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# REALTORS® LEGAL ALERT

## **LEGAL ALERT FOR REALTORS®** **Cash Poor Transactions and Short Sales** **Handling the Business Opportunity**

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### INTRODUCTION

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The listing broker read that correctly. Short sales and foreclosures can be a profitable business opportunity for the Realtor® who knows how to navigate around the issues involved and is willing to tackle a situation that is a little different than a run-of-the-mill transaction. Short sales and foreclosures generally already contain the two most vital ingredients to a successful transaction: a highly motivated seller and potential buyers who smell a bargain. It is up to the Realtor® to stir these ingredients in the right proportions and at the right time to produce a sale.

This Legal Alert will talk about some of these issues and provide some suggestions on how to turn what appears to be a losing situation into new business.

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### IDENTIFYING THE SHORT-SALE SELLER

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The first step to the Realtor's® successful handling of the potential short sale or the foreclosure is for the Realtor® to realize that it is a potential short sale or foreclosure.

Stop at the land records before the listing presentation. The Realtor® wants to check the land records to determine for the Realtor's® own purposes what mortgages and liens encumber the property. The land records will not only identify who is owed but at least the initial amount that was owed to each creditor who has filed a mortgage or lien. While at the town hall, do not forget to ask the tax collector whether the taxes are current. Delinquent property taxes and the 18% interest they accrue can add up very quickly. This is useful information to know before sitting down with the seller. It does not take a rocket scientist to calculate that a property the Realtor® believes will sell for \$350,000 but has mortgages, liens and delinquent property taxes totaling \$375,000 does not have any equity that can be used to pay commissions.

In situations that are close calls, the Realtor® may wish to inquire as to whether the mortgage payments are current. For example, the Realtor® believes that the property will be saleable at \$350,000 but the encumbrances total \$335,000. Knowing that conveyance taxes and closing attorneys will be paid before anyone else, the equity situation is a close call with regard to equity available to pay commissions. Sellers that are behind two or more payments face the imminent prospect of a foreclosure, which will really place both the agent and the seller under the gun. Another method that can be used to determine if a

foreclosure has been started is to visit the Connecticut Judicial Department website <http://www.jud.ct.gov> and perform a case name search using the seller's name.

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## IT'S A CASH POOR LISTING, NOW WHAT?

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A listing broker's exposure in a cash poor transaction is twofold. First, the listing broker may not be paid for its services. Second, the listing broker may have to pay the cooperating broker's commission out of the listing broker's own pocket if an offer of compensation is made in the MLS and the cooperating buyer agent meets the qualifications to collect a cooperating brokerage payment.

What are the listing broker's options?

1. Weigh the risk of not getting paid (and owing a cooperating broker's fee), looking at all the information available. If the listing broker decides that the risk is too great, the listing broker can tell the seller that it is not taking the listing. Keep in mind that a lender may ask the listing broker to compromise its compensation at some point and that the listing broker is being asked to save a dire situation for both owner and lender under circumstances where quick action is needed. Listing brokers are entitled to consider these factors in determining the level of its compensation.
2. Many times the listing broker will want to take the risk and take the listing. In this case, the listing broker needs to determine "how much" and what kind of assurance from the seller regarding the listing broker's compensation is adequate.
  - Talk to the seller about the cash poor status of the property and inquire as to how the seller plans to pay the commission. Sometimes the seller has additional assets that can be utilized to pay commissions. The listing broker should be satisfied that the seller can pay the commission in the manner stated by the seller.
  - The best protection the listing broker can get from the seller is to have the seller place the commission money in an escrow account, for example, with the seller's attorney. As a practical matter, few sellers have the wherewithal to do this.
3. Periodically, monitor the status of liens on the property throughout the listing period. This will require periodic trips to town hall but may well be worth the effort if the listing broker discovers that additional liens have been placed on the property since the date of the listing. This will also give the listing broker notice if a foreclosure has been started.
4. Keep any buyer agent with an interested prospect advised of the status of any liens or concerns about commission.
  - A listing broker will want to keep any cooperating broker fully and continually informed of any problems with the commission and any steps that the listing broker may need to take in reducing the commission.
5. *If the seller has no other source of funds, consider this fact when making the co-brokerage offer in the MLS. MLS requires the offer of a dollar amount or percentage but there is no requirement as to the amount or percentage offered. In addition, an MLS may have a rule permitting cooperating broker offers to be conditioned on bank or lender approval (check with the MLS to determine whether it has such a rule). In the absence of such a rule, it is improper to attempt to condition the cooperating broker payment offered in the "Remarks" section of the MLS listing or by some other means. However, no listing broker is required to offer a cooperating broker amount and put itself at risk of having to pay the cooperating broker payment out of its own pocket in order to "attract attention" to the MLS listing. The MLS is not a marketing vehicle, and the cash-poor seller should be made to understand that the cooperating broker offer in the MLS makes a compensation contract for which the listing broker is answerable and not a lure to be used to ensnare buyer agents.*

Brokers and sales associates each need to be sensitive to the exposures of a cash poor transaction and the warning signs for such a transaction. Brokers may want to have some procedures for sales associates to follow and may want to discuss aspects of a cash poor transaction at an office meeting. The better informed brokers and sales associates are about the warning signs of a cash poor transaction and the steps that can be taken to avoid exposure, the more likely it is that an office can avoid loss of commission or having to pay a cooperating broker's commission from the listing broker's own funds.

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## **BUYER INTERESTED IN CASH POOR LISTING, NOW WHAT?**

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Cash poor transactions are a business opportunity for buyer agents also, but the buyer agent needs to do a little homework in advance. The buyer agent should first consider where the agent's enforceable compensation arrangement will be found. The potential cooperating buyer agent will probably be faced with an MLS listing that either has a very small cooperating broker payment offered (because the listing broker has read this *Alert* and will protect themselves) or the MLS has a rule permitting the cooperating broker offer to be contingent on lender approval - putting the cooperating broker's fee at the mercy of some lender.

This is where the buyer agreement containing a fee is important. The fee in the buyer agreement helps guarantee that (a) the buyer does not make a side deal with the lender cutting out the brokers; (b) the lender will not have overwhelming leverage over the brokers since it is unlikely that the buyer will conclude the transaction if the brokers are not paid through the transaction; and (c) the buyer who is willing to pay the fee out of his or her own pocket has considerable negotiating leverage with the lender.

Once the ground has been prepared to help ensure compensation, the buyer agent's next task is to prepare the buyer. Lenders being asked to take a short payoff want two things: (a) speed and (b) certainty. The buyer interested in a foreclosure or short sale property should be advised to complete all inspections and other due diligence items, mortgage financing and other potential impediments to a closing so as to be able to present an offer as close to a cash, no-contingencies, quick close offer as possible. This buyer will have a considerable advantage over other offerors who submit offers containing contingencies.

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## **PREPARING THE LENDER'S OFFER PACKAGE**

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If a lender is going to be asked to take a short payoff, the offer package must be carefully and completely prepared. This is where the listing agent and the buyer agent earn their pay in a short sale situation. Someone in the lender's workout department is going to need to approve the lender losing money on this loan. That someone has a boss looking over their shoulder. The agent needs to put a package together with enough facts so this unknown and unnamed someone can feel comfortable about the decision they make and more importantly, also justify it to their boss.

At a minimum, the package should contain the following:

1. A recent CMA or BPO along with any other CMA or BPO performed on the property by the listing agent or other offerors;
2. A pro forma HUD-1 (the seller's attorney can prepare this) showing the adjustments, expenses, conveyance taxes, closing costs, delinquent tax payments and other expenses of sale so the lender can see exactly what it will receive from the transaction;
3. Photographs of any condition on the property (deferred maintenance, disorder, junk, messy housekeeping, broken or discarded items) that affect the value of the property. Remember, "a picture is worth a thousand words";
4. Along the same lines, any building, pest, septic and other inspections performed on the property, especially if those inspections reveal problems or defects. Include any violation notices from building or health inspectors;
5. Proof that the buyer can complete the transaction. This can consist of account statements

showing cash is available, mortgage commitment, pre-approval or pre-qualification statements. A mortgage commitment is best as pre-approval and pre-qualification statements are NOT contractual commitments to make a loan, and the seller's lender will not consider them as such;

6. Marketing history (copies of ads for the property, MLS listing, days-on-market, number and date of other showings). The goal here is to show that a bona fide effort was made to market the property, and this is the best offer that could be obtained.

In addition to these items, if there have been other offers on the property, a recitation or copies of those other offers should be included, especially if these offers were lower or not as attractive because of repair requests, Hubbard clauses or other items. If any of those offers fell through due to inspection or other issues, those offers and the reason that the offer fell through should be included.

Lenders are not obligated to respond within a particular time. The listing agent or seller's attorney is going to need to keep after the lender for a response. However, if the buyer and the buyer's lender are indeed ready to close, include the date when the buyer's mortgage commitment or rate lock will expire and require an answer at least 7-10 days prior to those expiration dates.

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### **FORECLOSURE STARTED: TOO LATE?**

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Darn, the lender got tired of waiting and started a foreclosure action. Is that property still available?

How this matter proceeds depends on how fast the buyer is able to close and where the property is located in the foreclosure pipeline. Keep in mind that a lender is often actually *less* likely to take a short payoff if the property is in foreclosure. The reasons are twofold. First, the lender has incurred attorneys' fees, appraisal fees and court costs which only added to the debt owed. Second, the lender may have already written the debt down on its books to the appraised value of the property so it has already taken a loss on the mortgage, and anything it recovers over and above the appraised value of the property, even if it is a year from the foreclosure, is considered profit on the banks books.

In addition, if the foreclosure is started but not yet complete, it is difficult to find someone willing to discuss an offer. Owners often throw up their hands because they are going to lose the property anyway and lenders will often not discuss property they do not own yet. Foreclosure attorneys generally do not have authority to discuss the sale of the property, but the attorney may know who to talk to at the lender. Try contacting the attorneys handling the foreclosure for this information and ask the attorney to contact the lender to advise the lender that it will not compromise the lender's foreclosure to discuss the sale of the property or a short sale. The attorney may not agree to do that, but one can ask. In addition, unless the owner is represented by another brokerage firm or an attorney, ask the owner for written permission to allow the listing broker to discuss the owner's mortgage and delinquent payment with the lender. The challenge then, is to engage the record owner of the property and that record owner's attorney because the record owner will need to ask the court for time to complete any sale. The agent representing the potential purchaser should have a buyer representation agreement in place where the buyer is agreeing to pay the agent's fee- even if that fee will be negotiated as part of the deal since the seller will probably have no funds to pay commissions and the foreclosing lender has little incentive to pay commissions. The buyer should also be prepped that a court is unlikely to delay a foreclosure to allow a buyer to meet contract contingencies.

Any offer should be made contingent on the approval of the court, since if the property is already in foreclosure and depending on where the property is in the foreclosure pipeline, the court must agree to delay, stay, dismiss or otherwise make provision in the foreclosure for a pending sale.

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### **ADVICE FOR REALTORS®**

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1. Short sales and foreclosures are business opportunities for Realtors®. They are different animals than the typical sale, but there is no reason to be afraid of them.
2. Listing agents should check the land records to determine the equity situation on a property

*before* they take the listing. There is nothing worse than being caught unknowingly in a short sale situation. Avoid the temptation to give legal or tax advice to the distressed owner.

3. Preparation is the key for buyer agents. The buyer agent should have a buyer agreement with compensation and know what the co-brokerage offer is on the MLS. The buyer should be educated on the necessity of speed and certainty and should be prepped to complete due diligence and other inspections in order to present as clean a proposal to the lender as possible.
4. A complete package should be prepared to send to the lender with the offer. The offer alone should never be sent to a lender. The lender should be given every scrap of information available to support the purchase price in the offer and to show that the offer is bona fide and the result of a bona fide marketing effort. Photos are invaluable to show conditions that would hamper marketing efforts or have an impact on the value of the property.

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## CONCLUSION

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Downturns in the economy do not stop commerce, but these downturns do change available business opportunities. Short sales and foreclosures are a business opportunity for the Realtor® who is willing to work on a transaction that is different than the ordinary but can be a source of business for the Realtor® willing to invest some time and preparation.

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**THIS LEGAL ALERT FOR REALTORS® IS INTENDED FOR GENERAL INFORMATION PURPOSES AND IS NOT INTENDED TO PROVIDE LEGAL ADVICE ON ANY SPECIFIC FACTS. IF THE LISTING BROKER HAVE SPECIFIC QUESTIONS CONCERNING THE LISTING BROKER OWN SITUATION, PLEASE CONSULT THE LISTING BROKER ATTORNEY.**

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