WHAT IS A SHORT SALE?

With all the talk about foreclosures lately, the term "short sale" is becoming commonplace. A short sale is when a lender accepts less than the full amount due on a mortgage when a property is sold. Sometimes, the lender will agree to the short sale to avoid the time and expense of a foreclosure.

When a borrower is in default on a mortgage, they not only owe back payments but also may owe late fees, property inspection fees, attorney fees, etc. These can add up quickly, and eat up all the equity the borrower had in the property. If the borrower is unable to bring the account current, the lender will then foreclose on the property.

With a foreclosure, the lender can lose more than the mortgage amount, due to the extra costs involved. These may include attorney fees, court costs, lost interest, eviction costs, maintenance, and selling costs. In some states, foreclosing on a property can take up to two years. Therefore, it may be in the best interest of the lender to accept the short sale.

It can also be in the best interest of the borrower, They will not have to endure the time and stress involved in a foreclosure, and their credit may not be as adversely affected. It is quicker and easier, and does not subject the borrower to the embarrassment of a foreclosure,

How does it work?

The first thing a borrower should do, when they can no longer afford a property, is to contact the lender immediately. The last thing a lender wants to do is foreclose on the property. Typically, lenders have departments that work with people, who are behind on their payments, to resolve the situation. If you cannot resolve the default with the lender, ask if they will accept a short sale. They should direct you to the department that handles these situations.

The lender will usually require the borrower to submit a lot of information, in order for them to consider a short sale. The information required may include:

- Income documentation such a W-2's and paycheck stubs to verify the borrowers' income,
- Bank statements to verify the borrowers' assets.

- Hardship letter – describing the reasons the borrowers are in the financial position they are in, and asking the lender to accept the short sale. This letter should be backed up with any documentation necessary, such as medical bills, etc,
- Fair market value of the property – depending on the lender this may require an appraisal, or they may accept a written opinion, known as a Comparative Market Analysis (CMA) or a Brokers Price Opinion (BPO), from a local Realtor.
- Preliminary Closing Statement from the sale of the property. This will show the proceeds of the sale, after the mortgage is paid off and all other closing costs and fess are paid. In the case of a short sale, this will be a negative amount in the amount of the shortage.
- Listing Agreement and Purchase Agreement – when they are available.

Once the lender has reviewed all of this documentation, they may or may not approve the short sale. If they do not, they will proceed with the foreclosure. If they do agree, you can close on the sale of the property and the lender will take the loss.

What happens then?

The borrower may not be 'off the hook'. The lender still has options to try and collect the shortage. As a condition to the short sale, the lender may require that the borrower sign a note to repay the shortage. They may also file a collection or a judgment for the amount of the shortage. In this event, it would be advisable to consult an attorney, with expertise in this area of real estate.

In addition, the IRS may come after the borrower for income taxes on the amount of the shortage. If the lender forgives the shortage, they will report the amount as income to the IRS, and the IRS will collect taxes on this amount. For more specific information on this, please consult a tax professional.