

Seller Concessions - New York State Bar Association Clarifies Ethics Opinion

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On December 15, 2009, an informal response was given by the New York State Bar Association's Committee on Professional Ethics (Inquiry No. 43-09) in which the State Bar Association clarified circumstances in which a lawyer may ethically participate in a residential real estate transaction, when the Seller has agreed to increase the sales price "in an amount equivalent to the amount of the Seller's concession". This excellent response by Committee Chair, Roy D. Simon, will be helpful to many lawyers who have avoided any transaction involving a gross up of a contract price with an equivalent Seller concession.

A "seller's concession" is simply a credit to be given to the purchasers at closing often applied to closing costs, repairs or other expenses of the purchaser. When it is a genuine credit, no gross-up of the transaction is applicable. For example, a Seller may agree to provide a seller's concession because the inspection report reveals that the roof requires replacement. The seller's concession referred to in the Bar Association opinion is one which is identical in amount to the gross-up of the purchase price and is intended to enable the purchasers to obtain greater financing for the transaction. The Seller continues to receive the same true sales price as was originally negotiated.

Opinion 817 – 11/2/2007

In 2007, the New York State Bar Association's Committee on Professional Ethics issued a formal Opinion (817) in which it essentially stated that participation by a lawyer in a real estate transaction that includes a "seller's concession" with a "grossed up" sales price is prohibited unless:

- [A] The transaction is entirely lawful;
- [B] The gross up is disclosed in the transaction documents; and
- [C] No parties are misled to their detriment.

Most attorneys have interpreted the last aspect of this Opinion, i.e., that "no parties are misled to their detriment" to essentially prohibit participation in such transactions because most mortgages are sold in packages or as part of real estate securities. There is little likelihood, therefore, that subsequent purchasers of a mortgage portfolio will have any awareness of transactions in which the purchase price has been increased and an equivalent seller's concession has been arranged in order to facilitate a larger mortgage for the borrower.

The 2007 Opinion rendered ethically conscious real estate attorneys incapable of determining under what circumstances the lawyer's participation in such a transaction would facilitate deception or misrepresentation. The Bar's Opinion stated,

"It seems obvious that there is potential deception implicit in the transactions but we cannot determine whether or in what circumstances actual deception will occur. Thus we hold that a lawyer may not ethically participate in such a "gross up" of the actual purchase price and concomitant seller's concession unless there is neither deception nor misrepresentation at work in the transaction and its predictable consequences."

The Typical Seller's Concession and Gross Up of the Purchase Price

The December 15, 2009 clarifying letter issued to the Chairman of the Professional Ethics Committee of the Richmond County Bar Association refers to the following facts:

Seller's Attorney is presented with a binder calling for a contract for the sale of a single family home for \$300,000.00 with a mortgage contingency for \$285,000.00, representing 95% financing.

Before the contract is prepared the buyer's loan officer (i.e., Lender) contacts the Seller's attorney asking that the contract be prepared containing the following language:

- (1) The selling price should be increased by \$18,000.00, to \$318,000.00, to reflect the seller's concession of 6% percent;
- (2) a sum certain seller's concession of \$18,000.00 will be applied to buyer's closing costs or otherwise; and
- (3) the mortgage contingency clause should be increased to reflect \$302,100.00 (representing 95% financing).

These circumstances have been presented many times since the 2007 Bar Association Opinion and most responsible attorneys, have avoided participating in such transactions based upon New York State Bar Association Opinion 817. The December 15, 2009 response from the Committee on Professional Ethics indicates that it is possible for an attorney to participate in such a transaction and specifies the specific circumstances which make it permissible.

Circumstances In Which Attorney Can Participate

The Bar Association Opinion which is limited to the facts set forth in the letter indicate that the following steps, if taken, would render participation by the attorney to be permissible:

1. The loan officer, an individual licensed by the New York State Banking Department, asks the Seller's attorney to put in writing that the above formula fully meets underwriting guidelines and was initiated by the loan officer.
2. The sales contract expressly states that the sales price has been increased by a sum equivalent to the seller's concession, clearly indicating that the price the seller agreed to receive was \$300,000.00.
3. A similar disclosure is set forth in the HUD-1 Settlement Statement.
4. Full disclosure is made on the Real Property Transfer Tax Return (RP-5217) and on the Real Property Transfer Report.

What Makes Lawyer Participation Permissible?

The new interpretation from the Bar Association indicates that State Bar Opinion 817 required that the transaction be entirely lawful, the "gross up" be disclosed in the transaction and that no parties be misled to their detriment. The new Opinion indicates that a seller's concession or "gross up" is not on its face, improper. The new letter clarifies the intent of the original Opinion, i.e., that there be full disclosure in the transaction documents in order to ensure that no interested party is misled. The new letter indicates that the Real Property Transfer Report instructions (paragraph 13) requires that a seller's concession be deducted to reach the actual or full sales price. In most transactions which took place prior to Opinion 817, such significant disclosures were not customarily made. The new letter distinguishes between the validity of a seller's concession as opposed to a "gross up" of the selling price. The new Opinion notes that:

"That gross up, if not expressly disclosed as such, is the type of dishonesty, fraud, deceit and misrepresentation proscribed by Rule 8.4(c)." [referring to the particular section of the Rules of Professional Conduct to which attorneys are bound].

"A lawyer who knowingly participates in a real estate transaction that fails to expressly disclose the gross up of the sales price in exchange for the seller's concession

in the transaction documents violates the provisions of Rules 8.4(b), (c), (d) and 3.4(a)(6).”

The question of future mortgage investors is fully addressed. The new letter, which again is limited to the facts set forth, does address the potential fraud on the ultimate mortgage investor. The Opinion states in part:

“If all the documentation discloses that the gross up is an increase in price equivalent to the seller’s concession, there is no ethical violation or misrepresentation because everyone later in the chain of mortgage title or interest should, therefore, be apprised of the circumstances surrounding the original loan.”

“Where all documents that refer to the sales price expressly state that the sales price has been increased by a sum equivalent to the seller’s concession, the lawyer’s ethical duty has been satisfied.”

Will Attorneys Now Be Able To Participate in Transactions Involving a Seller Concession?

The December 15, 2009 informal response states that it is “...not a formal opinion and is based solely upon the information submitted and the representations set forth in your inquiry. It shall have no effect as precedent insofar as any other state of facts is concerned.” Accordingly, an attorney who chooses to rely upon the informal December 15, 2009 letter, must necessarily comply fully with the various steps set forth in the fact pattern outlined in the letter. The fear engendered by original Opinion 817 resulted in many difficulties for brokers, buyers and sellers when attorneys refused to participate. Now that a road map has been provided, such transactions should not continue to present the difficulties previously experienced.

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