

Basics of a Short Sale Transaction

Short sales are fast becoming both an integral and significant part of the market. More and more homeowners are finding themselves unable to keep up on their mortgage payments due to factors such as the borrower's financial circumstance, the property's physical condition, or local real estate market conditions. In situations such as these, it might make sense to consider a short sale as opposed to foreclosure. It's important to note, however, that short sales are typically only approved as a very last resort.

What is a Short Sale or Short Payoff?

A short sale occurs when a lender allows a property to be sold for less than the existing loan balance. A negotiated short sale may result in a discounted purchase price for the buyer who would finance the property much the same way as in any conventional real estate sale.

When a lender agrees to take a discounted payoff, a borrower is typically in default of their mortgage. There may be instances, however, where there is no default like in the case where the loan balance exceeds the value of the home.

Negotiating a Short Sale

A number of factors go into a lender's decision of whether or not to discount a loan and, if so, by how much:

- The borrower's overall financial situation.
- 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's listed on the market.
- The cost of marketing and selling the property.

Factors that may lead a lender to resort to a short sale include:

- A property purchased in an inflated market that has experienced a significant downturn.
- A property located in an area where home values have dropped, or the value has decreased to a point where the loan is "upside down".
- A property refinanced at more than 100% of its value.
- A property whose condition has deteriorated to a point where it would require extensive repairs to make it marketable.

Hardship Test

A lender will require a borrower to pass a stringent hardship test before they will approve a short sale. The borrower must be experiencing one or more of the following hardships:

- An illness or injury in the immediate family which has wreaked havoc on personal finances.

- A spouse has died or a divorce has occurred and there is insufficient income to pay the loan.
- An employer has transferred the borrower out of the area and they're unable to sell or rent the property.
- A borrower has been called away to active military duty for an extended period of time and lacks the income to pay the loan.
- The borrower is unemployed and has no expectations of finding employment due to local economic conditions beyond their control.
- The borrower has been incarcerated and no longer has the income to pay the loan.

It's important to note that the company servicing the loan currently in default isn't authorized to approve a short payoff sale. Final approval must come from the investor who owns the loan. Oftentimes it can take between one and six months to negotiate and close a short sale, depending on the lender.

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