

General Information on Short Sales

Definitions

Short Sale –

A real estate transaction where the lender takes less than the full amount of the payoff that would otherwise be due at the closing of the sale to a third party. The lender does not take title to the property and the deed is transferred from the seller directly to the buyer

Deed in Lieu of Foreclosure –

A transfer of the real estate from the owner/borrower to the lender by deed where the property does not pass by the power of the courts. In some cases, the borrower will pay an agreed deficiency (the difference between the loan amount due and the agreed value of the property) to the lender over time.

Foreclosure –

A forced transfer of property which is commence by a lender filing a lawsuit against an owner of the property for non-payment of the loan. The court orders a judicial sale of the property and title passes by judicial deed to the highest bidder at the auction.

REO (Real Estate Owned) –

A sale of property by the lender as title holder (owner of the real estate) after the lender has acquired title to the property through a Deed in Lieu of Foreclosure.

The Short Sale Process

1. Normally, the seller has not made payments to the lender for a number of billing cycles.
2. The seller performs a title search and determines all lien claimants and other amounts outstanding (taxes, assessments, second mortgages, etc.).
3. The seller's attorney or negotiator contacts lenders and lien holders.
4. The seller accepts a sales contract for the property (after disclosing it is a short sale and including a Short Sale Rider to protect the seller).
5. The seller's attorney or negotiator supplies the short sale lender with the following documents:
 - a. The offer contract
 - b. The proposed HUD-1 showing the amount expected to be netted to the lender

- c. A Hardship Letter (a written explanation as to what “event” has caused the seller to fall behind on payments – health, job loss, etc.)
 - d. The listing agreement with the real estate broker with proper disclosures to the seller
 - e. Tax returns
 - f. Broker Opinion of Value (informal presentation of comparables with market analysis)
6. The lender reviews the short sale package submitted and obtains its own appraisal of the property.
 7. The lender either approves the short sale or states the conditions of its acceptance (such as obtaining a promissory note for all or part of deficiency, amending the purchase price or reducing the commission).
 8. The lender issues its payoff letter and conditions (the seller gets zero funds).
 9. The transaction closes and the lender approves the final HUD-1.

Issues for Sellers

1. Is remaining debt released?
2. Is forgiven debt taxable? (Insolvency test under IRS from 982)
3. Is bankruptcy an alternative?
4. Can the foreclosure be defended in court for violations of lending laws or other defenses?
5. Can the property be sold and leased back to the owner?
6. Can a forbearance agreement be arranged with the lender if the hardship is short-termed?

Issues for Buyers

1. A short sale is usually “as is” with no repairs, so critical inspections are a must.
2. Expect deferred maintenance and budget for these future items.
3. Keep in mind that approval from the seller’s short sale lender can take several months, and closing is not guaranteed.
4. Is this the tip of the iceberg for the neighborhood or the condo association in terms of prices? What effect will additional foreclosures have on FHA approval of the building?