

Distressed Property Issues Affecting Foreign Buyers and Sellers

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In the current real property market in South Florida, distressed property issues abound. Their effects are widespread and affect everyone in the market, either directly or indirectly. Foreclosures, REO, and Short sales have become common terms to most real estate professionals; however to foreign national clients, they are generally misunderstood, feared and worse, can have significant legal implications or consequences to the client.

This article attempts to briefly outline the issues that should be considered in certain situations for foreign Buyers and Sellers in this distressed market environment. It should be noted that all circumstances are different, and that each transaction has its own set of unique facts, and that this article only briefly outlines the issues at hand.

Section One

Foreign Buyers of Distressed Real Property

Given currency rates, concerns over foreign government stability, and reduced new construction prices downtown, there are many foreign national Buyers focusing on property in South Florida. While this is of course a welcome and encouraging sign, it is important to counsel Buyers looking at purchasing distressed property on the multitude of issues that can arise. These include:

(i) **SHORT SALES** - Often times, the seemingly best deals for end user and investor Buyers are purchasing real property through a short sale. In fact, in most instances it is the preferable end result for the foreclosing lender as well, and this point of negotiation is important to remember. However, as most real estate professionals these days realize, they are not without their frustration and delays. Furthermore, Buyers should be advised to retain an attorney to advise and protect them as to contract issues and title issues. Specifically, at the time of contract, even the standard FAR and FAR/BAR contracts and Short Sale Addendums present real issues for a short sale buyer to be aware of upfront at the time of contract. Particularly:

(a) Whether the Buyer has the right to cancel the deal if the Short Sale approval is not received by a certain date?

(b) Who will be responsible for past due maintenance and special assessments that have accrued since Seller stopped paying?

(c) Will the closing costs be paid by the parties normally accustomed to paying them or does contract differ?

(d) What will the Effective Date of the contract be for purposes of applying for financing, doing inspections and making deposits?

(e) Was there a Second Mortgage that was properly dealt with, as the First Lender approval does not apply to the rights of the Second Mortgage lien holder?

Of course, how to take title to the property, tax implications, including FIRPTA, and mortgage loan issues will always apply for foreign Buyers, whether in a short sale or not.

(ii) REOs - When a short sale cannot be closed, the foreclosing lender will generally take back the real property through the judicial foreclosure process as dictated by the legal system. Thereafter, once they obtain title to the property after the Clerk's Sale through a Certificate of Title (CT), they will generally list the property for sale. Foreign Buyers should be aware of several pitfalls, and as a result, strongly consider hiring a real property attorney to protect them properly. These pitfalls include:

(a) Are there open permits or code enforcement liens that did not get wiped out through the foreclosure process and may not be covered under a title policy?

(b) Were the taxes paid, as the foreclosure does not wipe these out either?

(c) Closing costs and other standard provisions that REO Sellers require Buyers to agree upon in the REO Seller's form Addendum, i.e. financing waiver, inspection limitations, and other disclaimers.

(d) Is the title agent insuring the foreign Buyer or the agent of the REO Seller, and if so, who is really protecting the Buyer at closing from exceptions to coverage that may have significant legal effects?

(e) Was the foreclosure suit properly dismissed, and the Lis Pendens released as to the subject property?

(f) Were the Florida Statute §718.116 provisions properly complied with such that the Association does not attempt to collect from the Foreign Buyer?

(iii) CONDOMINIUM RELATED CONCERNS - Even if the transaction is not a short sale or REO purchase, foreign Buyers, as well as all Buyers, should be concerned with the financial stability of the Condominium Association and the related legal and financial issues that can arise if there is an unstable Association. These include:

(a) Possible special assessments due to budget shortfalls, cuts in services to reduce budget, and increased future assessments.

(b) If there is a significant amount of delinquent owners, there may be increased legal costs to the Associations as well as problems with FNMA or FHA approval of loan applications which could affect property values.

(c) Rental restriction changes as a result of the changing marketplace.

Section Two **Foreign Sellers of Distressed Real Property**

As we all know, many foreign nationals bought real property in South Florida during the past decade. Many of them obtained mortgage financing to purchase in these transactions. Those finding themselves grossly upside down from a debt to equity standpoint, are unsure as to their rights and liabilities given this situation, and want to proceed to selling the property, but want to ensure that all legal implications are properly resolved at closing. These issues can be difficult to resolve for foreigners. Clients should be aware of the following points of concern:

1) LIABILITY TO MORTGAGE HOLDER UNDER THE PROMISSORY NOTE - Depending on whether title is in the name of a corporation (offshore or domestic) or in a client's individual name, generally there is personal liability for the foreign individual property owner under the Note. In the case of a corporate owner, there is generally a Personal Guaranty in place. As such, a foreign owner needs to be represented as it ultimately may be difficult to negotiate a release of liability. This is important as most foreign nationals will want to preserve (and ultimately rehabilitate) their credit as much as possible to one day purchase another property through mortgage financing.

Specifically, short sale applications may be more difficult without a social security number or ITIN. It may be more difficult to put together the required financial documents generally required by a short sale lender. Perhaps the leverage that the lender or foreign owner perceives is different than originally contemplated? All these issues are better addressed earlier rather than later in a transaction.

2) FIRPTA AND SHORT SALES - At this time, most all real estate professionals are familiar with the provisions of the Foreigner Investment in Real Property Transactions Act (FIRPTA). However, it is extremely important to now understand how FIRPTA affects short sales involving a foreign Seller. In past years, a foreign Seller with equity in the real property would pay the required ten percent withholding amount from the net sales proceeds. However when the property is upside down, this is an entirely different matter. The Internal Revenue Service does not distinguish between Sellers with equity or Sellers who are upside down. Withholding pursuant to FIRPTA applies in both instances. As such, a Seller in a short sale will have to come to closing with the ten percent from his/her pocket, in order to be compliant. Further, the FIRPTA requirements apply to the Buyer and Settlement Agent, as well as to the Seller. As such, it is much better to advise a foreign Seller who is upside-down that this will be the case; rather than have a surprise at closing!

Section Three

YOU CAN'T GO TO JAIL FOR NOT PAYING A DEBT!

Many foreign owners of real property that is upside down are worried about the long term implications of being upside down and know that it does not make good business sense to keep paying for a property that is grossly under water and costs more on a monthly basis than what a comparable rental property may cost. However, because they are foreigners, they worry about the unknowns. For instance, many think they may have immigration issues related to their green cards or visas. This is generally never the case. A debt under a promissory note and mortgage is a purely civil matter. The bank or mortgage holder can only pursue civil court remedies in collecting this debt. In fact, there are many defenses available to a foreign debtor in a foreclosure action. A real property attorney should be consulted with in order to fully cover these points. However, in conclusion, one should not panic when confronted with this situation. Workout options are available. It may be time consuming and include payment to legal and tax professionals; however ignoring the issues will not make them go away, and generally has a way of making for bigger problems in the long run! There is help out there; and in this market, experience does matter.