

Representing Buyers of REOs in Oregon

By

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By now, most Realtors® have heard the rumblings about defective bank foreclosures in Oregon and elsewhere. What you may not have heard is that these flawed foreclosures can result in potential title problems down the road.

Here's the "Reader's Digest" version of the issue: Several recent federal court cases in Oregon have chastised lenders for failing to follow Oregon's trust deed foreclosure law. The specific law, found in ORS 86.735(1), essentially says that before a lender may foreclose, it must record *all* assignments of the underlying trust deed. This requirement assures that the lender purporting to now hold the note and trust deed can show the trail of successive assignments back to the original bank that first made the loan. Having such proof is a form of establishing that the lender is the proper party to file the foreclosure.

Due to poor record keeping years ago during the securitization frenzy, many banks now cannot locate the several assignments that occurred over the life of the trust deed. Since Oregon's law only requires assignment *as a condition to foreclose*, the reality of the law didn't hit home until the foreclosure crisis was in full swing, i.e. 2008 and after.

As they were now unable to comply with the successive recording requirement, the statute was frequently ignored by many lenders. The result was that most non-judicial foreclosures (i.e. where the lender forecloses the trust deed by newspaper advertisement and public recording of certain documents) in Oregon were potentially flawed. Some recent Oregon federal judges have held that the failure to record the missing Trust Deed Assignments results in the foreclosure being invalid.

Thus, it now appears that some bank REO properties may contain a title flaw when they are sold into the open market. This raises some questions:

- How will the lender convey title? Most bank REO Addenda supersede the OREF Sale Agreement in several important areas – one being the quality of the title. OREF's Sale Agreement provides that the seller will convey title by Statutory Warranty Deed. The Bank Addenda for their REOs do not do so. At best, they convey title by a Special Warranty Deed. But, this only guarantees the quality of the title during the bank's short ownership after getting the title from the foreclosure trustee. A Trustee's Deed carries

no warranties. Since it was during the trustee's flawed foreclosure that the problem occurred, this means that the bank's Special Warranty Deed will not cover the potential defect. The only thing that would suffice is a Warranty Deed, and some banks won't do this.

- What about title insurance? Will the title company *exclude or provide* coverage for foreclosure flaws? The preliminary title report should contain the answer. Realtors® should not become "title sleuths", however. But, one hint is whether the preliminary report contains a printed standard exception (not a special exception) saying, essentially, that it will not provide coverage should a title claim arise due to the bank's failure to properly conduct the foreclosure. If title insurance coverage is denied, it could result in the worst possible scenario: the bank/seller makes no warranties to protect the buyer from an invalid foreclosure, and the title company provides no insurance to cover the invalid foreclosure. This is not to say all title companies are excluding coverage – rather, it is to alert Realtors® to be watchful, ask questions, and read the buyer's title report. If there is any question at all, buyers should be encouraged to consult with their own legal counsel.

The other area of concern is the physical condition of REO properties. Because market prices remain so stagnant, and REO inventories continue to climb, banks are selling many of their foreclosed properties at very attractive prices. As a result, buyers and investors are generally willing to accept the stringent AS-IS provisions usually made a part of every REO sale. But do they fully understand the extent of these disclaimers? Here are a few of the clauses I've seen in bank REO Addenda that buyers (and the real estate agents representing them)¹ should be aware of:

- The AS-IS clause attempts to disclaim liability for all defects - even if the bank had prior knowledge of them;
- The bank reserves the right to terminate the transaction at any time – even after everyone has signed;
- The bank limits the buyers' remedies to a return of their own earnest money deposit – which is really no "remedy" at all;
- There is no right to prevailing attorney fees should a dispute arise;
- There is no right to arbitration;

¹ Although not addressed above, listing agents should be careful to make sure they meet the affirmative obligations of full disclosure required in ORS 696.805(2), which includes the following duties *to all parties*: (a) To deal honestly and in good faith; (b) To present all written offers, written notices and other written communications to and from the parties in a timely manner without regard to whether the property is subject to a contract for sale or the buyer is already a party to a contract to purchase; and (c) To disclose material facts known by the seller's agent and not apparent or readily ascertainable to a party.

- The bank expressly eliminates the buyer's remedy of specific performance that currently exists in the OREF Sale Agreement;
- The typical AS-IS clause in bank Addenda is sometimes a page or more in length, containing legalese unfamiliar to many Realtors® and their clients;
- The Addendum usually provides that if there is any inconsistency between it and the standard OREF Residential Sale Agreement, the terms of the Addendum prevail.

Brokers representing buyers of REO properties should be careful to explain to their clients that many of the "standard" buyer protections found in the OREF printed form are superseded by the bank's Addendum. While prices may be attractive, the strict "AS-IS" nature of REO transactions today requires that every buyer's pre-closing due diligence be as extensive as possible – possibly more than the standard equity sale. Once an REO purchase is closed, it could be virtually impossible to later complain that the bank had any special disclosure obligations.

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