

## **THE “DISTRESSED HOMEOWNERS” LAW: SIGNIFICANT LEGISLATION AFFECTING THE PREFORECLOSURE AND TAX SALE MARKETS**

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By the time you read this, the Governor will have signed into law House Bill 2791 which imposes new obligations on those who invest in distressed properties. Taken with the contractor - registration law that passed in 2007 and a bill to impose warranties on any new or remodeled homes (that narrowly failed to pass this year) this new law is evidence that real estate investing is in for some significant changes.

The target of this year’s new law is the distressed homeowner who is either in foreclosure or “in danger” of foreclosure or a property tax sale. Some portions of the law apply to distressed residential properties that are not necessarily the personal residence of the owner, namely investment properties.

There are a few new terms you need to know: the homeowner is called a “distressed homeowner”, an investor is called a “distressed home consultant” or “distressed home purchaser” (or both) and the “lease back (with an option)” transaction is called a “distressed home conveyance.”

What is a Distressed Homeowner?

A “distressed homeowner” is someone who is late on his or her payments to the lender or property

Taxes - regardless of whether he or she has received a formal Notice of Default or a Notice of Trustee Sale. Payments can be as little as 30 days late.

Importantly, under this new law, a homeowner who has a “good faith” belief that he or she will likely default on a mortgage some time in the coming four months due to lack of funds and has told one of a list of people of this belief also qualifies for protection under the law.

### **Becoming “Distressed Home Consultant”**

You can become a “distressed home consultant” very easily.

A person is a “distressed home consultant” if he or she tells the homeowner that he or she can stave off foreclosure, or save the homeowner’s credit, or obtain an extension of the foreclosure sale or arrange for the homeowner to become a tenant in the home with a right to repurchase the home later.

Regularly mailing or otherwise contacting homeowners on the foreclosure lists is one of thirteen ways that you can be classified as a “distressed home consultant.”

Why is this important? The first thing you need to know about being a “distressed home consultant” is that you become what is called a “fiduciary” of the homeowner.

That means that in all matters pertaining to the home, you must act in the best interest of the homeowner (even if it’s counter to your own interest) including fully disclosing to the homeowner everything that might be necessary for him or her to make a wise decision on the property.

This includes telling the homeowner about any profit you expect to make on the deal and - accounting to him or her for all of the proceeds of the ultimate disposition of the property if you purchase the home. You must also have a written agreement with the homeowner setting out everything you are proposing to do for the homeowner. -

If a “distressed home consultant” does not follow the rules for fiduciaries, it is possible that the homeowner could sue and recover damages - including all of the profit or other compensation you receive. On the other hand, if you fully disclose and act properly and the homeowner freely agrees, then he or she should not be able to sue afterwards, claiming that you broke the rules. It is crucially important that you document the disclosure and the homeowner’s agreement to your expected profit.

Licensed real estate agents are not excluded from the definition of “distressed home consultants” if they systematically contact owners who are in preforeclosure to obtain listings. The new law does not change their status, because licensed agents are already fiduciaries of their sellers and buyers.

### **Thinking about Leasing Back to a Distressed Homeowner?**

The second consequence of being a “distressed home consultant” is that you become a “distressed home purchaser,” if you purchase the home and lease it back to the homeowner - with an option to repurchase later. The new law imposes specific requirements on the purchase and sale agreements for both your purchase and the subsequent repurchase of the residence by the original homeowner and sets specific requirements for the financial terms of the deal.

Oddly, if you are a “distressed home consultant,” then as a fiduciary, you must work to the homeowner’s best interests. But if you become a “distressed home purchaser,” you are not permitted to tell the homeowner that you are acting in the homeowner’s interest or assisting the homeowner to save his or her home.

The agreements must meet specific formatting and disclosure rules and include a five day right of rescission for the homeowner to cancel the transaction without penalty. For example, you must include a statement that you cannot guarantee that the homeowner will be able to repurchase the property. Both parties must sign and date the agreement that returns the property to the homeowner before the homeowner signs the deed transferring the home to you.

Under this new law, if the former homeowner is unable to repurchase the home by the end of the agreement and is required to leave the premises, you must pay the homeowner no less than 82% of the fair market value of the property at the time the homeowner leaves. This can be in the form of paying off the homeowner’s mortgage, or in forgiving unpaid rent from the homeowner but not every cost or offset can be included in the calculation.

If the homeowner defaults on his or her lease, the new law also makes evicting him or her more difficult by allowing the homeowner to dispense with paying the rent into court as part of resisting an unlawful detainer action. [RHA’s clarification of this point: If the homeowner defaults on rent payment of their lease with the distressed home consultant, HB 2791 also makes evicting the homeowner more difficult allowing them to pay the rent in to the court registry as part of resisting an unlawful detainer action.]

### **Pre-approve Your Seller!**

The third leg of being a “distressed home purchaser” under the new law is that you are not even permitted to buy the home for the purpose of eventually selling it back to the “distressed homeowner” without documenting – beforehand - that the homeowner can reasonably be expected, to be financially capable of making lease payments and completing the repurchase by the end of the agreement.

The new law presumes that the homeowner is unable to meet the terms of a lease option or other such agreement, unless you can show the contrary with very specific documentation.

### **There are consequences**

The consequences of not following this new law can be significant.

Violations of this law are automatically violations of the Consumer Protection Act which means that if the homeowner wins, the court is authorized to award the former homeowner up to three times the actual damages (up to \$100,000 if you are found to have acted in bad faith) and make you pay his or her attorney's fees.

### **Short Sales**

One part of the pre-foreclosure market has not been affected by certain aspects of this legislation. Short sales are not included within "distressed home purchases" because in a short sale, the homeowner who sells to an investor typically has no occupancy or repurchase rights.

However, even if you are negotiating a short sale if you systematically contact owners who are shown by court records or other documents to be in foreclosure or in danger of foreclosure, or say anything to a distressed homeowner about negotiating with the bank to collect less than the entire amount due under the mortgage and release the seller from personal liability for the difference then you are a "distressed home consultant" and are subject to the obligations of fiduciaries, meaning that you may have to do things like minimize the seller's tax burden by minimizing the amount that the loan(s) is shorted - contrary to your own best interests of securing the lowest price.

### **Unintentional Violation**

The new law also creates the possibility that you may not know that the homeowner is a "distressed homeowner" and so unintentionally violate the law. Remember, simply mailing out on a regular basis to the lists of foreclosures or tax sales automatically makes you a "distressed home consultant" when dealing with these people.

A homeowner in trouble may consider it against his or her negotiating interest to disclose to you that there is any distress at all. As I mentioned at the beginning of this article, the law defines a "distressed property" to include the situation where the homeowner has a good faith belief he or she is "likely" to default on a mortgage and has reported it to someone. It's not required that he or she tell either the buyer or the "distressed property consultant."

However in most cases of a "distressed home purchase" (again, remember this is lease back with an option only) it will be clear - there are not going to be too many reasons why a seller wants to remain as a tenant in the property with the right to repurchase the home at some time in the future.

### **What Do You Do Now?**

The new law imposes specific disclosure and payment requirements on certain types of distressed transactions and prohibits some kinds of sales altogether, such as a purchase with leaseback and option to repurchase without the investor documenting in advance the homeowner's ability to meet the financial terms of the deal. It may still be possible to buy a home from a distressed, homeowner without being classified, as a "distressed home consultant." The definition is not clear on this point: but if you do not "troll" the foreclosure lists and instead simply advertise to buy houses without regard to whether the owners are in financial distress, make none of the statements in the definition about saving the homeowner's credit and so forth if a homeowner contacts you and tells you the house is in foreclosure, and simply offer to buy without any leaseback or option for the homeowner to repurchase in the future, a reasonable argument exists that you are not a "distressed home consultant" and are therefore not a fiduciary and you are also not a "distressed home purchaser."

The requirements including the specific wording and formatting for contracts subject to the law are found in Chapter 34 of Title 61 and- Chapter 18 of Title 59 of the Revised Code of

Washington. Check out the “Resources” tab on [www.reapsweb.com](http://www.reapsweb.com) for a link to the law and the House Bill that is changing it.

If you invest in pre-foreclosure or tax sale properties, then you should familiarize yourself with these changes. The new law takes effect June 12, 2008. Given the many areas covered in the new law, a future article may cover things that space limits prevented discussing here.

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