

“BUT WAIT, IF YOU BUY RIGHT NOW...”

Tips for A Creative Closing

By Joan M. Brady, Esq., CRP, GMS and Laura J. Henneberry, CRP, GMS

With some help from the experts, Laura Henneberry and Joan Brady shed some light on how to properly structure incentives to get through the issues of staying RESPA compliant, meeting the buyer's lender's underwriting requirements, and getting the deal closed.

Late-night commercials are the best. You wait and wait for the final, “and if you order right now” hard sell. It seems that the real estate negotiation process is similar these days. “But wait, we'll throw in a home warranty, a new set of dishes, six months of homeowner association dues, two snow shovels, and an invisible fence if you write a contract by 2:32 this afternoon.”

This really isn't that far from what is happening today.

During the past five to seven years, it was not necessary for a seller to offer a buyer any incentive to purchase his or her property. It was, for all intents and purposes, a seller's market. Times were good. You listed your house with a knowledgeable agent; you cleaned it up a bit; and within days and/or weeks, you had a contract in hand. Life was good.

The market has flipped itself on its head. It now is a buyer's market and they are expecting - no, demanding - any and all concessions to purchase a particular house. This is on top of a “low” sales price because, in the buyer's estimation, if the seller does not like the offer, the buyer will find a seller that does!

So, how do you negotiate deals that are going to stay RESPA compliant, meet the buyer's lender's underwriting requirements, and get the deal closed?

Jeff Arouh and RESPA

First, a little understanding of what Fannie Mae and Freddie Mac are looking at when it comes to buyer incentives.

Jeffrey Arouh, a partner in the New York office of the national law firm of Holland & Knight LLP, and a member of the Public Policy Committee of Worldwide ERC®, explained that the federal government sponsors enterprises that assist in the conduct and maintenance of the national mortgage market.

The Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac") are government-sponsored enterprises that purchase, guarantee, and assist in the investment of loans on residential properties. In order to assist lenders to determine which loans are eligible for these benefits, both Fannie Mae and Freddie Mac has published guidelines regarding acceptable loans. Some of these guidelines contain limitations regarding seller concessions or contributions by the seller or other interested parties to the purchase price paid by the buyer. That is, there are specific controls on the amount of permitted buyer incentives. According to Arouh, these controls are designed to ensure that there is adequate equity in the property to cover the Fannie Mae or Freddie Mac insured or guaranteed loan.

Arouh has advised that, from a legal perspective, these guidelines are fairly straightforward. Basically, the rules provide that the maximum amount that can be contributed to the transaction by a seller or any other person interested in the transaction (like a real estate agent or broker) is controlled by the type of property and the loan-to-value ratio. For example, the maximum allowable contribution that may be made by a seller or a real estate broker or some

other interested party to any specific transaction (the maximum incentive that may be given without adjusting the purchase price for underwriting purposes) is limited to:

** 2 percent of the property's sales price (or appraised value, if lower) for a mortgage secured by an investment property;

** 3 percent of the property's sales price (or appraised value, if lower) for a mortgage secured by a principal residence or second home, if the LTV is greater than 90 percent;

** 6 percent of the property's sales price (or appraised value, if lower) for a mortgage secured by a principal residence or second home, if the LTV is between 76 percent and 90 percent; and

** 9 percent of the property's sales price (or appraised value, if lower) for a mortgage secured by a principal residence or second home if the LTV is 75 percent or less.

While these guidelines do not affect all loans, they are good to keep in mind because, on some level, they reflect a best practice. On another level, it is extremely important to recognize that, while providing buyer incentives may enhance the ability to "make a deal," there is an element of disclosure that must be addressed. That is, the mortgage lender expects a property to have a certain value and to provide a certain "equity cushion" representing the buyer's contribution to or investment in the transaction. When buyer incentives (or seller concessions) are taken into account, that value may be changed significantly and there is some obligation on the part of the broker and, perhaps the seller, to ensure the mortgage lender is aware.

The Fannie Mae and Freddie Mac guidelines provide that the mortgage lender, for underwriting purposes, must make a downward adjustment of the sales price of a property to reflect the amount of any concessions or incentives that exceed the limitations described above.

This applies to gifts of property or any other meaningful benefit that is provided by the seller, the broker, or another interested party to the buyer. The failure to make these disclosures may amount to mortgage fraud and, given the recent state of the mortgage market, this is something in which no seller or real estate broker would want to be involved.

According to Arouh, there are nuances and sensitive areas that the buyer, seller (especially if a builder or developer), and the broker must be aware of concerning the payment and receipt of buyer incentives. Certainly, disclosure is a must. Sometimes, the question becomes disclosure by whom, to whom, and when the disclosure must be made. It is clear that hidden concessions or under-the-table payments are not permitted and, given the state of the mortgage market, will not be tolerated by mortgage lenders or mortgage insurers, and the previous practice of writing a check to the buyer and not telling the lender about it just does not work.

Beverly Kovacik and the Contract

So, as an agent, what are you to do? Beverly Kovacik, CRP, GMS, relocation director of Pacific Union GMAC Real Estate, (CITY, ST) says that the two biggest obstacles to a successful transaction are agreeing to a realistic sales price and working with a reputable and knowledgeable lender. Assuming, for purposes of this article, that the seller has set a reasonable sales price, the lender becomes all-important.

According to Kovacik, the most common incentives offered to buyers are buydown points, homeowner's dues and/or property taxes being paid for a year on behalf of the buyer, all closing costs paid in escrow, cars, or the latest incentive to hit the market: gasoline for a year (or a lump sum toward gasoline). The most outrageous concession that she has seen was the brand new Ferrari parked in front of the \$3.5 million home.

Whatever the concession offered, the lender must be aware of what is going on and the buyer, working with the lender, must qualify for the loan product that best fits the buyer's personal circumstances. Kovacik counsels her agents that they must keep in mind that any concession must fit into the buyer's loan structure.

Now that the seller has agreed to a concession, what does this mean for the buyer's ability to obtain - or keep - a loan? For example, do these seller paid costs (whether a repair credit or closing costs, for example) affect the buyer?

Vickie Craig and the Lender

Vickie Craig, a regional vice president with Wells Fargo Home Mortgage, (city, ST) said there are a number of things that buyers and sellers should consider when it comes to seller concessions, including the concession itself.

Craig added that seller concessions must be properly disclosed.

Most banks allow concessions up to 3 percent of the sales price that a seller can pay on behalf of their buyer and applied to their closing costs, she said.

And, given today's real estate market, many sellers are getting creative with the incentives they want to offer. It is pretty common to see builders tossing in big screen TVs, health club memberships, cars and even vacations if it means selling a house that has been stuck in unsold inventory.

However, a seller gift of this nature that is not material to the transaction can disrupt the desired structure of financing for the buyer. The maximum loan amount must be reduced by the value of the gift and has the potential to increase the down payment that will be required of the

buyer. In a situation where the buyer does not have surplus funds for the purchase, a concession that unloads a big gift on a buyer can negatively affect their ability to purchase the house.

One of the most common seller concessions is a credit toward the buyer's closing costs, she said. But when this concession is offered to a relocating employee it has the potential to become a huge financial challenge, especially if the company has already agreed to pay closing costs as a part of a home-purchase program. Many times it is better to simply get the seller to agree to a price reduction.

So, how can a seller leverage a concession for a buyer's benefit? In general, there are several pointers that must be kept in mind - and the most important is consulting the buyer's lender during the contract phase of the transaction to discuss the concessions being offered by the seller, according to Craig.

Stephanie Lococo and the Closing

You have a contract. The incentive is a go from the seller's and buyer's perspective, the buyer's lender has signed off on it, and now it is time to go to the closing.

Stephanie Lococo of Global American Title Insurance Agency, Inc., (city, ST) a seven-year veteran of the "creative closing wars," indicates that she recognizes two primary directives for any closing: first, follow the RESPA (Real Estate Settlement Procedures Act) rules and, second, carry out the mortgage lender's written closing instructions.

The key to a successful closing, according to Lococo, is having the appropriate paper trail for any approved credit. Any credits must be clearly disclosed on the HUD-1 Settlement Statement to be REPSA compliant and, in turn must satisfy the directives of the lender's underwriting procedures and guidelines which are typically governed by Fannie Mae or Freddie

Mac. If these directives are not satisfied, the lender will not be able to approve funding of the buyer's loan. In states such as Illinois (where closings are funded at the closing table), closings can take two to three hours while paperwork is resubmitted to the lender for approval. If the lender has been provided all appropriate documentation of the agreement between the parties, the closing process is much more apt to go smooth.

These days, Lococo states, lenders want to see and review far more documentation than in the past. Some lenders require virtually the entire loan package be faxed back to them before they will approve funding, and in some instances, initiate the wire of the loan proceeds.

And If You Buy Right Now

As we discussed, the various aspects of the closing process with our contributors, there were certain themes that ran through each interview: first, know and comply with "The Rules;" second, deal with reputable professionals; third, disclose all agreements in writing between all parties to the transaction; and, finally, have realistic expectations.

So go ahead - let the buyer "order away." You are ready for it!

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