

Short Sales - Legal Aspects
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At the May, 2008 mid-year meetings of the National Association of Realtors (NAR), the Board of Directors of NAR adopted changes to the model Multiple Listing Service (MLS) Rules to reflect the realities of short sales. Every MLS must now give to the Participants, the ability to disclose to other Participants any potential for a short sale.

Definition of a Short Sale

Short sales are defined by NAR as follows:

“...a transaction where title has transferred; where the sale price is insufficient to pay the total of all liens and costs of sale; and where the seller does not bring sufficient liquid assets to the closing to cure all deficiencies.”

Notice By Listing Broker to Cooperating Brokers

When a listing broker takes a listing involving a potential short sale, the listing agent should communicate to cooperating brokers through the confidential “broker-to-broker” information fields in the MLS:

- a. that a short sale may be applicable to the transaction (i.e. “possible short sale”); and
- b. how any reduction in the commission resulting from the short sale will be apportioned between the listing agent and the cooperating broker.

The Westchester-Putnam MLS has already provided for a change in Modification M7 which is used to alert cooperating brokers to pending foreclosures and bankruptcies. This modification has now been expanded to refer as well to short sales. When using the M7 designation a listing agent should also select M7A or M7B so that the cooperating broker can ascertain the listing agent’s policy if a commission reduction must be addressed. Moreover, the listing agent should use the broker-to-broker remarks field to expand upon the M7 designation so that cooperating brokers are alerted at the earliest possible date to the potential of a reduced commission.

Short Sales Are Now a Reality

California-based www.ForeclosureS.com reported on August 11, 2008 that the number of pre-foreclosure filings during the month of July were at record levels, both nationally and in 14 states and the District of Columbia. Short sales have become a reality in every marketplace. They are a result of weakness in the economy, a fall in the median prices of residences over the past two (2) years, the mortgage crisis, which has resulted in the inability of many homeowners to refinance their mortgages in order to pay off

increasing consumer debt, and/or the loss of quality employment. Filings in Westchester, Putnam, Dutchess and Bronx Counties are at historically high levels although the states with the highest foreclosure rates continue to be Nevada, Arizona, California and Florida.

How to Handle a Short Sale

NAR has prepared "The Short Sale Workflow", an excellent analysis and explanation for Realtors to use when handling a short sale. The document was prepared by the NAR Short Sale Issues Working Group, was published in the spring of 2008 and is available at NAR's website at www.Realtor.org and WCBR's website at www.wcbr.net. This document appropriately cautions Realtors to remember that they are not to practice law or to give legal advice. Realtors are guided to work with skilled legal counsel in completing short sale transactions.

The Workflow document also addresses the Mortgage Forgiveness Debt Relief Act of 2007. This Federal Law passed in December of 2007, allows up to Two Million (\$2,000,000.00) Dollars of qualifying mortgage debt which has been forgiven in connection with the sale of a taxpayer's principal residence in 2007, 2008 and 2009, to not be treated as income to the taxpayer. One of the serious issues involving short sales that existed prior to the adoption of this Act was that whatever portion of the mortgage was forgiven by the lender became the subject of an IRS Form 1099 at the end of the calendar year, requiring that the amount of mortgage indebtedness forgiven, be reported as income by the already struggling taxpayer. In recognition of the seriousness of this circumstance, Congress passed the Debt Relief Act to ensure that homeowners are not then subjected to payment of income tax liabilities for which they do not have the resources. The Debt Relief Act is not available for vacation homes or investment properties and applies only to principal residences. Sellers should be advised to consult with tax or legal counsel regarding other nuances in the Act.

Addendum to Listing Agreement

The Short Sale Workflow document includes an Addendum developed by the California Association of Realtors which is added to the listing agreement when a potential short sale is apparent. The Short Sale Addendum should be tailored to New York transactions. If a Realtor in New York State is involved in a short sale, it is strongly recommended that a short sale addendum be utilized. The Addendum relates to an explanation of what is likely to happen in the short sale circumstances, references the need to consult with counsel regarding tax consequences, credit consequences and lender considerations. Most importantly, it authorizes the listing agent to contact the lender to obtain approval of the short sale.

Contract of Sale

The California Association of Realtors also developed an addendum to the standard forms of Contract of Sale utilized in California. These forms are included in the Workflow document created by NAR. Attorneys involved in short sales should be adapting the California format to the transactions occurring now in New York. These contract riders provide for essential contract considerations such as: a) a contingency for the short sale approval by the lender, b) the time periods to obtain short sale approval, c) confirmation that no assurance can be given that a lender will approve of the short sale, d) an acknowledgement that the buyer and seller may incur costs that cannot be reimbursed if the lender does not consent to the short sale, e) authorization for the seller to continue to market the property despite a buyer's offer, and f) confirmation that the parties are to seek the advice of legal counsel (and in particular, tax and other expert advice) regarding the consequences of a short sale.

Avoid Arbitration. Communicate!

The failure of a listing agent to adequately notify cooperating brokers about the potential for a short sale or about the listing agent's policies for the collection of commissions, will result in an arbitration claim by the cooperating broker. Without proof that full and adequate notification was given by the listing agent before an offer was presented, the listing agent will likely be held liable to the cooperating broker for the commission offered through the MLS regardless of what the listing agent actually collected.