



SHORT SALES – GUIDANCE FOR LICENSEES

Recent economic challenges have resulted in a proliferation of short sales and the need for real estate and mortgage professionals to provide competent assistance to property owners considering a short sale. This bulletin is intended to provide guidance to those professionals who provide short sale services and to address some of the most typical issues related to short sales brought to the attention of the Washington State Departments of Financial Institutions and Licensing. This bulletin also outlines the licensing requirements for providing short sale services under the Mortgage Broker Practices Act (Chapter 19.146 RCW), the Consumer Loan Act (Chapter 31.04 RCW), and the Real Estate License Law (Chapter 18.85 RCW).

A “short sale” is a real estate transaction where the proceeds of the sale will not generate sufficient funds to pay the debt(s) secured by the property (and the seller is unable to pay the difference) and therefore, any creditor(s) with a security interest in the property must consent to receiving less than they are owed in return for releasing any lien on the property. The fact that a creditor may release its lien to allow the property to be sold does not mean that the creditor has or will forgive the deficiency.

The Departments of Financial Institutions and Licensing recognize that short sale service providers need specialized expertise. Short sales are complicated transactions because they require that the seller negotiate at least two separate agreements. One is the purchase and sale agreement with the buyer and the other is the agreement with the creditor(s) to accept less than the amount owed and secured by the property. The Department of Licensing regulates real estate brokerage services related to the purchase agreement between the seller and the buyer. The Department of Financial Institutions regulates persons offering loan modification services and the negotiation of reduced loan payoffs with creditors.

In addition to requirements discussed in this document, any person who provides, offers to provide, or arranges for others to negotiate, obtain or arrange a short sale must also comply with rules the Federal Trade Commission adopted on November 19, 2010, regarding Mortgage Assistance Relief Services. See <http://www.ftc.gov/opa/2010/11/mars.shtm> for required disclosures, limitation on fees and limitations on performance representations.

Short Sale Guidance

The Department of Licensing (“DOL”) and the Department of Financial Institutions (“DFI”) require that a person have either a mortgage loan originator license, a real estate license, or be an attorney licensed to practice law in Washington, to negotiate short sales. Any attempt to evade these licensing requirements is the unlawful practice of real estate brokerage under Chapter 18.85 RCW, a violation of Chapter 31.04 RCW, the Consumer Loan Act, a violation of Chapter 19.146 RCW, the Mortgage Broker Practices Act, or a violation of Chapter 2.48 RCW, the unauthorized practice of law.

A real estate or mortgage professional should carefully consider the information in this bulletin when advising a consumer regarding a short sale. In addition, a real estate or mortgage professional may choose to give consumers a copy of the Short Sale Seller Advisory, published by DFI and DOL, to provide consumers with additional information and resources regarding short sales.

A property owner may consider a short sale when they are “upside down” on their mortgage or cannot make the current loan payments. Unfortunately, the property owner may not have sufficient information to make a good decision about selling the property.

Issues include the following:

- A seller may be required to sign a promissory note for the amount of any deficiency or the lender may not “forgive” the deficiency and pursue the seller for that amount at a later date. In either case, the seller still owes the money, but the lender’s security interest in the property is simply released so the property can be sold.
- If there are multiple lenders or lien holders (such as a 2nd or 3rd position lenders) the holders of the subordinate liens may seek a deficiency judgment against the seller.
- Any forgiven debt may be considered taxable income for Federal Income purposes
- A sale made to avoid foreclosure could be considered a “Fraudulent Conveyance” if not made for a reasonable price.
- Some mortgage contracts contain a “due on sale” clause. This is particularly important when there is “cross collateralization.” A delinquency on, or a sale of, one property owned by a borrower can trigger a due on sale clause on another property.

When a lender approves a short sale and receives a “short payoff,” that approval is often conditioned on certain requirements and the seller may be required to sign affidavits or other documents verifying these requirements are met.

Some common conditions include the following:

- The seller cannot receive any proceeds from the sale including a sales commission, a negotiator’s fee, or any sum that is not disclosed to the lender.
- The sale does not involve a “flip” transaction. Thus, it is important that brokers disclose all terms of the transaction. It could be considered a violation of RCW 18.85.361, RCW 19.146.0201 or RCW 31.04.027 to mislead a lender, permit a party to make a false

statement to a lender, or misrepresent or conceal any offers from the lender.

- The property is marketed at a fair price. Short sale properties may not be listed for an amount greater than the fair market value to discourage buyers from presenting an offer or for far less than their fair market value to convince the lender that the property will not sell for a higher amount. A broker owes a duty to deal honestly and in good faith with all parties to a transaction. In addition, a broker may not knowingly commit, or be a party to, any material fraud, misrepresentation, trick, or scheme, whereby any other person lawfully relies upon the word, representation or conduct of the broker. Brokers that deceive or aid in the deception of a lender are subject to enforcement action.

GUIDANCE FROM THE WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS

For Third-Party Mortgage Loan Modification Providers and Others Engaging in Short Sale Negotiations

DFI has seen growth in the business of mortgage professionals assisting owners with modifications of mortgage loans, either by obtaining a lender's agreement to modify the terms of a loan and enabling an owner to remain in the home, or by negotiating an adjustment of an existing loan in a settlement transaction, such as a deed in lieu of foreclosure or a short sale. If the owner wants to remain in the home and has the ability to make reasonable mortgage payments, the licensee should attempt to negotiate a modification of the loan's terms and conditions. If the owner either cannot pay the loan or a reasonable modification amount or is so hopelessly "upside down" that continuing to pay for the home no longer makes economic sense, the licensee can assist the owner with a short sale or some other alternative to foreclosure.

Pursuant to the Washington Consumer Loan Act, Chapter 31.04 RCW (the "CLA") and the Mortgage Broker Practices Act Chapter 19.146 RCW (the "MBPA"), a residential mortgage loan modification is defined as "a change in one or more of a residential mortgage loan's terms or conditions. Changes to a residential mortgage loan's terms or conditions include, but are not limited to forbearances; repayment plans; changes in interest rates, loan terms, or loan types; capitalizations of arrearages; or principal reductions." Residential mortgage loan modification services are defined as "negotiating, attempting to negotiate, arranging, attempting to arrange, or otherwise offering to perform a residential mortgage loan modification." A loan originator is defined as an individual who for compensation or gain (i) takes a residential mortgage loan application, or (ii) offers or negotiates terms of a residential mortgage loan.

Entities engaging in short sale negotiations for compensation must obtain a license under the CLA or the MBPA, and the individuals who conduct loan modification activities on behalf of such entities must obtain a mortgage loan originator license under one of those two acts. Short sales conducted as part of the negotiation of a real estate transaction by a licensed real estate broker do not require licensure under the CLA or the MBPA, unless the real estate broker is paid separately for the short sale negotiation, in addition to receiving a commission for the real estate transaction. However, this does not extend to unlicensed assistants.

The MBPA and the CLA licensing exclusions for real estate brokers do not apply to real estate brokers who act solely as third-party short sale negotiators or loan modification services providers. Negotiating short sales for a fee is not an activity that requires a real estate license; therefore, a loan originator license from DFI is required if that is the only service the real estate licensee provides.

Real Estate licensees must be providing real estate brokerage services for the transaction in order to negotiate a short sale on behalf of either party to the transaction. Real Estate licensees may not charge any additional fee above the normal and customary commission to provide short sale negotiation services.

Real estate and mortgage professionals engaged in short sale negotiations should consider whether such negotiations and related activities could be considered the unauthorized practice of law.

GUIDANCE FROM THE WASHINGTON DEPARTMENT OF LICENSING

For Real Estate Brokers and Managing Brokers

DOL is charged with administering RCW 18.85, RCW 18.86.030 and RCW 18.235 (the “License Law”), pertaining to real estate brokerage services.

An owner may market his or her own property for sale without having to obtain a real estate license. However, if a person obtains an interest in real property from the owner with the intent of finding another buyer before completing the transaction with the original property owner, the person is putting transactions together *for others* and DOL will consider taking action against the perpetrators for the unlicensed practice of real estate activities. Although the unlicensed person may purport to fit within an exemption to the licensing requirement, DOL would consider this the misuse of the exemption in order to evade the License Law.

A broker representing an owner in a short sale owes the owner the same duties as any other owner under the License Law. A broker should advise a short sale seller to seek appropriate tax, legal and other professional advice or counsel. In addition, brokers have a duty to all parties to disclose material facts, deal with honesty and in good faith, and to exercise reasonable skill and care. For example, a broker may not prepare and present a “phantom offer” to a lender to start the short sale process, when in fact there is no legitimate offer to purchase the property. That practice is dishonest and fraudulent and DOL will pursue disciplinary or administrative action against brokers engaged in such practice.

DOL has received complaints about an improper short sale transaction where a real estate broker makes an offer on a distressed property and then negotiates a short sale payoff with the seller’s lender. When the broker knows the amount that the lender will accept, the broker – as the seller – begins marketing the property at a higher price. The planned “flip” is not disclosed to either the seller’s lender or the potential buyer. If the broker can find a buyer who will pay more than the short sale payoff, the broker arranges a simultaneous closing. If the broker does not find a new buyer, the broker lets the property go into foreclosure. In other words, the broker only intended to close the original purchase transaction if the broker could make money on the “flip.” DOL will pursue disciplinary or administrative action against those brokers engaged in such practice.

It is important for real estate brokers to keep their designated brokers, branch manager or managing broker informed about all transactions and report any questionable activity. DOL is available as a resource, although it cannot approve or recommend any specific business models.

To follow the best practices when a broker is buying a short sale property for the broker’s own account, a broker should:

- Buy the property from the competitive market and allow the seller’s lender to consider all offers.
- Close the transaction and take possession of the property. What occurs thereafter is not subject to DOL scrutiny. For example, a broker can close, make improvements to the property, and then list the property for sale. There is risk in marketing the property for resale before the broker closes.

- Disclose all material facts, in writing, and explain to all parties and the lender, the details of the transaction and your intentions. By doing so, you ensure that the parties and the lender will have made an informed decision. Remember that a broker must deal honestly and in good faith, present all bona fide written offers, and disclose all material facts.

Frequently Asked Questions

Question – *Does my existing mortgage loan originator license allow me to conduct loan modification activities and short sale negotiations in a third party representative capacity with a homeowner's lender or the lender's agent?*

Answer – Yes. Third-party loan modification activities and short sale negotiations are mortgage transaction activities regulated under the MBPA and the CLA. A company that has obtained a license as a mortgage broker or a consumer loan company has the necessary licensure to engage in these activities and its licensed loan originators may conduct the activities on the company's behalf.

Question – *If I have an inactive loan originator license, may I conduct short sale negotiations with a lender or the lender's agent on behalf of a homeowner/seller even though I am not employed by a mortgage broker?*

Answer – No. A mortgage loan originator licensee must be sponsored by a licensed mortgage broker, a consumer loan company or an exempt entity.

Question – *Must a real estate broker obtain a license from DFI to negotiate with a lender to obtain a short sale approval on behalf of a seller?*

Answer – Not unless the real estate broker is paid separately for such negotiation services (in addition to receiving a commission on the real estate transaction) or the commission is increased to pay for the negotiations. A real estate broker, whether directly representing a homeowner in a real estate transaction or representing other parties in a real estate transaction, is excluded from licensure by DFI for the activities of negotiating a short sale approval with a lender or the lender's agent on behalf of a homeowner. However, a real estate broker should consider whether such negotiations and related activities could be considered the unauthorized practice of law.

Question – *If a real estate managing broker forms a company that conducts negotiations with a lender on behalf of a borrower for a fee, is the company also excluded from licensing by DFI based on the real estate broker's exclusion?*

Answer – No. If a real estate managing broker forms a company whose services include negotiating, in a third-party representative capacity, compromises or adjustments of homeowners' residential loans for compensation or gain, the company is subject to licensure as a mortgage broker or consumer loan company under the MBPA or the CLA, respectively.

Question – *I am a licensed real estate broker who buys short sale properties. If I also negotiate the short sale approval with the lender or the lender's agent on behalf of the homeowner/seller, is a license required from DFI?*

Answer – No. DFI recognizes that when a licensed real estate broker is a party to a real estate transaction and negotiating an adjustment or compromise to a homeowner's residential mortgage loan and the broker is excluded from the licensing requirements of DFI. However, a real estate broker should consider whether such negotiations and related activities could be considered the

unauthorized practice of law. A real estate licensee who performs brokerage service on their own behalf is still subject to the real estate licensing laws.

Question – *I am a real estate broker who negotiates short sale approvals with lenders or their agents on behalf of my clients and I do not charge a separate fee other than my real estate commission for my services. My assistant does much of my clerical work, faxing documents or making document submissions on my behalf. Does he or she need a license from DFI?*

Answer – No. As long as an assistant performs only clerical or administrative functions, and does not engage directly or indirectly in negotiations with a lender, or lender’s agent, no license is required from DFI.

Question – *I am a real estate broker who negotiates short sale approvals with lenders or their agents on behalf of my clients. I also want to offer assistance to consumers for obtaining modifications to the repayment terms of their existing loans without the modification resulting in a real estate transaction such as a short sale. Do I need a license from DFI?*

Answer – Yes, if such loan modification activity is conducted for compensation or gain. However, a real estate broker, or anyone else, may offer mortgage loan modification services without the need for licensure if such services are provided for no direct or indirect compensation or gain.

Question – *I am a real estate broker who negotiates short sales and am paid by the buyer who receives a seller’s closing cost concession in addition to my normal commission. Is this legal?*

Answer – No. You are not allowed to charge any amount in excess of the normal and customary commission applicable to the transaction notwithstanding the short sale negotiation services. The arrangement is also deceptive to the lender if not fully disclosed.

Question - *I am a Designated Broker. I know one of my brokers just went through a messy divorce, and she is trying to sell the house as part of the divorce process. She needs to get her lender to agree to a short sale. She referred herself to another broker in the office who is now her listing broker. The listing broker asked me to pay a referral fee to the seller. Is this okay?*

Answer – Probably not. Lenders typically prohibit a seller from receiving any proceeds from a short sale transaction.

Question – *I work for an escrow company. I have been asked to help a borrower negotiate with their lender for either a loan modification or a short sale for a fee. Is that legal?*

Answer – No. You must be a licensed mortgage loan originator.

If you have additional questions, please feel free to inquire:

Department of Financial Institutions
dcs@dfi.wa.gov

Department of Licensing
RealEstate@dol.wa.gov