

## Basics of a Short Sale Transaction

When is a property a candidate for a short payoff in lieu of foreclosure?

### What is a Short Sale or Short Payoff?

A short sale or short payoff is generally defined as a sale in which a lender allows the property securing a mortgage or deed of trust to be sold for less than the existing loan balance, due to factors such as the borrower's financial circumstances, the property's physical condition, or local real estate market conditions.

A short sale is really a form of pre-foreclosure sale and occurs when the mortgagee agrees to accept less than the loan amount to avoid foreclosure. A negotiated short sale may result in a discounted purchase price for the buyer. The buyer would finance the acquisition much the same as in any conventional real estate acquisition.

### Negotiating a Short Sale

What makes a lender decide whether to take a discount on a mortgage? What formula do they use to decide how much to take? A borrower is typically in default when the lender decides to take a discount. There may be instances where there is no default. This usually means that the borrower is upside down on the mortgage and what is owed exceeds the value of the house. There are a number of factors that go into a lender's decision about whether to discount a loan and by how much. These may include:

- the borrower's overall financial condition;
- the property's "as is" value;
- the cost to put the property into resale condition;
- the property's "as repaired" value;
- the cost of securing and maintaining the property while it is being marketed for resale; and

- the cost of marketing and selling the property.

A short sale is usually the lender's last resort before foreclosure. Some lenders will only approve a short sale when foreclosure is not economically feasible because the borrower is insolvent and one or more of the following may have occurred:

- The property was purchased or refinanced at the top of a seller's market at an over-inflated price, and a substantial drop in value has occurred.
- The property was financed as an interest-only adjustable rate loan and the borrower has no capacity to refinance at a lower interest rate.
- The property was refinanced at more than 100% of its value.
- The property is located in an area where property values have dropped due to local economic conditions, or the home's value has decreased to an amount below the loan balance due.
- The property's "as is" condition has deteriorated to a point where it is not feasible for the lender to put it in a marketable resale condition.
- The proposed purchase price is more than the lender would be able to sell property for after foreclosure.
- Any sales commission proposed in a contract is less than what the lender may typically have to allocate after the foreclosure process is complete to market and sell the property.

### Hardship Test

Most lenders have a stringent hardship test that the borrower must pass in order to have a short sale approved. The borrower must be experiencing one or more of the following:

1. The borrower or immediate family member has experienced an illness that has wreaked havoc on personal finances.
2. The borrower's spouse has died or a divorce has occurred and there is insufficient income to pay the loan amount.
3. The borrower's employer has transferred the borrower out of area and he is unable to sell or rent the property.
4. The borrower is on active military duty for an extended period and lacks monthly income to pay the loan amount.
5. The borrower has suffered a disabling injury that precludes him from working.
6. The borrower is unemployed and has no expectations of finding employment in the foreseeable future due to local economic conditions.
7. The borrower has become financially insolvent.

Borrowers are usually requested to provide the following information to the lender for consideration of a short sale:

- a personal hardship letter that defines what the hardship is and proof of the hardship claim;
- a Third Party Disclosure for authorization to speak to the Realtor or other representative about the loan status;
- a completed financial worksheet of net income and monthly expenses;
- copies of the last two years' Federal Income Tax returns with all schedules;
- copies of last two months' payroll stubs;
- copies of last two months' bank statements for all accounts;
- a copy of the Sales Contract signed by both the seller and the buyer; and
- estimated closing costs showing a detailed breakdown of all projected costs including Realtor commissions for listing and selling agents.

Once the lender has the above information, it could take between three and six months to negotiate and close a short sale, depending on the lender.

### Broker's Price Opinion (BPO)

The lender will also do a market analysis of the property. The Broker's Price Opinion (BPO) may be the single most influential component the lender considers when deciding how much they are willing to

accept as a reasonable short sale offer.

The lender hires a real estate agent, broker, or appraiser to assess the property and give their professional opinion of its value to the lender.

There are two types of BPOs:

1. Full BPO—A full inspection of the home is performed.
2. Drive-by BPO—Pictures are taken of the outside of the home and of other homes in the area.

The following requirements are necessary for a full BPO:

- Run comps and take pictures of the surrounding neighborhood or subdivision;
- Inspect the overall condition of the home and estimate the cost of repair. Take pictures of inside of the home.
- Formulate an "opinion" of property's value based on information gathered, and submit a detailed report of research to the lender.

An agent can try to influence the broker's price opinion by being present when the BPO is performed and by doing their homework, which includes:

1. Compiling comps, estimated costs of repairs, and other relevant information that will justify a discount.
2. Making sure the homeowner is not present during the BPO.
3. Shadowing the agent or appraiser as they perform their inspection and providing them with information about the home, repairs, and the neighborhood.

The above information is a general guide that can be used in attempting to effectuate a successful short sale. As you can see, it really is a "numbers game" with the lender in control.

Not every homeowner facing foreclosure is a good short sale candidate. A giant step to getting a lender to consider your short sale proposal is to have as much information ready as possible to expedite the process.

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