

Beware of the Changes to the Contract by the REO Addendum!

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There are now a lot of listings that are REO sales. Those are Real Estate Owned by the prior lender, after that lender became the "successful" bidder at its foreclosure sale. REO Sellers are not normal sellers. If you are a selling agent negotiating a purchase of REO property, you should be prepared to inform the Purchaser about some differences.

The REO Seller usually provides an Addendum changing the usual terms of the Purchase and Sale Agreement [P&SA]. This post discusses three changes that are important to the Purchaser: (1) the form of deed, (2) the form of title insurance and (3) the designated escrow agent.

Last month I met a real estate broker who told me about a recent purchase of an REO property for himself. He got a great sale price. However, the REO Seller provided a Quitclaim Deed with no promises about title, and the closing agent in Florida did not get a title insurance policy for the Purchaser. I advised him to immediately order a title insurance policy (*I do that a lot*), and to hope the title company would be able to insure he was the owner of the house and it was free of prior liens.

The Form of Deed.

The REO Seller will change the usual P&SA form by an Addendum that changes the form of deed to be provided. Usually, the REO Seller will agree to provide a Quitclaim Deed, "Special" Warranty Deed or Bargain and Sale Deed. See my 7/24/09 blog post, [What Promises of Title are Given by a Foreclosure Sale or Bank Sale?](#), for a full explanation of the differences in the promises of title given by those deed forms.

It is reasonable that the REO Lender will not warrant the condition of title.

The prior lender doesn't know much about the property being sold. Its employees didn't live there. The people that were living there lost the property by foreclosure. There could be active disputes about boundaries, the location of improvements, or compliance by the improvements with covenants, easements, zoning, building regulations, etc., that the REO Seller will not know about.

The REO Seller hired someone else to conduct the foreclosure. The REO Seller will not promise the Purchaser that the title has been properly foreclosed. The REO Seller will not promise the Purchaser that the foreclosure eliminated liens on the property arising from the prior owners. In fact, often there are foreclosure problems and prior liens still have foreclosure rights that can be enforced against the Purchaser.

The Purchaser therefore must entirely rely upon the owner's title insurance policy for protection. If there are title disputes going on with that property, if there are problems with the prior foreclosure, or if there are unknown liens still encumbering this property, the Purchaser will only be able to seek indemnity from the new title insurance policy, not the REO Seller.

The Form of Title Insurance.

The REO Seller will change the usual P&SA form by an Addendum that changes the title insurance for the Purchaser. The NWMLS P&SA form used in most of Washington states that the seller will pay the premium for the ALTA Homeowner's Policy of title insurance. Often, the Addendum does not obligate the REO Seller to provide any title insurance for the Purchaser. Other times, the REO Seller will only agree to pay the lower premium for the basic, standard coverage owner's title insurance.

The primary reason for the REO Seller to change the title insurance is simply to save money on the costs of the sale. The seller doesn't really care about the title insurance protecting the Purchaser.

If the REO Seller is not obligated to provide title insurance at all, that will save about \$900. If the Seller is providing only the standard coverage, that will save about \$125 compared to the Homeowner's Policy form.

Since the REO Seller does not receive normal promises about the condition of title, the Purchaser must rely entirely on the title insurance. The Purchaser should make sure that a policy is issued! And, not just any policy.

The Purchaser should choose a title company that will conduct a good title search of the prior foreclosure. A new home owner wants a house that is free from title problems. Even if a title insurance policy provides protection, an owner's claim is an upsetting process.

It is Federal law [see [Section 2608 of RESPA](#),] that the REO Seller may not require the Purchaser to use the title insurance company chosen by the REO Seller, if the Purchaser will receive purchase money funds from a federally-related mortgage loan. The REO Seller may have an arrangement with its designated title company, but the Purchaser may prefer a different company.

If the purchase is improved residential property, the Purchaser should choose the additional protection provided by the new ALTA Homeowner's Policy. See my 5/13/09 blog post, [What is Different about the ALTA Homeowner's Policy?](#), for a full explanation of the differences in protection provided by that policy compared to the standard coverage basic owner's form that is for unimproved and commercial property.

In some circumstances, the Purchaser may also want an extended coverage policy including a survey of the new property, to reveal issues with boundaries and the location of improvements. That policy form also provides protection against unrecorded liens, such as for labor or materials provided for recent improvements to the land prior to the sale.

The protection provided by title insurance varies quite a bit between these policies. The premium varies too. With typical transactions, the seller pays for that premium.

The real estate sales professionals should not choose the title insurance policy for the Purchaser. They should inform the Purchasers what the proposed P&SA provides about the duty of the Seller to pay toward the policy for the Purchaser. They should inform the Purchaser that different policies are available, but the Purchaser will be responsible for the premium above what the Seller will reimburse.

The title company will provide information about the policies and the premium for different levels of protection. The Purchasers may inform the escrow agent about their choice of policy even if the REO Seller Addendum does not obligate the Seller to pay the premium.

The Designated Escrow Agent.

Another common change made by the Addendum provided by the REO Seller is to designate a particular escrow agent. The REO Seller often has a special arrangement that provides convenience and much lower escrow fees due from the Seller. Usually the designated escrow agent is not located in Washington.

All escrow agents are not the same. A Purchaser should very carefully review the escrow instructions for the proposed transaction. In the transaction discussed at the beginning, the escrow did not obtain a title report and did not arrange title insurance for the Purchaser. It is very risky to presume the foreign escrow agent will perform the same duties that are commonly done in Washington.

The foreign escrow location causes some inconvenience for the agents and the Purchaser to get paperwork to escrow and of course the Purchaser will not be able to visit the escrow office to sign loan documents.

Similar to the change of the title insurance form, the primary issue for the REO Seller is the cost of the closing. The REO Seller will probably be paying no escrow fee, or a smaller fraction than usual. The foreign escrow agent fee is often quite a bit less than a typical escrow fee. *You get what you pay for with escrow services.* The Purchaser may prefer to pay extra to receive escrow services by a local escrow agent.

The REO Seller in some cases will not agree to a local escrow agent even if the Purchaser agrees to pay the difference. This month, CA passed a law [["The Buyer's Choice Act"](#)] allowing purchasers of REO property to choose their designated escrow agent. That does not affect Washington transactions. My experience is that the REO Seller will allow the change as long as the Purchaser pays the fee.

Inform the Purchaser.

None of these changes made by the REO Seller on the Addendum are necessarily right or wrong. If you are representing the Purchaser, you should inform the Purchaser about the changes and their options.

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