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Represent REOs with caution

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Up to 50 percent of all transactions in many markets are foreclosures, short sales and REOs. Like it not, these types of transactions are part of the landscape. While you're busy protecting everyone's interest, are you taking the necessary measures to protect yourself and your brokerage?

Back in the early 1990s, I specialized in representing REOs (properties that the banks had taken back in foreclosure). At that time, my role was to do essentially the same thing that I did with every other seller. The banks sent their representatives to regularly inspect the property; they were in charge of making any repairs; and they paid for the utilities.

In 2008, this is no longer the case. In their enthusiasm to list multiple properties from a single lender, agents often agree to pay for the utilities and repairs out of their own pockets. When the property doesn't sell or the lender goes out of business, the agents are stuck footing the bill.

Many agents who represent REOs are also having an issue with lenders not providing reimbursement for the expenses the agent incurred. When agents submit a request for reimbursement, the request is lost, disappears, or the person responsible doesn't return their calls. If the reimbursement is not processed prior to the lender's deadline, the agents can be out the money they paid. Paying the utilities for several listings can run thousands of dollars per month. While this practice doesn't happen with every lender, it's a serious risk you must address if the lender says that they will reimburse you.

Reimbursements are only the tip of the iceberg. Harold Justman, an attorney who spoke at the Foreclosure Workshop at Real Estate Connect, described how lenders are now trying to push the liability attached to the sale of the property onto the brokers and agents. Here are four of the dirty little secrets to look for in a lender's listing agreement.

1. Insurance

Many lender listing agreements require the brokerage to name the lender as an additional insured on their errors and omissions insurance. They also require the broker to indemnify them for any general liability or workers' compensation claims arising from the agent's marketing of the property. In other words, they require the brokerage to assume the insurance risks that are usually covered by the homeowner's insurance. If the lender is sued, the brokerage is required to defend the lender, even though this is a conflict of interest. The result is that the brokerage now has to pay for TWO separate attorneys to defend the lawsuit.

2. Property Management

Many REO listing agreements require the listing agent to engage in property management. Property management is a high-risk activity that requires special insurance. In fact, most errors and omissions policies exclude property management coverage. This means that the brokerage and the agents are personally responsible for any litigation costs or judgments. One solution to this issue is to set up a separate property management company independent from the brokerage. The property management company bills the lender for its services and if there is a problem, it is independent of the brokerage.

3. Disclosures

Many lender listing agreements require brokers to inspect the property weekly and to report defects to the lender. Since over half of the foreclosure properties have significant damage, the brokers are now in the difficult position of having to track and disclose defects. Most agents lack the knowledge to handle this job -- after all, that's why buyers use inspectors. This creates a huge risk-management issue for both agents and their brokers. By requiring weekly reports on the condition of the property, the lenders shift the disclosure burden entirely to the agents. Furthermore, since lenders in many states are not required to make disclosures about REO property, the liability for those disclosures rests solely on the brokers.

4. Indemnification

When lenders require agents to oversee repairs on the property, the lender shifts the liability for doing the repairs onto the agents. One of the most important ways to avoid litigation in any transaction is to give a credit to the buyers for repairs. If there is a problem with the work, it's the buyer's contractors that are responsible rather than the sellers and agents. When the agent arranges for the repairs, then the agent and the brokerage are responsible for any problems. Furthermore, some contracts call for a blanket indemnification of the lender for any problems arising out of the property.

What can you do? First, you do not have to agree to a "lethal listing agreement." It's negotiable, as is any other contract. If you represent REO properties, have the listing agreement reviewed by an attorney. Justman recommends that your contract include both mediation and binding arbitration. If the lender threatens to go somewhere else, don't be afraid to walk away from this business. If you sold 25 houses where you received a commission of \$5,000 per house, the legal fees from a single lawsuit would wipe out every bit of that profit. Furthermore, the cost to your business in terms of the depositions, the trial and the time away from your other clients is enormous. As Justman put it, "When you're in litigation, you're out of commission."