
MEMORANDUM RE SHORT SALE NEGOTIATION FEES

TO: MINNESOTA ASSOCIATION OF REALTORS® (“MNAR”) MEMBERS
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SUBJECT: ISSUES AND RISKS ASSOCIATED WITH SHORT SALE FEES
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This memo is prepared for the benefit of the Minnesota Association of REALTORS® (“MNAR”) by association counsel for the benefit of members being able to more readily identify and avoid certain pitfalls associated with short sale negotiation fees.

Residential short sale transactions permeate today’s marketplace, given economic conditions and inability of many homeowners to remain current on their mortgage payments. Unfortunately for many agents, despite the hard work, training, and knowledge that a successful short sale requires, the commissions are often pressured down to bottom dollar by the bank/lienholder approving the short sale.

In turn, this has caused some agents to look for creative ways to increase or even stabilize the fees generated from a short sale, when compared to a more traditional transaction. Separately, some very well intentioned agents who are not comfortable handling short sales may rely on a third-party negotiator for assistance in the short sale negotiation. Both of these issues create some potential pitfalls that need to be examined more closely, in light of Minnesota law, RESPA (a Federal law), and other applicable regulation. This memo is designed to identify and clarify the current key issues and pitfalls applicable to how short sale fees might be charged, and by whom.

The first questions that should be asked when considering whether a fee charged in a short sale is appropriate include (but are not limited to) the following: 1) which party is the negotiator serving?, 2) which party is being charged a fee?, 3) is the negotiator properly licensed under Minnesota law?, 4) what are the possible conflicts, if any, under Federal and/or Minnesota law?, and 5) would the fee be prohibited if all the parties to the transaction (including the lienholder(s) knew about this fee?

To understand why a short sale fee could be problematic, it’s important to have a working knowledge of some of the laws or regulations that apply, which include both Federal and Minnesota law, such as the following:

1. The Real Estate Settlement Procedures Act (RESPA): Section 8(b) of RESPA [12 USC 2607(b)] provides: *“No person shall give and no person shall receive any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction*

involving a federally related mortgage loan other than for services actually rendered.” The term “settlement services” includes services rendered by a real estate agent or broker. [12 USC 2602(3)] In the case of *Busby v. JRHBW Realty*, 513 F.3d 1314, 1321 (11th Cir. Ala. 2008), the Court determined that “*a fee is unearned in violation of [RESPA] when: (1) a fee is charged but no nominal or duplicative work is done in exchange for the fee.*”

a. Application to short sale fees = if a fee is charged where no service was rendered or can be demonstrated, the fee may be barred by RESPA.

b.

2. Regulation X [24 CFR 3500.14(c)]: Regulation X, a Federal statute independent of RESPA, provides: “*A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section.*” Any violation of this section is a violation of Section 8 of RESPA.

a. Application to short sale fees = if a fee is charged where no service was rendered or can be demonstrated, the fee may be barred by Regulation X.

b.

3. Minn. Stat. Ch. 82: Chapter 82 governs real estate brokers and salespersons licensed in Minnesota and serves as the governing law for enforcement measures brought by the Department of Commerce (“DOC”). Specifically, Minn. Stat. §§ 82.55 (Definitions), 82.67 (Agency), 82.70 (Compensation) and 82.73 (Standards of Conduct) apply to short sale negotiators.

a. Application to short sale fees = if a fee is charged by someone who is not duly licensed, or by someone acting outside of or in violation of the duties imposed by applicable licensing law, it could create a licensing/Department of Commerce violation.

b.

4. Violation of Short Sale Agreements/Addendum with Lender or Institution: Many short sale agreements and/or addenda with the Seller’s lender and/or Fannie Mae or Freddie Mac contain certain conditions or restrictions that could be violated given the structure of the short sale negotiation.

a. Application to short sale fees = failure to follow the requirements or restriction a lienholder imposes as a condition of a short sale may bar a short sale from occurring, or may be considered by the lienholder to be a fraud or misrepresentation (if it has already occurred).

b.

5. Claims of Fraud, Misrepresentation or Deceptive Practices: Failure to disclose an affiliated relationship between an agent or broker and a third-party negotiation company or failure to disclose a short sale negotiation agreement to the lender could raise claims of common law fraud, misrepresentation or deceptive practices, as further discussed.

- a. Application to short sale fees = if a fee is charged by someone who is operating with an affiliation or common interest that is not disclosed to parties to the transaction, liability in a civil action may be possible.

b.

6. MARS Rule: The Mortgage Assistance Relief Services requires certain disclosures and rules to be followed by any MARS provider (including those who negotiate short sales when the negotiator is not concurrently the listing broker).

- a. Application to short sale fees = if a fee is charged by a MARS Provider and the MARS Provider is not excepted from the application of the MARS rule, disclosures and prohibitions on advance fees may apply.

History of Short Sale Negotiation and Applicable Licensing

In Minnesota, it is quite typical that short sales are managed and negotiated by listing agents who are listing/marketing a property for sale, who attempt to secure lienholder approval of a short sale if the purchase price will not satisfy the outstanding debts secured against the property. The definition of a “real estate broker” under Chapter 82 of the Minnesota statutes includes one who “*for another and for a commission, fee or other valuable consideration... attempts to negotiate a sale of real estate.*” (Minn. Stat. §82.55). Therefore, it’s understandable that a duly licensed real estate broker or agent who is attempting to sell a client’s home might also be involved in securing approval of any lienholders to ensure the applicable mortgages can be released on or prior to the closing of the sale.

The issue becomes more problematic when “third party negotiators” become involved. Typically, a third-party negotiator is someone who is negotiating the short sale on behalf of the seller, but who is not also the listing agent. Since the early days of short sales, there have been short sale negotiators (many of whom were unlicensed or even out of state) offering to negotiate a short sale, in exchange for a fee.

While listing agents have been generally permitted to negotiate a short sale, the Minnesota DOC has opined in the past that the real estate salesperson or broker license does not entitle someone to act as a third-party negotiator without concurrently listing the seller’s property for sale. Consequently, unless the short sale negotiator has a Chapter 58 (Mortgage Origination) license, or is a licensed attorney assisting a client with advice or counsel in connection with the client’s short sale transaction, a third-party negotiator may be negotiating a short sale without having met the necessary licensing requirements.

Unique Scenarios Involving Short Sale Fees

In the past couple of years, there have been an increasing number of scenarios involving fees charged to a buyer or seller by an unlicensed short sale negotiator, or even charged by a listing agent to a buyer as a prerequisite for submitting buyer's offer to seller. Obviously both of those scenarios pose considerable risk, and should not occur.

If an unlicensed short sale negotiator is involved, not only is that individual at risk, but he or she could also create potential risk for a listing agent who has a fiduciary duty to protect the interests of the seller, who may not be aware of what role an unlicensed negotiator can or can't perform. Similarly, charging a fee to a buyer as a condition of submitting an offer not only violates the listing agent's fiduciary duties to the seller, but subjects a buyer to a fee which the buyer should not be required to pay, as no service has been rendered beyond that which the listing agent is already being paid by the seller to perform.

Current Issues with Short Sale Negotiation Fees

To understand some of the current trends and risks, we've compiled four case studies, attached as a supplement with this article.

Final note regarding commissions paid to agents.

Minn. Stat. § 82.70 requires that any commissions, fees or other compensation must be paid to the broker/brokerage, at which point such fee or compensation may be split with an agent or agents licensed to that broker. As a general proposition applied to all case studies, any fees earned by third-party negotiation companies comprised of brokers and/or agents must be paid to the brokerage company to which they are licensed.

Third-party negotiators who are real estate agents licensed under Chapter 82 and who receive negotiating fees directly or through a company independent of the brokerage to whom they are licensed not only run the risk of violating Chapter 82 themselves, but could create risk for the broker/brokerage to whom they are licensed. If the third-party negotiator is a Chapter 58 licensee, he or she will need to ensure all requirements of those statutes and requirements are satisfied separately.

In addition, the HUD-1 Settlement Statement provides the following certification by Seller and Buyer: *"I have carefully reviewed the HUD-1 Settlement Statement and to the best of my knowledge and belief, it is a true and accurate statement of all receipts and disbursements made on my account or by me in the transaction."* Failure of either Buyer or Seller to disclose any agreements with third-party negotiators or agents to perform short sale

negotiation services may fly in the face of the representation that individual has made on the Settlement Statement.

What will the Future Hold?

Short sale transactions, and the laws/regulations surrounding them, are continuously evolving. In some instances, the law is fluid. For example, the FTC's MARS Rule came out as a prohibition on upfront fees and a set of required disclosures that would impact listing agents who are negotiating a short sale as part of their work on behalf of their seller client, and the Rule later was modified such that MARS disclosures and certain other requirements do not apply when the listing agent is performing the work in trying to obtain lien releases for the short sale to occur.

Due to continual changes in the market, it's difficult to predict what is in store with the Department of Commerce ("DOC"), HUD, or other regulatory agencies. The Minnesota Association of REALTORS® regularly communicates with the MN DOC to ensure that members can be informed of any changing interpretations or new developments that occur with respect to regulation or enforcement initiatives.

If you are engaged in short sale transactions, as a listing agent, buyer's agent, or negotiator, you would be wise to continue to monitor any news and developments coming from your local association, the MNAR, the National Association of REALTORS® ("NAR"), the MN DOC or other such sources.

Case Study Supplement

Case Study #1: Short sale negotiation fee is being paid by the Seller and collected by the by the Chapter 82 licensed listing broker/agent or by a Chapter 58 (mortgage) licensee.

Licensing issues. In this case study, the negotiator appears to hold the appropriate licensing, given the current message from the Minnesota DOC. According to the DOC, real estate brokers and agents are not permitted to negotiate short sales unless given authority through a listing agreement with Seller or by holding a license under Chapter 58 (mortgage originator).

If the listing agent is negotiating the short sale, their compensation will likely be the real estate commission paid by the seller (or indirectly paid by the bank, if the seller has negative equity). Charging a separate fee for short sale negotiation would not be permissible without the agreement of the seller and any lienholder(s) approving the short sale. If a Chapter 58 licensee is negotiating the short sale, any payment they receive would require agreement by the seller and lienholder(s) as well. Listing agents should be careful to define their role separately and independently from any role a third-party negotiator may serve, so as to not have agency or fiduciary duty problems.

RESPA/Regulation X issues. The RESPA issue that may be raised in a scenario where Seller pays the listing agent or a third-party negotiator a fee to perform short sale negotiation services is that the fees may be considered “unearned or duplicative” in violation of Section 8(b) of RESPA. The same issue arises under Regulation X. If a clear and distinct separate service can be identified, for which an appropriate fee was disclosed and charged, this is less likely a violation of RESPA or Regulation X.

Violation of Short Sale Agreements/Addenda with Lender or Institution or common law fraud/misrepresentation issues. Both Fannie Mae and Freddie Mac limit commissions paid to brokers in a short sale transaction to 6% of the purchase price. Further, many agreements or addenda with lenders, Fannie Mae and/or Freddie Mac, contain language where parties agree that there are no undisclosed agreements relating to the current sale of the property. Failure to disclose the existence of a short sale negotiation fee or agreement not only would violate such agreements but may also violate the 6% cap on commissions if short sale negotiation fee is paid to a broker or agent in excess of 6%. Similarly, if an agent/negotiator/seller fails to disclose the existence of such fees or agreements, the lienholder(s) who would want to know about these agreements could pursue claims of fraud, misrepresentation or deceptive practices, or such issues could be explored by a regulator agency such as HUD or the DOC.

MARS Rule: Any Chapter 58 licensee working as a short sale negotiator on behalf of Seller is obligated to comply with the MARS Rule in making certain disclosures and prohibitions on advance fees may apply. The MARS forbearance on enforcement against listing agents who negotiate as part of the listing service (Chapter 82 licensees) may protect the listing agent from some of the MARS issues in this case study.

Case Study #2: Short sale negotiation fee paid is being paid by the Seller and collected by a third-party Chapter 82 licensee (not the listing broker) or by an unlicensed entity.

Unlike case study #1, this scenario involves an unlicensed negotiator. In such a case, the issues of case study #1 apply, in addition to possible ramifications with regulatory bodies such as the Department of Commerce for failure to maintain appropriate licensure. Any third-party Chapter 82 licensee who is not the listing broker or an unlicensed entity is obligated to comply with the MARS Rule in making certain disclosures and prohibitions on advance fees likely apply.

Case Study #3: Listing agent or third-party negotiator expects/demands that the Buyer pays a short sale negotiation fee to listing agent or negotiator.

Assuming the listing agent or negotiator is properly licensed (to avoid the licensure issue referenced in case study #2 above, this scenario poses significant RESPA, Regulation X, disclosure, agency and other issues.

RESPA/Regulation X. There may be a potential RESPA violation by a listing agent or short sale negotiator (either of whom are likely engaged by the seller), if that professional is expecting to collect fees from a buyer. Most likely, the individual paid/retained by the seller is negotiating on behalf of the seller. In the case of a listing agent, all fiduciary duties will be owed to the Seller. Charging the buyer a “negotiating fee” appears suspicious at best, and may be a violation of RESPA or Regulation X (or both) if no or nominal services are performed for the Buyer, or duplicative fees are charged (i.e. the listing agent has already agreed to negotiate the short sale on behalf of the Seller and is now expecting Buyer to pay “extra”).

Agency/Contract interference issues. If Buyer has already retained a Buyer’s broker, a listing agent or third-party negotiator attempting to collect a fee from Buyer may be interfering with the contractual/agency relationship between Buyer and Buyer’s broker.

Violation of Short Sale Agreements/Addenda. Case study 3 also runs the risk of breaching or running afoul of the terms commonly found in many bank addenda or short sale agreements, which may limit commissions to a pre-

determined amount, or may prohibit any “side arrangements” or fees collected in connection with the transaction which are not agreed to by the lienholder(s).

Common Law Claims of Fraud, Misrepresentation or Deceptive Practices. Any representations or guarantees made by the listing agent or negotiator to the Buyer suggesting that Buyer will get the property at a lower price as a result of the agent or negotiator’s services may raise claims of fraud, misrepresentation or deceptive practices. While the listing agent or negotiator’s statement that Buyer is purchasing the property at a lower price than what is owed on any outstanding mortgage(s) may be correct, there is no guarantee that the Buyer is getting the home for a lower price than what could be obtained without Buyer paying a fee to the Seller’s negotiator.

MARS Rule: Any third-party negotiator expecting or demanding a fee on behalf of Buyer is obligated to comply with the MARS Rule in making certain disclosures and prohibitions on advance fees likely apply.

Case Study #4: Buyer’s broker/agent expects or demands that Buyer pay a short sale negotiation fee.

This case study raises many of the issues addressed in the above scenarios. First, the Minnesota DOC does not appear receptive to the idea that a buyer’s broker has sufficient licensure to be a “short sale negotiator” (noting that there is no statute this author is familiar with which explicitly and clearly defines who is or is not appropriately licensed to serve as a “short sale negotiator” in the state of Minnesota). In light of this ill-defined area of law, proper licensure is the first consideration/risk.

RESPA/Regulation X: As highlighted previously, RESPA and/or Regulation X may be violated when a fee is charged where no service or nominal services are performed, or where the fee is duplicative. If the goal of a short sale negotiation is to release the mortgage such that the Seller may sell the property, whether this is a service to a Buyer is questionable. Further while a negotiator for a Buyer may be satisfied if the mortgage/lien is released even if the debt is not satisfied, a broker/negotiator working for Seller may be looking for a different result (satisfaction of debt). This raises additional agency considerations which will be discussed below.

Chapter 82: If the Buyer’s agent is performing short sale negotiation services for Seller to negotiate release of mortgages/liens impacting Seller’s property, it is difficult to clearly define the agency role, fiduciary duties, and responsibilities each broker/agent may have toward the seller. Having a Buyer’s agent perform work for the benefit of Seller, at the cost of Buyer, appears to create a host of licensing/agency concerns.

Violation of Short Sale Agreements/Addenda. Case Study #4 again creates possible conflict/concern with respect to any representations, warranties, or statements made within a short sale agreement or addenda, in the event that any such agreements or addenda bar or limit the ability of a Buyer's agent to negotiate on behalf of a Seller while collecting a fee from the Buyer. At the very least, such a fee should be fully disclosed and incorporated into the HUD-1 Settlement Statement to reduce (though it may not eliminate) such risk.

MARS Rule: Any Buyer's agent/broker working as a short sale negotiator is obligated to comply with the MARS Rule in making certain disclosures and prohibitions on advance fees likely apply.