

## Buying a Short Sale Property

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Prospective short-sales make up a considerable share of the homes currently on the market. A short sale can be good buying opportunity for the right buyer, at the right price and under the right circumstances. Successfully purchasing a short sale, however, requires an understanding of the property's value, the seller's situation and the mortgage lender's process. Knowing how to navigate around the inherent traps in a short-sale transaction is crucial for successfully purchasing a short sale.

### 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 mortgages and other liens. 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.

**NOTE:** In many short sale situations, there is a first and second mortgage loan and perhaps other debt secured by the property. The more liens encumbering the property, the more difficult a short sale becomes. Except as discussed below, this article will assume a single mortgage.

### Short Sale Versus a Foreclosure

A *foreclosure* 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*, *bank-owned* or *lender-owned* properties.

By contrast, a home listed as a *potential short sale* is one where the seller is proposing to enter into a contract with a buyer, where the seller's obligation to close is contingent upon the mortgage lender agreeing to release its lien for a reduced pay-off. The contingency typically requires that the lender forgive the unsatisfied balance of the debt as well.

The number of parties, parameters and processes involved in a short sale makes it a complex, specialized type of real estate transaction. For this reason, short sale deals have a high failure rate. By contrast, purchasing a lender-owned (i.e. a foreclosed) property is relatively simple.

### Not Every Short Sale is a Steal

Recognize that the nature of a short sale is to reset the property to market value, not below it. Don't assume that every short sale is a bargain, particularly given the time and uncertainty inherent in trying to purchase a short sale property.

### Understand the Timing and Don't Get Trapped

Perhaps the biggest drawback to attempting to purchase a short sale is the amount of time it can take to obtain lender approval. Mortgage lenders are overburdened with distressed loans – processing a short sale request usually takes at least 3 -6 months (even longer if there are multiple lien holders). Although some properties are marketed as *pre-approved* for a short sale, lenders tend to not even start their process until they have a complete *short sale package* that includes a contract. Before investing in what will be a drawn out process, it is important to properly assess the likelihood of success before entering into a short sale contract. In addition, the contract itself should provide you with an "out" to avoid wasting time, money and forgoing other purchase opportunities.

### **Understand the Seller's Situation**

The prospect of shedding negative net worth and “moving on” is attractive to a homeowner with negative equity in his home. Increasingly, homeowners who, though “underwater,” are capable of making their payments are seeking short sale approval. Lenders are most likely to approve a short sale where a foreclosure is otherwise inevitable. There is little incentive to approve a short sale when mortgage payments are current and there is no indication that the borrower is unable to make future payments.

The more you can learn about the seller's situation, the better you can assess the likelihood of the lender approving the proposed short sale, and avoid investing in a process with little chance of success. A check of the real estate records will indicate whether a foreclosure notice has been filed. In addition, the contract should include representations from the seller as to the number of lien holders, the amounts owed and the extent to which the seller is delinquent on each account.

### **Beware of Junior Liens**

In a foreclosure, junior liens 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. A check of the real estate records will reveal any secondary liens on the property.

### **Obtain the Right to Communicate With the Lender**

A short sale contract is between the seller and the prospective buyer; the mortgage lender is not a party to the contract. Because the buyer has no relationship with the seller's lender, absent consent from the seller, the lender will not discuss the status of the short sale approval with your agent. In order to keep you from being at the mercy of the listing agent in terms of status updates, the purchase contract should require the seller to authorize the lender to correspond with your agent.

### **A Compelling Contract is the Key**

In determining whether or not to consent to a short sale contract, a lender acts solely in its own interests. In addition to price (which determines the extent to which its loan will be repaid), the lender looks for simplicity and certainty in the transaction. Accordingly, a contract should be at a price that can be supported by the market, have no contingencies (other than a standard inspection contingency) or seller-paid items and calls for the property to be taken in “as is” condition. A cash transaction is ideal; otherwise, it is important to demonstrate that your financing is approved and ready to go.

### **Protecting Against Other Contracts**

Until the lender agrees to a short sale under your contract, the seller and the lender may entertain other short sale offers / contracts. If the lender consents to another contract, it necessarily means that the short sale contingency in your contract fails and your contract terminates. It may be possible to protect your position by including in your contract the right to see and match higher offers.

### **Have Quality Real Estate Representation**

Competent real estate representation is the key to successfully purchasing a short-sale property. Beyond identifying properties and assessing their value, your agent should understand lender processes and know how to write a contract that will appeal to the lender (not just price) and protect your interests.