

**WHOLESALING REAL ESTATE:
WHAT IT IS, WHAT IT ISN'T, AND WHAT NEEDS TO BE DISCLOSED**

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The word “wholesale” usually implies, as supported by the common definition of the word found in the dictionary, the sale of some type of good or commodity in quantity usually at a discount and for resale by the purchaser. When used in real estate, that term has an entirely different meaning. Usually it arises in the context of an individual or entity acquiring an equitable interest in a property, then marketing that property for sale to another buyer who eventually purchases the home from the original seller. Still with me? Let’s break it down. The following, while not the all-inclusive list of all wholesaling activities, is usually the most common pattern.

Seller owns a property. Seller is often highly motivated or on the brink of going into a distressed sale situation. Buyer 1 approaches Seller and offers to “wholesale” the property. Truth be told, I’m not exactly sure what is discussed, more importantly disclosed, to the Seller at this initial conversation with Buyer 1. Most likely, Buyer 1 advises they can sell the home quickly without repairs, involving a real estate agent, paying a commission, or that Buyer 1 will offer cash and a quick close.

Buyer 1 and Seller enter into an agreement outlining that Buyer 1 will market its equitable interest in the property for sale to other potential buyers (“Agreement One”). Through these marketing efforts, Buyer 1 will identify Buyer 2 who will ultimately purchase the property from the Seller. Buyer 1 and Buyer 2 enter into an agreement for the purchase of the property, often at a purchase price much higher than the purchase price in the agreement between Buyer 1 and Seller (“Agreement Two”).

At closing, Seller executes closing documents conveying the property to Buyer 2. Seller receives proceeds in an amount outlined in Agreement One. Buyer 2 pays the amount of the purchase price as outlined in Agreement Two. Buyer 1 is generally compensated by the difference between the purchase prices in Agreements One and Two.

Simple enough, right? Not so fast. Remember that the Pennsylvania Real Estate Commission and relevant licensing law requires a licensee to obtain the permission of an owner prior to marketing a property or any interest therein for sale. Therefore, a licensee must disclose the fact that he or she is going to market the equitable interest (or both the Seller’s legal interest and Buyer 1’s equitable interest) in the property. At best, it’s unclear whether the Commission’s requirement extends to the “owners” of the equitable title, legal title, or both.

Other issues arise in terms of who completes the Seller’s Disclosure as required by Pennsylvania law. The Pennsylvania Seller Disclosure Law applies to “a **transfer of any interest** in real property located within this Commonwealth...” 68 Pa. C.S. § 7103(A) [emphasis added]. When the Seller conveys its equitable interest to Buyer 1, Seller must likely complete a Seller Disclosure and provide it to Buyer 1. Similarly, depending on the structure of the second transaction, when Buyer 1 enters into Agreement Two with Buyer 2,

Buyer 1, Seller, or both may have transferred an interest in the property to Buyer 2, necessitating both Buyer 1 and Seller to complete a Seller Disclosure and provide it to Buyer 2. Of particular note, the Seller Disclosure does not require the disclosure of the owner's status as owner of the equitable interest, legal interest, or both. Whether disclosed from the outset or when Buyer 2 completes a title search and discovers Seller is the owner of the property and not Buyer 1, Buyer 1 never holds both legal and equitable title as the Seller conveys the property to Buyer 2. Regardless, remember that "I have not lived there" and "I only owned it for a month or two" are not legally permissible excuses for [Buyer 1's] failure to complete a Seller Disclosure.

Several financial implications should also be considered. All parties involved must consider the two transactions realty transfer tax trap. In the foregoing instance, the Pennsylvania Department of Revenue has taken the position that unless Agreement One is properly voided or novated, Seller has effectively conveyed equitable title to Buyer 1 and then conveyed legal title to Buyer 2. In other words, Buyer 1 and Seller would be jointly responsible for paying Two (2%) percent of the purchase price for Agreement One, and Buyer 2 and Seller (and Buyer 1 who is also conveying equitable title to Buyer 2) are jointly responsible for paying Two (2%) percent of the purchase price for Agreement Two. Be careful of the use of Novation Agreements without consulting with legal counsel. If not completed correctly, all obligations between Buyer 1 and Seller may be nullified as a result.

Likewise, often times the fee or compensation that Buyer 1 collects from Seller in locating Buyer 2 is more than what Seller likely would have paid had he or she just listed the property by conventional means, especially in the seller's market that currently exists in the area.

A final word of caution to licensees involved in a wholesale transaction: the Code of Ethics and all other Commission-imposed requirements apply. Article 1 of the National Association of Realtors® Code of Ethics prohibits licensees from purposefully misleading a consumer as to a property's market value, or from misleading a consumer as to savings or benefits realized by using that licensee's services. What does this mean for the licensee? Make sure the consumer is getting the whole picture before agreeing to the wholesale process.