



## Short Sales

### What they are and why they are not for everyone!

**What is a Short Sale?** It's the sale of real property (such as a home) that is encumbered for more than its value AND where the seller does not have the assets to pay the difference between the value and the debt.

#### Fundamental Understandings of a Short Sale

- Seller is allowed to take NOTHING from the transaction.
- First position lender calls all the shots and has all control of the decision process.
- Junior lenders (second mortgages) can defeat a short sale if they don't cooperate.
- The 'deficiency' is the difference between all debt recorded against the property and the proceeds generated from the sale of the property. (Not be confused with a "deficiency judgment" which can only be taken following a judicial foreclosure. See below)

#### Factors Indicating That A Short Sale May Not Be A Good Option For A Seller

- Seller's lender will not discharge the deficiency. The problem in this situation is the long-term liability that must be undertaken by the seller. When seller took out the loan, they signed a note and deed of trust. A short sale releases the deed of trust but the promissory note still exists unless specifically discharged by the lender.
- Seller's debt is the result of a large equity refinance and the equity was not used to improve the property. The problem is the potential for tax consequences. If the home is non-owner occupied, the seller pays income tax on any debt that is released and discharged. If the home is owner occupied, there's no income tax if the mortgage(s) being discharged are purchase money mortgages or rate and terms refinance or equity refinance with all equity reinvested in property improvements.
- There's more than one lien encumbering the property. The problem here is logistical difficulties closing the transaction and the long-term liability if the debt of the second mortgage is not discharged. A second mortgage lender does have the option to discharge all of the borrower's obligations on the loan.
- There is insufficient time prior to foreclosure. The problem here is just logistical; it could be impossible to finalize and close the short sale before the foreclosure date. However, with close

communication with the foreclosing lender (and trustee) the foreclosure CAN be delayed just as many times and for as long as the lender wishes.

- Seller indicates an unrelenting requirement to exit the transaction with cash. The problem here is that it is IMPOSSIBLE for that to happen and if, for some reason it occurred, it would likely create the risk of lender fraud.
- Seller's 'other' debt (unrelated to the house) exceeds seller's ability to repay. The problem here is that the short sale will not solve seller's problem

### **Short Sale Alternatives**

- **Refinance.** Typically a refinance is only available if the seller is not already in default and has sufficient income to support new mortgage payments. If this were the case, the seller probably would not be considering a short sale.
- **Loan modification or lender workout.** There are several programs, primarily with/from the federal government, that allow a borrower to work with existing lender to create new loan terms that make repayment possible, such as: an ARM is converted to a fixed rate loan; interest rate is reduced; repayment term is extended or the borrower can skip or reduce payments. Unfortunately, the success ratio with these loans has not been good and there has been a high ratio of defaults after loan modifications, so the borrower is right back in the same situation as before the loan modification. But federal government loan counselors are available to assist borrower with these modifications.
- **Deed in lieu of foreclosure.** A "Deed-in-Lieu" occurs when the borrower decides not to keep the home and to not contest anything from the lender and to just turn over the property to the lender. Signing a "Deed-in-Lieu" gives the lender immediate ownership of the property. It is only available if there is only one lien.
- **Foreclosure.**
  - **Non-judicial Foreclosure:** This is the most common version of a foreclosure because it is a much shorter and quicker process than a Judicial Foreclosure. In this process, following appropriate procedures and timelines for notice, a trustee's sale is held, typically at the county courthouse (or other public venue) on a Friday morning. After the sale, the winning bidder (very often the lender) takes title to the property. There is no lawsuit. The minimum time frame for a non-judicial foreclosure in Washington is, theoretically, 120 days but, in practice, it's not unlikely to take six to nine months or more. The entire balance owing on the foreclosed lien is eliminated. It's very important to note that junior liens (such as second mortgages) are not discharged if sale of property fails to generate funds sufficient to repay those junior liens.
  - **Judicial Foreclosure:** In a judicial foreclosure, the lender files a lawsuit against the debtor for foreclosure. It takes a minimum of one year from that filing to hold the foreclosure sale. The property is sold at foreclosure sale and, if proceeds are insufficient, lender takes

"deficiency judgment", which means that the lender can sue the borrower for the shortfall. The borrower has a one-year right of redemption, which means the borrower can reclaim the property within one year by paying the lender the amount of the shortfall. Thus the lender cannot sell or otherwise dispose of the property for one year after the foreclosure sale. This process is a requirement for a foreclosure on agricultural property.

- **Bankruptcy.** There are two types of bankruptcy, Chapter 7 and Chapter 13. In a Chapter 7 bankruptcy, the debtor surrenders all assets to the Bankruptcy Court for payment of repayable debts and a discharge of all others. A Chapter 13 bankruptcy involves working out a payment plan with creditors over an extended period of time. If interested in bankruptcy, consult a bankruptcy attorney.
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- **Short Sale Package:** To get approved for a short sale, lenders require receipt of a "short sale package" which typically will include the following:

- Short sale proposal letter
- Short sale application
- Seller's hardship ("distress") letter with supporting documentation
- Seller's financial information with supporting documentation
- CMA with supporting documentation
- Marketing history, showings and feedback
- Fully executed purchase agreement
- Proof of buyer's ability to complete purchase
- Preliminary title report
- Estimate of closing costs, from escrow
- Anticipated repair estimates

When you prepare and deliver those items to the seller can vary, depending on lots of factors. For example, if your property is listed for sale and the lender chooses to move forward quickly with a foreclosure, you'll want to notify them of your attempts to sell the property and see if you can get them to be delay the foreclosure sale while the home is listed for sale. How you price the home while it is listed may also be driven by how aggressive the lender is regarding proceeding with the foreclosure.

The extent of "distress" of the borrower might also have some impact on the lender's willingness to delay the foreclosure sale, so you may need to prepare the short sale package earlier to help persuade the lender to be lenient in their pursuit of a foreclosure. As you can see, a lot of factors are involved in this process and there are, essentially, no rules or guidelines to 'know for sure' what any lender might do in this process.

If you think you might be involved in a short sale, be sure to work with a real estate agent who has experience with short sales and understands both the legal and psychological aspects of the short sale process.