



Barnes Walker & Goethe, Chartered
3119 Manatee Avenue West, Bradenton, Florida 34205
Ph: (941) 741-8224; F: (941) 708-3225

SHORT SALE 101 SEMINAR

This Short Sale 101 Seminar is designed to briefly discuss and summarize some basic aspects and considerations of a Short Sale loan workout.

I. What is a Short Sale?

A Short Sale means the seller's lender is accepting a discount of the loan payoff to release an existing mortgage to allow a sale to occur. Typically, a seller most likely needs to be in default and have stopped making mortgage payments before a lender will consider a short sale. Just because the seller is requesting a Short Sale from seller's lender(s), it does not mean the lender(s) will accept the Short Sale terms. In the Short Sale scenario, the mortgage payoff exceeds the contract price, and the lender may either forgive all or a portion of the debt and release its mortgage lien on the property, therefore allowing the sale to occur or the lender can agree to release its mortgage on the property and not forgive the deficiency, but have the seller sign a new promissory note for the balance or, in the alternative, the lender can do a combination of the two.

II. A Short Sale is one of many alternatives that sellers have available to them.

If a seller is in trouble with a particular loan on a particular piece of property, the seller, depending on the seller's ability, can:

- (1) reinstate their mortgage;
- (2) arrange a loan workout or re-payment plan;
- (3) pay off the loan in full;
- (4) refinance the loan;
- (5) allow a foreclosure to occur (do nothing);
- (6) do a deed in lieu of foreclosure, or lastly;
- (7) declare bankruptcy.

A Short Sale may or may not be the best deal for the seller or the buyer and the Realtor® should always recommend a credit, legal, and/or financial advisor to help the Realtor®'s client evaluate the options available and to determine whether there are any other factors that may be positive or

negative for their current circumstances. The ideal candidate for a Short Sale is still making loan payments and has a credit rating worth preserving.

III. Why consider a Short Sale?

Short Sales do allow a closing to occur and, therefore, a commission to be paid. A Short Sale also allows the seller to sell the property upon its own terms, subject to the lender's consent, and possibly includes forgiveness of the deficiency amount. The effect of a Short Sale on a seller's credit report is much less damaging than a foreclosure, deed in lieu of foreclosure, or bankruptcy, since the negative entry on the credit report shows up as a pre-foreclosure and redemption matter, rather than a deed in lieu of foreclosure, or a foreclosure itself. The lenders do not wish to pursue a foreclosure or seek a deed in lieu of foreclosure because they do not want the property back, which would be the result of such a foreclosure or deed in lieu. They do not want the property back because they incur considerable costs in marshalling, restoring, maintaining, re-marketing, and selling the property. The lender is more apt, in this day and age, to work with a seller in a Short Sale or other workout situation, as it is better for the lender. In addition to a Short Sale having a less negative impact on a seller's credit rating, a seller who participates in a Short Sale can quickly sell a piece of property and cut its cash outflows and liability and/or invest in other properties in a quicker manner than they could in the aftermath of a foreclosure. The listing broker is also helping a seller who has financial problems as well as earning a commission. Buyers benefit because they can typically purchase a piece of property for less than fair market value and contract directly with the seller subject to the lender's approval, which means the buyer has some control of the property. If the property went through a foreclosure, a buyer would just typically be one of the bidders on the foreclosure steps or would have to wait a lengthy period of time while the foreclosure proceeded and negotiate with the lender's Realtor®, and, meanwhile, the property would be falling into further disrepair.

IV. The Process.

There is no universal set of rules or set process regarding a Short Sale, and each lender performs their Short Sale process differently. However, there are some basic general steps that can be expected and considered:

(1) The seller has to prove the seller is experiencing some financial hardship or other type of hardship and will be unable to continue making loan payments. In most cases, the lender will want to see that the seller has been in default. A lender will require the seller to provide a specific package of information regarding tax returns, financial statements, bank statements, and pay stubs; complete a loan application; provide title report; and possibly prepare a draft settlement statement, as well as sending a marketing plan from the Realtor®, which will be submitted as a Short Sale application package along with the real estate contract.

(2) The lender has to determine the value of the property. Once a seller has proven a hardship as set forth above, then the seller has to demonstrate that the property is worth less than the total amount that is owed to the seller's lender and other lien holders. The lender may require a broker's price opinion, a comparative market analysis, or, even in some cases, an appraisal of the property. The seller will be responsible for the costs of these items.

(3) The seller has to find a buyer and enter into a contract because, without a contract, a Short Sale cannot occur. Each lender of the seller has to approve the contract and the Short Sale process in order for a closing to occur. Most lenders will not even consider a Short Sale process until a contract is submitted.

(4) Final approval from all lenders must be obtained in order for the closing to occur. This includes negotiating the amounts that are to be repaid at closing in order for each lender to release their liens and therefore make the property marketable for sale to the buyer. Most lenders have specific departments and personnel to handle these Short Sale processes and negotiations, and, most of the time, authorizations must be obtained from several different levels of a lender's management to receive final approval. A final approval must be obtained in writing from each lender in order for the closing to proceed to completion.

(5) All parties have to allow the lender a reasonable time to review and approve or disapprove a proposed Short Sale. Every Short Sale lender has different procedures, and therefore their time frames are all different. It typically takes a minimum of sixty (60) to ninety (90) days to obtain approval from a Short Sale lender; however, if there are multiple lenders, it could take longer because further negotiation is necessary. You as a Realtor® can help your seller expedite the process by assisting the seller to prepare a Short Sale package for the lender that is complete. The longer the seller waits to send the package to the lender, the longer it will take to receive the final approval. The purpose of the package is to make sure that: (a) the reason for the default was unavoidable, involuntary, and beyond the seller's control; (b) the seller has truly experienced financial hardship; (c) the seller will not earn enough money to pay the deficiency in installments over time; and (d) the seller does not have enough money to pay some or all the deficiency in a lump sum. Some short sales are very frustrating in the time it takes to complete them. Therefore, create reasonable expectations with the buyers and sellers up front that a Short Sale is a time-consuming matter, since the seller and Realtor® must deal with lenders that are outside of the seller's control. Again, setting reasonable expectations up front is important. Remember that the lenders are all experiencing a large volume of Short Sale approval requests, and this adds additional time to the final approval process.

(6) The seller and the Realtor® must work hard and be patient but persistent because lenders are not only reluctant but also overwhelmed. It is important to follow-up with every document, every submittal, and every other action. Let them know the sale needs to happen as quickly as possible. You and your seller want to make sure the right people get the right information and want to "bug" them for approval without annoying them. It is important to set the contract up with the right time frames so as not to allow the buyer to back out too early. This would be very frustrating for you and the seller, since both of you would have spent considerable time, money, and effort.

V. Buyer Considerations.

Buying a piece of property through a Short Sale may be a good deal, but it is not always the case, and you must inform your buyer of such. First, there is no assurance that the seller will obtain final approval, although the buyer is obligating himself/herself to purchase the property during the period of time allowed in the contract to obtain approval of the Short Sale. Therefore, the buyer has to be patient and acknowledge that they may be precluded from making offers on other properties until such time as the closing occurs on the Short Sale property or the Short Sale

contract has been properly terminated. This is not a good scenario for a buyer who needs to purchase a property immediately. Additionally, with the extra time that it takes for lender approval, other factors may come into the picture that may cause a termination of contract, such as judgments against the seller, the buyer's loan's interest rate lock expiring, or the seller filing bankruptcy. Another consideration is that the buyer's remedy in case of a seller default under a Short Sale contract is most likely only the return of buyer's deposit, as the seller is, in all likelihood, insolvent and has no money, thus precluding buyer from obtaining seller's specific performance of the contract. Therefore, it is most important that the deposit be escrowed with a well-known escrow company, title company, or attorney. Being a "good" buyer (i.e., making a good down payment, having good credit, and being able to close quickly) is also a plus from the perspective of a lender considering the approval of a Short Sale.

VI. Seller Considerations.

As set forth above, a seller has many different options other than a Short Sale in case the seller finds itself in a hardship or in a default situation. This seminar just evaluates a Short Sale. Short Sales are not necessarily good for all sellers from a tax or financial perspective, so you have to urge the seller to get professional tax advice or financial advice regarding its particular situation. The seller's credit will be affected by a Short Sale, but not nearly as much as it would be by a foreclosure or a deed in lieu of foreclosure. The seller may also be liable for income taxes on any deficiency that the seller's lender forgives after the short sale has occurred. The seller's lender may not forgive any of the debt deficiency, and the seller then will be liable for said deficiency amount after closing. The lender, in its sole discretion, determines whether or not it will pursue a deficiency judgment. (At the printing of this outline, Congress has passed, and the President has signed, into law limitations on, and, in some cases, elimination of, income taxes owed on forgiven deficiencies. I will attempt to have details on this new law at the time of this seminar.) Additionally, there might be other tax consequences relating to a Short Sale, such as capital gains taxes, even though the property is sold for less than the mortgage debt owed on the property, provided it is not the seller's principal residence. (For example, in 1990, property is purchased for \$100,000 with a \$75,000 mortgage loan. By 2005, it has appreciated to \$300,000 in value, and, at that time, seller refinances and obtains a new \$250,000 interest-only mortgage loan. Unfortunately, in 2007, the property's fair market value drops to \$200,000, at which price it is sold. This sale is a Short Sale because the \$250,000 mortgage debt exceeds the property's price of \$200,000. However, since the property is being sold for \$200,000 and was originally purchased for \$100,000, there is a long-term capital gain of approximately \$100,000, upon which capital gains tax is owed.) I strongly urge Realtors® not to give any tax or financial advice. The seller must understand that it requires a lot of work to obtain a Short Sale approval, and the seller must be willing to devote the necessary time and effort. If your seller is not willing to do a lot of work, then it is not worth your time. The Short Sale process is also less public, thus, possibly less traumatic for the family.

VII. Listing Broker Considerations.

The listing broker that takes on a Short Sale transaction must be aware that a Short Sale can pose hidden difficulties and risks to the listing brokers, which include: (a) the potential loss of commissions on Short Sales that are not approved or otherwise fail, (b) the extensive time that Short Sales require, which may, again, be for naught, (c) marketing costs that are lost on failed Short Sales, etc. A listing broker that holds himself or herself out as handling Short Sales for

sellers also incurs additional liability, if, as result, a seller relies on the listing broker as an expert, whether rightly or wrongly. There is also additional liability for the listing broker should the broker assume additional duties to prepare a seller's personal financial statements, loan applications, and other documents required as a part of the Short Sale package. I would strongly suggest that you merely assist the seller to gather seller's personal and financial records to be inserted in the Short Sale package. It is also important for the listing agent to obtain the authorization and consent from a seller so the listing agent can communicate directly with the lender to follow up during the approval process. Due to privacy concerns and any potential liability relating to inadvertent disclosure of the seller's financial information, all confidential, financial, and private information provided in the package to obtain Short Sale approval should be disclosed to, and approved for release by, the seller, and not be provided to the buyer or the buyer's Realtor®. Additionally, make sure that the seller is negotiating with the lender's final decision maker. The amount and payment of the commission is a specific concern in that the commission may be reduced in negotiations with the lender or may be reduced by court order or mandate. Therefore, it is very important for the listing Realtor® to put in the MLS listing and the contract that the sale of the property is a Short Sale, and that, if the commission is so reduced, each Realtor®'s share will be proportionately reduced. If this provision is not inserted in the listing agreement and the lender requires that the commission be lowered, then the cooperating broker could demand its total share of the commission, and therefore, the listing broker would get stuck with the short end of the stick. There is a fairly good percentage of Short Sales that are not successful, and there is a high risk that you will spend a lot of time and money marketing, negotiating, and working with the seller, all of which will be wasted. You have to analyze the probability of success for each Short Sale. For example, if a property has three or four mortgages and the likely contract price will be half of the total amount owed, pursuing the Short Sale is probably not worth your time. I also highly recommend that you add a clause to your MLS listing that says: "Please contact listing broker prior to submitting an offer on this property, as this sale will be a Short Sale and its ability to close will depend on the approval of the seller's lender." This clause will, first, provide the required disclosure of the Short Sale and will, second, allow you and the other Realtor® to consider the probability of the transaction's success based upon the contract terms being discussed.

VIII. Cooperating Broker Considerations.

The cooperating broker who represents the buyer in a Short Sale transaction has to disclose to the buyer that there is some risk of the closing not occurring, but, nevertheless, the client is obligated to purchase the property until such time as the contract can be properly terminated. This means that, during this time, the buyer will not be able to enter into contracts to purchase other properties despite the fact that they may desire to do so. The cooperating broker also may be forced to take a lower commission than it desires due to lender or court requirements and/or mandates. The benefit of a Short Sale is that it can provide the cooperating broker with a very desirable property at a good price for one of the cooperating broker's buyers. This will surely result in a repeat client when that buyer is in the market to sell or purchase again. The biggest pitfall for the cooperating broker is the risk of loss of the broker's commission, since there are a lot of contingencies in the contract that must be met as far as the seller and the seller's lender are concerned.

IX. The following is a summary of practice tips and suggestions.

(1) Prepare early. Call each lender and get their Short Sale procedure so the seller can see the requirements and get working on them.

(2) Because the seller is most likely in a stressed emotional state, you need to use a delicate sales approach to persuade the seller to commence the Short Sale procedure, while firmly keeping the seller focused on completing and submitting the Short Sale package paperwork and working on the follow-up that is required. Also, tell the seller to deal honestly with the lender.

(3) Have the seller send a brief letter to all mortgage holders, giving the seller's permission to speak with you as the Realtor®. Otherwise, privacy laws will prevent them from speaking with you. It is critical to build a relationship with the seller's lender(s) because, once you gain creditability with the lender(s), the entire process becomes easier.

(4) Be sure to contact the correct department of the lender. Most of the time that will be the bank's loss mitigation department, and usually not the customer service department or the collection department. Finding the correct decision maker is the biggest initial challenge in Short Sales.

(5) In helping the seller prepare their package, be careful about discrepancies between seller's income and assets reported in the Short Sale package and the income and assets originally reported to obtain the current mortgage loan, as a big gap may indicate mortgage fraud unless employment or financial circumstances have drastically changed.

(6) Please note that the contract on the Short Sale property is a legal, binding contract once the earnest money has been deposited and the contract is fully executed. Without language in the contract stating that this is a Short Sale, conditioned upon the lender approving the contract and releasing all liens on the property, the seller may face legal problems for failing to perform their duty and obligation under the contract to convey to the buyer the property with marketable title if the Short Sale is not approved.

(7) It is important to find a buyer that is willing to be patient, has a reasonable deposit to escrow, has good credit, and is willing to close quickly after lender approval. I would have all buyers pre-approved for a mortgage before submitting an offer.

(8) When the listing Realtor® offers compensation through MLS, make sure there is a note that the gross commission may be reduced proportionately, as the transaction will be a Short Sale subject to lender's approval and direction.

(9) Use an "As Is" contract with right of inspection and have buyer complete all inspections early as you do not want to do a lot of work to have the buyer cancel at the last minute. Additionally, and probably more important, using an "As Is" contract does not obligate seller to put any more money into the property.

(10) Always put a clause in the MLS listing stating the transaction is a Short Sale and always use the Short Sale Addendum to the listing agreement.

X. Addendums, Contract Addendums, Listing Agreement Addendums. Barnes Walker & Goethe, Chartered, has contract addendums available for you to use when preparing short-sale contracts. If you would like more information, please contact us.

BARNES WALKER & GOETHE, CHARTERED
3119 Manatee Avenue West
Bradenton, FL 34205
Telephone: 941-741-8224
Facsimile: 941-708-3225
Email: bhounhout@barneswalker.com