SHORT SALES (BOON OR BUST?)

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I. Q: What is a "short sale"? A short sale is simply a transaction where the proceeds of the sale will not be sufficient to cover the outstanding debt and closing costs. In other words, the value of the property being sold is less than the total debt associated with the property.

II. Simple in theory, difficult in practice.
   a. Much effort required and very time consuming.
   b. Most of the work is required up front, before contract is ever approved.
   c. Totally contingent upon lender approval.
   d. Lender may not ultimately approve.
   e. Potentially a great deal of work for no results.
   f. Many pitfalls and much potential liability.
   g. Like a quadruple bypass (relatively common, bloody, risky, potentially fatal).

III. When is a short sale available or feasible?
   a. FNMA's preferred workout hierarchy:
      i. Forbearance
      ii. Repayment plan
      iii. Homesaver Advance
      iv. Modification of Mortgage
      v. Preforeclosure sale (short sale)
      vi. Deed-in-lieu of foreclosure
      vii. Foreclosure
   b. Has the homeowner exhausted the first four options?
   c. Is the homeowner already in default? Will the lender negotiate in the absence of default? Should you advise a client to default?
   d. Have foreclosure proceedings begun?
   e. Will homeowner be able to establish "hardship"?

IV. Pitfalls and traps.
   a. Lender is not a party to the contract, but has absolute control over the transaction (seller, buyer and Realtor have lack of control and predictability).

b. Unresponsiveness of lenders.
c. Multiple lenders.
d. Difficulty is ascertaining lenders and lienholders; difficulty in negotiating with multiple lienholders.
    i. First mortgage
    ii. Second mortgage
    iii. Homeowners' and condominium association liens and assessments.
    iv. Tax liens (federal, state, local).
    v. Utility liens.
e. Ambiguous or conditional estoppel letters.
f. Post-closing liability of seller.
g. General uncertainty for seller, buyer, new lender and Realtor.
h. Potential liability of Realtor and/or closing agent to seller and/or buyer.
i. Mortgage fraud.

V. Listing Agreement/Short Sale Addendum; Addendum to Short Sale Listing Agreement.

a. If no bank approval, then no commission due.
b. Bank approval contingency.
c. Requirement that all liability of seller be released at closing and that all liens and encumbrances be released. This is the ideal result, but often difficult to achieve.
d. Potential liability to seller if not properly handled.
e. MLS disclosures.
f. Compensation.

VI. Contract for Sale and Purchase; Short Sale Addendum.

a. Commission to be paid only upon closing.
b. No monies due from seller.
c. Seller to be released from all debts, liens and encumbrances, and subject to no right to deficiency judgment. This is the ideal result, but often difficult to achieve.
d. No guarantee of closing.
e. Lender authorized to discuss transaction with seller, buyer, attorneys, Realtors, closing agent.
f. Seller's right to extend.
g. Problems with FAR Short Sale Addendum.
    i. Time periods.
    ii. Multiple offers.

iii. Multiple escrow deposits.
iv. Disclosure, duties, conflicts of interest?

h. AS IS – WHERE IS.
i. Timing.
j. Buyer's financing commitment.

VII. Short Sale Package to Lender.

a. Authorization to Release Information.
b. Special forms required by lender?
c. Loan number, parties, address, contact information, social security numbers, dates of birth, drivers' license numbers, etc.
d. Estimated cost sheet for transaction (or HUD-1)
e. Hardship letter (with proof).
    i. Careful – must be consistent with original loan application.
    ii. Civil and/or criminal liability.
    iii. Mortgage fraud.
f. Financial information.
    i. Tax returns (2 years).
    ii. W-2's
    iii. Schedules.
    iv. Pay stubs.
    v. Bank statements.
    vi. Financial statements.
g. CMA or BPO.
h. Photographs.
i. Purchase contract.
j. No cash to seller.
k. No related parties – must be a bona fide sale between unrelated parties.

VIII. Disclosure, disclosure, disclosure.

a. All parties, all lenders to be advised of short sale.
b. Be especially wary with flip transactions.
c. All approvals to be in writing by party entitled to give approval.
d. ALL funds and disbursements to be disclosed.

IX. Caveats.

a. Precision and accuracy are extremely important.

b. If the short sale transaction is part of a flip, the end sale must be fully disclosed to the short sale lender, who must provide written acknowledgment to the closing agent of having received full disclosure of the end sale.
c. Likewise, the end-sale lender must be provided notice of the short-sale transaction and provide written confirmation to the closing agent of having received such disclosure.
d. If foreclosure proceedings have begun, requirements must be made for the dismissal of the lawsuit with prejudice along with discharge of the lis pendens. The short sale lender's payoff letter must include all costs and fees associated with the foreclosure action.

X. Is the potential reward worth the risk and the effort?

Short Sale FAQ From the Seller's Perspective[1]

Will there be any tax consequences to doing a Short Sale?

Typically, the tax consequences will be less severe vs. letting the home go to foreclosure. If the home is sold at foreclosure auction, you will still receive a 1099-A for the amount the lender lost due to the sale. In a short sale, most lenders (except for those that are out of business and not worried about the O.T.S.), will ALWAYS give you a 1099-C for the amount they have lost due to the short sale, if they decide to not seek a deficiency judgment (in almost EVERY case they will opt to send you a 1099-C for the amount of the loss). You should consult with a CPA regarding tax issues in a short sale. Additionally, you should become familiar with IRS form 982 prior to deciding to pursue a short sale.

Who will pay the real estate commission in a short sale?

In a successful short sale transaction the lender/creditor will pay the real estate commission and any other fees involved. The fees that are usually included in are as follows:

- Real Estate Commission- 5-7% of the cost of the home
- Any back taxes,
- Secondary notes or home equity lines of credit- this may not be paid in full but again negotiated and settled to for much less than the full amount.
- Typical closing costs, including title insurance, deed preparation and other closing costs

These fees will all be paid by the bank in a successful transaction. A $200,000 sale price could have anywhere between $12,000 to $15,000 in fees on top off any secondary notes and what it will cost to release the junior lien.

Can the bank give me a 1099-C and report my credit as paid less than agreed?

Legally? No. Do they do it anyway? Yes. So, you will need to keep that 1099-C as proof that they 'wrote off' that loss by essentially 'giving you the difference of the purchase price and amount owed as income'. The bank cannot legally report 'paid less than agreed' to the credit bureaus if they accepted partial payment of the not e and also sent you a 1099-C (income to you) for the difference of that note. Talk to a Real Estate Attorney for clarification on the subject. If needed, you or your attorney can contact the bank at a later date about 'fixing' their slight oversight in sticking it to you twice.

Can the bank seek a 'deficiency judgment' for the amount they lose by accepting a Short Sale?

In most states yes, but a lot of the time they will opt to send you a 1099-C and write it off as a loss on their books. The thing that you should know is that VERY FEW lenders will seek a deficiency judgment due to the cost to get the judgment and due to the fact that you probably can't pay it anyway. 99.99% of the time the lender will send you a 1099-C instead of even worrying about the deficiency judgment, even when they can legally seek that option. Once they have sent you a 1099-C, they cannot seek a deficiency judgment. They can only do one or the other, not both.

[1] From Phoenix Metro Real Estate Short Sale Pros, www.myrealpro.com. Accuracy of content is not guaranteed.

Why should I do a Short Sale? ***If I am going to have to move anyway, why shouldn't I just allow the bank to foreclose so I can stay in the house rent free for longer?***
The main benefit of a short sale is that many in many instances you can still stay in your home rent free just as long as if the house were to go to foreclosure and you will still be able to show your mortgages as "paid in full" vs. "foreclosure". The amount of loss to the bank is usually less in short sale, thus the amount of the 1099 to the homeowner in a short sale is less. You will also want to have an expert on your side dealing with the lender. If you allow your home to go to foreclosure, there is no one there to help you clean up the mess and pick up the pieces as you struggle with bad credit for the next 7-10 years.

What is a short sale?
A short sale is the process by which homeowners can sell their home for less money than they actually owe on the mortgage(s). This is accomplished by providing proper documentation to the lender(s) to convince them to reduce the mortgage balance to allow the sale. If the sale is approved, the mortgage lender(s) will actually take a loss on the mortgage. If a bank approves the discount of a mortgage, the home can be sold for a price lower than the amount owed without the seller having to come up with cash to cover the shortfall. The mortgage is satisfied and any foreclosure process stops.

How does the bank decide what price to put on the property?
Every bank has a specific method of deciding how much they'll accept on a short sale.

What type of situation is the short sale best for?
Most short sales are accomplished on properties heading toward foreclosure. This means the homeowner is at least 3 payments behind, and the foreclosure process has already begun. Recently however, more mortgages that are simply behind or "in default" are considered short sale candidates without actually being in foreclosure. Next, the homeowner typically has no equity or negative equity in the home. In other words, the total balance owed to the lender is equal to, or greater than, the price at which the house can be sold. Lastly, the homeowner must have some type of financial "hardship" which is preventing him from paying the mortgage.

How does a homeowner benefit from a short sale?
First and foremost, a short sale relieves the stress of being in foreclosure and it allows the homeowner to get rid of their big mortgage payment and move on with their lives. A short sale allows you to stop a foreclosure proceeding and get a fresh start. In our experience, this is the primary benefit to the homeowner. On the credit side, a short sale is arguably the lesser of two evils. Having some late payments and a foreclosure filed has already done damage to your credit. However, a completed foreclosure generally does more damage than a short sale agreed to by a lender. Obviously, a bankruptcy significantly damages your credit score.

I'm an investor, can I short sale my rental property?
Yes, but remember the "hardship" element which must be present. For investors there may also be some income tax issues resulting from mortgage relief. Remember to consult your tax advisor.

Does it matter what kind of loan I have?
Possibly. In some instances there is a potential risk of a deficiency judgment or a lawsuit on a loan contract, as opposed to judicial foreclosure.

I am in foreclosure. Is a short sale for me?
Each situation is different and must be evaluated individually. The important factors in relation to a short sale are:
a. Property in foreclosure or default
b. Personal financial hardship
c. Little or no equity in the property
d. At least 60 days until auction date
e. The value of the home has declined below the loan amount

What if my mortgage is an FHA, HUD or VA mortgage?
Short sales can still generally be accomplished on all of these types of mortgages, though each one has different criteria.

What options other than a short sale might I have?
a. Cure your mortgage default (bring your payments current);
b. Attempt a loan modification that adjusts the terms of your existing loan;
c. Refinance your mortgage with another lender;
d. Try to sell your home through normal channels;
e. Attempt to get your lender to accept a deed in lieu of a foreclosure; and/or
f. File for bankruptcy.

Who owns the house after a short sale?
The purchaser of the house is the owner after a short sale, just the same as in a normal sale. The mortgage lender is paid off and the previous homeowner moves to a different home.

What do I do about my back property taxes when I do a short sale?
Just as in a normal home sale, the property taxes are the responsibility of the homeowner until the date the sale is closed. Then they become the responsibility of the buyer. If your property taxes have not been paid this will affect the negotiations between the buyer and the bank, so you must inform me or any buyer of the taxes owed.

My home is really nice, why is the short sale offer price so low?
Sellers often have an emotional attachment to their home and may feel a short sale offer is too low. It is important to remember a few things. First, the seller in a short sale can never receive any money in the transaction. It should therefore be of little concern what price is offered as long as the short sale is done. The only real exception is when the seller has tax liability concerns. (If there is tax liability, a lower sale price means a larger mortgage relief and a greater tax liability.) Otherwise, the price should not matter to the seller. The important factor in a short sale is whether the lender will accept the price offered. Lenders often accept prices for short sales which may be surprising to normal homeowners or Realtors. Discounts of 30% are no longer uncommon. This happens for several reasons:
A. Sellers are often in denial about how bad the market really is for housing and therefore, how far the value has declined.
B. Lenders don't like the foreclosure process any more than homeowners do. Lenders incur substantial costs during a foreclosure process that can last more than 12 months. They have attorney fees, filing fees, publication fees, lost interest on the money that is tied up, property taxes, insurance, maintenance costs, as well as the potential for vandalism of a vacant home. This is all BEFORE having to try to sell the home as a bank-owned

(REO) property and pay sales commissions. A short sale is a way to avoid some or all of these costs. If a lender calculates his cost of eviction at $50,000 for a house, they will often take a $40,000 loss on a short sale instead and be better off for having done so.

Who pays the real estate commissions on a short sale?
The commissions are paid from the funds the buyer places in escrow and because there is no equity in the house, the lender ultimately is the one paying the entire sales commission.

How long does a short sale take?
A short sale can take 60 to 120 days or longer to complete. This is very important. The process is complicated and takes a lot of time. So to exercise the short sale option, you must act quickly. If you wait until one week before the auction date, no one can help you with a short sale. DO NOT WAIT.

I am behind on my mortgage payments, but not yet in foreclosure. Can I do a short sale?
Yes, this is happening with much greater regularity. Sometimes these are the most attractive short sales for both the buyer and the lender because the buyer can take advantage of the lender's ability to avoid the vast majority of the costs of foreclosure. In these cases, it is more important to have a very clear "hardship" story to explain to the lender why you are unable to make the payments.

My house needs a lot of repair; can I still do a short sale?
Yes, though it can make the process more difficult because the price must be lower to compensate for the repairs. The key is to show the bank's appraiser all the work that needs to be done.

I have more than 10% equity in my home - can I still do a short sale?
Probably not. However, you may be a candidate for a regular sale.

Other people are on the deed with me, but they don't want to short sell. Can I still do a short sale?
No. All parties listed on the deed or mortgage must sign the short sale purchase agreement. There are no exceptions to this.

I have other liens (i.e. mechanics, IRS, court judgments) on my house; can I still do a short sale?
Yes, but it gets much more complicated and will take longer. If this is the case with your home, be sure to COMPLETELY list all liens you have. Each lien holder must be negotiated with individually. A short sale in this circumstance will take substantially longer.

I have property I inherited but I can't afford the mortgage. Can I do a short sale?
Yes.

I have 2 or 3 mortgages on my house. Can I still do a short sale?
Yes, each mortgage or line of credit (HELOC) can be negotiated individually. It is important to know which mortgage filed the foreclosure or, if more than one are in foreclosure, which one filed first.

Is a Short Sale right for me?
Mortgage lenders are increasingly willing to work with borrowers faced with a financial hardship to accept a

discounted payoff on a mortgage. If you are faced with a hardship that makes it likely you will be unable to meet your obligation on your mortgage, your lender would prefer to settle the matter with you as opposed to taking the property through foreclosure. As you consider the option of pursuing a Short Sale, remember your lender is looking to limit any potential loss on your loan. By completing a Short Sale, your lender has arrived at a solution that is, for them, much better than a foreclosure.

Can I simply deed my property to someone else and avoid the hassle?

Deeding your property to someone without paying off the loan is nearly always a bad idea. In the first place, the lender still considers you primarily responsible for payment on the loan. If loan payments do not get paid, or if the lender ultimately forecloses, this will show on your credit. Secondly, when you deed your property to someone else, you give up control of the property. Along with the deed goes the ability to control the property. Do not deed your property to someone without paying off the loan unless you have consulted with an attorney.

What sort of hardship would my lender consider legitimate?

To some extent, that will depend upon the mortgage company considering the Short Sale request. Generally, so long as the hardship is real and the mortgage company believes the loan is likely to become delinquent as a result, the Short Sale request will be processed by the Loss Mitigation Department. A big key to getting Loss Mitigation to accept a hardship is to submit a strong hardship letter. The hardship letter sets the tone for the entire file. Below you will find a list of “hardships” that are common and frequently accepted by mortgage lenders:

- Family illness or injury
- Illness or injury in the extended family – particularly if it forces relocation
- Job relocation when the property is equity deficient
- Job loss or significant income loss
- Divorce or split of domestic partners
- Adjustment in mortgage payment or unforeseen increase in living expenses

I am current on my mortgage, will my lender consider a Short Sale?

The answer is, maybe. Some lenders will accept a Short Sale file for approval on loans that are not delinquent. Other lenders will not accept the file until the loan is delinquent.

Why would a mortgage company agree to accept a Short Sale?

There are actually several reasons why a mortgage company would approve a Short Sale payoff, including the following;

- Legal Concerns – Mortgage lenders have come under legal pressure to work with borrowers to equitably resolve situations where borrowers are unable to meet their mortgage obligation, particularly when the borrower makes an effort to arrive at a compromise solution.
- Wall Street is Watching – Mortgage lenders rely heavily on their ability to package and sell bundles of loans on the secondary mortgage market. They need to sell these bundles of loans in order to put the funds back to work by loaning the money again and collect loan fees along the way. If mortgages perform poorly after they are sold it could impact the lender's ability to sell their loans on the secondary market. A successful Short Sale gets the loan payoff resolved quickly.
- Asset Management Expenses- If a lender acquires a property through foreclosure, the property will be managed until it is repaired and resold. It is expensive to manage real property assets - homes – spread

throughout the region, the state and possibly even the nation. Keeping properties maintained, keeping utilities on, making repairs and the administrative costs attached to these activities are all costs the lender would prefer to avoid. A successful Short Sale eliminates most of these costs

- Reserve Requirement- Delinquent and non-performing loans place another burden on mortgage lenders. For all delinquent and non-performing loans lenders must set aside funds in reserve to deal with potential losses. These funds cannot be put to work generating new loan fees until the bad loans are resolved. A successful Short Sale lets the lender put more money to work.

How will a Short Sale affect my ability to buy a future home?

Fannie Mae primary home guidelines make foreclosures ineligible for a mortgage for 5 years, but its only 2 years for short sales. For non-primary loans, it's 7 years of ineligibility for foreclosures versus 2 years for short sales. All mortgage applications ask if you have had a foreclosure in past 7 years. No such short sale question.

How will this affect my credit score?

For foreclosures, your score may drop 250 to 300 points and will affect your score for 3 year. For short sales, typically a "Paid for less than full amount" or "Paid as negotiated" is reported and can drop your score for as little as 50 points for affect is only for 12 to 18 months.

What about credit history and future credit issues?

Additionally, foreclosures are on your credit history for 10 years. There is no "short sale" reported.
Short sales are also better for future security clearance and current and future employment.

How are deficiency judgments affected by short sales?

100% of foreclosures (except in those state where there is no deficiency), the banks have a right to pursue deficiency judgment. In some successful short sales, it is possible to have the bank waive the deficiency. Since the short sale is usually priced closer to market value, the deficiency is less compared to foreclosure.