

A WORD FROM RON CAHALAN

What is a Short Sale?

[By Ron Cahalan]

Today's real estate markets are adjusting all over the country. Home prices are trending downward in more than half the major markets. Add the popularity of minimum-down and no-down loans, interest-only loan programs, and the many "optional-payment" ARMs with potential negative amortization, and you end up with mortgage balances greater than the values of the homes being sold or refinanced.

This phenomenon has caused the rise of what are called "short-sale" transactions. A short sale occurs when the debt secured by the property offered for sale exceeds the net sale price. In that scenario, one or more of the lenders who have notes secured by the property may accept less than the amount actually owed in the payoff of the loan amount.

Now, typically the seller has to prove that remaining in the home rather than selling will create a financial hardship and that were he or she to remain in that position, the ultimate result would be default and foreclosure. The reason many lenders will entertain a short sale is that they will recoup much more money in a short sale than they would if the property went all the way into foreclosure and they incurred the legal costs of foreclosure and ended up with the property as an "REO," or real-estate-owned, anyway.

Here is an example: A homeowner loses his job. He finds that he needs to sell his home and do so before too many late payments show up on his credit report. The borrower/homeowner originally borrowed \$250,000 with no down payment (100% financing) with an 80%-20% combo loan (piggyback) back

in December 2005. The comps now show a market value of just \$210,000.

If the seller's agent could get an offer of \$210,000, the seller could get out of the property and have a fresh start. The banks are owed \$200,000 and \$50,000 respectively (both were interest-only loans). If the seller gets a month or two behind, then the balance will be even greater than the original loan amount.

Although the \$210,000 offer would not even cover the \$200,000 first-mortgage balance (after selling costs), the first lien holder would most likely accept the offer. There would then remain the issue of the second mortgage and any unpaid property taxes. The property taxes could be paid out of the proceeds from the short sale or paid by the new buyer. It is the second that is the issue now.

The agent for the seller (with the seller's permission) would also contact the second lien holder. Now, there are occasions where the first lien holder may take a bit less to give the second lien holder a piece of the proceeds from the short sale, but they are rare. Typically, the first lien holder will get the majority if not all the proceeds after the

costs of sale and taxes, and the second lien holder will be left with little to no monies at all.

The second lien holder is not in a position to argue much, unfortunately, as the foreclosure by the first lien holder would wipe the second lien holder out anyway. The only way it could protect its interest would be to buy out the first lien holder position so that it moves into the first position. Knowing the reduced value of the property and that by moving into the first position it would still most likely end up with little or nothing, it will probably settle for pennies on the dollar if anything at all. Its legal costs can easily exceed anything it may recover by pursuing the matter any further. This is why the rates are always greater on a second mortgage than on a first. The risks of loss are much greater.

The lenders would want a substantial amount of information to consider a short sale. They would require the completion of their own in-house short-sale package; financial documents and tax return and income information from the seller; and a hardship letter from the seller. The negotiations and considerations for a short sale can take weeks to complete. They would also most

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likely require an appraisal of the property regardless of the information from the real estate agents involved. The entire short-sale process can take as little as three weeks but can also take a few months depending upon the lenders, their position, and the market conditions.

Remember, the lenders do not want the house back any more than you want to lose the house. Try to negotiate a win-win

transaction before it hits your credit too hard. Good luck!

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On the Net

The Loan Crusader
www.theloancrusader.com

Lenders Are Liars
www.lendersareliars.com

The Mortgage Manifesto
www.mortgagemanifestoblog.com

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