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Navigating Short Sales: What to Do When the Sale Price Leaves You Short

If you're thinking of selling your home, and you expect that the total amount you owe on your mortgage will be greater than the selling price of your home, you may be facing a short sale. A short sale is one where the net proceeds from the sale won't cover your total mortgage obligation and closing costs, and you don't have other sources of money to cover the deficiency. A short sale is different from a foreclosure, which is when your lender takes title of your home through a lengthy legal process and then sells it.

1. Consider loan modification first. If you are thinking of selling your home because of financial difficulties and you anticipate a short sale, first contact your lender to see if it has any programs to help you stay in your home. Your lender may agree to a modification such as:

- Refinancing your loan at a lower interest rate
- Providing a different payment plan to help you get caught up
- Providing a forbearance period if your situation is temporary

When a loan modification still isn't enough to relieve your financial problems, a short sale could be your best option if

- Your property is worth less than the total mortgage you owe on it.
- You have a financial hardship, such as a job loss or major medical bills.
- You have contacted your lender and it is willing to entertain a short sale.

2. Hire a qualified team. The first step to a short sale is to hire a qualified real estate professional* and a real estate attorney who specialize in short sales. Interview at least three candidates for each and look for prior short-sale experience. Short sales have proliferated only in the last few years, so it may be hard to find practitioners who have closed a lot of short sales. You want to work with those who demonstrate a thorough working knowledge of the short-sale process and who won't try to take advantage of your situation or pressure you to do something that isn't in your best interest.

A qualified real estate professional can:

- Provide you with a comparative market analysis (CMA) or broker price opinion (BPO).
- Help you set an appropriate listing price for your home, market the home, and get it sold.
- Put special language in the MLS that indicates your home is a short sale and that lender approval is needed (all MLSs permit, and some now require, that the short-sale status be disclosed to potential buyers).
- Ease the process of working with your lender or lenders.
- Negotiate the contract with the buyers.
- Help you put together the short-sale package to send to your lender (or lenders, if you have more than one mortgage) for approval. You can't sell your home without your lender and any other lien holders agreeing to the sale and releasing the lien so that the buyers can get clear title.

3. Begin gathering documentation before any offers come in. Your lender will give you a list of documents it requires to consider a short sale. The short-sale “package” that accompanies any offer typically must include

- A hardship letter detailing your financial situation and why you need the short sale
- A copy of the purchase contract and listing agreement
- Proof of your income and assets
- Copies of your federal income tax returns for the past two years

4. Prepare buyers for a lengthy waiting period. Even if you're well organized and have all the documents in place, be prepared for a long process. Waiting for your lender's review of the short-sale package can take several weeks to months. Some experts say:

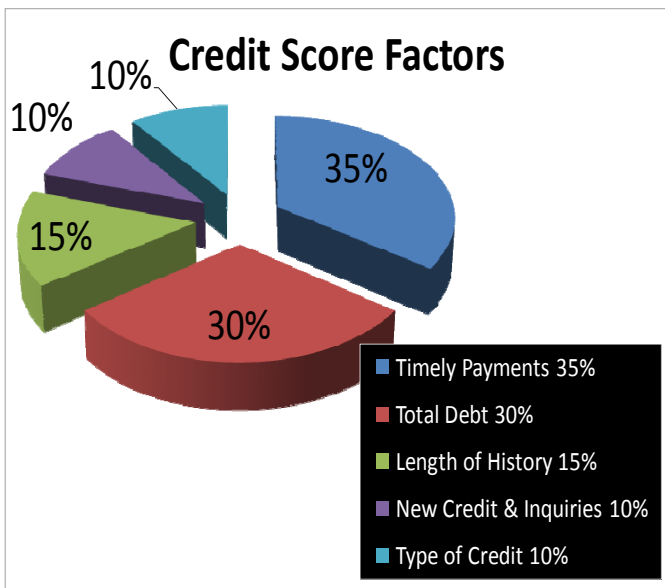
- If you have only one mortgage, the review can take about two months.
- With a first and second mortgage with the same lender, the review can take about three months.
- With two or more mortgages with different lenders, it can take four months or longer.

When the bank does respond, it can approve the short sale, make a counteroffer, or deny the short sale. The last two actions can lengthen the process or put you back at square one. (Your real estate attorney and real estate professional, with your authorization, can work your lender's loss mitigation department on your behalf to prepare the proper documentation and speed the process along.)

5. Don't expect a short sale to solve your financial problems. Even if your lender does approve the short sale, it may not be the end of all your financial woes. Here are some things to keep in mind:

- You may be asked by your lender to sign a promissory note agreeing to pay back the amount of your loan not paid off by the short sale. If your financial hardship is permanent and you can't pay back the balance, talk with your real estate attorney about your options.
- Any amount of your mortgage that is forgiven by your lender is typically considered income, and you may have to pay taxes on that amount. Under a temporary measure passed in 2007, the [Mortgage Forgiveness Debt Relief Act and Debt Cancellation Act](#), homeowners can exclude debt forgiveness on their federal tax returns from income for loans discharged in calendar years 2007 through 2012. Be sure to consult your real estate attorney and your accountant to see whether you qualify.
- Having a portion of your debt forgiven may have an adverse effect on your credit score. However, a short sale will impact your credit score less than foreclosure and bankruptcy.

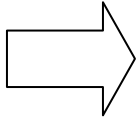
Note: This article provides general information only. Information is not provided as advice for a specific matter. Laws vary from state to state. For advice on a specific matter, consult your attorney or CPA.



When dealing with the credit score ramifications of shorts sales and foreclosures it is important to know there is not a blanket answer. Every credit report contains its own variables, which will impact individual reports differently. The critical aspect is the number of months of delinquency, reducing this occurrence is better for the credit score. Generally speaking, a short sale would accomplish unloading the property quicker than a foreclosure and therefore accomplish the task of reducing the number of months delinquent. However, in regards to the decline in credit scores let's look at the typical pattern leading up to a short sale or foreclosure:



The scores were shot before the mortgage even became delinquent. The reality is that the scores can only go so low, just like the scores can only go so high with a good repayment history. At the worst point the homeowner may have scores in the 400 range, the scores will not stay that low for long. Once the delinquencies cease, the scores will begin to rebound. However, it is a slow process in rebounding from such a severely adverse situation. The next 12 months are the worst, and the progression goes for the next 7 years until the delinquencies fall off the credit report entirely. Realistically once the 2 - 3 year mark is crossed the scores rebound to a nice range as long as there have been on-time payments on existing accounts.



The reestablishment of credit accounts is imperative to allow for something positive (i.e. payments) to be feeding into the credit report.

Fair Isaac treat short sales, foreclosures and deed-in-lieu of foreclosure as the same “serious derogatory” item, so why do a short sale?

Answer: we don’t know what the future holds (and neither does Fair Isaac), short sales offer less exposure to future collection action and harassment, future employers may ask what happened (credit reports are often times used for hiring and promoting in large corporations). By reducing the delinquency and getting closure the road to recovery happens sooner, as opposed to the likely longer process of foreclosure.

Here is a quote I received from Craig Watts, Public Affairs Manager at Fair Isaac Corporation, “Based on the information that lenders report and the way it shows up on consumer credit reports, the FICO scoring model assesses a foreclosure, short sale, or deed in lieu as a serious derogatory tradeline. They all represent a major failure on the part of the consumer to meet his mortgage obligation.

Keep in mind that the FICO score's goal is only to rank-order consumers based on their future repayment risk. Failure to repay a creditor has consistently proven to be highly predictive of future repayment risk. Down the road a ways, Fair Isaac hopes to see significantly more examples of short sales and deed-in-lieu settlements on the credit report samples that the big credit bureaus provide us to analyze, preparatory to our updating the FICO scoring model. Only then can Fair Isaac statistically determine if there are useful distinctions that the scoring model could make between the predictive value of those settlement types in order to produce a more predictive score”.

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Copies of *The Credit Road Map* are available at discount for orders of 5 or more, email or call for details.

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A practical guide for navigating your way to good credit

BY PATRICK RITCHIE