The Short Sale

As a person ready to sell your home, you may have heard something about the "short sale" from friends and possibly real estate professionals. This brochure is an attempt to give you an overview of just what the short sale is, if it is a solution for you and the steps necessary to make this type of sale happen.

What is a Short Sale?

The definition is simple. A short sale occurs when a lender adjusts a loan pay-off down to accommodate the sale of a property. For example, a seller might have a loan balance of $100,000 and a buyer willing to pay only $80,000. If the lender accepts the offer, he has agreed to "short sell" the pay-off down $20,000.

There are many other terms describing the short sale, which you may have heard. The most common terms in the industry include:

- Short Pay Sale
- Compromise Sale
- Write Down Sale
- Negotiable Sale
- Pre-foreclosure Sale
- Pre-Sale
- Loss-prevention Sale

Don't be confused. All of these terms describe the same principle for the same transaction. The term varies from lender to lender, however the most common name is the Short Sale.

Why would a lender accept a pay-off for less than the loan balance?

Lenders must manage and mitigate their losses. The short sale option is usually a prelude and/or alternative to foreclosure. Because banks are required to maintain reserves on all properties in foreclosure, it can be financially advantageous to accept a pay-off for less than the loan amount. Remember, there must be a willingness by the lender to negotiate this type of arrangement.

Who and what situation qualifies for a short sale?

There is mainly one requirement for qualification and that is proof of hardship. Hardships are not necessarily financial. The most common hardship situations are:

Impending divorce – A situation where both spouses may be able to meet the payment before the divorce, neither party alone can afford the payment afterwards.

Illness – Illnesses where the person is unable to work and continue the loan payments.

Unemployment – A situation where an individual has inadequate income to meet his/her loan obligation.

"Hardball" – For lack of any other term, hardball refers to anyone who no longer wants the property for whatever reason and will accept the consequences whatever they may be.

What are the consequences of implementing a short sale?

1. In the vast majority of short sale situations the seller maintains a satisfactory credit rating however, derogatory credit is a possibility.
2. IRS law will require the issuance of a 1099C (Cancellation of Debt) for the difference between the loan amount and pay-off amount. For example, a property with a loan amount of $100,000 short sells for $80,000. Therefore, the lender can issue the seller a 1099C for $20,000 with applicable taxes due to the IRS.
   In reality, only about half of the banks issue a 1099C because there are usually several parties involved. None of the parties involved (lender/bank, Fannie Mae/Freddy The Short Sale Mac or mortgage insurance) are willing to accept the responsibility to issue the 1099.

There are several advantages to the short sale. The seller can reduce his/her debt, avoid foreclosure, maintain credit worthiness and most importantly, get out from under the mortgage.

However, there are also some disadvantages. Bad credit and tax liabilities can occur. In addition, any short sale from a VA loan requires payment in full (for the full amount) or the seller loses all veteran benefits including death, educational and medical until the balance is paid.

The key decision makers in the short sale process include the lender, investor and the mortgage insurer (MMI/PMI). The lender (sometimes also the "investor") typically gathers all the information required to consider a short sale package. The lender will then calculate what the actual loss is, and either approve or disapprove the package. The final decision maker is the mortgage insurer. MMI/PMI will only approve a package that has been signed off by the investor and require the most comprehensive support information.

How do you avoid pitfalls in the short sale transaction?

Now that you are armed with some short sale basics and may have made the decision to pursue this solution, there are several steps you can take to minimize your personal losses.

1. Consult an attorney and your accountant and find out how the potential negative ramifications can affect you. Real estate agents cannot advise you on legal issues.
2. Choose a competent real estate agent. The dynamics of the short sale transaction can be extremely complicated. Make sure you choose a Realtor who has specific experience with short sales. The agent's knowledge can minimize the time and potential losses involved.
3. Be prepared to give the lender all the documentation required to qualify. The information requested will be similar to the needs of your original loan package with the additional proof of hardship. Information usually requested includes tax returns, paycheck stubs, bank statements, copies of debt balances and payment schedules. ALL INFORMATION GATHERING SHOULD BE ACCOMPLISHED PRIOR TO OPENING ESCROW.
4. Be prepared to sign a statement authorizing your agent to deal with the lender on your behalf.
5. Be sure your agent uses an licensed independent escrow provider. The escrow function is a critical element in the short sale close. Only licensed independent

escrow corporations or companies are 100% neutral, licensed by the DOC (Department of Corporations) and in business solely to provide escrow. They are escrow specialists and also have more progressive knowledge about the latest industry trends.

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