

## **The Shutdown and its Effect on Real Estate Transactions**

**By John Dolgetta, Esq.**

On December 21, 2018, the Federal Government partially shutdown all non-essential services. This is now the longest government shutdown in U.S. history. As a result, some federal loan programs have been affected. The shutdown is also affecting conventional loans, causing delays and even cancellations of transactions.

Real estate professionals should understand how this may impact transactions already in contract and those currently being negotiated. The shutdown may also affect clients contemplating financing options, such as FHA (Federal Housing Administration) loan, VA (Veteran's Administration) loans and SBA (Small Business Administration) loans. It is also critical for attorneys representing both residential and commercial clients to be aware of these issues when negotiating and finalizing contracts on behalf of their clients. The experience gained from handling these issues will be useful for real estate professionals in connection with future shutdowns as well.

### **NAR's Survey and Assessment of the Impact**

On January 7, 2019, the National Association of Realtors (NAR) conducted a survey that provides very helpful information concerning the initial effect of the shutdown on real estate transactions and the market. (*See Federal Government Shutdown*, NAR, at <https://bit.ly/2H6J9KN>). According to NAR's Chief Economist, Lawrence Yun, the government shutdown "...is an unambiguous negative for the real estate market." (*See Shutdown a Negative on Market*, *NAR Video*, Lawrence Yun, NAR Chief Economist, and Megan Booth, NAR Director of Federal Housing Policy, at <https://bit.ly/2Hb3n65>). Lawrence Yun pointed out that delays are being caused due to the unavailability of certain mortgage products and the shortage of staff at various governmental agencies, affecting both residential and commercial transactions.

Megan Booth, NAR Director of Federal Housing Policy, reported that while most home loan programs (conventional, FHA and VA loans) are running smoothly and are closing, there have been some issues in that additional specialized loan programs are being affected (i.e., USDA (Rural Housing Service) loans and reverse mortgage loans are unable to close during the shutdown). NAR, however, was able to work vigorously with the Federal Emergency Management Agency (FEMA) to get the Flood Insurance program reinstated, and as a result, borrowers should be able to obtain flood insurance in connection with home purchase transactions.

### **NAR's Survey Results**

The survey conducted by NAR revealed that 75% of the Realtor members responding (i.e., 2,211 out of the approximately 52,000 members) reported that the shutdown had "no impact to their contract signings or closings." 22% of those surveyed indicated that the shutdown had an impact either on current and potential transactions. Of the 22% indicating there was an effect, 25% cited that the "buyer decided not to buy" due to "general economic uncertainty." While the

survey does not indicate what the uncertainty consists of, the current interest rate increases are likely a factor. Again, while the shutdown may also be a factor in this last category, there are likely many others being considered by buyers.

NAR's survey provides very useful information which should be utilized by real estate professionals in guiding and advising their clients. Of the 22% who said their transactions were impacted, 17% indicated that there was a delay due to the client obtaining a USDA (U.S. Department of Agriculture) loan, 13% reported the inability of the lender to verify employment with the IRS, 9% and 6%, respectively, pointed out that there was a delay when using FHA and VA loans. Real estate professionals should be aware of the financing options buyers are contemplating and should provide their clients with the guidance as to the potential issues and delays which may exist.

NAR's survey further revealed that some transactions were either not entered into or cancelled due to various reasons (i.e., buyers lost a bid because they were using an FHA loan (6%); buyers lost a bid because they were using a VA loan (3%); buyer (i.e., a federal employee or federal contractor) was rejected by a lender because of the government furlough (3%); buyer decided not to proceed because of the government furlough (3%); contract was terminated because buyer was using an FHA loan (2%), USDA loan (2%) or VA loan (1%)). If the shutdown continues, government employees who are not receiving their pay checks and are applying for loans will certainly have issues obtaining financing for their real estate purchase.

### **Other Issues Due to Lack of IRS Services**

As Kelly Phillips Erb, Senior Contributor at *Forbes*, points out, the fact that the IRS was not issuing tax transcripts was causing delays. (*See Shutdown of IRS & Other Government Agencies Is Causing Headaches for Homebuyers and Lenders*, [Forbes.com](https://www.forbes.com), January 2, 2019, at <https://bit.ly/2VQ18bt>). In residential and commercial real estate loans, borrowers and guarantors are required by lenders to execute form 4506-T (Request for Transcript of Tax Return) (*see* <https://bit.ly/2HccT94>) which are required to verify income information necessary to provide financing.

The IRS issued a bulletin indicating that "it will begin processing requests for transcript information made through the Income Verification Express Service (IVES) program. (*See IRS Bulletin* at <https://bit.ly/2AJUiLO>). Nevertheless, the bulletin does indicate that it will take "time to ramp this service up to normal operating status...and begin to process requests backlogged since the funding lapse began on December 22, 2018." The Real Deal reported that Robert Broeksmit, CEO and President of the Mortgage Bankers Association, was successful in lobbying senior officials at U.S. Treasury Department (including Craig Phillips, a senior advisor to Treasury Secretary Steven Mnuchin) to get approximately 400 employees back to work so that the IRS could restart processing tax transcripts. (*See Mortgage Industry Chief Gets Some Federal Employees Back to Work*, The Real Deal, January 13, 2019, at <https://bit.ly/2D6sjro>). Reportedly, the IRS is operating at a 15% staffing level, and therefore, delays are still likely. (*See Government Shutdown has Little Effect on Real Estate*, *Mortgage News Daily*, Jann Swanson, January 8, 2019, at <https://bit.ly/2sodMBd>).

Another issue affecting real estate closings is the title companies' inability to obtain information from the IRS concerning tax liens that come up on a title search. In a press release issued by the American Land Title Association, it was reported that "[t]he continued government shutdown is disrupting closings and causing problems for title companies trying to obtain lien payoff information from the [IRS]." (*See Government Shutdown Delaying, Cancelling Deals Involving IRS Liens*, ALTA TitleNews Online Archive, January 8, 2019, at <https://bit.ly/2RMvgWb>). Ms. Phillips Erb explains that "[t]ypically, before sale, a title company will check to make sure that the sellers can provide clear title. In addition to confirming any mortgages and like, this means that any federal tax liens that show up on a title report must be addressed. The normal route is for a taxpayer to request a discharge, withdrawal or subordination of the lien, depending on the amount in question and the circumstances, prior to settlement. However, if there's not sufficient IRS staff to answer phones or respond to lien satisfaction requests, the lien will remain on the report, and that's likely to stall any planned settlement." The low IRS staffing level will also affect and delay the issuance of Tax Release letters from the IRS relating to Estates, needed by title companies in transactions involving Estates selling real property.

### **SBA Loans Are at a Standstill and Affecting Commercial Transactions**

The Small Business Administration (SBA), not considered an essential agency, is also closed during the shutdown. There are thousands of small business currently in contract which have applied for an SBA loan or are contemplating entering into a commercial real estate transaction contingent upon obtaining SBA financing.

In a recent article by Mark Anderson, the author points out the unavailability of SBA loans could affect commercial transactions where "...sellers have a time commitment to complete a transaction, such as in a 1031 exchange, where the seller doesn't pay capital gains taxes if sale proceeds are invested in another property within 180 days. In other cases, small business owners may need to complete a deal by a specific date or risk losing the property and may also have to forfeit non-refundable deposits." (*See Federal Government Shutdown Could Delay SBA Loans, Real Estate Deals*, Sacramento Business Journal, January 9, 2019, at <https://bit.ly/2srivlq>).

Mr. Anderson also highlights that SBA loans (particularly the SBA 504 loan) are used to purchase commercial real estate. Conventional commercial loans typically require borrowers to contribute 25% to 35% of the purchase price and are usually for short terms (10 to 15 years). An SBA 504 loan allows for loans of up to 90% loan-to-value ratios and terms of 25 years. Therefore, it is a very popular option for commercial purchasers.

In other instances, sellers and purchasers have specific mortgage contingency dates in their contracts by which they are required to provide a mortgage commitment letter. Sellers and purchasers may elect to cancel their contracts because of the inability of a purchaser to obtain the mortgage commitment letter by the requisite date. Sellers may want to cancel the contract and place the property on the market again to try to attract purchasers who will use conventional commercial financing. On the other hand, Purchasers may elect to cancel, if the contract permits, to avoid possibly forfeiting their deposit.

## What Should Real Estate Professionals Do?

Real estate professionals should advise their clients of the potential issues which could affect their real estate transactions. They should ask their clients specific questions relating to the type of financing being pursued. Real estate agents should work with the mortgage professionals to determine which loans may be affected by the shutdown. Mortgage representatives are on the front line and can provide guidance as to the specific delays they are experiencing. It is also important to advise the client that some products like FHA and VA loans are proceeding as usual. While there may be some collateral delays, financing is still available, and applications are still being processed.

Real estate attorneys also need to address these issues specifically in the contract of sale. Attorneys representing purchasers should include language providing for automatic extensions in the event of a government shutdown or slowdown affecting financing conditions. Purchaser attorneys should consider including language extending the mortgage contingency period and the closing date on a day for day basis, for as long as any such delay may last.

Attorneys representing sellers, on the other hand, should include provisions which limit the amount of time a purchaser has to obtain a mortgage commitment. If the contract does provide for an automatic extension due to force majeure (or unforeseen events, such as a government shutdown), an outside date should be included whereby a seller is permitted to terminate the contract and is free to place the property back on the market.

As always, real estate professionals should manage their clients' expectations. The more a client knows the less anxiety there will be. Sellers and buyers should be informed of the risks and potential delays before accepting or submitting an offer. Hopefully, the government shutdown does not last much longer, but in the meantime, it is imperative that real estate agents discuss the potential issues and explain how they may affect their specific transactions.

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