

Short Sale Issues in Today's Real Estate Market

There are many sources available for investors and licensees to learn about short sale systems being utilized in the market now. Just because someone is teaching these short sale methods does not mean that everything being taught is correct. IREC never approves or blesses licensees'/investors' contract forms or business models for short sales. Licensees need to be careful when becoming involved in short sales to not assist in double contracts or defrauding a mortgage holder. The mortgage holder expects the short sale property will not be immediately flipped in a simultaneous double closing at a higher sales price. The Commission's new Guideline #18 Dealer in Options (attached) provides useful information to licensees and investors. Cooperating with an unlicensed practitioner, or assisting in the deception of a lien holder will subject you to discipline by the Idaho Real Estate Commission, so if you have any questions about whether something is legal or correct, call the Commission.

The short sale scenario to be careful of, involves an investor who is flipping a property for a profit. Many times these investors are engaging in the unlicensed brokerage of real estate. Many times these investors are making false or incomplete representations to the mortgage holders to obtain favorable releases of liens. In some cases the "flip" transaction creates a double contract because the new lender will not loan on a flip transaction, or the deed is not properly "seasoned".

Mortgage holders require borrowers receive no proceeds from their short sales. A licensee selling his own property should not receive any proceeds from his own short sale, including any real estate commissions or short sale negotiation fees. Accurate and complete disclosures are required from the all parties involved in the transaction. DISCLOSURES are critical in short sales!!! Many title companies are no longer allowing simultaneous closings on short sale transactions now.

Common Red Flags:

- Non arms-length transaction: seller is licensee, relative, employer, etc.
- Seller is not currently reflected on title
- Seller has no interest in property, but possesses an Option to purchase the property (flipper has no right to offer the property for sale)
- Home owner shown to be a tenant or unknown
- Seller owned property for short time
- The distressed homeowner has quit claimed title or signed a warranty deed to a third party
- Investor not allowing subsequent buyer to pursue FHA financing due to title seasoning requirements by lender
- Investor tells you that the Idaho Real Estate Commission reviewed and approved this program

Sincerely,



Jeanne Jackson-Heim, Executive Director
Idaho Real Estate Commission

Enclosure: *IREC Guideline #18*

DEALER IN OPTIONS

The Idaho Real Estate License Law requires that a person acting as a “dealer in options” must hold an active Idaho real estate license. A “dealer in options” is defined by statute to include any person who obtains or uses options to purchase real property “for another or others,” whether or not the options are in his name or title passes through him.

This Guideline addresses the License Law’s distinction between being a “dealer in options,” which is defined as brokering activity and requires a license; and using an option to purchase property for a person’s own account, which does not require licensure. The Guideline also addresses the implications of having a licensed person involved in the option holder’s activities.

Purpose and Scope of the License Law

The License Law does not attempt to regulate the real estate market itself. Instead, it defines and regulates the activities of persons who “broker” real estate deals “for another or others.” However, the Law recognizes and exempts from regulation the option, purchase or sale of real estate “for a person’s own account,” and similarly exempts the sale of an interest in real property “by its owner.”

An Option Holder is Not An Owner Of The Property, and Must be Licensed to Broker that Property

It is important to note that a person who obtains an option to purchase property has not obtained any ownership interest in that property, and accordingly, the License Law’s “owner exemption” does not apply. Because an option holder is not an owner of the property, he may not list, sell, negotiate, procure buyers for, or otherwise broker that property unless he has a license.

The Commission often sees documents called “option agreements” or “reservation agreements” but which are not legally-enforceable options to purchase. To have an enforceable right, or option, to purchase real property, the option contract must contain all terms material to the contract, including price, expiration date and an exact description of the property. An option contract is binding upon the seller and entitles the option holder/buyer the right - but not the obligation - to purchase the property on the terms and conditions set forth in the option agreement. An “agreement” granting the holder merely the ability to make an offer which the seller is not bound to accept, is not a binding option agreement.

Dealer in Options vs. Option for Person’s Own Account

As noted earlier, if a person uses an option to purchase property for his own account or use, no license is required. However, a person is acting as a Dealer in Options and must be licensed if the person uses options to purchase property “for another or others.”

1. Use of Option to Purchase Property “for Person’s Own Account.”

Example #1:

Investor locates distressed property and obtains from Seller an option to purchase the property for a sales price of \$300,000, which is less than the \$350,000 Seller owes bank. Investor negotiates with bank to accept \$300,000 to release lien. Investor then exercises his option and purchases the property from Seller for \$300,000. The market value for the property is \$350,000, and Investor has \$50,000 equity in the property.

If Investor had no agreement with any Other Buyer to purchase the property at the time Investor exercised his

option and purchased the property, it would appear that Investor used the option to purchase the property “for his own account or use.” As such, Investor’s transaction is exempt from the licensing requirement.

2. Dealer in Options – Use of Options “to Purchase Property for Another or Others.”

Example #2:

Investor locates distressed property and obtains from Seller option to purchase Property for a sales price of \$300,000; which is less than the \$350,000 Seller owes bank. Investor negotiates with bank to accept \$300,000 to release lien, *and then finds Another Buyer who agrees to pay \$350,000 for Seller’s property*. Investor then exercises his option and structures a transaction (or sequential transactions) by which the Other Buyer ultimately purchases the property for \$350,000, with Investor making \$50,000 profit. (Note: under the statute, it does not matter whether title passes through the investor first if the option was used to purchase property for another.)

Because Investor had an agreement from Another Buyer to purchase the property before Investor exercised his option, Investor has used the option “to purchase property for another” and not on his own behalf. Investor is acting as “dealer in options” and must be licensed.

In summary, an Investor using options is acting as a “dealer in options” if, before the Investor exercises his option to purchase, he contracts with another buyer to purchase the property.

Other Brokering Activities for which Investor Must be Licensed.

Whether an Investor has an option to purchase or not, he may be engaged in Unlicensed Practice if he lists, sells, or negotiates the sale of property he does not own, or if he or procures buyers for property that he does not own. For example, where an Investor locates a distressed property and obtains Seller’s agreement to allow Investor procure an ultimate Buyer for that property, the Investor is engaging in brokering and must have a license.

Question 1: Is the Investor required to be licensed if he hires a Licensee to list the Properties?

If an Investor is acting as a Dealer in Options, or is otherwise procuring buyers for properties that he does not own, is the Investor engaged in Unlicensed Practice if he hires a licensee to list and otherwise broker the transactions?

Yes. If an Investor is using Options to put together sales between property owners and Other Buyers, he is acting as a dealer in options (brokering) and must be licensed, even if he hires a licensee to assist him by listing the property. Note: in these schemes, the listing typically names the Investor, not the Owner, as seller.

Question 2: Does a Licensee Violate the License Law by participating in an Investor’s Dealer in Options scheme?

Potentially, yes. A licensee who knows, or reasonably should know, that the Investor is not the property owner may be in violation of the License Law for misrepresenting the identity of the Seller, and also for assisting the Investor in the Unlicensed Practice of Real Estate.