AUBURN MLS MEETING MEMO

To:	Auburn Brokers/Title Officers/Lenders
From:	Brigit S. Barnes, Brigit S. Barnes & Associates, Inc.
Subject:	Realtor Disclosures Re Short Sales ï The Never Ending Story
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As many of the deals continue to be those where the property is selling underwater or substantially underwater, what is the state of mandated and/or prudent disclosures by agents?

Holmes v. Summer

Under the recently decided Holmes v. Summer case, 144 Cal. App.4th 1510 [4th Dist. October 6, 2010], brokers owe a duty to disclose existing monetary liens and encumbrances that exceed sales price, where the cooperation of the lenders is necessary, as in what is now commonly called the ñShort Saleò.

The purpose of the disclosure should be obvious -- a buyer should be advised as early as possible of the risk that his/her offer will not be accepted so that he can evaluate the risk and determine whether he wants to maintain his offer, or pull out and look elsewhere. Further, under recent FTC regulations, such disclosures are explicitly required [see discussion of federal Mortgage Assistance Relief Services (MARS) rules below]. Following the language of current CAR forms, such disclosures should be prepared and provided to the purchaser and his agent by seller and his agent no later than 7 days after the offer is signed. After Holmes, a broker proceeds with this methodology at his own risk.

In Holmes, neither the listing broker nor the sellers ever disclosed that the property was encumbered with $1,141,000 of existing debt, so that the finally agreed price of $749,000 could not be accomplished without the active cooperation of the three lenders. The buyers sold their existing residence to allow them to complete the purchase, and then discovered that the agreed price was so low that all lenders would not agree to accept the amount in liquidation of the debt. Sellers bailed, and turned out to be judgment proof, so the case was fought out by the Realtor [really insurance defense for the Realtor].

The listing broker in this case, Beneficial Services, RE/MAX out of Huntington Beach, originally defended successfully on the bases that: (1) issues to be disclosed have to do with the desirability of the property, not financing; and (2) since it represented the sellers, it did not have a duty of disclosure to the buyers; and (3) since the deeds of trust were recorded, a diligent search by buyers would have turned up these defects. The court of appeal, however, reversed the trial court and held that: (1) a seller must disclose any fact materially affecting the value or the desirability of the property; and like the seller, where

the sellerôs broker is aware of those same facts it must disclose the information [Lingsch v. Savage (1963) 213 Cal. App.2d 729, 735-- property defects]; and (2) under [Reed v. King 145 Cal. App.3d 261, (1983)ð multiple murders] the sellers and their agent must disclose facts that affect the desirability of the purchase, and since it was entirely foreseeable that the buyers would rely on the terms of the offer and injure their position in order to be able to perform under the unrealistic contract price of $749,000, the sellers and their agent were jointly and severally liable for the actual damages to the buyers. (3) The court demolished RE/MAXôs claim that it was not liable because it represented the sellers, not the buyers: where the agent is aware of a fact which would manifestly affect the buyerôs decision to make an offer, such as here where either the lenders must all cooperate to accept an amount substantially less than they were owed or the sellers must put serious money into escrow to close, ***the agent must disclose the state of affairs to the buyer, before the contract is formed***. Lastly the court determined that (4) although a preliminary title report would have disclosed the existence of the debt, it would not have disclosed the remaining balances; and further, and to my mind most important, even where a buyer has constructive notice of a potentially adverse fact affecting value or desirability, ***such notice does not protect the seller or the seller's agent from claims for damages for failure to disclose***.

As to ruling (3) above, the court also addressed a brokerôs duty of confidentiality due the seller under Civil Code §2079.16; the court pointed out that this duty cannot be read out of context with a brokerôs other duties -- duty of honesty and fair dealing and good faith, and the duty to honestly disclose all matters affecting the property.

Practice Pointer: In Holmes, the appellate opinion is unclear whether the disclosure was ever made to the buyers. However, the courtôs language of immediate mandatory disclosures is clear. As a result of Holmes, regardless of the forms being currently used in your office and where you got them, all agents should be instructed that as soon as material facts that may affect a buyerôs decision to purchase a residential property are known, they must be disclosed. Any inspection forms should be modified to address financing issues, and the items for disclosure should be approved by the seller and submitted to any purchaser or agent contacting for a possible purchase once an interest is expressed. If additional facts are discovered after the ordinary disclosure forms are prepared and distributed, an amended disclosure to the buyer and the agents should be immediately distributed, even if the form is by email or letter. The actual language adopted by the Attorney General is that mandatory disclosures are to be delivered as soon as practicable.

New FTC Requirements for Short Sales – Warning

On January 31, 2011, the FTC announced Mortgage Assistance Relief Services rules (MARS) which became effective February 23, 2011. As usual, the interpretations of these new rules are as clear as mud. Under CARôs most recent E-bulletin [2-28-11], real estate agents who negotiate short sales with lenders and promote their services as a way to help consumers avoid foreclosure fall under the MARS rules [generally understood as applying to negotiations for loan mods, deed in lieu negotiations, loan forbearance agreements, or extension agreements]. If the brokerôs activities fall under MARS, the broker or agent must refrain from:

- Collecting any kind of advance fees.[1]

The brokers and agents subject to MARS must retain all records for 24 months,[2] among other things, and must make the following disclosures:

- That the agent is not associated with the government, and that the lender or lenders may not agree to a change in the loan;
- That the consumer may stop doing business with the brokerage at any time without penalty;
- That the consumer must pay the brokerôs total compensation as specified if the consumer accepts the lenderôs offer; and
- That the consumer does not have to pay the brokerage fee if the consumer rejects the lenderôs offer.
- Provide a notice from the lender explaining the material differences between the existing and proposed loan.

CAR plans to have standard forms available for Realtors shortly which correspond with these federal regulations. However, real questions abound -- especially where offices are already ensuring that neither advance fees nor commissions connected with negotiating the short sale are collected. For such offices, it would appear that their current procedures avoid the additional federal regulation.

[1] But see DRE regulations, which effectively restrict all advance fees.

[2] Always remember to follow the most restrictive rule: in California, a broker must retain all records for a minimum of three years.