misplaced, the seller would be put in the position of being legally required to sell its home to two or more buyers. Moreover, if a seller chooses to sign multiple offers for its lender's review, at a minimum, each offer should be drafted to put the prospective

buyer on notice that this may occur.

The second scenario occurs when a listing REALTOR® receives several offers on the same property. The seller does not execute the offers, but instead tenders each offer to the seller's lender to obtain its approval prior to the seller signing any of the offers. The use of this procedure eliminates any risk that the seller inadvertently approved more than two offers and, thus, legally obligating the seller to sell its property to two or more buyers. Unfortunately, this advantage is offset by the basic problem that there is no binding purchase agreement with any of the buyers. The buyers may revoke their offer at any time and walk away from the transaction.

Finally, there are REALTORS® who deal with multiple short sale offers on the same property by treating them as they would multiple offers in a conventional market. The seller initially accepts an offer subject to the seller's lender's approval. Any offers thereafter accepted by the seller are accepted as properly documented backup offers. From the seller's perspective, these backup offers should include the terms permitting the seller to amend any prior existing agreement without triggering any backup offer. From a buyer's perspective, these backup offers should contain a date when the buyer can decide he is tired of waiting, declare the transaction at an end and receive the return of the earnest money deposit. Legally, this last method minimizes the legal risks to a seller in accepting multiple offers.

The present foreclosure glut and the sometimes unorthodox transactions caused by short sales have not changed the law of contracts. Multiple offers handled in the context of a short sale should be handled in the same way multiple offers are handled in a conventional market.

CONCLUSION

While contract law is no different for REO's than for other properties, the provisions in the contracts themselves are often very different. REALTORS® need to keep this in mind when reviewing "counterproposal" forms presented on behalf of lender/sellers.