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Short Sales

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I. Introduction

Unfortunately, in the past, lenders were making loans in amounts that ultimately became too difficult for borrowers to repay. Some of these borrowers may not be able to fulfill their mortgage obligations. When a borrower is no longer in a position to make the mortgage payments, is facing foreclosure and the current market value of the property—including escrow costs—is less than the loan on the property, the borrower may consider a short sale. This could save the lender the expense of foreclosure proceedings and from having another REO property on its books. From the borrower's perspective, the short sale prevents having the foreclosure on the borrower's credit history, and releases the borrower from an obligation that he or she can no longer afford.

In essence, a short sale is a sale transaction subject to a lender's approval in which the lender consents to a sale of the security interest for less than what is owed on the note and accepts the proceeds in full satisfaction of the loan amount. A short sale requires much paperwork and preparation on behalf of the borrower. Typically, before applying for a short sale, the seller must have a ready buyer and all the paper work prepared to present to the lender. The buyer of the property must also be prepared for a protracted time period to conclude the purchase of the property.

II. Lender's Options Upon Borrower's Loan Default

Q 1. What options does a lender have on a debt secured by California real property if the borrower does not make the payments on the loan?

A A lender may foreclose on the defaulting borrower's real property which secures the loan. There are two types of "foreclosures" available to a lender: a trustee's sale and a judicial foreclosure.

(*Bank of Italy National Trust & Savings Assoc. v. Bentley*, 217 Cal. 644 (1933).) Technically, a trustee's sale is not a "foreclosure" but the term has been used for both a trustee's sale as well as a judicial foreclosure.

The lender may also be able to pursue "guarantors" of the debt who have signed written guarantee agreements (not including the borrowers).

Q 2. *What other options may the lender consider instead of foreclosure when the borrower is delinquent?*

A Depending on the situation, a lender may consider one of the following:

Loan Workout: Basically, a loan workout is any resolution of a problem loan between the lender and borrower that modifies the original loan agreement. Some of these options include forbearance (e.g. forgiving a portion of the debt or late charges); deferment; renegotiating interest rate, monthly payment amount, principal amount, maturity date; or the enforcement an acceleration clause in the loan.

Deed in Lieu of Foreclosure: After the borrower is in default, the borrower voluntarily delivers title to the lender for consideration and the lender accepts the conveyance of the property in full satisfaction of the mortgage debt. Using this method, the lender saves the costs of foreclosure and the borrower may be able to avoid having a notice of default on his/her records. (*Hamud v. Hawthorne*, 52 Cal.2d 78 (1959).)

Short Sale*: A short sale is a transaction in which a lender allows the real property securing the loan to be sold for less than the remaining mortgage amount due and accepts the proceeds as full payment of the loan. A lender may accept a short sale when the borrower is in severe financial straits and market conditions make a short sale the best choice to mitigate the lender's damages. Like a deed in lieu of foreclosure, this saves the lender the costs of foreclosure and the borrower avoids having a foreclosure on his or her credit report.

Short Payoff*: With a short payoff, the lender accepts less than the remaining mortgage amount as full payment of the loan. The property need not be sold.

*Note: Some lenders do not differentiate between a short sale and a short payoff.

Q 3. *What is a deficiency judgment?*

A A deficiency judgment is a judgment obtained by the lender in court against the borrower for the difference between the unpaid balance of the secured debt and the amount produced by sale or the fair market value of the security, whichever is greater, in a judicial foreclosure. (Cal. Code Civ. Proc. § 726 (b).) A lender may obtain a deficiency judgment only with a judicial foreclosure. With a trustee's sale foreclosure, the lender cannot go after a deficiency judgment.

With a short sale, the lender may be able demand the balance still owed on the note that the sales transaction did not cover (e.g., short sale of the property pays the lender \$120,589.23 but the full amount owed on the note is \$250,000). This difference may be referred to as a "deficiency balance." It is not really a "deficiency judgment" since no court has issued such a judgment as part of a judicial foreclosure. However, recently passed statutes and recent case law discussed in the next section offer significant protection against a lenders ability to collect a deficiency balance to sellers of short sale properties.

Q 4. Under what circumstances is the lender prohibited from going after the "deficiency balance" as defined in Question 3 after a short sale?

With the passage of SB 458, effective July 15, 2011, after the short sale of a residential property of one-to-four units, the holder of any senior or junior deed of trust cannot pursue the borrower (seller) for any deficiency under the note. If the lender consents to the short sale in writing, as long as the proceeds of sale were tendered to the lienholder as per the buyer and seller's agreement, then no deficiency can be collected or is even owed, and no deficiency can be rendered or even requested. The borrower (seller) is protected even if the loan is refinanced as long as it's secured by a trust deed.

An exception to SB 458 occurs if the borrower (seller) has committed fraud with respect to the sale of the property or has committed "waste" of the real property (e.g., severely damaged the property) (Cal. Code Civ. Proc. § 580e (b)). Under these circumstances, the borrower (seller) may still be liable for the deficiency balance.

Note: SB 458 doesn't apply if the borrower (seller) is a corporation or political subdivision of the state (Cal. Code Civ. Proc. § 580e (c)).

For properties that closed escrow prior to that date, a recent court case assists borrowers as a California appellate court ruled that a lender is prohibited from collecting a deficiency judgment if the loan involved in the short sale was a purchase money loan. (Coker v. JP Morgan Chase Bank (2013 WL 3816978) filed July 23, 2013). The Coker case involved a borrower who successfully negotiated a short sale, but agreed to remain responsible for the deficiency on a purchase money loan. After close of escrow, the lender demanded that the borrower repay over \$116,000. The court, however, ruled that the anti-deficiency protection for purchase money loans under section 580b of the California Code of Civil Procedure applied not just to foreclosures, but to short sales as well. The court also decided that the waiver of a borrower's anti-deficiency protection under section 580b was void as against public policy.

Q 5. Can a lender obtain a deficiency judgment against a defaulting borrower following foreclosure?

A It depends. California has "anti-deficiency statutes" that protect certain borrowers from deficiency judgments. A trustee's sale foreclosure does not involve the courts and does not permit the lender to go for a deficiency judgment. In order to be able to go for a deficiency judgment, the lender must use a judicial foreclosure (which involves a court proceeding).

Generally, there are five situations in which a deficiency judgment is prohibited:

1) Purchase Money. If the loan is obtained to purchase a residential 1-4 unit property all or part of which was intended to be owner-occupied at the time of the loan and the loan is secured by that property, the lender may not obtain a deficiency judgment against the defaulting borrower. This loan is entitled to "purchase money" protection. (Cal. Code Civ. Proc. § 580b.) However, should the buyer refinance the home, the new loan is no longer "purchase money." Thus, the buyer would lose the protection against a deficiency judgment in the event of a default.

2) Certain Refinanced Mortgages. Starting January 1, 2013, California law protects homeowners who default on their refinance loans from personal liability for any deficiency following foreclosure. Senate Bill 1069, extended anti-deficiency protection to include any loan used to refinance the purchase money loan, plus any loan fees, costs, and related expenses for the refinance. The anti-deficiency protection, however, does not extend to any "cash out" in a refinance, which is when the lender advances new principal not applied to any obligation owed under the purchase money loan.

This new law only applies to refinance loans or other credit transactions used to refinance a purchase money loan, or subsequent refinances of a purchase money loan, that are executed on or after January 1, 2013. For purposes of this law, any payment of principal shall be deemed to be applied first to the principal balance of the purchase money loan, and then to the principal balance of any new advance and interest payments shall be applied to any interest due and owing. (Cal. Code Civ. Proc. Section 580b.)

3) Seller Carryback. If the purchase money loan for any type of real property is financed by the seller and secured by that same property, the lender/seller may not obtain a deficiency judgment against the defaulting borrower/buyer. (Cal. Code Civ. Proc. § 580b.)

4) Trustee's Sale. A lender may not pursue a deficiency judgment against the borrower should the lender opt to foreclose by a trustee's sale foreclosure (a non-judicial action). (Cal. Code Civ. Proc. § 580d.)

5) 3-Month Time Limit. An action for a deficiency judgment must be brought within 3 months from the time of judicially-ordered sale. (Cal. Code Civ. Proc. § 580a.)

6) Fair Value Limitations. A deficiency judgment is limited by the difference between the amount of the indebtedness and the fair market value of the property, unless the actual sale price exceeds that value. (Cal. Code Civ. Proc. §§ 580a, 726 (b).)

When a deficiency judgment is not permitted, a lender would opt for a trustee's sale foreclosure which is quicker and less expensive than a judicial foreclosure.

When a deficiency judgment is permitted, the lender may obtain one only following a judicial foreclosure, or when the security has become valueless (such as when security for a second trust deed loan is wiped out when the first trust deed lender completes its foreclosure). Holders of a junior deed of trust (second, third, etc.) should note that if the "wiped-out" junior lien is not purchase money or seller carryback, then the junior lien holder may sue on the note and the borrower on the junior loan may be personally liable. (*Roseleaf Corp. v. Chierighino*, 59 Cal. 2d 35 (1963).)

Q 6. Can a lender avoid the "foreclosure process" and just sue the borrower on the note (i.e., treat it as an unsecured note)?

A No. In the event of a borrower's default, the lender has two options--a judicial foreclosure or a trustee's sale foreclosure (either one is referred to as the "foreclosure process"). However, a lender cannot opt to sue on a note secured by a mortgage or trust deed instead of going through the foreclosure process by treating the note as an unsecured note. This restriction is referred to under the law as the "one action rule" or "one form of action rule." (Cal. Code Civ. Proc. § 726.) A lender might prefer to sue on the note instead of foreclosing when the note is for a greater amount than the value of the property securing the note. That way, the lender can get a judgment and attach a lien against other property, personal or real, owned by the borrower. The "one form of action rule" prohibits the lender from this "third" option.

One exception to the "one form of action rule" is if the security for the loan has become "valueless" after the lender's security interest was recorded (e.g., this would be the case for a "wiped out" junior lien holder who now holds an unsecured note). In this case, the lender can sue directly on the debt (note) unless the borrower's loan falls into category (1) or (2) in Question 4.

Q 7. Why would a lender agree to accept a short sale?

A Lenders may have ample incentive to negotiate a short sale with a distressed borrower. For example, should the lender take back a property pursuant to a foreclosure sale, the lender would become responsible for a variety of costs, including property maintenance, utilities, HOA fees, and might risk destruction of the property by vandalism. Furthermore, lender-owned properties (REO) may take a long time to sell, in part because so many REO properties are now for sale.

A lender will typically evaluate the financial situation of the borrower as well as current market conditions to determine whether or not to agree to a short sale. It is really a business decision for the lender to determine whether it would receive more money by accepting the short sale, or completing a foreclosure, reselling the property, and pursuing personal liability (i.e., deficiency judgment against the borrower and/or claims against guarantors, for loans on which those remedies are available.)

III. Effect on Borrowers of Short Sales

Q 8. *Is the seller in a short sale relieved of all debt obligations owed to the lender?*

A In general, as long as the property is a residential 1 to 4, then yes a seller in a short sale will be relieved of all debt obligations owed to the lender (see question 4 above).

However, for all other types of property the answer is more nuanced. Each lender is different, but some have borrowers sign a short sale agreement that releases the lien on the property without cancelling the promissory note. This allows a short sale of the property to proceed while at least potentially leaving the borrower responsible for any deficiencies on the loan. While there are no cases directly on point yet, it would appear that the anti-deficiencies statute that protects borrowers in foreclosures (Cal. Code Civ. Proc. § 580d.) do not apply when the property is sold as in a short sale.

Q 9. *What language in the lender's "approval" letter lets the seller know that the seller in a short sale is relieved of any further debt obligations owed to the lender?*

A Sample release of liability language may be as follows:

Satisfaction and Release of Liability. If all of the terms and conditions of this Request are met, upon sale and settlement of the property, we will prepare and send to the settlement agent for recording, a lien release in full satisfaction of the mortgage, foregoing all rights to pursue a deficiency judgment.

Q 10. *What language in the lender's "approval" letter lets the seller know that the seller in a short sale is not relieved of any further debt obligations owed to the lender?*

A Sample language in an "approval" letter might read as follows:

Example 1:

The amount paid to [lender] is for the release of [lender's] security interest only, and the borrower/seller is still responsible for all deficiency balances remaining on the loan, per the terms of the original loan documents.

Example 2:

[Lender] reserves the right to proceed for a deficiency judgment for any deficiency balance remaining on the loan.

Note: Do not rely on verbal assurances from a lender's representative that this is just "boilerplate" language and doesn't mean anything.

Q 11. *So what have lenders been doing if their "approval" letter does not relieve the seller of any further debt obligations?*

A Some lenders have been assigning the notes to collection agencies and after the short sale, sellers have been receiving calls from collection agencies.

Q 12. *Does a short sale adversely affect a defaulting borrower's credit rating?*

A Yes. Lenders will report the short sale as being settled for less than the full balance. This would show up on the borrower's credit report as a negative mark for seven years. (Cal. Civ. Code § 1785.13.)

Q 13. *Suppose the borrower is late with his/her mortgage payments, causing the lender to begin the foreclosure process by filing a notice of default. Before the foreclosure sale occurs, the borrower pays the lender what is owed on the note. Could these activities appear on the borrower's credit report?*

A Yes. The lender can report to a credit bureau receipt of any payments made 30, 60, 90 or more days after their due date. This may appear on a borrower's credit report as a "foreclosure in process," "foreclosure proceedings," "current was 30," or in some other way. Any such terms, or other similar reporting comments, harm that individual's overall credit rating.

Q 14. *Is the method by which lenders report a short sale a negotiable item?*

A Typically, no. The short sale is usually reported to credit reporting agencies as settled for less than the full balance. However, a borrower may try to negotiate this at the time the short sale is being arranged.

Q 15. *Are there any special risks to borrowers when negotiating a short sale with their lender?*

A Yes. In particular, REALTORS® who assist borrowers should be aware and warn their clients of one particular risk. If the borrower was less than completely honest when using the stated income method in applying for the loan, this information may become apparent to the lender when the documentation listed in Question 22 (such as tax returns and paycheck stubs) are submitted to the lender in the application for short sale approval. This may put the borrower at great risk of potential liability for their dishonesty.

Q 16. *Are there any tax effects of a short sale?*

A Yes. The tax implications for the borrower could be so significant that a short sale would not be in the borrower's best interest. Before a short sale is contemplated, it is strongly recommended that the borrower seek the advice of a professional tax advisor.

Generally speaking, any relief of indebtedness from a short sale, regardless of whether the loan is a recourse or nonrecourse loan, is taxed as ordinary income. There are, however, some exceptions to

this rule that may benefit a taxpayer involved in a short sale. For more information on the tax implications of short sales, see the CAR legal article, [Taxation of Foreclosures, Deeds in Lieu of Foreclosure, and Short Sales](#).

IV. Licensing Requirements for Short Sales

Q 17. *What is a short sale consultant?*

A A short sale consultant is someone who advises on short sales. Depending on the agreement between the parties involved, the typical short sale consultant assists a homeowner or listing agent to prepare a short sale application package, submit it to the homeowner's lender, and negotiate with the lender on the homeowner's behalf to approve the short sale.

Q 18. *Does a short sale consultant have to be a real estate licensee?*

A Yes. Generally, if a short sale consultant negotiates real estate loans or performs services for borrowers or lenders, both the short sale consultant and the short sale consulting company must be properly licensed with the California Department of Real Estate (DRE). More specifically, unless an exemption applies, a real estate license is required for someone who, for compensation or in expectation of compensation, does or negotiates to do any of the following acts on behalf of another:

- Solicits borrowers or lenders for loans secured by real property;
- Negotiates loans secured by real property;
- Performs services for borrowers, lenders or note holders for loans secured by real property; or
- Collects payments for loans secured by real property.

(Cal. Bus. & Prof. Code § 10131(d).)

To check someone's license status with the DRE, go to its Web site at <http://www2.dre.ca.gov/PublicASP/pplinfo.asp>.

Certain exemptions to the licensing laws may apply. For example, a real estate license is not required if someone merely performs clerical or administrative services, such as assembling a short sale package as long as final determination as to its completeness is made by the broker (see 10 Cal. Code of Reg. § 2841 which lists other permissible clerical activities). For other exemptions to the licensing laws, see C.A.R.'s Legal Q&As, [Licensing Guide for REALTORS®](#), [Licensing Chart for REALTORS®](#), and [Unlicensed Assistants](#).

See also the Legal Q&A, [Short Sale Negotiators](#).

Q 19. *Can a licensed short sale consultant collect an advance fee?*

A No. An advance fee is a fee charged upfront for services not yet performed. An advance fee is defined to include a fee claimed, demanded, charged, received, collected before fully completing the service the licensee contracted to perform. The services to be performed cannot be separated or divided into components for the purpose of avoiding the law. A licensee cannot write a limited-service contract for any type of loan negotiation or sale of notes. (Cal. Bus. & Prof. Code § 10026.) A real estate broker cannot get paid in advance to solicit lenders on behalf of borrowers in connection with loans secured by residential one-to-four unit real property until the borrower becomes obligated to complete the loan. (Cal. Bus. & Prof. Code § 10085.5.)

Advance fees are prohibited for loan modifications (Cal. Civ. Code § 2944.7, Cal. Bus. & Prof. Code § 10085.6).

Furthermore, if a Notice of Default has been recorded against a property involving one-to-four owner occupied residential units, an advance fee is prohibited for foreclosure-related consulting services under the foreclosure consultant law (Cal. Civ. Code § 2945 *et seq.*).

V. Disclosure Requirements in Short Sales

Q 20. *Must a real estate transfer disclosure statement be given to a buyer in a short sale transaction?*

A Yes, if the property being sold is a residential 1-4 unit dwelling and the transaction doesn't fall into one of the regular TDS exemption categories. No exemption exists for a short sale transaction in which the borrower sells the property to an outside buyer, using the sale proceeds to pay off the lender. See the C.A.R. legal article, [Exemptions from the Transfer Disclosure Statement \(TDS and MHTDS\) Law](#), for a list of all the exemptions from the TDS requirement.

Q 21. *Must other disclosures be given to a buyer (or seller) pursuant to a short sale?*

A Yes. Short sales are treated just like other sales transaction depending on the type of property being sold. See C.A.R. legal article, [Sales Disclosure Chart](#), for a summary of the disclosure requirements.

In addition, recent federal law known as the Mortgage Assistance Relief Services (MARS) rules impacts short sales potentially requiring certain additional disclosures. See, in particular, Questions 11, 12, 13, and 15 of the Legal Q&A, [MARS Rules for Short Sales](#) regarding the applicability of the MARS rules to short sales and see Section III for the disclosure requirements.

Q 22. *Suppose a distressed seller enters into a contract to sell his/her home to a buyer pursuant to a short sale. Should the listing agent inform the lender if and when other offers are made on the property?*

A The short sale lender will generally have a set of requirements that the seller must follow in order to obtain short sale approval. The lender may require that all offers be presented to the lender. If that is a condition of approval then the listing agent will need to inform the lender if and when other offers are made on the property. It is important for the listing agent to apprise himself or herself of the lender's requirements in a short sale in order to make sure that the lender's requirements are being followed. Generally a short sale affidavit at close of escrow will be required to be signed by both the seller and the listing agent which states that the lender's various requirements were followed.

Q 23. *Should a listing agent working with a distressed seller attempt to negotiate a future listing agreement with the lender?*

A No. Listing agents working with distressed sellers owe them a fiduciary duty. Since in a short sale situation a lender could choose to foreclose on the seller, the lender's interests are potentially adverse to the seller's interests. Attempting to negotiate a future listing agreement with the lender raises the issues of "to whom is the agent's loyalty devoted" and "has the agent violated the fiduciary duty he/she owes the seller." The safer practice is to avoid putting oneself in such a position.

VI. Short Sale Application Process and Other Issues

Q 24. *What is the process for applying for a short sale?*

A It is always in the best interest of the borrower to keep the lender informed. If the borrower is in default of the loan and is contemplating a short sale, it would be best for the borrower to let the lender know before the foreclosure proceedings are well under way. The lender may or may not grant more time to the borrower to find a buyer. In general, the process goes as follows:

- First, the borrower must find a buyer for the property.
- Second, the borrower must prepare all the necessary documents (See Question 18).
- Third, the borrower must submit all documents to the lender.
- Fourth, the lender will send out their own appraiser to make sure that the buyer's offer is at fair market value.
- Fifth, the lender will make a determination on whether or not to agree to the short sale.

Q 25. *What documentation will a lender typically require?*

A Lenders will typically require a distressed borrower to furnish a variety of documents, which could include the following:

- Written explanation (and proof) of the hardship the borrower is experiencing;
- Copy of the purchase contract signed by both the buyer and seller (borrower);
- Copy of the TDS;
- Proof of the buyer's ability to purchase the property, i.e., a completed loan application, pre-approval by another lender, or evidence of cash on hand (bank statement);
- Copy of the certified escrow instructions; Preliminary title report;
- Estimated net/closing statement certified by an escrow officer acceptable to the lender;
- Completed and signed IRS Form 4506, "Request for Copy of Tax Form;"
- Completed and signed personal financial worksheet;
- Previous two years tax returns;
- Employment paycheck stubs for the past two months;
- Profit and loss statement (if the borrower is self-employed);
- Past three months bank statements.

Q 26. *Does C.A.R. provide any special forms for short sales?*

A Yes. REALTORS® may use C.A.R. form SSIA (Short Sale Information and Advisory) which listings agents should give to their client when they take the listing and buyer agents should give to their clients so that they will also understand the issues involved in buying a short sale. Also, C.A.R. form SSA (Short Sale Addendum) is to be used with a purchase agreement.

VII. Lender Use of Online Auction Platforms

Q 27. *Are certain lenders requiring the use of third party online auction services in short sales?*

A Certain lenders are now requiring or recommending that the listing agent in a short sale use a third party online auction company, even though an accepted offer, albeit contingent upon the lender's approval has been presented to the lienholder. For example, Nationstar Mortgage and Bank of America, have started utilizing the services of Auction.com, a California licensed brokerage

in certain short sale transactions. The use of the third party auction services can be mandatory or optional depending on the lender and the particular property involved.

Q 28. How does the bank utilize the services of the online auction provider in the short sale?

A How a lender utilizes an online auction service for its short sale process can vary. However, the general outline below applies to most lenders.

1. The lender will send a letter requiring that the seller and listing agent agree to utilize, consent to, and cooperate with, an online auction company in the marketing of the property as part of the short sale process.
2. The seller and listing agent are required to sign documents regarding the terms of using the online auction company. The provisions of such agreements can be potentially onerous. For example, some agreements require the seller to indemnify and defend the online auction provider in potential legal claims.
3. The listing agent at first lists the short sale on the MLS and submits offers to the seller for review.
4. The seller will accept the best offer contingent upon the lender not receiving a better offer through the online auction process. The lender may advise the listing agent to make this a contingency of any accepted offer or may simply, when issuing an approval, make it a condition of the approval.
5. Once the seller accepts the best offer, traditional marketing on the MLS stops. Marketing continues for potential buyers to make offers through the online auction platform. The listing agent is usually asked to assist with open houses and, possibly to post signs for the online auction as well. The auction company may also undertake its own marketing efforts through its website.
6. An auction is held through the online auction company.
7. The auction company may require the winning buyer at the auction to pay a fee. For example, an online auction company may require buyers to pay a 5% "buyer's premium" for any purchase. When a 5% premium is required the auction buyer must effectively pay at least 5% more than the previously accepted offer to get the property. This premium requirement also effectively precludes buyers using FHA/VA/USDA buyers from participating as such fees are generally not permitted by those loan programs. Some conventional lenders may not allow borrowers to pay such a premium either.
8. If the price obtained through the online auction service is higher than that obtained through the MLS (generally excluding the buyer premium fee) then the buyer who bid through online auction service will get the property. The original buyer is able to participate at the online auction as well in case their original offer is overbid.
9. The property is then conveyed through a normal escrow procedure to the buyer who made the highest offer whether it is a buyer who has the contract with the seller or by the over-bidder at the auction.

Q 29. Does the use of online auction service affect the listing broker's commission?

A Generally there is no change to the listing side commission. This is why this controversial practice generally raises greater concerns among buyers' agents. However, the listing agent may be asked to take on new duties in these types of short sales. They may have to agree to hold additional open houses and conduct additional marketing efforts for an auction company as part of the process (although sometimes the broker may also be compensated for this extra work). Again remember specifics can vary by lender and are subject to change.

Q 30. Does the use of an online auction company affect the buyer's agent's commission?

A Possibly. If the final sale is to a buyer who submitted an offer through his agent in response to an offer of compensation on the MLS, as opposed to a buyer who secured the property through the online auction, the buyer's agent will normally receive the commission offered on the MLS (assuming the buyer's agent is a member of that MLS or a reciprocal MLS). If the property is sold through the online auction company then the amount of the buyer's side commission is less certain. In some cases the amount offered is the same, in some cases less.

Q 31. *Is using an online auction platform legal?*

A Yes, the sale of real estate through an online auction platform is legal. However, depending on what the activities of the online auction company are, the online auction company may be required to hold a real estate license.

Q 32. *Why would an online auction platform require a license?*

A An online auction platform might do more than simply facilitate an auction. In many cases such companies will act to solicit buyers and sellers to use their services. Soliciting persons for real estate activity requires a real estate license.

Q 33. *Since Auction.com generally does advertise and solicit buyers and sellers, should it be licensed?*

A Auction.com does have a California real estate broker's license and therefore may engage in licensed activity

Q 34. *Don't online auction companies typically state they are not agents for the seller?*

A Yes, but simply stating that they are not agents does not mean that they are not in fact engaging in licensed real estate activity. In many of the typical contracts the online auction company requires its signs to be placed on the property that is being sold, and properties are advertised on the company website. It is possible the website ads could be seen as equivalent to a newspaper posting classified ads (which doesn't require a license), but the placement of signs on the property is likely to be seen as a solicitation of buyers, thus requiring a license. Again, however, many leading online auction companies are in fact licensed, so even if they are engaging in licensed activity that would be legal.

Q 35. *When a short sale lender requires a seller to use a third party online auction platform doesn't that interfere with the listing agent's exclusive listing agreement?*

A Yes. The C.A.R. standard form residential listing agreement grants the listing agent the "exclusive and irrevocable right to sell or exchange" the seller's property. Unless the listing agent consents to the property also being marketed by the seller or a third party the use of another method of marketing the property for sale would violate the exclusive listing agreement.

Q 36. *Since the lender is interfering with the exclusive agreement that the seller signed with the listing agent, does the seller have a cause of action against the bank for requiring the seller to use a third party?*

A Possibly. The short sale lender is not obligated by law to agree to a short sale on a specific property. While various recent laws and settlements have been reached, such as the National

Mortgage Settlement which requires lenders to do a certain volume of short sales, and laws now regulate their conduct during the short sale process, they do not require short sale consent on any particular property. Therefore, the lender may be able to set conditions to the short sale with a sort of "take it or leave it" approach to the seller.

However, the lender requirement for the borrower to use an auction service is not without peril to the seller. If the seller has signed an exclusive agreement with a listing agent, the demand by the lender to use a third party auction service could violate that seller's agreement with the listing agent subjecting the seller to a risk of suit over commission from the listing agent. Furthermore, while terms vary, some online auction houses have onerous term requiring, for example, the seller to indemnify and protect the auction house at the seller's expense in case of suit. Requiring a distressed borrower to use services which create such burdens on a seller could be seen as unconscionable acts by the short sale bank and could be grounds for suit by the seller.

Q 37. Are there causes of action that a listing agent may be able to pursue against a lender for interfering with the listing agreement?

A Yes. There are various causes of action that a listing agent may have against the short sale bank for taking actions which interfere with a listing agents existing exclusive listing agreement with a seller. However, there are difficulties with pursuing such claims as it may be difficult for the listing agent to establish damages. The two central claims are listed below.

1. Inducing a breach of contract. The tort of inducing a breach of contract has the following elements (legal requirements) (a) a valid contract between plaintiff and a third party; (b) defendant's knowledge of this contract; (c) defendant's intentional acts designed to induce a breach or disruption of the contractual relationship; (d) actual breach or disruption of the contractual relationship; and (e) resulting damage.
2. Intentional interference with prospective economic advantage. This tort has the same elements as the above action but also requires that the interference be wrongful.

Q 38. What are the difficulties with pursuing the claims discussed in question 9?

A Simply put, the issue is proving damages. Even when requiring the use of an online auction platform the short sale lenders are paying the same commission to the listing agent as the listing agent would have received even if the online auction platform had not been used. This is generally why the main complaints regarding this process have been from buyers' agents and not listing agents. Damages are a required element of the above causes of action and are not met when the listing agents are receiving their commission.

Q 39. What about the lenders who require the listing agent to do additional work (e.g., putting up signs or holding additional open houses)? Couldn't that additional time count as damages?

A Yes, potentially such additional work could be considered damages. However, such damages may be difficult to prove in that the short sale lender could argue that a listing agent, especially in a short sale, may have to hold additional open houses in order to get back up offers anyway, and so they are not asking a listing agent to do much more than they otherwise would. Although some lenders, will agree to pay for the additional work or make the work optional, which would again take away the damages claim.

Q 40. *There are reports of some banks effectively taking the listing away from the listing agent and insisting that the seller only use the online auction method. If this is true would that create a claim for damages?*

A Yes. There is still the potential hurdle of the lender simply arguing that they have a right as a creditor to set the terms, but in this case there is a strong claim as there are clear damages. Also, at least officially, most major lenders state they will not engage in that type of conduct.

Q 41. *Does the buyer's agent have any claims against the short sale lender?*

A In the typical scenario where an online auction company is used, a buyer's agent has an offer accepted by the seller which was obtained while the property was on the MLS. Then the offer is subject to being overbid on the online auction platform. The existing buyer can bid at the auction, but would be required to meet the auction requirements which would include the 5% percent buyer's premium.

Buyers' agents are understandably upset at this process. However, it is ultimately not that different from the existing process where a lender may require that a seller continue to market the properties for back up offers even though an accepted offer has been presented and "approved." If a buyer's agent's offer is the one that is ultimately accepted, and it is not overbid at the auction platform, then the buyer's agent will get the same commission that he or she would otherwise have been entitled to. However, if the buyer's agent's client is overbid at the auction but then enters the auction and is successful, there could be an issue for the buyer's agent if the auction company does not want to pay the full commission offered on the MLS. Often the amount offered through the auction process is less than that offered on the MLS. However, the agent who procured a buyer through the MLS may be entitled to the MLS commission even if the buyer becomes the successful buyer through the auction process under a procuring cause theory.

Q 42. *Does a listing agent have to agree to participate with the online auction platform?*

A The listing agreement signed between the listing agent and the seller is an exclusive agreement. If the seller insists on using an auction platform due to the bank's requirements that is arguably a breach of the listing agreement entitling the agent to a commission. However, as a practical matter, if a short sale lender requires the seller to use an online auction platform as a condition of short sale approval, and the listing agent in response threatens the seller with a claim for breach of listing if the seller does use the auction platform, the listing agent is simply asking for problems. The seller could argue that the listing agent, knowing the market and the lender requirements, should have never have taken the listing. Suffice it to say even if a listing agent has a legal claim, the real estate licensee may not be seen in a sympathetic light. Potentially a listing agent could push back and state he or she will not participate in any activity to assist the auction process but will otherwise not object to the auction company doing its marketing and other activities.

As for the buyer's side, if the listing agent and seller have agreed to the lender's terms, there is not much a buyer's agent could do, as ultimately the sale is subject to lender approval which even in a regular sale generally allows the short sale lender to consider back up offers and accept those over the accepted offer.

Q 43. *Why are banks using this platform?*

A Banks are distrustful of many real estate licensees. There is a perception by some lenders that real estate licensees are not properly marketing properties in order to (1) get quick sales: or (2) make

more money by double ending the deal which often means the acceptance of an inferior offer; or (3) alternatively that some agents are committing fraud by working with certain investor clients and only presenting offers from them. All of the above conduct results in the bank obtaining a lower price than what the market warranted. The auction then acts as a way to make sure that the property is marketed and to ensure that the price obtained through the MLS is the best price.

Q 44. *Is there no way to stop this practice?*

A It is possible that some brokers may in fact be able to show harm when either a seller cancels a listing due to the bank demands, or the bank demands that the listing agent spend time doing work for the online platform without additional compensation or if a bank actually demanded the listing agent to terminate his or her listing. Once damages are established, an interference with contracts claims as discussed above may be viable to pursue.

Alternatively REALTORS® may wish to discuss with the banks ways to address their concerns about properties not being marketed properly. For example, allowing offers from buyers' agents to be presented simultaneously to the listing agent and to the bank will make it is clear that all offers are being presented to the bank, and therefore, that the agent is not doing anything to suppress or cherry pick offers.

Also while there have been comparatively few instances of homes actually being sold through the online platforms (which would mean the auction price was higher than the price obtained through the MLS), it may be useful to study those situations to figure out why that occurred. Were those properties not marketed properly? Being able to address such issues may be a way to help limit these issues with the lenders.

Q 45. *Where can I obtain additional information?*

A You may consult the seller's lender directly about their policies and what is required to apply for a short sale of a property. The internal departments that handle short sales differ by lender. You may try asking for the problem loan department, loan workout department, loss mitigation department, or foreclosure department.

See also all the other short sale legal articles that can be found under the Foreclosures and Short Sales category of the [Legal Articles \(By Category\)](#) page.

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CALIFORNIA ASSOCIATION OF REALTORS®
Member Legal Services
525 South Virgil Avenue
Los Angeles, CA 90020

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