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Reform Boon for Real Estate Lawyers

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Brokers and Agents Need Advice on Stricter Appraisal And Lending Standards

By Jason W. Armstrong

Daily Journal Staff Writer

Anyone who has bought a home is familiar with the thick stack of documents to be read and signed.

The stack has gotten even thicker recently as a series of new regulations and legal documentation requirements have made buying a home more complicated today than it was prior to the real estate downturn.

This, according to attorneys, raises the legal stakes for residential real estate and mortgage brokers who already are under greater pressure to craft clean, airtight deals - the antithesis of the types of transactions lawmakers and regulators say drove the nation's housing meltdown.

Meanwhile, the sweeping government financial reform legislation passed last month dramatically tightened appraisal and lending standards, among other things associated with the home buying process.

With all the changes, lawyers say they increasingly are getting calls from real estate brokers and agents to make sure they are doing everything by the book to avoid future pitfalls.

"I've had discussions with brokers about potential liability and similar issues," said David E. Harris, a shareholder at Miller Starr Regalia in Walnut Creek whose practice include real estate and construction litigation. "Guidelines have changed pretty radically since the collapse of the housing market."

In a sign that brokers are under more legal and regulatory scrutiny than ever before because of the housing bubble and ensuing financial crisis, a recent change in federal rules will require mortgage brokers to be fingerprinted as part of an extensive background check in order to do business after Oct. 1. They will have to sign up with a central registry under standards set by the Federal Reserve, Comptroller of the Currency and other regulators. In another major change, the Federal Reserve this week finalized rules banning lender bonuses for mortgage brokers who persuade borrowers to accept a higher interest rate than necessary.

In California, the state policy changes causing many brokers headaches include a January revision of the 1974 Real Estate Settlement Procedures Act. The update requires brokers and lenders to give potential borrowers a more detailed "good faith estimate" of the costs of a home loan, including origination fees and title insurance costs. If those disclosures are incorrect, the broker could be on the hook for the difference and the discrepancy could scuttle the deal.

"Now we have to guarantee fees that we're often relying on a third party to give us," said Fred Arnold, past president and public relations chairman of the California Association of Mortgage Brokers.

Arnold, who works as a broker with American Pacific Mortgage in Roseville, said his colleagues have consulted attorneys to review certain transactions and the company set up a "compliance hotline" for employees.

"The whole industry is in a mode of over-documentation and delay to make sure it doesn't cost people a lot in the long run because someone made a clerical mistake," Arnold said.

Real estate brokers are struggling with their own paperwork as they adjust to the specialized forms and disclosures governing short sales, a popular alternative to foreclosure, according to Robert J. Bell, a San Diego-based real estate transactional partner at Luce Forward Hamilton & Scripps.

In short sales, which comprised 12 percent of all homes sales in the first quarter of 2010, the bank accepts a payoff for a property that is worth less than the outstanding mortgage. The deals require large amounts of additional documentation including thorough evidence of financial hardship on the part of the borrower.

"Large brokerage houses have their own in-house legal people, but you will get brokers who will want to hire attorneys in complex deals that they don't feel they understand," Bell said. "They might have their client hire a tax attorney to advise them on the ramifications of letting the property go to foreclosure or doing a short sale."

Further complicating deals was the state Department of Real Estate's April addition of a string of new technical caveats to the state's Residential Purchase Agreement.

Major changes include a "coupling" of the loan and appraisal contingencies on a property. Before, when a buyer removed a loan contingency - meaning he or she qualified for a mortgage - the property maintained its appraised value. Now, a loan contingency release automatically removes the appraisal contingency unless a broker or agent actively separates the two contingencies in the contract.

That could prove tricky, because a lender could order a new appraisal, said Jason Oppenheim, a Beverly Hills-based real estate broker, lawyer and general contractor.

"If a buyer's agent hasn't decoupled the loan contingency and the appraisal contingency in the contract and the lender ends up not funding the loan because of the appraisal, the buyer can lose his deposit," said Oppenheim, a partner with Joyce Rey of Coldwell Banker Previews International. Oppenheim, who represents buyers and sellers of high-end homes, previously worked as an associate at O'Melveny & Myers in Los Angeles. He said his legal experience has proven important to his brokerage job, particularly in light of the recent contractual changes and increased regulatory scrutiny.

For example, while representing the buyer and seller of a recent Brentwood home sale, Oppenheim said he was faced with a "litany of issues" including thorny certificate of occupancy issues in the title report that arose from additions over the years.

"Throughout the escrow process on this property it was necessary for me to draft amendments [and] agreements," Oppenheim said. "My background as an attorney was important as I was often in a position where I was being asked by both of my clients to avert future confusion and potential adjudication."

Harris said lenders have tried unsuccessfully to hold brokers liable for deals gone bad through a federal court case called *Holley v. Crank* (2004) 400 F.3d 667. In that case, the 9th U.S. Circuit Court of Appeals held that a real estate broker could be sued for his agent's alleged mistreatment of a minority couple in a transaction.

Liability is "always a concern," said Geoff Hamill, a Claremont-based real estate broker with Prudential Wheeler Steffen Real Estate Inc.

"With most of the companies that insure us, their coverage has become less and their deductibles have become higher," he said. "I personally make sure all my work is double-checked and triple-checked."