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John Torvi - A list of all the do's and don'ts of short sales for real estate agents

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When an agent evaluates whether to list a property that is under water, the agent must recognize that the seller may be looking to the agent as more than simply a real estate advisor. This is an emotional time for the seller who is losing the property against his/her will and may be in the midst of other financial problems. The short sale can affect the seller's overall financial situation in ways that are beyond the agent's expertise.

Before Taking the Listing

Do: Consider the likelihood that the transaction would be completed. For example, how quickly must the property be sold or how significant is the short fall that the lender must approve?

Don't: Advise the seller whether a short sale is an appropriate solution for the seller's financial situation.

Do: Recommend that the seller consult with an attorney and accountant to assess alternatives to a short sale, such as loan modification, deed in lieu, bankruptcy or refinancing. There may have been predatory lending involved in the procurement of the loan, which may have caused the seller to be in default. This should be analyzed by an attorney as a potential defense to keeping the house.

Don't: Never tell a seller that a short sale is better than foreclosure or that a short sale releases the seller from the loan. A short sale is not a foreclosure nor affected by the antideficiency laws that protect a homeowner from a deficiency judgment for the difference in value between the value of the home and the amount of the loan. This means that a lender can pursue the seller after the short sale for the deficiency.

Do: Evaluate ahead of time whether the seller will refuse to sell the home unless the seller receives a release from the lender for the deficiency amount.

Don't: Never attempt to review the loan documents to advise the seller whether the seller has a non-recourse loan or the loan has any other potential defenses or remedies.

Do: Advise the seller to consult an accountant. There may be adverse tax consequences and the forgiven debt may be considered taxable income. There are tax reliefs to homeowners who are insolvent, but this analysis is beyond the expertise of the agent.

Don't: Give the seller advice regarding timing and process of foreclosure nor refer the homeowner to foreclosure websites for evaluating the law. The loan documents may be subject to interpretation of individual State laws and information provided on these websites may be wrong.

Before Starting Negotiations

Do: Evaluate the current title on the property. If the seller is not on the title or is not the only owner on title, proper approvals should be procured to list the property. The agent must also evaluate how many lien holders exist on the property. The seller must negotiate with all of them, and keep them all

appraised with the status of the transaction.
Don't: Ignore any lien holders, even if they are not the ones negotiating for a short sale.

Approaching the Lenders

Do: Get permission from the seller to communicate with the lenders directly, in order to expedite the process.

Don't: Be involved in the preparation of any financial statement that the lender requires, especially since it may significantly vary from the financial statement prepared by the homeowner when he/she applied for the loan. Any preparation of financial statements should be done by the homeowner with the assistance of his/her accountant.

During the Transaction

Do: Be careful in representing the seller's interests. The agent should put in the counteroffer that it is subject to lender's approval and at seller's discretion. The lenders may demand harsh conditions from the seller in order to agree to the sale price. A seller should have the option of rejecting the lender's terms.

Don't: Be cautious about using middle men who sell themselves as negotiators and completely avoid using unlicensed negotiators. They may demand compensation from the buyers. Forcing the buyer to pay a commission may affect the agent's fiduciary duties to the seller. Also, when the listing agent has a relationship with the negotiator, and the buyer is paying for the negotiator, an agency relationship may be created between the buyer, negotiator and listing agent, which may expand the listing agent's duties to the buyer.

Do: Properly document the short sale negotiations to avoid any misunderstanding and protect the agent in case of a claim.

Don't: Ignore a buyer who is trying to be "creative", as he/she may be doing something illegal or unethical. Some investors may attempt to purchase the property by transferring title to themselves or obtaining power of attorney from the seller and then doing the short sale. The investor may violate the Home Sales Equity Law, which requires certain notices to be given to the seller when a Notice of Default has been recorded. The agent may also have a conflict of interest representing both the investor and the seller.

Do: Strictly adhere to all lender instructions and not allow any monies to be paid outside of escrow. This duty extends to payments made after escrow had closed and not specifically stated on the HUD-1. Knowledge of fraud may subject the agent to liability for the entire deficiency amount, even if no duty was owed.

Don't: Be aware of sellers attempting to "sell" their property to friends or family members, or who solicit other potential buyers to make a low offer so that the seller's relative's offer will be accepted.

Do: Specifically disclose referral fees or commissions if negotiators or other third parties are involved, and the agent must assure that these payments are paid through escrow and payable to the broker of record.

Don't: Never allow for two different "final" HUD-1 to be created: one for the parties and one for the lenders.

Do: Be familiar with all State mandated forms and use them as applicable. Attach a short sale listing addendum to the listing agreement and a short sale addendum to the sale agreement.

Don't: Ignore red flags, such as a buyer not being allowed to communicate with the lenders.

Do: Explain to the escrow agent that the transaction is a short sale, and ask the escrow agent to constantly date-down the file so that any new recordings can be discovered by escrow and properly addressed by the parties.

Don't: Do not assist the seller or investor to de-value the property if he/she is asked to provide a broker price opinion. The agent should not consult an investor or seller to destroy a property in order to reduce its value.

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John Torvi is the director of marketing and sales at the Herbert H. Landy Insurance Agency, Needham, Mass. Contributing on article was attorney Fredric Trester of the Law Firm of Manning, Marder, Kass, Ellrod & Ramirez LLP, Los Angeles.