

SHORT SALES

Short payoffs, or short sales, are the latest catch word in real estate - more prevalent in today's market and a significant trend of the 90's. A short payoff is termed as "any debt forgiveness granted to a homeowner by a lender." Often a short sale comes in the form of a bank allowing a homeowner to sell a home for less than what is owed against the property.

A "short payoff" occurs when your lender agrees to accept less than the total owed in exchange for a release of the mortgage as a lien on the property. Other terms for a short payoff include short sale, pre-foreclosure sale, or pre-sale.

According to HUD, short payoffs account for approximately 50% of all workouts on conventional loans. This option is one of the oldest and most frequently used, and it is the one that lenders are most familiar with. Since they are the most familiar with it, it is the option they prefer more than any other.

You must determine how much time you have to sell your home. Refer to a Foreclosure Process timeline. If you decide to sell your home to avoid foreclosure, the way to handle it depends on whether or not you have equity in your home. You have equity in your home if there will be enough money to pay off your mortgage in full after all the expenses are paid when you sell. If not, then you must apply for a short payoff.

If you have equity in your home, you can sell it just as you would if you were not in foreclosure. The only difference is that you must order the loan payoff statement from the foreclosure attorney or trustee instead of getting it from your lender. Your only concern should be closing the sale and paying off the loan before the end of the redemption period.

Homes with no Equity:

You must apply for a short payoff if the sale of your house will not leave enough money to pay off all the mortgages and other liens on your property. If this is the case, call your lender immediately and get a financial package from them to make your request for a short payoff. The sooner you do this, the sooner the lender can complete its review of your short payoff request. Different lenders have different packages for different workout options. Make sure that you request and receive the package to apply for a short payoff

The longer you wait to get the package, complete it and return it to your lender, the longer it will take to get the short payoff approved. The longer it takes to get the short

payoff approved, the greater the chance that the buyer for your house will get impatient and void the contract in order to buy another house.

The basic purpose of the financial package is: 1) to make sure that the reason for the default was unavoidable, involuntary or beyond your control, 2) to make sure that you have experienced financial hardship, 3) to make sure that you do not earn enough money now to pay the deficiency in installments over time, and 4) to make sure that you do not have money to pay some or all of the deficiency in a lump sum.

Here are some important points to remember about selling your house if a short-payoff is required:

Carefully choose the people who will represent you in the sale of your home. Many attorneys and realtors are not familiar with the short sale process. It is important to use an attorney and a realtor with experience in foreclosure and short sale procedures.

The listing agreement that you sign with your realtor must provide: "The seller's obligation to perform on this contract is subject to the approval of the lien holders on the property. The Seller may cancel this agreement prior to the ending date of the listing period without advance notice to the broker and without payment of a commission or any other consideration, if the seller tenders a Deed-in-Lieu of Foreclosure."

It is very important for you to write this language on the listing agreement. If you do not, you may be liable to pay a realtor commission even if you do not sell your house! The contract that you sign to sell the property absolutely must provide: "This contract is contingent upon acceptance by the seller's lien holders."

If your lender does not approve the contract, this language will allow you to back out. If the contract does not have this language and your lender does not approve a short-payoff you must either bring money to the closing to make up the shortage or your buyer can sue you for breach of contract!

Each case is different. Your lender's decision to approve or deny the short-payoff will depend on many factors.

FHA-Insured Mortgages:

HUD has clear guidelines for reviewing short-payoff requests. As long as you meet the guidelines, your request will be approved. After your lender receives all of the written documentation from you, they will have the house appraised. The basic guidelines for approval are:

- Your loan must be 2 months behind
- You must live in the property
- The reason for the default on the mortgage must be unavoidable, involuntary or beyond your control
- The house must appraise for at least 70% of the unpaid principal balance
- The contract price must be at least 95% of HUD's appraised value
- The net amount to your lender after all closing expenses are paid must be at least 87% of HUD's appraised value

VA Guaranteed Mortgages:

Unlike HUD, the VA has no set guidelines for reviewing short payoff requests. Rather, they conduct their own analysis to determine if they would lose less money by completing the foreclosure or allowing you to sell the house.

Conventional Mortgages:

There are no guidelines available for reviewing short payoff requests on conventional mortgages. Conventional loans usually have an investor such as Fannie Mae or Freddie Mac and private mortgage insurance. Your short payoff request must be approved by all the parties to your mortgage: your lender, the investor and the private mortgage insurer. This process takes time, so prepare the buyers to wait about 60 days from the contract date until closing.

Short payoff requests are an art form. Each one is different and the parties to the contract must bring the following qualities to the transaction: patience, persistence, knowledge, experience and creativity.

The more liens on the property, the more difficult it is to complete the short payoff.

•What is a short pay off?

Imagine your home is worth \$200,000, but you owe \$220,000 on it. If you were to sell it in the open market at \$200,000, you might net \$184,000, or \$36,000 less than what you need to pay off the loan. A short pay off is where your lender will forgive a portion or all of the short amount.

•What lender would just write off that type of money?

Just about all of them will, with justification. Justification might mean a substantial loss of income that would prevent you from paying on the mortgage, therefore being forced in a position to sell the home. Attempting to sell short so you can upgrade to a larger property is not justification. In addition, lack of cash reserves will also serve as justification. Don't expect to place your home on the market at 75% of market value and expect your lender to jump on any offers.

•How will this affect my credit?

Depending on how you negotiate the transaction, it could go on your credit report as, "settled," or, "paid," or "short payoff." It depends on the lender and how well you can negotiate.

•Are some lenders harder to deal with than others?

Yes. If you have a Freddie Mac loan, Freddie Mac will probably want you to contribute to the short sale, get your agent to reduce brokerage fees, and get the buyer to take the property with the termites. Some lenders will just ignore you.

•What will my lender require from me in order to consider participating in a short sale?

Packaging is very important. When you place the property on the market (go with an agent), your agent should send the lender the following:

1. Your past 2 years tax returns
2. Letter of hardship
3. Complete loan application
4. Preliminary title report
5. Listing contract
6. Copy of MLS
7. A marketing plan for your home
8. A broker price opinion (like an appraisal).

When you have an offer, all of the above should be enclosed with the offer (except for the marketing plan) plus the purchase agreement, and a good faith estimate as to what the lender will net after the close of escrow.

•Why should I list with an agent? It seems if I can save the brokerage fee that the lender would net more and be more inclined to accept any offers that come in.

You are correct. If your loan is current, you may be able to get a qualified buyer yourself. If your loan is delinquent, or in default, you don't have time to play around getting your home sold. You need as much exposure as possible.

•What happens if my lender say's "No," and I'm in foreclosure?

This is one situation where "No," means, "Maybe, you just haven't convinced me that participating in a short sale is to my benefit." Keep hammering your lender, and do not take your home off the market until your lender agrees to a sales price and the prospective buyer has formal loan approval.

•Should I try to hide any assets in order for the lender to consider participating?

Most assets are traceable, except for personal collections (guns, coins, etc.). If you own another property, it will show up on your credit report. Your lender may back track to your original loan application to see if there are any other assets. No, don't hide assets. If your lender discovers you're not dealing honestly, they'll never co-operate.

•Can any real estate agent or attorney handle a short sale?

A lot will say they can. There's no real way to tell if they can. If your home goes into foreclosure, you'll get flooded with a ton of mail. There's a good bet that most of the mail is from people who have helped out previously in these situations. One way to tell is if the person you're dealing with will ask you for the information outlined above. They'll know these are the requirements.

•Question: I believe that the loan is secured by the property, so the bank cannot go after your assets to make you pay the remaining balance of the loan. The bank will try and guilt you into doing so, ignore them. If they refused, threaten to foreclose and be ready for the bank to do so. At that point, they will usually negotiate.

Once you refinance the property, take out an equity line of credit, obtain a consumer loan that is secured by the property, this rule no longer applies. The lender has the right to go after you in a deficiency judgment, even if a senior lien holder takes the property back and a junior loses his security instrument.

•How can I assure a non-purchase money lender won't go after me after the short sale?

When any lender agrees to a short pay, they are relinquishing their right to pursue the borrower in the future.

•Are there any tax ramifications?

Yes. According to IRS Section 108 a-e, there are debt/income interpretations that may come into play. The IRS may view the deficiency on a non-purchase money loan as income and demand you to pay taxes on that amount. If the short pay transaction resulted in a net loss of \$20,000 to the lender, your tax liability could be around \$6,350.

•So why would I want to do a short sale only to owe the IRS money?

To limit your tax liability. In some cases (not Citicorp, Fannie Mae, or Freddie Mac) the senior lien holder will allow for some funds to be allocated to the juniors. If you allow the property to go into foreclosure, and the juniors lose 100% of their money, you can get taxed on the full amount. You should really contact a CPA concerning this part of the Tax Code.

•I have an FHA loan. They won't do a short pay. Any suggestions?

Any feedback from other states would be appreciated. There are certain regions where FHA will not participate in short sales. One region is the state of California. If you are in foreclosure on an FHA loan in California, you may want to approach HUD to see if they will consider a lower interest rate, or some type of repayment schedule until you get back on your feet.

