Short Sale Transactions

A short sale transaction, also known as a short payoff, identifies the sale of real property wherein a lender allows the property to be sold for less than the current balance due on a Mortgage or Deed of Trust secured by the property. Upon receipt of the negotiated payoff amount, the lender agrees to release the lien against the property. In essence, a short sale may be negotiated in order to avoid foreclosure.

Lender Considerations for Short Sale

A lender may consider and accept a short sale due to various factors including an adverse change in the borrower's financial status, existing condition of the property, or real estate market conditions. Delinquency in at least one monthly payment or default of loan will be taken into account by the lender. There may also be an occasion where no delinquency has occurred, but default may if a borrower's loan amount has exceeded the current market value of the property. Factors a lender may use in their determination include:

- Borrower's financial status and proof of hardship
- Physical condition of the property "as is"
- Costs to repair and/or prepare the property for resale
- Costs to market the property for resale
- Comparison of current loan balance to fair market value of property
- Potential costs incurred to maintain property through anticipated foreclosure

Short Sale as Last Option to Foreclosure

When looking at the current real estate market conditions and the borrower's inability to meet their mortgage obligation to the lender, a short sale is typically the last option before foreclosure for the lender. If a borrower is delinquent or in default, it may be due to various conditions including:

- The property was purchased or refinanced at 100% or more of the fair market value
- The existing loan against the property is structured as an interest-only adjustable rate mortgage and the borrower is unable to refinance at a lower interest rate
- There has been a decrease in value of the property since purchased in a seller's market at a potentially overinflated price
- The property is located in an area where local real estate conditions have changed causing a decrease in the resale value compared to current loan amount due
- The property is located in an area where economic conditions have changed decreasing the value
- The physical condition of the property "as is" has been damaged or diminished, and the cost to put it into marketable condition for resale isn't reasonable
- The borrower has a contract offer for a sales price maximizing repayment to the lender, compared to fees incurred and resale considerations after foreclosure

Borrower Test for Hardship

In consideration of a borrower's financial status, most lenders will require the borrower to complete a hardship test for short sale acceptance. Criteria for hardship may include:

- Reduction in income and excessive financial responsibilities
- Unemployment for extended period of time
- Illness or injury to borrower or family member increasing overall financial obligations and/or inhibiting the ability to work and obtain income

- Death or Divorce of a spouse or co-borrower reducing income available for loan payment
- Inability to rent or sell the property for a value to cover existing loan amount or payments
- Borrower status on active military duty for an extended period of time lacking monthly income

Short Sale Documentation for Lender

There are several forms of documentation a lender will require to assess the potential short sale acceptance. The borrower must typically provide the following items:

- Hardship letter identifying the reason as well as proof of hardship
- Financial worksheet exhibiting net income and expenses
- Copies of recent bank statements for existing accounts
- Copies of current pay stubs
- Copies of recent Federal Income Tax Returns
- Completed Third Party Disclosure form authorizing a representative or broker to discuss loan status
- A copy of the real estate sales contract including any amendments completed with signatures by seller and purchaser
- Current market analysis of the property handled by broker or other professional
- An estimated HUD1, settlement statement, or net sheet including all closing costs and broker commissions anticipated to complete sale

It is reasonable and expected that once a lender has received the required documentation for short sale consideration, it may take up to six months to negotiate and close such transaction. This amount of time varies with each situation and lender.

Market Analysis and Broker's Price Opinion (BPO)

A market analysis is critical to a lender in their determination of what may be a reasonable amount to accept for a short payoff. The lender will do a market analysis by means of a real estate broker, agent, appraiser or inspector hired to assess the property and submit their professional opinion as to its current value. Such Broker's Price Opinion (BPO) may be done in one of two ways:

- A Drive-By BPO which may include photos of the home and surrounding area along with documentation of the professional evaluation
- A Full BPO of the property to include running comps, including property photos evidencing condition, completing an internal and external inspection with estimated cost of repair, and documenting the assessment of the marketable value based on the research

As the volume of potential foreclosures increase in our region, it is easy to see that much effort is spent in short sale transactions as a viable option to foreclosure. Each lender must follow their internal procedure in consideration of accepting a short payoff and timeliness varies.

The information contained here should be used as a general guide to identify components and potential use of a short sale, acknowledging that not every homeowner or borrower is a strong candidate to consider. It is important that you, as a representative of the borrower, have as much knowledge and information readily available to expedite the process and successfully close a short sale transaction.