



For Homeowners: Understanding the Short Sale

This primer will provide an overview of the Short Sale for current homeowners considering this option. We'll address why the Short Sale may or may not be a good alternative to foreclosure, the advantages and disadvantages of the Short Sale and how to proceed with a Short Sale.

What is a Short Sale?

A Short Sale is most simply described as having the lender (mortgage bank) agree to take less to settle the loan than what is actually owed on a home. In other words, selling the home “short” of its full mortgage loan amount.

Example: Mortgage loan amount (amount owed): \$289,950
Short Sale amount (price home sells for): \$259,950

Short Sale is not a new term or technique. It's a real estate transaction that has been utilized for years but has recently gained wider attention because of the economic and real estate downturn. The Short Sale is perhaps in more frequent use today than it ever has been, however, it is not an easy solution and it can be difficult to qualify for a Short Sale.

Why consider a Short Sale?

The Short Sale is typically used as an alternative to foreclosure. Increasingly, due to the distressed economy and real estate market correction, homeowners are finding they have little or no equity in their homes. Many homeowners are “upside down” on their mortgage loans. This means they owe more than their home is worth in today's market.

Homeowners who are “upside down” on their mortgage loans and have encountered financial hardship may be facing foreclosure because they can no longer pay their mortgage and they cannot sell their homes for enough to cover what they owe the bank.

In these cases, a Short Sale is worth considering. A Short Sale can be a more productive option for both the seller and the mortgage lender. It allows the seller to avoid the painful and embarrassing foreclosure process. It also can be less damaging to personal credit. For the lender, a Short Sale can often be less costly than adding to its foreclosure inventory. For a Short

Sale to be considered by a lender, two things are key: the current market value of the house and the ability of the homeowner to pay the mortgage.

The Advantages of Short Sale

Although negotiating a short sale may be difficult, it is often worth the effort because it can be less damaging to an individual's credit and easier on future mortgage applications than a foreclosure. Some of the advantages to a Short Sale include:

- Helps protect the homeowner from complete foreclosure (a foreclosure stays on a credit report for seven years)
- Allows the lender to avoid having a foreclosure “on the books” and adding to their foreclosed inventory
- May offer a good deal for the buyer; Short Sale homes are often in better shape than foreclosures since the homes are usually lived in by the seller until the sale is finalized, and not abandoned and neglected as foreclosures can be
- Provides a productive solution to an otherwise negative situation

The Disadvantages of Short Sales

Short Sales are not a simple, quick and no-hassle solution. The drawbacks to a Short Sale include:

- Extensive paperwork and stringent requirements
- Negative affect on credit rating, and/or further financial obligations if the lender should continue to pursue unpaid debt

Property taxes are still owed, and it's important to understand that there is no guarantee that a lender who accepts a short sale will not legally pursue a borrower for the difference between the amount owed and the amount paid. As well, the I.R.S. treats the loss (the amount of the loan the bank absorbs) as income to the homeowner. However, there are provisions in the tax law to avoid taxable income if the debt forgiven was used to purchase or improve a primary residence. There is also a law that helps protect insolvent taxpayers.

Seek Expert Help

Expert counsel is crucial when deciding whether to Short Sale your home, go through foreclosure, consider bankruptcy or other options. Even more than in boom real estate times, an experienced, licensed real estate professional can ensure that the seller's best interests remain foremost during cases of hardship.

In fact, homeowners may want to seek out a real estate professional with a Certified Distressed Property Expert® (CDPE) designation. A Certified Distressed Property Expert® (CDPE) designation is achieved through extensive training in the options, solutions and effective methods for assisting homeowners dealing with financial hardship.

To locate a CDPE® real estate professional, visit www.cdpe.com. Additionally, a real estate lawyer and/or accountant may be consulted.

The Process



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Short Sale requirements vary by lender but the process demands extensive legwork and documentation. A licensed real estate agent will help the homeowner navigate through the process and address any state specific issues. Generally the steps for negotiating a Short Sale include the following:

Start Early

The best outcomes for homeowners who have gone through a Short Sale have been achieved when the homeowner starts the process as soon as they anticipate a problem. In fact, it's ideal to start the process before a mortgage payment has been missed. Being responsible and proactive can save the homeowner several points on their credit report. The sooner the Short Sale process is started, the sooner a sale may be negotiated and the fewer mortgage payments the homeowner may miss.

Talk to the Lender

Critical to the process is getting in touch with the lender's "decision maker". For some institutions, this may be the supervisor of the "Loss Mitigation Department" or, for smaller banks, it may be an Executive such as the Vice President. It may take several calls and conversations to identify the key decision maker. Additionally, the homeowner will need to establish the real estate agent's authorization to negotiate on their behalf.



Provide Information

Documentation is important and will take some time. In fact, there's often more stringent documentation required for a Short Sale than a home purchase. There may be some variances depending on your lender but typically the following documentation will be required:

- **Hardship Letter:** This letter explains why the homeowner is in a hardship situation. The point is to explain the unfortunate situation the homeowner is in, what he/she has been through (perhaps job loss, illness, etc.) and what they are facing if they go through a foreclosure. Since all other information that will be provided is factual and numbers-based, the hardship letter is the opportunity to pull at the heartstrings and appeal to the lender's emotional side.
- **Disclosure of Income & Assets:** Full financial disclosure and straightforward information is the best policy here. The lender will want documentation that supports the claim of a distressed financial situation and the absolute inability to repay the full amount of the home loan. All savings accounts, money market accounts, certificates of deposit, stocks and bonds, assets, real estate and any other investments must be divulged. Retirement accounts must also be reported. However, while a bank can't "seize" funds from a retirement account, they can deny a Short Sale if they feel the homeowner should "dip" into their retirement account to help pay their loan obligation. Copies of bank statements will also be required and the homeowner should be ready to explain any large cash withdrawals, unusual number of checks, etc.
- **Comparative Market Analysis/Broker's Price Opinion/Appraisal:** There are various ways to determine the current market value of a home. In any case, a licensed real estate professional is the best ally for the homeowner in the process. The Comparative Market Analysis (CMA) is a document primarily based on a comparison of area homes. The CMA substantiates the

homeowner's claim that, due to a drop in property values and market changes, the home cannot be sold for enough to satisfy the loan value. The CMA will show prices of similar homes in the area that are active on the market, pending sale and homes that have sold in the past six months. The Broker's Price Opinion (BPO) is less formal than a CMA and is prepared by the real estate agent based on their professional experience. An appraisal is the most formal documentation and is most effective in conjunction with a CMA. A certified appraisal may be conducted by the lender, depending on their requirements.

- Purchase Agreement: Another set of documentation best handled by a real estate professional, the Purchase Agreement is essentially an offer from a prospective buyer. The lender will want to have a copy of the Purchase Agreement along with the Listing Agreement from your Realtor. The lender may negotiate on the Purchase Agreement to minimize their loss as much as possible.

Summary



Although a Short Sale can be a preferable alternative to foreclosure, it is not without its challenges. A licensed real estate professional is strongly recommended. In fact, homeowners in distressed financial situations may want to seek a Certified Distressed Property Expert® (CDPE) who can provide even more guidance and counsel specific to their situation.

A Short Sale can wreak less havoc on personal credit, and make it possible for the homeowner to purchase a home sooner in the future than if he or she had undergone a foreclosure. When the Short Sale process is started early, there's even more likelihood that the homeowner's credit will not be damaged as much as in a foreclosure situation. A Short Sale can help the homeowner avoid some of the stress, embarrassment and “loss of control” of foreclosure. However, the stringent Short Sale process requires much documentation and patience. Taxes may be incurred and, while the homeowner can try to negotiate with the lender on how the Short Sale is reported to credit agencies, there are no special guidelines or assurances that protect the homeowner in a Short Sale.

At its best, the Short Sale can make a tough situation less difficult and damaging for the homeowner and lender.

Resources

Federal Reserve Mortgage Foreclosure Resources:

<http://www.federalreserve.gov/consumerinfo/foreclosure.htm>

Certified Distressed Property Expert® (CDPE)

<http://www.cdpe.com>

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