Buying a Short Sale Property

General

1. **What is a short sale?**

   A short sale occurs when a property is sold at a price lower than the amount the homeowner owes on the mortgage, and the homeowner's mortgage lender(s) agrees to the "short" payoff. A lender might accept a short sale with the property worth less than the balance of the mortgage, if the borrower cannot continue to make the monthly loan payment, does not have enough money to pay back the full balance of loan and needs to move out of the property.

2. **Is the mortgage lender's approval necessary in a short sale?**

   Yes, because in a short sale, the mortgage lender will be receiving less than amount the borrower owes on the mortgage. The lender needs to verify that the homeowner cannot continue to pay the mortgage and determine if a short sale is better than foreclosing on the property.

3. **Why do homeowners sell their homes through a short sale?**

   Homeowners pursue a short sale when they can no longer pay the mortgage, need to move from the property and want to avoid a foreclosure. With a short sale, the impact on the homeowner's credit record might not be as bad as a foreclosure in some circumstances.

4. **Who benefits from a short sale and how do they benefit?**
   - Home seller – Avoids foreclosure and the many headaches that come with a foreclosure, allowing a graceful transition into more affordable housing.
   - Buyer – Purchases a property at a fair market value and avoids having to deal with the risks of buying a foreclosed property.
   - Seller's mortgage lender – Mitigates its losses by avoiding the process of foreclosing and reselling the property.
   - All other parties – Listing agent, buyer's agent, appraisers, mortgage broker, the title company, and the insurance company will all earn a profit from a short sale transaction for services rendered.

5. **What are the pitfalls of buying a short sale property?**
   - The short sale process may take more time than a traditional retail sale to complete and it may be difficult to pin down a firm closing date until the seller's mortgage lender(s) agrees to the short sale. Junior-lien holders such as second mortgages, HELOC lenders and other special assessment liens may also need to approve the short sale. If a buyer is bound by a specific timetable to buy a home, the short sale may not be an ideal route.
   - There are many roadblocks which can derail a short sale. With extra research, a buyer should be able to uncover the possible obstacles and plan for them.
   - Buying the property on an "as is" basis.
   - The seller of the property will normally have to pay some money at closing or agree to an unsecured debt in order to have the short sale approved. If the seller refuses, then a short sale may fall through even if the seller has approved the sale.
   - The approving lender will rarely agree to pay for any extras that a regular seller would normally agree to. This could mean higher closing costs for the buyer. The buyer will need to shoulder those costs. (For example, the buyer covers the cost for inspections and repairs).

6. **If the seller is selling a property for less than what they bought it for, does that mean the buyer instantly earns equity on the property?**

   Not necessarily. The seller could have bought the home at a time when property values were high, possibly in a booming market. Today, the housing market is down and the value of many properties has declined. If a buyer purchases a short sale property at a price that is lower than what the property is appraised for in today's market, then the buyer enjoys a discount and picks up some equity. However, in today's market most short sale prices are close to comparable retail sales.

7. **Why does the short sale purchase process usually take longer that a regular purchase?**

   The seller's mortgage lender needs to thoroughly review a seller's short sale request. Gathering the required documentation and doing bottom-line reviews can take significant time to complete before a short sale is approved. Also difficult negotiations that take place between the parties involved, such as junior-lien holders and the seller, may delay the process.

8. **Can I complete a short sale purchase transaction on my own?**

   Because of the complex nature of a short sale transaction, it is strongly recommended that buyers work with a real estate professional who has a track record in successful short sales. With the experience and connections, such an agent should be able to identify and help resolve possible hurdles, help put together a viable offer, protect the buyer's interests, and negotiate the best deal.

Short Sale Listings

1. **How can I find properties that are being sold on a short sale?**

   Buyers can use an online database, such as a Multiple Listing Service, or consult real estate professionals who have experience in short sale transactions. Aside from "short sale," some key phrases to look for are "subject to bank approval," "preforeclosure," "third-party review required," and "pre-approved by bank" which may indicate that the property is being sold on a short sale.

2. **What is the difference between a short sale listing that says "approved for short sale" and "third-party review required"?**

   "Approved for short sale" means the bank has already determined that the homeowner qualifies for a short sale and has approved the request to sell the property at a reduced price. It is possible that an earlier buyer made an offer that was approved, but did not close the transaction. Making an appropriate and timely offer on an "approved for short sale" listing may be a quicker process because the seller no longer needs to be qualified.

   "Third-party review required" means the homeowner has not sought approval yet from his/her lender to do a short sale or approval is pending review of the homeowner's application. This means the process could take longer. Plus there is a risk that the homeowner will not qualify for a short sale in which case the property will need to be sold at a higher price.

Short Sale Approval

1. **What are the reasons the mortgage lender will not approve a short sale?**
    - The homeowner still has the money to pay the mortgage and cannot show reasons why he/she should not pay the mortgage.
    - The mortgage lender has determined that the payout from private mortgage insurance could reduce the loss enough and chooses to foreclose the property.
    - A short sale is not likely to close because the property title is not clear, possibly due to subordinate liens, and cannot easily be transferred.
    - The foreclosure process is too far along already to complete a short sale transaction.
    - The homeowner has filed for bankruptcy. Negotiating a short sale is considered a collection activity, which is prohibited in bankruptcies.
    - The mortgage lender initially approved the short sale but the homeowner refused to make a contribution to help reduce the lender's losses.

2. **What is a settlement statement?**

    A settlement statement, also known as a "HUD-1," shows how the money from the sale is distributed to all of the participants in a real estate sale. Before the seller's mortgage lender approves a short sale, it will look at the proposed settlement statement to review the following:

    - Real estate professional commissions
    - Buyer's financing source
    - Payment to cover outstanding liens and taxes
    - Proposed closing date
    - Expenses that raise a red flag

    These items provide the lender an idea of the buyer's capability to purchase the property and the extent of the lender's loss if it approves the short sale with the buyer's price offer.

Make an Offer for a Short Sale Property

1. **Should my offer match the listed price?**

   Like buying any property, to increase a buyer's chances of success, the offer needs to be competitive. In the case of a short sale, the offer may need to be closer to the market value of the property rather than the list price. Short sale listings are often priced low for the purpose of attracting multiple offers. But this doesn't mean the property will sell at that listed price. Note that most banks will not evaluate the seller's request for a short sale until there is an offer on the table.

   The property's market value can easily be gauged by looking at comparable homes that have sold in the area recently. In today's improving market, short sale prices have risen dramatically. An experienced real estate agent will provide the best advice about how to negotiate a reasonable sales price.

2. **Should I start with a lowball offer in case bidding or negotiations occur?**

   The seller's mortgage lender will check property values in the area so a lowball offer is not recommended. Many banks are so overwhelmed with short sale requests and multiple offers that they will most likely not even counter-offer if you submit a lowball.

3. **What should be included when an offer is submitted?**
   - The purchase contract that the buyer and the seller sign.
   - Earnest money deposit. To the bank reviewing the offer, a sizeable deposit means the buyer is a serious buyer. An earnest money deposit will be considered part of the down payment.
   - Pre-approval letter as proof that the buyer has the ability to purchase the property at the proposed price.
   - Information about recent home sales for similar properties in the same area that show prices comparable to what the buyer is offering to pay for the property.|

4. **What are the reasons the mortgage lender would reject an offer?**

   The most common reason is simply that the offer price is too low. If the short sale will make the lender take a bigger loss than foreclosure, the lender will usually have to foreclose. Both the seller and the buyer need to make sure the sale makes sense for everyone, not just the seller. Other reasons include:

   - Short sale package submitted by the seller is incomplete. An experienced listing agent would prevent this.
   - Seller is not eligible for a short sale because the seller has the money to pay the mortgage, fail to demonstrate financial hardship, the value of the property is likely to be enough to pay off the mortgage, etc.
   - Indication that the short sale may not be an "arms length" transaction. The buyer must be unrelated and unaffiliated with the seller and must agree not to sell or rent the property back to the seller.
   - A subordinate lienholder, like a second mortgage lender, makes unreasonable demands upon the seller and other lenders so that the offer cannot be approved.

   Note that it is not uncommon for the lender to respond with a counteroffer. As with any real estate transaction, buyers will need to know beforehand what their limits are so they can either accept the counteroffer or walk away.

5. **How can I increase the chances of my offer being accepted?**

   Short sale buyers, with the help of an experienced real estate professional, may increase their chances of success if they:

   - File all the required short sale paperwork in a timely and efficient manner.
   - Assure the seller they will wait for short sale approval.
   - Have a strong pre-approval letter.
   - Put down a sizeable earnest money deposit.
   - Submit an offer that closely reflects the market value of the property.
   - Follow up diligently to track the review and approval process. It is recommended that buyers obtain a name and contact number of someone at the lender's loss mitigation department to follow up with. The buyer will need authorization from the seller to allow the mortgage lender to discuss the seller's loan.

6. **Should I start shopping for a lender even if the property I am interested in has not been approved for short sale?**

   Yes. In evaluating a buyer's offer, the seller's mortgage lender will consider the buyer's ability to purchase the property. Ironically, after a long wait for the lender's approval, buyers are also expected to move quickly to close the deal. It is therefore recommended that buyers work with a reputable and flexible lender and secure pre-approval for financing by the time an offer is submitted.

Other Impediments to a Short Sale

1. **Why does a short sale become more difficult when there are more lenders involved?**

   A short sale can only happen when all lien holders on the property agree to the short sale. Lenders holding second mortgages on the property (such as home equity lines of credit or piggyback loans) are also taking a loss on the sale. They will want to receive a certain amount from whatever is left after all costs are paid. Often, there will not be enough funds left to payoff junior lien holders. Here is where the delays and negotiations take place.

   If the loan was sold to an investor, such as Freddie Mac or Fannie Mae, the investor will have to approve the short sale. Investors will have their own requirements and review process before they approve a short sale.

2. **Can the seller impede the short sale process?**

   Yes, when a seller is uncooperative and slow to gather/submit the required documentation, this may stall the review process. This sometimes happens when sellers – who know that a short sale can adversely impact their finances – are reluctant to give up their homes. They may have very little motivation to cooperate.

   Also, sellers may be required by one of the lenders to make a payment, usually called a "contribution", at closing to help reduce the lenders losses. Some sellers wait until the last minute and then refuse to make the contribution or think that the buyer will make it for them. When this happens, the short sale is not approved and will not close. The seller has to understand up front that he/she is receiving a financial windfall and a small payment to reduce the lender's losses is expected.

Short Sale Contracts

1. **What is a short sale addendum?**

A short sale addendum is a critical document in many short sale transactions because it provides the details regarding some of the following:

- Contingencies upon which a contract can be canceled or executed.
- Bank's approval of the short sale.
- Specific time period the buyer is willing to wait for short sale approval.
- Release of the buyer's earnest money deposit.
- Property inspections.
- Costs that the buyer and seller may be responsible for as a result of executing the short sale contract.
- Consideration of multiple offers on the property.

It is important to work with a real estate professional with experience in short sale transactions to ensure the short sale addendum includes the items that will protect the buyer's interests during the short sale review and execution process.

2. **Can the home seller cancel the short sale contract?**

Yes, a seller may cancel the short sale contract because:

- The seller's situation changes and he/she decides not to sell.
- A foreclosure action prevents the short sale.
- The seller accepts a higher offer.
- The seller has filed for bankruptcy.