SHORT SALE MEMORANDUM

IN GENERAL.

A short sale occurs when a lender agrees to allow a homeowner to sell a home for less than the mortgage owed on it. The lender will either absorb the difference or require a borrower to pay it back in the lump sum judgment or payment plan. In South Florida, with home values dropping, the tight credit crunch and an overall deteriorating economy, the short sale alternative is beginning to be utilized more often.

The short sale process is somewhat complicated and certain conditions need to be met before a lender will consider a short sale. Note, as an aside, that some lenders will not even consider negotiating a short sale. However, for those that do, the first and most important consideration is whether the borrower has the financial ability to make his or her mortgage payments. The borrower must demonstrate a lack of ability to carry the mortgage any longer. In most cases, the lender will request that the homeowner write a sincere hardship letter explaining their adverse financial condition. Reasons often include job loss, divorce or the fact that they could never really afford the home in the first place.

In addition, most lenders will ask for substantiation like pay stubs, bank account information, W-2's and anything else that helps to paint their financial picture. Important: This may be risky sometimes because the documents considered may reveal that information submitted on a 'stated income' loan may not have been accurate thus exposing the borrower to accusations of mortgage fraud so be careful. It should be noted here that a lot of lenders may consider modifying the mortgage before considering a short sale. It should also be noted that it is a common myth that borrowers need to be behind in their mortgage payments in order for a lender to consider a short sale. That is not necessarily the case. This means that it may be possible for a borrower to save his/her credit by acting early. It may be harder to sell your case to the lender at this early stage but with proper back up, it is possible. This is an important consideration as the application process for a short sale can take from 60 days to 6 months to get an answer from the lender. Once it is approved it can be another 30 to 45 days to close.

In scenarios with two loans, it gets complicated. However, the process is similar with both lenders. It should be a coordinated effort so that each respective lender feels as though it is not assuming all of the risk. As an example, we had a file where the second mortgagee agreed to allow the borrower to keep paying the loan but on an unsecured basis. It only agreed to do so once it was verified that the first mortgagee sufficiently compromised on what it was owed.

The next condition is that the value of the home be equal to or less than the amount owed on the mortgage. A lender will never agree to cut someone a break if the property appraises at a value higher than what is owed on the mortgage. A lender will want to see that a property has been listed on the MLS at the total amount owed on the mortgage and that there have been no bites. Note that some lenders will ask the realtor to prepare a Comparative Market Analysis especially in markets like South Florida where values are declining. A large portion of short sale candidates have already gone through one or more rounds of price reductions. Once you get to a price that attracts Buyers, you should then approach the bank about a short sale opportunity. Remember, you can't have a short sale without a buyer so it is important in this market to start early and be aggressive in trying to find a buyer. In terms of negotiating the short sale, it is a good rule of thumb to NOT ask a lender to take more than a 20% loss.

There are pitfalls to a short sale negotiation. It is recommended that a borrower seek the advice of a professional to handle the deal. A lot of people facing the type of financial hardship that coincides with having to consider a short sale have other problems like tax liens, association liens, etc, all of which can derail a short sale.

Now, once a lender agrees to a short sale, it generally does one of three things. First, the lender may write off the difference as a lass and issue the borrower a 1099. <u>This means that the borrower will have to pay taxes to the IRS for the forgiven debt</u>.

The lender can also issue a promissory note or a deficiency note, requiring the borrower to payoff the difference in monthly installments. A third thing the lender can do is to demand that the borrower pay off the difference after the short sale in a deficiency judgment which will be recorded in the public records and can hurt the borrower' credit score. It should be noted, too, that it is likely that a short sale will negatively impact credit scores, as well. A short sale is reported as a settlement. It is not good but it is far better than a foreclosure. A short sale generally results in a FICO drop of between 60 and 100 points whereas a foreclosure results in a 200 to 260 drop.

The following is a brief outline of the short sale conditions described above:

-You must be willing to give up the property
-You need to prove to the lender that you are unable to afford the payments
-The market value of the home must be lower than the amount owed
-You must a buyer who is ready, willing and able to close
-You should be prepared to payoff the difference
-Your credit report may suffer

CONTRACT CONSIDERATIONS:

In drafting a contract involving a short sale, you should consider the following:

-Contract should say, "Subject to Seller's Mortgage Holder(s)' Approval"
-Usually lender prefer the contract to be an As Is contract so there is no threat of repair items
-Consider having the Buyer pay for some usual Seller closing costs. Otherwise, they would come out of the lender's pocket and they consider this as additional loss and will want to mitigate as much as possible
-Contemplate a closing date tied to the Seller's lender's approval which could take substantially longer than usual
-If listing agent, call the Seller's lender for guidance prior to signing contract

TITLE PERSPECTIVE:

As you can imagine, there are underwriting requirement that we, as the title company, have to consider as well. It would help you have a general understanding of our requirements so that you may contemplate them when structuring a deal. Our considerations are as follows:

-The transaction must be a bona fide short sale between unrelated parties
-The short sale lender must provide a detailed payoff statement showing the outstanding balance on the loan, the amount to be forgiven and acknowledging the newly discounted amount
-The short sale lender's written approval of the HUD-1 displaying the discounted amount required for full satisfaction of the mortgage per the payoff letter
-The HUD-1 may not show any monies going back to the Seller but my show monies having to be paid by the Seller
-If the deal is a flip, the short sale lender must be acknowledge same in writing
-If a foreclosure action has already been filed, the action must be dismissed

Although it will be our responsibility to ensure compliance with these items it would be helpful for you to have a working knowledge of what we will expect.