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Are Rogue Realtors Becoming Escrow Vampires?

A wholesaler and longtime friend called me to ask if either I or any of my students was looking at two specific properties. He gave me the addresses but they didn't strike a bell with me. I asked why and he went on to relate that he had contracts on both and that the realtors involved had stolen his deposits and he was having to fight to get the deals closed and/or get his money back. These deals have some serious lessons for newbies and seasoned pros alike so take the time and read all of this article – it could save you tens of thousands of dollars!

Here are two examples of real estate investors buying properties and assuming they were getting clear, marketable and insurable title – but they didn't! The first example was an investor selling through a realtor and the realtor asked the buyer to have the deposit made directly to his firm. First lesson, NEVER write an escrow check to a realtor or his firm. Rather, write your escrow to the closing agent or an attorney who will escrow these deposits. Many brokerage firms have their own closings agents where they direct the business, and this is not any better than writing the deposit to the agent himself.

If you read listing agreements, very often the agent is entitled to get his commissions from the “failed” deal before the seller gets any escrow money. So if there is a problem with closing, the realtor has the escrow deposit and the buyer will have to fight the realtor who may be making more money from the escrow deposit than the commission on the property (cheap REO Properties).

Real life example #1 – Investor-buyer signed a contract for an REO with a licensed realtor and the lender's addendum stipulated they would provide insurable and marketable title. The buyer was required to put up a large deposit, but didn't initially because he had resold the property to another investor and was getting the actual deposit from the second investor. Ironically, the second investor sold it again to another investor who was the final end-buyer who actually put up the deposit that trickled down to the realtor. The original investor related to me that he is finding major title issues, or discrepancies, in at least 10% of his deals, while we are finding closer to 20% in our deals.

The investor-buyer's closing agent that was shadowing the deal called to say that the seller had a lien attached to another property (not the REO he was selling) and the title wouldn't be “marketable” if the lien issue wasn't cured before closing. The investor could close, but his title policy would list an “Exception” for the lien and the lien would stay attached to the property when it was resold. Besides having our deals shadowed by our closing agent, we always have the closing agent delete the “B-1's” or Schedule B exceptions to the title policy at the closing. Only once have they refused recently and we wouldn't close until they finally did.

This cross-filing of liens in the public record, against a common owner, is reasonably recent in most municipalities because of the budget crunches by local governments. It is especially onerous if you are a trustee on a land trust and

don't even own the property in question. Simply put, the lender has a lien against another property and it attached to all the other ones he owned, including this property. So when the investor-buyer goes to sell in the future, this lien is a cloud in the public record and should be paid by the seller, if it is properly disclosed.

The original investor-buyer now knows there is a title issue and he checks the contract and sees that the seller agrees to deliver insurable and "marketable" title - which can't be done unless the lien is resolved. The seller can get insurable title but with an exception to the lien included. This is not legally a marketable title so the original buyer-investor could still close and let the end-buyer find out months or years later, and then expect a law suit to follow. What he did was contact everyone involved and tried working toward a resolution. The closing agent agreed with the investor-buyer but the realtor didn't and canceled the contract for failure to close "on or before the closing date" and kept the deposit.

I guess what added insult to injury in this case was that the realtor started calling his investor list to re-sell the property and collect yet another deposit and possibly keep yet another escrow deposit. By the way, the \$5,000 escrow was almost double the commission the realtor would have received if he had sold the property to the original investor-buyer. An Asset Manager (lender) selling an REO will almost always ask that the deposit be placed with the closing agent of their choice. If you see an Addendum that wants the deposit held by the realtor, it is likely because it is not an REO or the Asset Manager doesn't know it is happening.

What the final outcome will be is anyone's guess, but the realtor should be reported to the Attorney General's Office and his Board of Realtors. Likely it will take at least that action to get the deal completed with the first investor and to get the end-buyer's deposit back.

Real life Example #2 – This property was an REO and the Contract Addendum stipulated that insurable and marketable title would be conveyed. However, there was an IRS lien against the property from the former homeowner. IRS liens are different in that they are supposed to have a "lifetime" of 120 days from when the property is transferred. This means that should the IRS choose, it can come back for 120 days after a sale and pay the buyer what he paid for the property and take it over.

During the 120 days, the title cannot be conveyed as marketable because there is a possible claim existing against the property. The IRS could issue a release of lien but it seldom happens unless you go to a local area office and plead with a supervisor. I have never seen a telephone call or mail work, and sometimes even an office visit doesn't.

So once again, the investor-buyer wants to hold up the closing until the IRS lien "expires" and the closing agent agrees but the realtor sends the deposit check to the Asset Manager who cancels the sale for lack of closing "on or before" a specific date. In this case the realtor again calls his investor buyers list and tries

to re-sell the property. The original investor-buyer had the money at risk in this case and now has to pursue threats of legal action and eventually a law suit.

It appears that in both of these cases, the realtors over-stepped their authority and were taking advantage of a situation that they partially created by not refunding the investor-buyer's deposit. Again, if the realtor has his own closing agent it had to be disclosed to the buyer and the seller. You as a buyer are allowed to escrow your deposit with another escrow agent despite what the agent may want or may say to you, unless you give up this right contractually. How often could something like this happen? If it happens to you just once, it shouldn't have if you listen to what I am conveying to you!

Just for the legal eagles out there - a "marketable (good) title" is the explicit ownership of real property that can be readily transferred to a new owner without the likelihood that any claims may be made by any outside parties. If claims exist against the property they are referred to as encumbrances or clouds on the title. Marketable title is a basic premise of any contract unless otherwise stated in the contract.

The average buyer has an expectation that his purchase will be a marketable title and in most cases it will be. The problem lies in those cases where a title is transferred with encumbrances, with, or without the knowledge of the buyer. The buyer believes that because he is getting an insurable title he is also getting a good (marketable) title. Increasingly, this is not the case especially with REO (bank-owned) properties.

An insurable title is actually an "indemnity insurance policy" against monetary loss due to defects in a title for a real property and from any mortgage liens on the property. It also protects a lender's interest in the property against loss due to title defects and is always required by institutional lenders. A property can be conveyed to a buyer with deficiencies listed in Schedule "B" of the title policy - if there is no institutional lender involved or if the lender doesn't disapprove of the deficiencies. Therefore, a title can be conveyed as "insurable" but not be a marketable title.

To sift through that fog, it means that you could buy a property and get an insurable title but when you go to re-sell it, you could find out that the buyer can't get it financed because the title is clouded. There are many reasons for a clouded title – probate issues, deed restrictions, city or county liens, IRS liens, and many others. Titles to properties can be un-clouded by legal actions such as a "Quiet Title" action or laying off lines. Be careful that you understand what you are doing when you go to close on a property and READ the title commitment from the closing agent BEFORE you close on a property.