

LISTING BROKER MUST DISCLOSE SHORT SALE TO BUYER

The Hollister Pinnacle

By Patrick Casey

January 31, 2011

Short sales of property have become very common in the past several years. In a short sale, the seller is selling the property for less than the total amount that the seller owes on the property. In order to conduct a short sale, the seller must obtain the lender's approval that it will accept the sale proceeds in order to remove its deed of trust against the property. If the lender is not willing to remove the deed of trust, then the seller cannot convey clear title to the buyer and the sale will not go through. In most situations, the seller will list the property with a real estate agent, who will market the property and try to sell it.

In the recent case of Holmes v. Summer (2010) 188 Cal.App.4th 1510, a California Appellate Court ruled that a seller's real estate agent has an affirmative duty to disclose to the buyer that the property is subject to a short sale and that this disclosure must be made prior to the buyer signing the purchase agreement for the property. In the Summer case, the property owner hired Sieglinde Summer and Beneficial Services, Inc. (the "listing broker") to sell a property in Huntington Beach, California. The listing broker listed the property for sale at a price of \$749,000 – \$799,000. At that time, the property was subject to three loans secured by three recorded deeds of trust against the property totaling \$1,141,000.

Phil and Jenille Holmes ("Holmes") saw the property for sale on the multiple listing service and contacted the listing broker about the property. The listing broker showed the property to Holmes and did not mention that the property was subject to secured loans totaling \$1,141,000. The Holmes made an offer to purchase the property for \$700,000, and the listing broker prepared a counteroffer at \$749,000 with a 30 day escrow. The Holmes accepted the counteroffer of \$749,000 and opened escrow to purchase the property. The counteroffer did not make any mention of this being a short sale or the need for lender approval of the sale.

After opening escrow, the Holmes proceeded to sell their current house with the expectation that they would be moving into the new house in Huntington Beach. The lender did not approve the short sale and the Holmes were not able to purchase the property. The Holmes believed that they had been deceived since no one had told them that the property was subject to a short sale and they sued the listing broker for failure to make this disclosure. The Holmes did not sue the actual seller because the Holmes believed that the seller had no money and that it would not be worth pursuing the seller.

In suing the listing broker, the Holmes argued that the listing broker was obligated to disclose that the property was subject to a short sale "because it indicated a substantial risk, over and above that inherent in the routine residential sales transaction." The listing broker countered that having to make this disclosure to the buyer would require the listing broker to disclose the

seller's confidential financial information, including the strategy in determining the price at which the seller would be willing to sell. The listing broker also argued that the amount of debt on the property did not affect the overall value or desirability of the property. The trial court agreed with the listing broker and ruled that the listing broker had not committed any deceit to the Holmes and was not negligent in this case.

The Appellate Court reversed and determined that the listing broker was negligent to the Holmes by not disclosing to them - prior to signing the purchase agreement - that the property was subject to a short sale. The Appellate Court referenced the general rule that a seller must disclose any facts that materially affect the value or desirability of a property that are known only to the seller or that are not going to be easily determined or ascertained by the buyer. In addition, a seller's real estate agent also has a similar disclosure obligation to a buyer if the seller knows of such facts that should be disclosed to a buyer.

The Appellate Court said that a buyer may also be harmed if he or she enters into an escrow that, unbeknownst to the buyer, is highly unlikely to close for one or more reasons. The court cited precedent establishing that a real estate agent is "under a duty to exercise reasonable care to protect those persons who the agent is attempting to induce into entering a real estate transaction for the purposes of earning a commission." The court determined that it should be foreseeable to a real estate agent that someone purchasing a \$749,000 home may have to sell their existing home in order to proceed with the purchase. (The Appellate Court did not say whether the purchase agreement established the sale of the Holmes's existing residence as a condition to purchasing this property).

The Appellate Court stated that real estate brokers have certain disclosure obligations, such as to disclose if there is any neighborhood nuisance, if any murder occurred on the property, if improvements were made without obtaining the requisite permits, and any conditions to closing escrow. The court reasoned that the buyers (Holmes) were injured because of the seller's failure to convey title to the property, and that this failure should have been foreseeable by the listing broker based upon the fact that the property was subject to a short sale. In ruling that the listing broker was liable to the Holmes for damages, the Appellate Court said that a broker's failure to disclose such a fact disrupts the marketplace for property sales, resulting in "purchasers becoming leery of the marketplace and lenders preparing to extend credit to those purchasers wast(ing) valuable time in processing useless loans." For these reasons, the Appellate Court determined that a listing broker must disclose the fact that a property is subject to a short sale to the buyer prior to the buyer actually signing the purchase agreement.

As much as this case is about a listing broker's disclosure obligations to a buyer, it is equally about a seller's disclosure obligations to a buyer. It is always in the seller's, the buyer's and their brokers' best interests to disclose anything and everything that they know about the property. If there is ever a question about whether or not to disclose something, the answer is to make the disclosure and the sooner, the better. This is especially true about a short sale, which is time consuming and cumbersome for everyone to get through. A seller and his or her broker should disclose up front in any multiple listing service posting and in any advertising or meetings regarding the property whether a property is subject to a short sale. Even if a seller is selling a property directly without a broker, the seller needs to disclose up front if the property is going to

be subject to a short sale. It will save everyone a great deal of time and money and likely avoid an expensive lawsuit.

This column is the work product of Lombardo & Gilles, LLP, which has offices in Hollister and Salinas. Patrick Casey is an attorney with Lombardo & Gilles, LLP. You may contact the author at (888) 757-2444 or patrick@lomgil.com. Mail your questions to Patrick Casey, It's the Law, c/o The Pinnacle, 380 San Benito St., Hollister, CA 95023.