



Committee on Professional Ethics

Opinion 882 (10/14/11)

Topic: Lawyer's participation in residential real estate transaction that includes both a "seller's concession" and an equivalent "gross-up" in the sales price

Digest: If the sales price in a residential real estate transaction has been "grossed-up" in exchange for a "seller's concession," all transaction documents containing the grossed-up sales price must disclose that the sales price has been increased by a sum equal to the seller's concession.

Rules: 8.4(c).

QUESTION

1. May a lawyer ethically participate in a residential real estate transaction if the sales contract, the HUD-1 Settlement Statement, the transfer tax return, and any other documents that contain the sales price all disclose both that the amount of the sales price has been increased ("grossed-up") and that the amount of the increase equals the amount of a "seller's concession"?

FACTS

2. Seller's attorney has been presented with a contract for the sale of a single-family home for \$306,000, with a mortgage contingency clause for \$290,700, representing 95% financing. The contract also contains a provision for a "seller's concession" (*i.e.*, a reduction in the sales price)¹ of \$6,000. The seller's concession on its face requires the seller to pay \$6,000 of buyer's closing costs.

3. In reality, however, the seller will not pay the buyer's closing costs. Rather, the sales contract expressly states that the sales price has been increased ("grossed-up")

¹ The existing federal government policy regarding seller's concessions is found in U.S. Department of Housing and Urban Development ("HUD") Handbook 4155.1, § 2.A.3 (available online at <http://www.fhaoutreach.gov/FHAHandbook/prod/infomap.asp?address=4155-1.2.A.3>), and in HUD Handbook 4155.2, § 4.8 (available online at <http://www.fhaoutreach.gov/FHAHandbook/prod/infomap.asp?address=4155-2.4.8>). HUD apparently has not adopted any provisions addressing the "gross-up" of the sales price in response to a seller's concession; the HUD regulations discussing sellers' concessions are silent as to gross-ups.

by \$6,000, a sum equal to the seller's concession regarding the buyer's closing costs. The contract thus clearly indicates that the net price the seller agreed to receive was \$300,000. Similar disclosures, which show both the seller's concession and the equivalent gross-up in the sales price, are set forth in the HUD-1 Settlement Statement, the Real Property Transfer Tax Return, the Real Property Transfer Report and all other documents stating the sales price in connection with the sale of the real property. The inquiring lawyer wants to know whether it is ethical for a New York lawyer to participate in the transaction under these circumstances.

OPINION

4. In N.Y. State 817 (2007) this Committee opined that a lawyer's participation in a residential real estate transaction that includes both a "seller's concession" and a "grossed up" (increased) sales price is ethically prohibited unless the gross-up is disclosed in the transaction documents. That opinion did not hold that a seller's concession or gross up was improper. Rather, the opinion held that full disclosure of the gross-up in the transaction documents was necessary to avoid a misrepresentation regarding the amount of the purchase price.

5. In essence, we concluded in N.Y. State 817 that it is a misrepresentation under DR 1-102(A)(4) (the predecessor to Rule 8.4(c)) for the transaction documents in a residential real estate transaction either to contain an untrue statement of a material fact or to omit a material fact where the untrue statement or the material omission makes the statements contained in the transaction documents materially misleading.

6. A statement may be literally true with respect to the facts stated, but may fail to include other facts necessary to prevent a false implication, and a "failure to disclose is generally considered as much a misrepresentation as a false affirmative statement." *U.S. Express, Inc. v. Intercargo Ins. Co.*, 841 F. Supp. 1328, 1337 (E.D.N.Y. 1994). An assertion need not be fraudulent to be a misrepresentation. Disclosing a seller's concession without disclosing a matching gross-up in the sales price produces a half-truth, which is a form of misrepresentation within the meaning of Rule 8.4(c).

7. Our opinion in N.Y. State 817, at ¶ 14, makes this conclusion abundantly clear. We stated as follows:

[A] lawyer may not ethically participate in such a "gross-up" of the actual purchase price and concomitant seller's concession unless there is neither deception nor misrepresentation at work in a transaction and its predictable consequences. At a minimum this means that the gross-up (and not merely the grossed-up purchase price) must be disclosed in the transaction documents. We are persuaded that merely reporting "a seller's concession" may imply either that the seller has agreed to reduce the purchase price he or she would otherwise have obtained or that the reported sales price is the actual price of the property, less certain costs the seller has agreed to

pay. If neither of these is the case, then reporting a concession, without more, is misleading under DR 1-102 [now Rule 8.4].

8. In reaching this conclusion we were aware of New Jersey Opinion 710 (2006) and its December 22, 2006 clarification.² See N.Y. State 817 nn. 4 & 8. We are also aware that after we issued N.Y. State 817, a further clarification of New Jersey Opinion 710 was released.³ Nothing contained in New Jersey Opinion 710 or the two subsequent clarifications is inconsistent with N.Y. State 817 or with this opinion.

9. We have been advised that, in the circumstances addressed in our opinion here, the mortgagee bank is generally furnished with copies of the following documents: (i) the contract of sale with its riders and addenda (if any), (ii) the HUD-1 Settlement Statement, (iii) the closing statement, (iv) the mortgage, (v) the note, (vi) a mortgage title policy, and (vii) the deed. We assume that the real property will be assessed based upon the \$306,000 “disclosed” sales price, not the \$300,000 actual price, unless the documents make clear to the assessor that the true sales price was \$300,000. See RP-5217 Real Property Transfer Report Instructions ¶ 13 (requiring that the seller’s concession be deducted to reach the actual or full sales price).

10. The factual pattern described in this opinion is unlike the circumstance where the seller actually bears an economic cost equivalent to the concession. For example, if a building inspection discloses a defect in the structure (e.g., a leaky roof) that will require the buyer to expend \$6,000 in remediation costs, the seller may reduce the sales price by \$6,000. Thus, the initially agreed sales price of \$300,000 would be reduced to \$294,000 and would not be grossed-up by a like amount. This is a distinction with a difference. In the situation we address, in contrast, the “gross-up” in the sales price to offset the seller’s supposed concession could well be characterized as a subterfuge. It does not change the economic result of the transaction for the seller. As stated in *LaSalle Bank, N.A. v. Shearon*, 23 Misc. 2d 959, 964-65, 881 N.Y.S. 599, 603 (Richmond Cty. Sup. Ct. 2009):

The term *seller’s concession* implies that at the time of closing the seller is conceding a certain amount of the purchase price to enable the purchaser to complete the purchase. Using the facts presented in this case, a seller could concede or reduce an amount of the purchase price in order to pay for a portion of the purchase price and/or the closing expenses. But a *seller’s concession*, as it is utilized in this transaction, is a misnomer with no foundation in logic or mathematics because the seller concedes nothing to the purchasers. In this case, the sellers inflated the price of their home from \$335,000 to \$355,100 to allow the Shearons [the buyers] to borrow additional funds to close

² The December 22, 2006 clarification of N.J. Op. 710 (2006) is available at 187 N.J.L.J 42 (2007) and at <http://www.judiciary.state.nj.us/notices/2006/n061222a.htm>.

³ The further clarification of N.J. Advisory Op. 710 after we issued N.Y. State 817 is available at 193 N.J. 419, 939 A. 2d 794 (2008).

the transaction. The sellers conceded nothing other than to act as coconspirators to circumvent the Banking Law restrictions on the closing costs to mortgage ratios and to manipulate the public records of the true sales prices and market data.

11. The problem is not the seller's concession in the abstract. Many seller's concessions are legitimate. The problem here is the matching "gross up" of the sales price, which effectively wipes out the seller's concession. If a buyer has to pay \$6,000 to get a \$6,000 discount, then the true sales price has not changed. Thus, a gross up, if not expressly disclosed as such, is a misrepresentation and is proscribed by Rule 8.4(c). Consequently, if a lawyer participates in a real estate transaction in which the lawyer knows (or should know)⁴ that the transaction documents containing the grossed-up sales price do not expressly disclose that the sales price was increased by the same amount as the seller's concession, the lawyer violates Rules 8.4(c). The fact that the practice may be widespread does not authorize an attorney to participate in the misrepresentation. The Rule is equally applicable to the buyer's attorney, the seller's attorney, and the lender's attorney.

12. Even where the seller's concession and matching gross-up are suggested by a mortgage broker, a loan officer, or some other employee at the mortgage bank, the lawyer is not relieved from making the necessary disclosures. Disclosure may be even more important in that situation because the lender's representative – the very person who might be expected to detect a misrepresentation (the supposedly increased sales price that is fully offset by an unexplained seller's concession) – is encouraging the misrepresentation. No function other than to misrepresent the purchase price can be ascribed to a gross-up equal to an unexplained seller's concession. A lawyer may not participate in that misrepresentation no matter who suggested it.

13. Essentially, the inquiry poses a simple question: are the Rules of Professional Conduct violated when a seller, buyer, lender, and their attorneys engage in the device of a seller's concession accompanied by a like increase in the purchase price that create a misrepresentation? We conclude that the Rules are violated. And the violation is not without consequences. The misrepresentation in the sales price (treating the grossed-up price as the true sales price) may mislead tax assessors, real estate appraisers, and mortgage investors. However, if all transaction documents disclose that the gross up is an increase in price equivalent to the seller's concession, then there is no misrepresentation – and no ethical violation – because everyone later in the chain of mortgage, title, or interest has the information at hand to understand the true sales price.

⁴ Rule 1.0(k) provides as follows:

"Knowingly," "known," "know," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

A lawyer "should know" a fact when it can be readily inferred from the circumstances.

14. Applying these principles to the facts we have been given, we conclude that an attorney may ethically participate in a real estate transaction where the sales price is grossed-up by an amount equal to a corresponding seller's concession if the amount of the gross-up and the amount of the seller's concession are expressly and meaningfully disclosed in all documents that state the sales price, including but not limited to the contract of sale, the HUD-1 Settlement Statement, and all other documents that the attorneys prepare, review or approve.

15. A seller's concession is not *per se* inappropriate. The vice of the seller's concession here is the misrepresentation resulting from lack of disclosure that the buyer agreed to the grossed-up sales price solely in exchange for the seller's "concession." The misrepresentation would be canceled by meaningful express disclosure of the true nature of the transaction. Thus, where all documents that refer to the sales price also expressly state that the sales price has been increased by a sum equivalent to the seller's concession, the lawyer's ethical duty has been satisfied. For example, a lawyer could ethically participate in a residential real estate transaction where the sales contract, the HUD-1 Settlement Statement, the transfer tax return and any other documents that contain the sales price each contain the following statement (or a substantially similar statement): "The sales price has been increased by a sum equal to the seller's concession."

16. We are aware that when the transaction documents accurately disclose the connection between the gross-up of the sales price and the seller's concession, some banks or other lenders may be unwilling or unable to approve the amount of mortgage money a buyer needs. That does not change our opinion. Under Rule 8.4(c), lawyers may not engage in conduct involving misrepresentation. Whether lenders wish to participate in transactions where the transaction documents meaningfully disclose the connection between the gross-up and the seller's concession is a matter for the lenders and their regulators. Whether lawyers may participate in such transactions when the documents do not meaningfully disclose the connection between the gross-up and the seller's concession is a matter for the Rules of Professional Conduct.

CONCLUSION

17. We conclude that Rule 8.4(c) does not permit lawyers to participate in residential real estate transactions involving a grossed-up sales price that was exchanged for an equivalent seller's concession unless all documents stating the grossed-up sales price also disclose that the sales price has been increased by the amount of the seller's concession. Conversely, when a residential real estate transaction involves both a seller's concession and a grossed-up sales price, but each document stating the grossed-up sales price also discloses that the sales price has been increased by a sum equal to the seller's concession, there is no misrepresentation, and therefore no ethical violation.

DISSENT

18. A minority of the Committee disagrees with the conclusion in this opinion that a disclosure of more than the fact of the seller's concession is necessary. The minority believes that the existence of the federal guidelines cited in footnote 1, which permit, within certain defined limits, seller's concessions that provide a benefit to buyers in connection with their financing without altering the required loan-to-value ratio, strongly indicates that the industry as a whole is familiar with the practice of financing a buyer's closing costs. There is no evidence that tax assessors, real estate appraisers or mortgage investors are misled where a seller's concession – inherently a reduction in the amount the seller receives – is disclosed in the various transaction documents. It makes no economic or ethical difference, in the minority's view, whether such a concession is agreed upon as part of the initial price discussion or as part of a later "gross-up" of the sales price.

(43-09)