

Something Your Real Estate Broker Does Not Know: Why The Real Estate Market Just Got Worse For Sellers

In the event you are one of the many who did not think the the real estate market could get any worse for sellers, I regret to inform you, it just has. In a recent published opinion, California's Fourth Circuit Court of Appeals has created yet another obstacle that home seller's throughout the state will now need to deal with. Based on the Court's ruling, it is now the law that "non-refundable" funds released to the seller in the course of an escrow must, in most instances, be returned to the buyer when the sale fails to close. More troubling that the rule itself is the fact that the recent change is something your real estate broker is likely not aware of.

The Court's ruling is bad news for sellers. According to DataQuick Incorporated, more than 65% of recent escrows for home sales throughout Beverly Hills and West Los Angeles are extended 30 days or more beyond the originally negotiated term. The reason is primarily the result of the buyer's inability to obtain financing. Typically, when this happens, the buyer requests an extension of the escrow closing date and the seller, faced with a struggling economy and a limited supply of buyers, reluctantly agrees to extend the escrow. Though this scenario can routinely occur without incident, serious problems can arise when one extension turns into several, or when the seller has other obligations, such as funding deadlines on its purchase of a new home, which it can not meet absent the sale of its current residence. In these instances, the seller's only recourse is to request for the buyer to release "non-refundable" funds during the extended escrow period. According to many brokers and agents, this practice is commonplace in today's market, since it not only permits the buyer the additional time it requires, but it also permits the seller to have funds available to it for its purchase of its replacement property.

Unfortunately for many sellers, the recent ruling made by the Fourth Circuit Court of Appeals renders this useful and fair practice meaningless since it forces the seller to return released monies it receives. In the Fourth Circuit Case, the plaintiff and defendant opened escrow for the purchase of a \$14 million home in Laguna Beach, California. The seller requested an extension of the escrow period and released \$620,000 to the seller, which the parties agreed would be "non-refundable." Ultimately, the buyer elected not to proceed with its purchase and requested the return of the \$620,000. When the seller refused to return the money, a lawsuit followed.

Though the Orange County Superior Court agreed with the seller and refused to order the return of the money, the Fourth Circuit Court of Appeals disagreed and reversed the decision of the trial court. Based on the Court's ruling, it is now the law that funds released to the seller in the course of an escrow must, in most instances, be returned to the buyer when the sale fails to close. According to the Court, the new rule applies even when the parties agree that the funds are to be "non-refundable"! Interestingly, when presented with the above scenario, 86% of local real estate agents and brokers stated that monies released and identified as "non-refundable" should remain with the seller.

The Court's ruling is bad policy. First, it is confusing for agents and brokers, who are the front line professionals primarily responsible for arranging these transactions, but who are not licensed as attorneys and therefore not automatically trained to apply the ruling. Second, the ruling creates more obstacles for sellers in an already difficult market and interferes with the rights of represented and sophisticated parties to freely negotiate and contract.

Notwithstanding, the Court of Appeals did suggest that there are some limited exceptions that will permit the seller to retain the released monies. The exceptions are as follows:

- (1) The seller can rightfully retain released monies when the parties expressly agree through written amendments to the escrow instructions that the non-refundable deposits are expressly given as consideration for the extension of the escrow;
- (2) The seller can rightfully retain released monies if the original contract provided for liquidated damages and the released monies do not exceed 3% of the purchase price; and
- (3) The seller can rightfully retain released monies if the seller can legally establish actual damages equivalent to the sums released.

Of course, it must now be the priority of every real estate broker and practitioner to become well versed in the new rule and the exceptions to it and to arrange their transactions accordingly.