How To Mitigate Your Mortgage Crunch Through "Short Sales"

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Consumers snapped up Adjustable Rate Mortgages (ARMs) like kids in a candy store only a few short years ago. As part of those ARMs, banks were often willing to lend up to 95 to 100 percent of the value of the home through what the industry termed 90/10 or 80/10/10 mortgages. For example, loans where the first mortgage was based upon 90 percent of the home's appraised value, and a second home equity line of credit for the remaining ten percent of the home's total value (100% financing).

That model was very attractive to American debt junkies (us homeowners), who could finance all of those closing costs, pay off high interest debt using our paper asset (home), and avoid Private Mortgage Insurance (PMI). When the ARMs adjusted, and real estate values plummeted, however, homeowners in the Hudson Valley felt the pain.

So, what's a homeowner to do when the mortgage is more than the value of the house, and that house is not selling? There are several possibilities: 1) bankruptcy; 2), if your lender is generous, reaffirming and refinancing the mortgage; 3) offering the bank a deed in lieu of foreclosure, or 4) a new kind of arrangement that is particularly in vogue now called "short sales." In "short sale" arrangements, the seller essentially works out a deal with the lender to sell to a buyer for less than the face value of the mortgage, without foreclosure, bankruptcy, and some of the attendant hardship (and sometimes includes an agreement from the bank that the seller is not responsible for the remainder of the loan over the short sale price). For the patient buyer, a short sale can save significant money on the purchase of a new home. From a social perspective, the short sale works a type of personal bailout of the sub-prime mortgage lenders because we individuals end up correcting the over-lending and out-of-whack appraisals that caused the crisis in the first place. Collectively, we are correcting the problem ourselves.

From the Seller's Perspective

A short sale requires a negotiation. The seller and seller's lender must consider several factors in deciding whether to pursue a short sale, including the reasons why the seller deserves a break. For example, was it unforeseen circumstances that caused the financial hardship—injury, layoffs, divorce, illness? Other considerations include whether the costs of foreclosure outweigh the costs of the short sale; how many other properties does this lender have in default in this community; whether there are co-signors who can be held responsible for the balance owed on the mortgage; the value of the real estate, and how quickly houses are selling in that market.

When a mortgagee defaults, it is imperative for the defaulting homeowner (seller) to hire competent legal and financial advisors to help wend the way through the difficult process. Counsel will know the steps, and can generally delay the process and make the lender listen to the distressed homeowner.

From the Buyer's Perspective

Short sales are not necessarily "bargains." Just because a property is listed with short sale terms does not mean the seller's lender will automatically accept the negotiated deal being offered by the seller or the seller's agent (whether that be an attorney or real estate agent). Be aware that if the seller has defaulted on his obligations, the lender will most likely not consider a short sale unless all of the factors discussed above make sense. Indeed, this particular short seller might just be over-encumbered, so a discounted price might actually mean that the house is at its market value, not below it.

The Process

Lenders make it tough to speak to the right people to start the short sale process—the "loss mitigation" department. Without competent legal counsel, sellers generally end up discussing the late payments with the lender's collections department, which offers only one option: pay now. These kinds of discussions only delay the short sale process. If you, as either buyer or seller, are serious about completing a short sale, you

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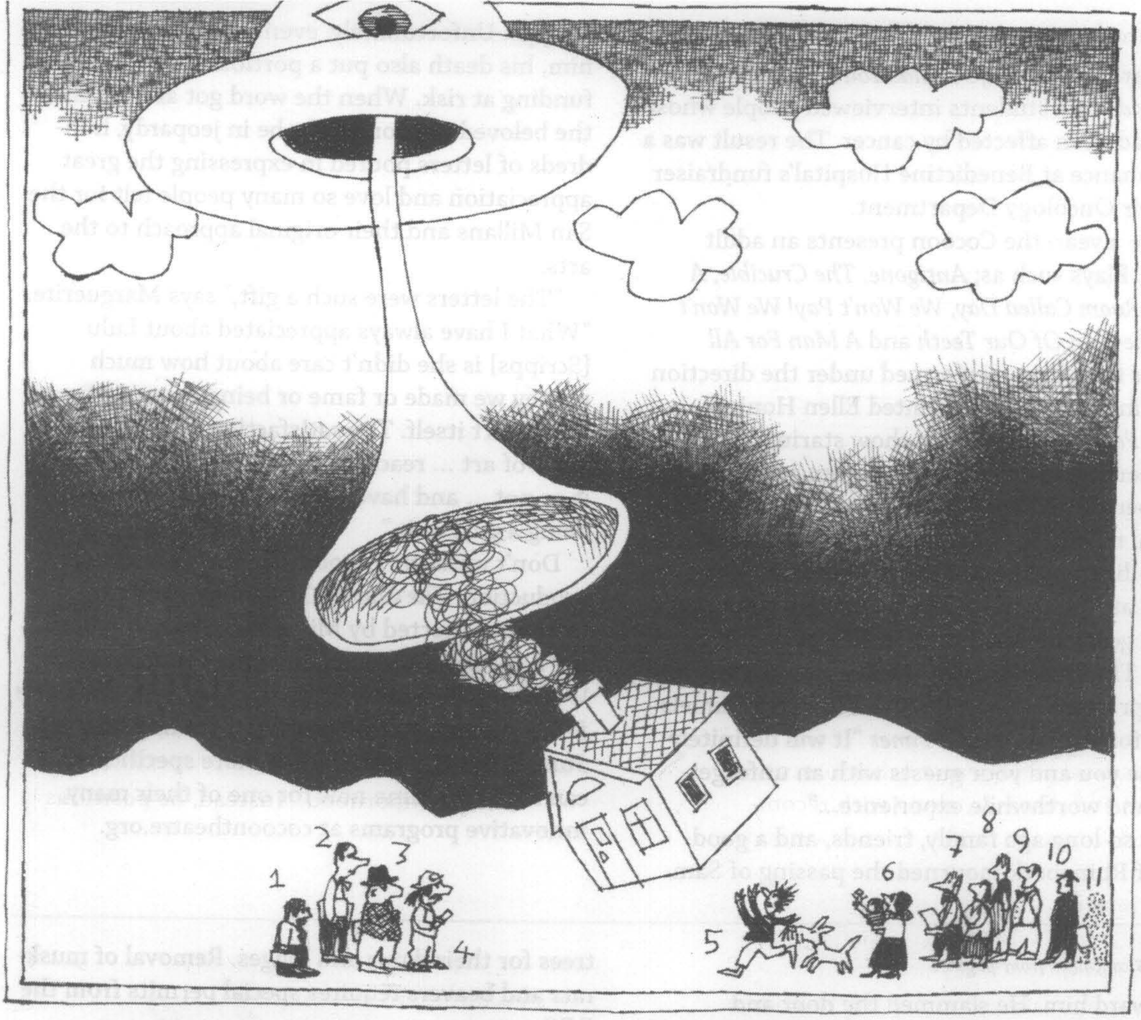

The cast: 1. Short Salesman 2. Private mortgage insurance agent 3. ARMs expert 4. Plumbers' Union representative 5. Homeowner (seller) 6. Innocent bystander 7. Equity specialist 8. Default surreal estate expert 9. Attorney 10. Another attorney 11. You

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or your attorney(s) will have to work hard at discussing the options with the people authorized to make the deal happen.

Once you, the distressed seller, have the right person at the lender's end, be sure that you are systematic and thorough in the presentation of the short sale possibility. For example, loss mitigators are more motivated to clear up and resolve defaulted loans if you can explain all of the details and discuss objections to a short sale. For example, you will need to have a reasonable explanation as to your financial difficulties, accompanied by recent pay stubs, copies of medical bills, checking account statements and other evidence to document the fact that you really need to make this short sale.

A lender will also need a real estate broker's opinion as to the value of the property, one that sets forth the value of comparable properties, the general condition of the neighborhood, the specific property's condition in relation to neighboring houses, and an itemized description of needed repairs. Obviously, the lower the broker's estimate, the more likely the mortgage lender is to approve a short sale.

Buyers and their representatives must also understand and present the key details of the transaction to the lender, including the cost of a short sale for title, attorneys, taxes, and commissions; the purchaser's financing (all cash is best); proof of payment for outstanding liens and taxes; timing; and other expenses that might raise a red flag for the lender.

Tips and Traps

As when dealing with any distressed real estate, buyers and sellers must understand the issues and hire competent legal and financial advisors if they want to complete a transaction. Short sales provide several additional traps for the unwary. For example, closing costs will include title and escrow fees, attorney fees, a portion of unpaid property taxes, re-conveyance fees, notary fees, delivery fees, documentary and/or transfer fees. Who is going to pay those? The amount on a monthly loan statement may not include interest if interest is accrued until the date a loan is paid off, yet the negotiated sale price should include all such interest and costs. Be careful to understand the terms of any short sale before agreeing on a final price. Indeed, the lender may sometimes require the seller or the buyer to make up the difference between the purchase price and the principal amount of the loan after the sale is completed. The Internal Revenue Service considers mortgage relief and the discount of debt to be "income" to the seller. As income, the "debt relief" may be taxable, so if you're selling it's imperative to check with your accountant before undertaking the transaction. Finally, the seller's credit score may be impacted negatively.

In sum: if you're a homeowner facing a dire financial situation because you're trying to sell and your mortgage amount exceeds the value of the house, a "short sale" may help you avoid some of the bigger and more stressful problems associated with foreclosure, bankruptcy and abandonment.

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