Your Guide Through The Short Sale Process

By Michael Cuevas

What is a Short Sale?
The term "Short Sale" is used in the real estate world to describe when there is more debt owing against the property than the actual property is worth. The owner can't sell or refinance the property unless the mortgage or lien holders agree to accept a payment that is less-or-SHORT-of the amount the owner actually owes. A short sale is when a borrower who is underwater on their property has no other way but to short the lender(s) the payoffs in order sell the property.

Why do a short sale?
The answer is simple. Borrowers do a short sale to avoid having a foreclosure, which can be very damaging on one's credit. A short sale is also another way for borrowers to understand the outcome of the situation and to lessen the amount of late payments in a lengthy stressful foreclosure process.

The Foreclosure Timeline
Knowing your states foreclosure timeline is essential. Most borrowers have no idea how long they can be in their property until they will get evicted. Some think its one-month after first missed payment while others think it's much longer. The truth is it is depends on what state you are located in since foreclosure law varies state by state. You must first know whether your state is judicial or non judicial.

IL is a judicial state; therefore, the foreclosing lender must go through the court system in order to foreclose on any borrower. In IL is takes approximately 210 days to foreclose on a borrower after Notice of Default (NOD) is served.

It is important to understand what NOD (Notice of Default) means. Notice of default is the official notice that foreclosure has been filed and being pursued. A borrower should know if an NOD has been filed because they will have been served in person or through some certified mailing. They can also expect to get a thick stack of legal documents, which may look very threatening.

In some states the process may be as quick as a couple months. It is super important your real estate professional truly understands your state's timeline since that is really the timeline you are up against. Depending on your situation you will now know how fast or slow you need to move to beat the foreclosure sale date.

The Different Types of Liens

When facing foreclosure or a short sale, it is so important to distinguish the different types of liens on your property. There is a lot of miscommunication and bad advice out there on this subject. It is ESSENTIAL that your real estate professional understand this aspect of the transaction as it may make the difference between walking away with no financial liabilities and having recourse against you.

- **1st Mortgage:** This is the primary mortgage or senior lien on the property. As long as this lien is being "shorted" the bank who holds this will control the deal in terms of how much is paid out in total commissions, payout's for title/attorney fees, and how much will be allowed to payout the 2nd mortgage or junior lien holders. They pretty much run the show and all other subordinate liens are at their mercy. Most first liens will treat the deal in the same manner in regards to any deficiencies. They will most likely issue the seller a 1099. The first lien position or senior lien holder is typically the foreclosing lien. This is also normally the larger dollar amount. Seniority is granted by the time it was recorded. In a deficiency judgment state they may come after the borrower for any deficiency.

- **2nd Mortgage:** True 2nd mortgages were commonly used during the previous boom years as a creative financing tool to allow buyers to avoid paying PMI. They were highly prevalent during the subprime boom. About 1-2 years ago you would see more of these types of loans attached to the property but in the current short sale market you will see more HELOC's (Home Equity Line Of Credit). If a property goes into foreclosure the 2nd mortgage is wiped out and the 2nd lender will receive nothing. 2nd mortgages typically settle for $3000 to $5000 per deal or $0.01 to $0.05 cents on the dollar. Remember, the loan in 1st lien position will generally only allow $1,000 to $5,000 so there is really nothing else they can do. 99% of 2nd mortgages are at a zero equity position in the property in this market. These typically are not too difficult to deal with although you may run into a few snags here and there. Bottom line is they understand their position in the foreclosure process and that they will be wiped out at foreclosure, therefore, they will take what they can get in most cases.

Please note that while the chances are highly unlikely that a true 2nd lien can come after a borrower after foreclosure sale, they have every right to as long as the borrower is in a recourse state. If they were to follow through on this they would technically have to sue the borrower. Truthfully, banks in these positions generally are not going to throw good money after bad money by chasing someone down that will only file bankruptcy if they were pursued. You can expect the vast majority of lenders in this position to send the seller a 1099. It is rare to see this type of lien pursue the deficiency, but they have every right to in a recourse state.

- **HELOC, Home Equity Line of Credit:** This is more like a credit card and needs to be negotiated for a settlement in order for the client to get a full release from this debt. Unlike a true 2nd mortgage, if a foreclosure were to take place on the seller's property, the bank/lender who issued the HELOC still maintains the rights to collect for the debt owed even after foreclosure, whereas, the true 2nd mortgage is completely wiped out at foreclosure. Their lien on the title of the property will be gone, but their rights to collect on the deficiency will not. The main difference is HELOC debt is a collectible debt after foreclosure sale. There are many stories of borrower's attorneys advising to walk away and let the property foreclose. In this case, not only do those borrowers have a foreclosure on their credit, but they also have the full amount owed on the HELOC as a collectible balance. HELOC's right now are generally getting settled for about $0.10 to $0.20 on the dollar. Smaller local banks will demand more, therefore, use this as a guideline. A true 2nd lien can sue for the difference but will rarely do so. A HELOC doesn't have to sue for the difference. Their rights are already retained due to the characteristics of the loan. This is an important detail that you must be familiar with. Your clients need to be made aware of the consequences of the HELOC if the property were to go into foreclosure. The difference is mainly for a true 2nd to come after you they have to go through the hassle of suing someone, whereas, a HELOC's right never go away. Banks will typically sell this right to some collection company which will be much more difficult to deal with.

Where do you start?

Believe it or not a short sale is conducted like a typical real estate transaction. It is your agent's job to bring in a purchaser for your home through aggressive and traditional marketing. It is once you receive an offer, where the short sale process begins. However, before the process begins, it is essential you and your specialist are ready to go which is why the following forms must be completed. The following documents outline what is needed for a short sale package. No lender will begin the process of a short sale without a full package being submitted into the short selling lenders.

Short Sale Documents Defined

- **Authorization Letter:** This is a letter that allows your default specialist to speak to the lien holder on your behalf. Without it we cannot communicate with your lien holder.

- **Payoff Request:** This document allows us to order your current payoff amount. This is essential to us so we know how to renegotiate your loan.

- **Hardship Letter:** This is your reasoning and explanation to the bank. This is where you state why you are in the situation you are in. For example: job loss, medical, falling real estate prices, death, divorce, etc.

- **Pay Stubs (2 most recent):** This is so the lien holder can see an accurate accounting of your monthly income

- **Bank Statements (2 months most recent):** The bank does not care if you make money, but they do want to confirm that your deposits correspond with your paycheck stubs and that the money spent each month is substantiated with your financial worksheet.

- **Federal Tax Returns:** We will only need the first two pages. The lien holder is only interested in the bottom line.

- **Financial Worksheet:** This is the document where you paint out your monthly financial picture for the lien holder

- **Do Not Call Form:** This gives written notice to lien holders and more importantly stops your phone from ringing.

- **Exclusive Listing Agreement:** This shows that you are actively trying to sell the property and do something about your situation.

- **Real Estate Purchase Contract:** Once you have an offer your lien holder will need to verify there is really an offer to purchase.

- **Estimated HUD:** This will show an estimation of what the bank will net after the sale.

- **Loan approval for the buyer:** Your lien holder will want a full loan approval to the new purchaser. They need to make sure you have a ready, willing, and able buyer.

Short Sale & Loss Mitigation Timeline, Structuring Your Deal

0-30 days

File Submitted

30 Days

60 Days

90Days +

BPO or value ordered

File assigned to negotiator

Negotiate/market File

Receive approval and close

Stage I

In the first 30 days your real estate professional should make sure once a full short sale package is sent into the lender(s), a BPO (broker price opinion) is ordered. A BPO is like an appraisal of a property submitted by a Realtor. It is this value of the property that will eventually determine the end sales price, as everything will revolve around this number only. Different lenders have different guidelines on short sales, but in general, the value submitted as the BPO will be a key factor in final sales price. Expect the initial offer to get countered by the lender. The second thing your real estate professional needs to do is make sure the file is assigned to a negotiator on the banks end who will process the file on that end.

Stage II

Stage II of the short sale process consists of receiving the value of the BPO and working with all additional liens on title. It is important during this stage that your real estate professional obtain short sale approval letters with favorable terms for you. Remember it is only an offer of mortgage assistance. Your professional should have exit strategies planned should the initial offer not work out. During this stage your agent should be finding the happy medium between the lender, buyer, and seller in terms of price of the subject property.

Stage III

Stage III you should receive the pay off demand letter or the short sale approval(s) from your lender. Your real estate professional should make sure your buyer is willing ready and able to close on the property at this point contingency free. Short sale approvals typically only have 30 days to close or you may have to start over which is why timing, exit strategies, and coordination with all lien holders, buyer, and seller are so important. Please note these are only terms offered to you and you have the right to accept or reject the lenders offer.

Understanding your relationship with your lender or servicer.

As the market has changed, so should the mentality of a short sale specialist. The most important concept to take into consideration is the agent's fiduciary duty to the seller on a short sale and that is to liquidate the property and move on. An agent has no duty to the bank on the short sale, as the bank is not the agents' client. Their duty to their seller should be to get them out of the property with the least amount of financial damage as possible. Agents often confuse short sales with REO's (bank foreclosures or real estate owned) and they think the lender must see all offers. They also think the bank is the owner of the property. The seller is the owner of record all the way until the bank repossesses it at foreclosure sale or a judge deeds the property back to the bank. Therefore, they have every constitutional right as the property owner and seller. Only the Seller can accept, reject, and entertain all offers. A short sale is only an approved payoff amount the bank is going to accept or deny to release their lien interest and, preferably, settle the debt that is owed to them by the Seller. It is also against the seller's interest to submit every offer you get on the property. I hate when agents do this and I see it all the time. It's completely ridiculous and I want to ask them whom they work for. Please tell me how this is in the seller's best interest. Your job is to help your sellers get out of this situation, not the opposite.

The seller owns the property. The bank owns the note attached to the title of the property. The Realtor works for the seller, not the bank. Only the seller can have the final say on the short sale. According to

Realty Trac as of September 2011, Bank foreclosures sell for 39.92% under market value while short sales sell for 20.51% under market value. The mere fact that the seller is participating in a short sale is a way to mitigate the banks loss so who do you think is wearing the pants?

Pricing the Property

During stage I of the short sale process the lender will determine the eventual sales price on your property by basing that value off of the BPO or appraisal they do. Since you will not be receiving funds from the sale, do not be so concerned with the price, but more so with the terms of your release. It is rare that you will have financial liabilities associated with the short sale, but the terms are more important to you. My best advice is to lose any emotional attachment you have with the property.

Deficiency Judgment

What many people tend to ask next is what happens to all the money that is never paid back to the bank? The result of a lender taking less money than what they are owed is called the deficiency amount. There are several ways a lender can handle a deficiency amount. In Illinois lenders have every right to pursue the borrower for the deficiency amount by receiving a judgment against a borrower for their loss. During a short sale this is what will most likely happen with the deficiency amount.

- **Forgiveness** - A foreclosure may result in cancellation of debt income depending on whether the bank pursues a deficiency judgment. If the bank chooses not to pursue a deficiency judgment, or pursues the judgment unsuccessfully, the borrower may incur income tax liability for debt forgiveness.

- **1099 Tax Form** - The lender may choose to tax the borrower on the deficiency amount as a capital gains tax. They basically consider their loss as your gain, therefore making it taxable. In many circumstances the client involved in the short sale is in financial hardship so may be able to claim insolvency. This can eliminate this obligation, but you should consult with a good attorney or tax professional.

- **Promissory Note** - A lender can issue the borrower a promissory note which can pay back the amount owed over an extended period of time say 15-20 years in the form of monthly payments.

- **Cash Contribution** - Sometimes the lender may just ask for cash at the time of closing ranging anywhere from $200-$5,000.

One point to remember is these are remedies for the lender to cure their loss. Since each situation is different, results will vary. The most important thing to remember is none of these listed above are any worse than having a foreclosure on your credit.

The Mortgage Forgiveness Act of 2007

When your real estate professional negotiates your short sale correctly you can expect to be given debt forgiveness in conjunction with receiving a 1099-C (cancellation of debt). The legislation that is in effect right now can best be summarized as follows:

Any borrower who receives a 1099 resulting from short sale or foreclosure are completely forgiven from any 1099 tax liabilities if they…

- Reside in the residence as their primary
- Can show they are insolvent if 2nd home or investment property.

This is the most common way the deficiency amount is resolved. You should always confirm this information with your CPA or and attorney.

Your Credit Score

When you foreclose on a home your credit will be altered for about 5+ years, to say the least. However, when you do a short sale your credit is also affected, but for a much shorter time period and less damage is done. The truth is there is no concrete answer as to how many points it will affect your score. Every person has his or her own FICO and each individual's score will vary. What I can tell you is the late payments are typically what have the major affect on a borrowers credit. Most people are usually able to qualify for a new loan and buy a new home within 2 years after a short sale vs. the 5+ years if you were to go into foreclosure. Since everyone is different its best to consult with a credit repair-person or your real estate professional in more detail.

FAQ’s

Why don’t I file Bankruptcy?

Short Sale vs. Bankruptcy – When faced with foreclosure many people tend to turn to bankruptcy as an option of solving their problem. Now there is a large difference many of the “professionals” fail to tell you. Filing for bankruptcy will consolidate your debt and can wipe out your liabilities, but it will not save you from having a FORECLOSURE put onto your credit report. Instead, now you will have both a bankruptcy and a foreclosure on your credit. If you plan on eventually turning back your property you WILL STILL HAVE A FORECLOSURE ON YOUR CREDIT REPORT. Trying to conduct a short sale while in bankruptcy can hold up the process, but it is not impossible. It will just take some more paperwork. My best advice is to consult with a great bankruptcy attorney prior to making any decision should you have additional debt you are unable to control besides your property. One key point to keep in mind is if your home is the only debt that is creating an uncontrollable situation for you then a short sale option is most likely your best bet vs. a bankruptcy. If you have other uncontrollable debt then a bankruptcy might also be needed in addition to a short sale. You should consult with a bankruptcy attorney should this be the case.

Why will the bank “forgive” my debt?

Simple, the bank does not want to go into foreclosure. It takes time and costs money. Conducting a short sale is really like a pre-foreclosure; you are just securing a buyer prior to your sale date. Banks usually find themselves losing more money if it goes into foreclosure and lenders do not want to tally up another foreclosure on their books. They understand their loss, as loan defaults are part of the business they are in. As in any situation they are trying to cut their losses and move on.

What do I do after a short sale?

After your short sale, the stress of your housing payment is extinguished and it's time to get back on track to restoring your credit. Many people will rent for a while until their credit is fixed and then it's time to get back into another house. With the right team of people working for you, you will be in a new house before you know it.

How much money does this cost YOU?

It costs you nothing! When conducting a short sale, or any real estate transaction, you always must deliver free and clear title to the new purchaser of your property. While we are conducting a short sale with a lender, all costs are taken into account and paid for by the lender from the purchase price of the new buyer bringing your loan current. Part of the amount you are shorting the lender includes all the closing costs typically associated with selling a home. These costs are viewed as a wash for any lender because if they took the property back they would have to pay them anyway since the property would have to be free and clear when resold. These include property taxes, title costs, attorney fees, back assessments, and even commissions, which is how we are paid.

Alternatives to Foreclosure:

- **Do Nothing**

If a homeowner does nothing, they most likely will lose their home at foreclosure auction. Loan applications generally ask if the applicant has ever been foreclosed upon. Credit reports also disclose this damaging information. Not the best option.

- **Payoff Request**

Completely paying off the entire loan amount plus any default amount and fees. Usually this is accomplished through a refinance of the debt. New debt is normally at a higher interest rate and there may be a prepayment penalty because of the recent default. With this option, there should be equity in the home.

- **Reinstatement**

Paying the entire default amount plus interest, attorney fees, late fees, taxes, missed payments and fees.

- **Loan Modification**

Utilizing the existing mortgage company to refinance the debt or extend the terms of the loan. This may allow the homeowner to catch up at a more affordable level. To qualify, you must prove to the lender you have fixed the problem that caused the late payment.

- **Forbearance**

Lender may be able to arrange a repayment plan based on the homeowner's financial situation. The lender may even be able to provide a temporary payment reduction or suspension of payments. Information will be required from the lender to show that you are able to meet the new payment plan requirements.

- **Partial Claim**

A loan from the lender for a 2nd loan to include back payments, costs, and fees.

- **Deed in Lieu of Foreclosure**

Give the property back to the bank instead of the bank foreclosing. Banks generally require the home be well maintained, all mortgage payment and taxes must be current. Most loan applications ask if this has ever happened.

- **Bankruptcy**

This option can liquidate debt and/or allow more time. I can refer you to a qualified bankruptcy attorney.

-Chapter 7 (Liquidation) To completely settle personal debt.

-Chapter 13 (Wage Earner Plan) Payments are made toward a plan to pay off debts in 3-5 years.

-Chapter 11 (Business Reorganization) A business debt solution.

- **Sale**

If the property has equity, (money left over after all loans and monetary encumbrances are paid) the homeowner may sell the home without lender approval through a conventional home sale. In this case, the homeowner will get cash from the sale. On the other hand, a Short Sale, also known as a pre-foreclosure sale, can be negotiated with your lender by your Real Estate Professional if what is owed is MORE than the property's value. **This is what we specialize in!**

In Conclusion

I hope that this information will help you better understand the short sale process. It is important you discuss your particular situation with your real estate professional since all situations differ. Based on your current liens and timing of your short sale I can help you get into more detail but would need more information. Please feel free to reach me directly at **773-988-6599.**

Sincerely,

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