



# FORECLOSURE & SHORT SALES

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## I. INTRODUCTION

Unfortunately, many REALTORS® are now being asked to either list property which is in the process of foreclosure or to sell property that has already been foreclosed by a lender. In many instances, a REALTOR® will receive a call from an out-of-state lender who asks her to list, take possession and sell a home that is in some phase of the foreclosure process. Another common situation involves a REALTOR® being contacted by homeowners whose home is being foreclosed and who indicate they want to sell the home quickly to save their equity in the home. There are significant issues involved in both of these situations.

In order to address the issues involved in a foreclosure situation, it is necessary to know a little bit about the foreclosure process. There are a few significant steps in the process.

## II. DISCUSSION

### A. The Foreclosure Process

First, the foreclosure process usually begins when a homeowner does not timely make their payments to a lender who has a mortgage on their property. The vast majority of foreclosures of residential property is done by advertisement, *i.e.*, there are no court proceedings. The first act in the foreclosure process is the posting of a Notice of Foreclosure by advertisement on the homeowner's property and a Notice of Foreclosure being advertised in a county-wide publication for a period of at least four (4) weeks. In situations where property is occupied, typically the occupants remove the Notice of Foreclosure which is posted on their property within minutes after it is posted. The Notice of Foreclosure identifies the debtors, the property by its legal description, the amount owed, and the date of the sale.

Second, a foreclosure sale is held by the sheriff's office, typically at the county courthouse, on the date set forth in the Notice of Foreclosure. Theoretically, anyone can submit a bid at the foreclosure sale. In the vast majority of instances, only the lender holding the mortgage submits a bid, and the lender's bid is the amount of its indebtedness. In other words, if a lender holds a mortgage which secures \$100,000 of indebtedness by the homeowner, the lender will bid its indebtedness, *i.e.*, the \$100,000, at the foreclosure sale. If a third party wished to submit a successful bid at the foreclosure sale, they would have to bid some amount in excess of the indebtedness owed to the lender. In our example, assume that someone bid \$110,000 in response to the lender's bid of \$100,000. Ultimately, the lender would be paid their indebtedness of \$100,000 and the titleholder whose property is being foreclosed would receive the excess amount.

Third, the sheriff provides the high bidder at the foreclosure sale with a so-called sheriff's deed.

Fourth, typically homeowners have six (6) months from the date of the foreclosure sale to redeem the property. In order to redeem their property, they would need to pay the successful bidder the amount which was bid at the foreclosure sale, plus interest accruing from the date of the sale. Again, in our example, if a lender bid \$100,000 at the foreclosure sale, the homeowners would need to pay the lender \$100,000 (plus interest) during or prior to the end of the six-month redemption period in order to keep their home. It is important to know that, after the foreclosure sale, the homeowners may occupy their home during the entire redemption period without paying anything to the lender or paying taxes. As will be discussed below, if, on the other hand, the homeowners have abandoned their home prior to the foreclosure sale, there may be a much shortened redemption period.

Fifth, if a homeowner is unable to redeem his property during the redemption period, then at the end of the six-month redemption period, the purchaser at the foreclosure sale will be deemed to have taken title to the property pursuant to the sheriff's deed. The new legal titleholder, *i.e.*, the successful bidder at the foreclosure sale, is then entitled to possession of the property. If the homeowner will not voluntarily leave the property, then the successful bidder typically has to begin eviction proceedings.

The above-described steps for foreclosure have been greatly simplified for purposes of this article. Nonetheless, they are general benchmarks by which REALTORS<sup>®</sup> can determine where homeowners and their property are at in the process. It is critical for a REALTOR<sup>®</sup> to know where a homeowner or a lender is in the foreclosure process at the time a homeowner or

lender seeks his assistance in listing and selling the home. Obviously, if the homeowner is in the last two weeks of the six-month redemption period, it would make little sense for a REALTOR<sup>®</sup> to take a listing and attempt to sell the property and close the transaction within the two-week period. At the end of the two-week period, the homeowner will no longer be the legal titleholder to the property and the REALTOR<sup>®</sup>'s listing would typically not be binding upon the new legal titleholder, *i.e.*, the successful bidder at the foreclosure sale.

REALTORS<sup>®</sup> should keep in mind that while a foreclosure sale cuts off most junior liens; this is not the case where the homeowner redeems. If the homeowner redeems the property, it will continue to be subject to all junior liens. Often then, the lender is in a better position to sell the property after the redemption period expires than the seller is during the redemption process.

### **B. Shortening of the Redemption Period**

Among the bills passed by the Michigan legislature during the last days of its 2006 session was House Bill 1203 dealing with the mortgage foreclosure process as it relates to residential property. This bill permits a mortgagee to shorten the redemption period at any time during the foreclosure process if the home has been "abandoned." A home is deemed to be abandoned if the lender inspects the home and it does not appear occupied. In this event, all the lender needs to do is post a notice on the home and send a letter to the homeowner's last known address. If the homeowner does not respond within 15 days, the redemption period will be deemed to have expired.

Obviously, when listing an unoccupied home in foreclosure, the REALTOR<sup>®</sup> needs to make certain that the homeowner has put the mortgagee on notice that it has not abandoned the home.

### **C. Listings with the Homeowner**

Homeowners have the legal right to list and negotiate the sale of their property after the foreclosure sale and during the redemption period. When a REALTOR<sup>®</sup> is asked to list a property which they understand to be in the foreclosure process, it is extremely important for the REALTOR<sup>®</sup> to have appropriate title work done to determine what the total indebtedness is against the property. For example, a REALTOR<sup>®</sup> may be aware of the fact that Acme Bank has just foreclosed a mortgage against the Smiths property and bid the \$100,000 owed it at the foreclosure sale. On its face, the property appears to be worth \$150,000. However, upon receiving the title work for the property, the REALTOR<sup>®</sup> discovers that the Smiths granted a second mortgage to Ace Bank in the amount of \$30,000 and a third mortgage to Sam's Finance Company in the amount of \$25,000. In other words, in order for the Smiths to redeem the property and sell and close the property without concessions by the lenders, it would be necessary to obtain at least \$155,000 on the sale of the property, net of the REALTOR<sup>®</sup>'s commission and closing costs. In this situation, the REALTOR<sup>®</sup> may decide to decline to list the Smiths' property. It should be readily apparent to the REALTOR<sup>®</sup> that in selling the Smiths' property, it is extremely likely that it will result in a "short sale," *i.e.*, a sale in which the proceeds of sale will not completely pay off all the liens on the property, the REALTORS<sup>®</sup> commissions and necessary closing costs, such as state and county transfer taxes.

If a REALTOR<sup>®</sup> chooses to take a listing that will most likely result in a "short sale," the REALTOR<sup>®</sup> should be advised of several potential problems. First, most lenders will not

typically negotiate in advance a reduced payment of the amount owed them. In other words, the REALTOR® will need to come up with a ready, willing and able buyer who is willing to pay some price for the property. Typically, it will only be after these efforts that the REALTOR® will know whether the lender or lenders who hold mortgages on the property will accept some reduced amount to permit the sale to proceed forward. Obviously, there is no legal requirement that a lender accept less than the amount owed it in consideration for the release of its mortgage. Second, when the REALTOR® submits the listing for the property to the MLS, there is some risk in offering specific compensation to participants in the MLS. For example, if a REALTOR® offers compensation in the amount of 3 percent of the purchase price, but the payment to the lender and hard closing costs leave only an amount available for payment of commissions in the amount of 3 percent of the purchase price, the REALTOR® could be looking at a claim by the cooperating REALTOR® for the entire 3 percent. In dealing with other REALTORS® with respect to potential “short sales,” REALTORS® should be up front about the possibility of insufficient proceeds to pay a full commission.

A cooperating broker who becomes involved in a short sale transaction may very well be asked to accept a commission amount that is lower than the amount offered through the MLS. While a cooperating broker has no legal duty to accept the lower amount, his or her refusal to do so may in fact mean that the transaction will not close. Cooperating REALTORS® are cautioned against agreeing to take a lower amount with the idea that they will later pursue the additional amounts through arbitration. The commission amount to be paid to a cooperating broker by a listing broker is a matter of contract. The listing broker and the selling broker may agree to a commission amount that is different from the amount offered through the MLS – even orally. The issue with an oral modification will be whether the listing broker can prove that there was in fact an agreement by the cooperating broker to accept a lower commission amount. If the hearing panel in an arbitration finds that such an agreement was made, then it is likely to conclude that the cooperating broker is not entitled to any additional amount.

In listing and selling properties which are in the foreclosure process, a REALTOR® must be extremely sensitive to time. While sellers and buyers regularly contend that time is of the essence in a transaction, time *is* really of the essence with regard to property which has been foreclosed and for which the redemption period is running. A listed property must be closed and the property redeemed (*i.e.*, the high bidder at the foreclosure sale paid off) prior to the end of the redemption period. If there is a sale pending, but it does not close prior to the end of the redemption period, both the homeowner and the buyer will lose their rights to sell and buy the property.

There is also a very delicate disclosure issue also involved in the listing and sale of property which is subject to the foreclosure process. It seems highly unlikely that a court would find that the existence of a foreclosure sale was “confidential information,” inasmuch as a notice of the foreclosure sale was printed in a county newspaper at least four (4) times and a notice of foreclosure was posted on the property. Nonetheless, in many instances a buyer, particularly an out-of-town buyer, has no notion that a foreclosure sale has been held for the property. Thus, a REALTOR® and a seller must decide whether the existence of the foreclosure sale will be revealed to a buyer. On the one hand, revealing the existence of the foreclosure sale and the redemption period may instill in a buyer the notion that time is of the essence in closing the transaction. On the other hand, disclosing the existence of a foreclosure sale and the running of the redemption period may embolden a buyer to attempt to buy the property at a much lower price based on the seller’s financial distress. Further, a buyer may choose to wait out the end of

the redemption period thinking they can buy the property more cheaply from the foreclosing lender. The bottom line is, the REALTOR<sup>®</sup> and seller must have a meeting of the minds with respect to whether information regarding the foreclosure sale will or will not be revealed to buyers.

#### **D. Listings with Lenders (or other Successful Bidders at Foreclosure Sale)**

As noted at the outset, many REALTORS<sup>®</sup> in Michigan receive calls from out-of-state lenders who wish the REALTOR<sup>®</sup> to take possession of property, list the property and sell it for the lender. It is extremely important for REALTORS<sup>®</sup> to understand where the property is at in the foreclosure process when they are contacted by the lender. A foreclosing lender has no rights in the property until after the redemption period has expired. For example, assume Acme Realty is contacted by Ace Bank, a California lender, to take possession of the property at 123 Elm Street and list it for sale. Ace Bank specifically instructs Acme Realty to contact a locksmith and have the locks changed. An agent of Acme Realty goes to 123 Elm Street and sees that there is still personal property within the house. What should the agent for Acme Realty do? The answer is absolutely nothing, until Acme Realty can determine where 123 Elm Street is in the foreclosure process. If this property is in the fourth month of a six-month redemption period, Ace Bank has no right to change the locks or otherwise possess the property (assuming there is no court order permitting it to do so). Thus, if Acme Realty changed the locks, it would be subject to a civil damage claim from the homeowner.

When REALTORS<sup>®</sup> are contacted by lenders to take possession of properties in foreclosure, the REALTOR<sup>®</sup> should contact the attorney who conducted the foreclosure for the lender and see if they can obtain a copy of the sheriff's deed which was provided at the foreclosure sale. The sheriff's deed will specify the dates for the redemption period. If the redemption period has not expired, in most instances, it would probably not make economic sense for the REALTOR<sup>®</sup> to take the listing for at least two reasons. First, the REALTOR<sup>®</sup> will not be able to arrange any showings of the property, as the lender has no rights to possess the property. Second, assuming a buyer was found for the property during the redemption period, the lender would not be able to commit to the sale, as there is still at least an outside chance that the present homeowner could redeem the property.

If the REALTOR<sup>®</sup> discovers that the redemption period from the foreclosure sale has ended, then a REALTOR<sup>®</sup> can certainly list the property for the foreclosing lender. The foreclosing lender now holds legal title to the property. Nonetheless, a listing agent for a lender who has taken title through foreclosure is still well-advised to get title work for the property at the outset of the listing. This title work is necessary, as there may still be liens on the property which will have to be dealt with by the REALTOR<sup>®</sup>. As an example, assume the Smiths granted a first mortgage to Ace Bank, a second mortgage to Acme Bank, and a third mortgage to New Bank. Assume further that the Smiths defaulted on the mortgage to Acme Bank, which was foreclosed by Acme Bank. While the foreclosure of the Acme Bank mortgage would extinguish or eliminate New Bank's mortgage, it would not eliminate the first mortgage to Ace Bank. The Ace Bank mortgage was senior in time and would remain on the property. In selling the property, the REALTOR<sup>®</sup> would have to take into account the Ace Bank mortgage, *i.e.*, how it is going to be paid off.

## **E. Disclosure Requirements**

A common question is whether a lender who has taken title through a foreclosure sale needs to provide a seller's disclosure form and a lead-based paint disclosure form. Neither disclosure need be made at the foreclosure sale, *i.e.*, when the sheriff accepts bids at the courthouse. Only the lead-based paint disclosure must be made when the lender lists the property for sale to third parties after the completion of the foreclosure process. The seller's disclosure act contains an exemption for this subsequent sale by the lender. Note that the exemption from the seller's disclosure act requirement only applies if the lender is the successful bidder at the sale. If a third party outbids the lender, then that party must provide a seller's disclosure statement if he or she goes on to sell the property. Obviously, that statement should make clear that the third-party seller has never occupied the property.

## **III. CONCLUSION**

In conclusion, REALTORS<sup>®</sup> dealing with property in the foreclosure process must be keenly aware of what stage the process is in and what amount of debt will need to be satisfied to successfully sell the property. Otherwise, a REALTOR<sup>®</sup> can put in a lot of work for nothing or, even worse, find himself in a difficult legal situation.

Finally, while this article is devoted to REALTORS<sup>®</sup> working with sellers or lenders, REALTORS<sup>®</sup> representing buyers of property in foreclosure should also be mindful of a couple of matters. First, extensive home inspections should be obtained by the buyer prior to entering into a binding purchase agreement, as in many instances, homes in the foreclosure process have not been properly maintained for obvious reasons. Further, a REALTOR<sup>®</sup> may wish to suggest an additional pre-closing inspection for the buyer's benefit, again based on the notion that the sellers had little or no interest in maintaining the property that they will otherwise lose to a lender. Second, if the homeowner is the seller, and the redemption period is running, the buyer's agent should make certain that the buyer is aware of and understands that they could lose their ability to purchase the property if it is not closed prior to the expiration of the redemption period. It would be helpful if a REALTOR<sup>®</sup> representing such a buyer has something in their file to indicate that the buyer was made aware of and understood that the property was in the process of foreclosure and that time was of the essence.