

## Understanding Short Sales

(Seller's Perspective)

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Where a homeowner's mortgage balance exceeds the home's value and the owner is unable to make the mortgage payments, a *short-sale* may offer an alternative to foreclosure. A short-sale is a complicated, adversarial and drawn-out process. A successful short-sale requires an understanding of the short-sale concept, as well as skillful management of the process.

### Short-Sale Defined

In real estate terminology, a *short-sale* is the sale of a home for less than what is needed to pay off the mortgage, after the costs of the sale. In a short-sale, the mortgage lender agrees to release its lien for less than what is owed on the loan so that the property can be sold with clear title. The lender may or may not also agree to forgive all or part of the difference between the loan balance and the short-sale proceeds (known as the *deficiency*). A short-sale is often more attractive to a lender than having to foreclose.

### Short-Sale Versus Foreclosure

A *foreclosure* is when a mortgage lender forces the sale of a home in order to pay the delinquent loan. If the property can not bring a price higher than what is owed, the lender will purchase it for an amount equal to the loan balance. The foreclosure sale extinguishes any junior liens on the property and the lender (now the owner) is able to market the home for sale with clear title. Foreclosed homes appear on the market as "foreclosure" or "lender owned" properties.

A key distinction between a short-sale and a foreclosure is that in a foreclosure, the lender takes title to the home and then must sell it to recover as much of the loan as it can (possibly pursuing the borrower for the deficiency). In a short-sale, the home is sold by the borrower, with the lender's agreement to release the mortgage for the net sale proceeds, which are less than the loan balance (possibly agreeing to also forgive all or part of the deficiency).

### The Advantages of a Short-Sale

From a homeowner's perspective a short-sale is preferable to a foreclosure. Because a short-sale is, in effect, a *negotiated settlement* of a debt, it will have a less adverse impact on the borrower's credit rating than a foreclosure. Further, to the extent a short-sale is more attractive to the lender (and it often is), the homeowner has some leverage to employ in negotiating forgiveness of the loan deficiency.

In the case of a troubled mortgage loan, the lender's objective is to maximize its recovery / minimize its loss. A mortgage lender will consider a short-sale strategy where foreclosure is otherwise inevitable.

From the perspective of the lender, a short-sale avoids having to take title to the property through foreclosure. This, in turn, allows the lender to avoid the substantial time, cost and risk associated with acquiring, owning and selling the property.

### Qualifying For Short Sale Approval

In considering a short-sale strategy, understand that lenders are not in the business of doing favors; the lender will attempt to get as much of the loan repaid as possible. A lender's initial response to a short-sale request will often be an attempt to *restructure* the loan. Accomplishing a short-sale requires

*selling* the strategy to the lender as the best way for the lender to minimize its loss. From a lender's perspective, a short-sale will make economic sense where all of the following apply:

- It is unlikely that the owner will become current or stay current on payments
- The loan balance clearly exceeds the property's current value
- The owner has limited assets from which the lender can recover a foreclosure deficiency
- There are few, if any, other mortgage lenders or lien holders

Short-sales are most often approved where the lender believes that foreclosure is otherwise imminent, and that a short-sale represents the best chance to minimize its loss on the loan.

### The Short-Sale Package

All lenders have a checklist of what they require in order to consider a short-sale request. A *Short-Sale Package* will require borrower financial information, including tax returns, bank / investment account statements and pay stubs. An important part of the package is a compelling *Hardship Letter* explaining why the borrower can no longer afford to make the mortgage payments. The package should also include a letter authorizing the lender to speak directly with the listing agent.

The most important part of the Short-Sale Package is a contract for the purchase the home. While the mortgage lender is not a party to the contract, the closing is contingent upon the lender agreeing to release its mortgage for less than full repayment of the loan. The lender will often require certain contract modifications as conditions to approving the short sale.

A market analysis provided by the listing agent, along with an independent *Broker Price Opinion*, will indicate the value of the home. A *net proceeds calculation* – contract price less all costs, pro-rations, allowances and commissions from the sale – will show what is available to apply toward the mortgage debt. The lender will consider the market value of the home relative to the contract price and the anticipated net proceeds in determining whether or not to consent to the proposed short-sale.

### Second Mortgages and Other Liens

In a foreclosure, all junior liens (e.g., a second mortgage) are automatically extinguished, enabling the first mortgage lender to sell the property with clear title. With a short-sale, however, payments to any junior lien holders for agreement to release their liens must be negotiated. The more liens on the property, the more difficult it is to make short-sale work. At some point, it makes more sense for the first mortgage holder to just foreclose.

### Quality Real Estate Representation is Critical

Experienced, knowledgeable and competent real estate representation is critical to successfully pursuing a short-sale strategy. The right agent can help determine if a short-sale is, in fact, the best course of action and assess the likelihood of its success. Beyond simply marketing the property for sale, the agent should fully understand lender processes and be adept at packaging and *selling* the deal to the lender. At all times, the agent should be focused on promoting and protecting the seller's interests.

### Obtain Legal and Financial Advice

A short-sale will likely have negative financial consequences, relating to the loan deficiency, credit score and possibly income taxes. Before initiating (and in pursuing) a short-sale strategy, a homeowner should obtain legal and tax advice from qualified professionals.