HOMEOWNER PRE-FORECLOSURE

SURVIVAL GUIDE

What You Need to Know About Short Sales

Background

The foreclosure crisis that began in 2006 took many homeowners—and their mortgage servicers—by surprise. In the beginning, it was a problem concentrated among subprime loans, but it soon spread to include a broad cross-section of America. The ensuing recession and high unemployment only exacerbated the problem. By the third quarter of 2011, *7.99 percent* of all loans were delinquent, and another *4.43 percent* were in foreclosure, according to the Mortgage Bankers Association (MBA).

Since then, a number of programs have been initiated to help people keep their homes, but they have only been mildly successful. According to Fitch Ratings, most borrowers that receive loan modifications will *re-default* within a year.

Hardship, Foreclosure and You

You may be among those homeowners who are finding it hard to make monthly mortgage payments. If you've experienced a job loss, pay cut, unexpected medical bills, divorce, disability or other calamity, you're probably worried about the prospect of foreclosure.

Or, you may owe far more on your property than it's worth, and doubt the wisdom of continuing to make payments.

In either case, you have some options:

1. **Refinance.** With this option, an entirely new loan is generated in place of the old one, usually with a lower interest rate, resulting in lower monthly payments. Unfortunately, refinancing is usually available only if your home is worth more than you owe on it—which eliminates many homeowners today. The federal government's *Home Affordable Refinance Program* (HARP) does provide a refinance option for loans with higher loan-to-value, up to a certain point. But that program is only available for GSE loans (those owned by Fannie Mae or Freddie Mac).

2. **Modification.** This involves changing the terms of the existing loan to make the payments affordable. The mortgage servicer may lower the interest rate, extend the loan term, or in some cases reduce the principal balance. For several years, this has been the option promoted by mortgage servicers and the federal government. By now, most distressed homeowners have had some experience with the modification option; it works in some cases, but unfortunately not for everyone.

There is a third option, which allows a borrower to exit an unsustainable mortgage and move on: the short sale. In today's environment, more and more Americans are finding this to be the best solution for their mortgage woes.

What Is a Short Sale?

A short sale is a real estate transaction in which the proceeds from the sale are less than the balance owed. The investor that owns the loan (the *noteholder*) must therefore approve the transaction. This means that instead of *two* consenting parties, a short sale involves at least *three*: buyer, seller, and noteholder. This is why short sales can be complicated, and take a long time to negotiate.

Why Pursue a Short Sale?

It is in your interest to avoid foreclosure, for many reasons: A foreclosure will create a derogatory entry on your credit report that typically lasts for seven years. This will make it hard or impossible for you to purchase another home or obtain consumer credit during that time. By contrast, those who complete short sales may repurchase with Fannie Mae loans in as little as two years.

The credit damage from foreclosure can also impact other activities, such as applying for a job. And, there are less tangible effects, such as emotional anguish and social stigmatization. A short sale allows you to avoid much of this grief and start fresh.

Here’s a summary of the benefits to you:

- Your mortgage loan can be considered paid
- You avoid the stigma of foreclosure
- You experience less credit damage than with foreclosure
- You incur few or no out-of-pocket expenses
- You may be able to stay in the property rent-free during the sale
- You have the opportunity to negotiate *all* debts affecting the property
- You may be able to buy again more quickly than after foreclosure

How It Works

Traditionally, a borrower seeking a short sale must contact the bank and ask for approval. This still applies, but today mortgage servicers themselves are also reaching out to homeowners with the short sale option. This is known as a *lender-initiated* or *top-down* short sale.

Initiatives such as the federal government’s *Home Affordable Foreclosure Alternatives* (HAFA) program allow a homeowner to obtain pre-approved short sale terms from the bank. With the help of a real estate agent, the homeowner can then put the home on the market and solicit offers. Otherwise, the traditional method is to list the home for sale, solicit offers, then present the best one to the bank for approval.

Who Is *The Bank?*

The "bank" that borrowers interact with is actually the mortgage servicer, employed by the loan investor to manage payment activities on its loans. The servicer must act according to guidelines specified by the investor in a *pooling and servicing agreement* (PSA). The servicer may have *delegated authority* to make decisions within certain parameters; otherwise its actions must be specifically approved by the investor.

All other lienholders on a property must also be included in short sale negotiations: If there is a second mortgage, home equity line of credit, tax lien or other encumbrances, these must be resolved before a short sale can close. It's easy to see why expert help is essential to a successful transaction! A certified short sale specialist can help you navigate the treacherous waters of short sale negotiation and achieve a successful close.

Getting Approval

Mortgage investors will approve a short sale when they conclude that it's the best way to minimize *loan loss severity*. For you as a homeowner, the transaction may be fraught with emotion and personal concerns; for the investor, it is purely a financial calculation. Your task, then, is to show the servicer why a short sale makes the most sense.

Typically, the servicer will begin by establishing a probable selling price, using an appraisal or a *broker price opinion* (BPO) from a real estate agent. With this information, the servicer will establish its *minimum acceptable net proceeds* (MANP)—the amount it must receive after all sale expenses have been deducted. If the expected proceeds meet or exceed this number, the chances of an approval are usually good.

The Risk of Waiting

Most delinquent homeowners today know that the foreclosure process takes months or years to complete. So, many opt to simply do nothing—basically challenging the bank to foreclose. Since they can live rent-free for a long time, they feel no incentive to consider a short sale.

The danger in this approach is that by the time foreclosure is actually imminent, it may be too late to use the short sale option. When a delinquency remains unresolved, foreclosure may be delayed, but it will come—unless some definite action is taken to avert it. And once a foreclosure sale date is scheduled, it may be impossible to persuade the servicer to hold off.

In its HAFA guidelines, Fannie Mae actually *forbids* servicers from considering a short sale if a foreclosure *is scheduled or could be completed* within 60 days. This reality can come as a rude surprise to homeowners who were hoping to propose a short sale at the last moment.

The Advantage of Being Proactive

By listing the property for sale, you can keep your options open. The sale process itself may take several months, followed by a settlement or escrow period, which may also be lengthy. During that time, you can typically remain in the house, often without making any payments. Servicers actually prefer to keep homes occupied, to reduce damage from neglect and vandalism.

Most importantly, until the sale closes, you still have the same options you did before. It's a smart way to protect yourself from the relentless foreclosure process.

The Importance of Seeking Expert Help

If standard real estate sales are complicated, short sales are far more so. The number of stakeholders and variables involved make them among the most difficult transactions imaginable. But with a *trained, certified* short sale specialist, your chances of success increase dramatically. And since sales commissions are typically paid by the mortgage investor, along with other expenses, your choice of an expert agent to help you is risk-free.

Taking the First Step

If you're wondering whether a short sale might work for you—it's easy to find out. A knowledgeable agent can analyze your situation and advise you on your prospects. Then, the decision is up to you.

Best of all, getting preliminary advice from an expert costs you nothing.

The first step is yours. Take control of your future—starting today.

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