



SHORT SALES – GUIDANCE FOR LICENSEES

Licensed real estate brokers and mortgage professionals may occasionally assist property owners considering a short sale. This bulletin provides general guidance to those professionals and addresses the most typical issues related to short sales. 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. Any creditor(s) with a security interest in the property must consent to receiving less than they are owed in return for releasing their lien on the property. The fact that a creditor releases 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. 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 (DOL) regulates real estate brokerage services related to the purchase agreement between the seller and the buyer. The Department of Financial Institutions (DFI) 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 https://www.ftc.gov/news-events/news/press-releases/2010/11/ftc-issues-final-rule-protect-struggling-homeowners-mortgage-relief-scams for required disclosures, limitation on fees, and limitations on performance representations.

Short Sale Guidance

DOL and DFI require that a person have either a mortgage loan originator license, a real estate broker 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; and/or a violation of Chapter 2.48 RCW, the unauthorized practice of law.

A real estate broker or mortgage professional should carefully consider the information in this bulletin when advising a consumer regarding a short sale. In addition, a real estate broker 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 owe more on their property than their property is worth 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 facing property owner may 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 instead 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 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 tax 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," in which a property serves as collateral for a loan on a second property. 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. Failing to provide the necessary documents may prevent the short sale from closing. Providing false information may be fraudulent.

Some common terms or 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 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 who 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

Mortgage professionals may assist owners with modifications of mortgage loans, in accordance with Washington State law, 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 is able to make reasonable mortgage payments, the licensee should attempt to negotiate a modification of the loan. 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 CLA and MBPA 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. 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 increase their 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 regulates real estate brokerage services through its administration of RCW 18.85, RCW 18.86, and RCW 18.235, collectively referred to as the licensing laws. A broker representing an owner in a short sale owes the owner the same duties as any other owner under the licensing laws. However, due to their complexity, short sales may require additional considerations from a broker.

A broker should advise a short sale seller to seek appropriate tax, legal and other professional advice or counsel.

DOL sometimes receives complaints about improper short sale transaction activity by brokers. DOL will pursue disciplinary or administrative action against brokers engaged in improper practices, including:

- 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.
- A property that is part of a short sale must be marketed at a fair price, and brokers may not manipulate a property's listing price.
- A broker may not make an offer on a distressed property and then negotiate a short sale payoff with the seller's lender. In this prohibited scheme, 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."

As with any transaction, 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.

Frequently Asked Questions

Does my existing mortgage loan originator license allow me to conduct short sale negotiations with a homeowner's lender?

Yes. Third-party short sale negotiations are mortgage transaction activities regulated under the MBPA and the CLA.

If I have an inactive loan originator license, may I conduct short sale negotiations with a lender even though I am not employed by a mortgage broker?

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

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?

Not unless the real estate broker is paid separately for such negotiation services—that is, receives compensation for that service in addition to the 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.

If a real estate managing broker or a 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?

No. If a real estate managing broker or 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.

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?

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.

I am a real estate broker who negotiates short sale approvals with lenders 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, such as faxing documents or making document submissions on my behalf. Does my assistant need a license from DFI?

No. Provided that an assistant performs only clerical or administrative functions and does not engage in negotiations with a lender, no license is required from DFI.

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?

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

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?

No. You must be a licensed mortgage loan originator.

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

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