



LOAN FORGIVENESS – A Primer on Short Sales

INTRODUCTION

As a result of completing this section, you shall be able to:

- ✚ Describe a “Short Sale”
- ✚ Describe factors that lenders evaluate before agreeing to a “Short Sale”

YOUR ROLE

As a result of completing this section, you shall be able to:

- ✚ Counsel sellers on various options available to them
- ✚ Explain the basics of the “Short Sale” process
- ✚ Describe what the lender typically looks at when evaluating whether a seller qualifies for a “Short Sale”
- ✚ Describe characteristics of a good buyer candidate for a “Short Sale”
- ✚ Describe benefits to you if you choose to work “Short Sales”

The Hidden Monster – The Deficiency Balance

As a result of completing this section, you shall be able to:

- ✚ Describe 3 ways lenders can handle deficiency balances
- ✚ Describe the 4 ways a seller might avoid tax liability of a “Short Sale”

LEGAL PITFALLS

As a result of completing this section, you shall be able to:

- ✚ Describe 2 disclosure challenges you may encounter when working with sellers in a “Short Sale” situation
- ✚ Describe one action you should to take when you discover you are working a “Short Sale” situation
- ✚ Understand the 7 legal pitfalls describe by Robert Freeman

EXAM

As a result of completing this section and to earn credit for this course, you must:

- ✚ Satisfactorily answer at least 70% of the questions correctly



INTRODUCTION

You receive a call from a potential home seller at the office. They explain that they would like to interview you for listing their home; can you come over in the next day or two to offer them a market analysis and explain your services. WooHoo! You think. But did your questioning uncover any information that might assist you with understanding that their motivation may be centered on the fact that they are or soon will be in financial distress? Are you prepared to advise them about the option of “Short Sales”, especially when the price you’re suggesting based on your careful market analysis just isn’t enough because they owe more than that on their mortgage and home equity loans?

Or... You receive a call from someone telling you they are in financial trouble. They bought their home last year for \$500,000, and foolishly took advantage of the mortgage broker’s sales pitch and obtained a 100% loan. Now, the house will probably only sell from \$475,000, and he just lost his job and can’t afford to continue with the monthly mortgage payments.

Or ... you receive a call from a potential home buyer. They’re interested in looking at foreclosed or “short sale” properties. How will you lead them through and manage the “Short Sale” transaction?

Flat or falling home prices, home-equity credit lines, 100-percent financing that sucked out equity, and spiking interest rates on adjustable mortgages are converging to create a regrettable, but expanding niche for real estate practitioners. In this lesson we’ll explore some of the more common questions that you may face as more and more homes fall into the “Short Sale” criteria.

You will find a variety of definitions for a “Short Sale” in various publications, newsletters, briefs, and legal writings. Generally it comes down to three ingredients: (1) The homeowner is in financial distress, (2) They owe more against their home than what they can sell it for (3) They MUST sell. For these folks, a “Short Sale” becomes an alternative to help them avoid foreclosure which has more impact on their credit score. Some, but not all, “short” sellers may also be in default on their mortgage loans and already be headed for foreclosure.

Understand that most of these people are in financial distress and possibly dealing with a life-changing event such as a death in the family, a medical problem, a divorce or a job loss. They are very emotional and may not want to face up the reality. They probably want to keep their home, but have no idea how. They are being barraged by phone calls and letters, and are wondering where they will be living a month from now. To handle these tough situations, you must first have a soft sell approach, listen to their issues and let them vent. Instead of talking about your services or yourself right off, pay attention to what they’re saying and ask follow-up questions when appropriate.

If, however, the homeowner doesn't have to sell, or doesn't want to sell, there are many other options available.

- ✚ They could move into a more affordable home and rent out their existing home (if the rent will support the payment)
- ✚ They could take on a housemate (but there are numerous down sides to this option)
- ✚ They could refinance (though this is not always the best path). Homeowners in a “Short Sale” situation are often in financial distress, which means higher rates and fees because they are seen as a higher credit risk to a new lender.
- ✚ They could talk to their existing lender to modify the terms of the existing loan.

HUD offers approved housing default counseling and homeowners who do not want to sell or don't have to sell should seek them out. As a real estate consultant, you may wish to provide them with information relating to these HUD-approved agencies rather than letting them flounder and blindly trust just anyone who might approach them with promises that look and sound too good to be true. We all know there are those out there willing to take advantage of homeowners in distress.

To sell “short” means the seller is asking the underlying lender(s) to accept less than their payoff in order to facilitate a sale of the home in lieu of foreclosing on it. As many of you know, foreclosures are expensive and time consuming for a mortgage lender. Banks and lenders are in the business of making loans not foreclosing on homes. Their decision to agree to a “Short Sale”, however, has to make rational, logical sense. They will start by reviewing the seller's proof of financial distress before deciding to go this route.

You should understand that not all lenders will allow a “Short Sale”. Their decision depends on a number of factors: Where is the house? How much loss will the lender suffer? What is the possibility that a speculator/investor will buy at a foreclosure sale? What is the liability risk the bank assumes by owning the property after foreclosure? How much money will be tied up during the holding period? What additional costs will be associated with an REO such as attorney's fees? Does the seller have other assets or a high-salaried job? Each lender has its own requirements, so you and/or sellers must consult the specific lender to determine what they need in order to move forward with the “Short Sale” process.



YOUR ROLE as the Seller's Agent

Unfortunately, “Short Sales” are a reality for home owners who owe more than their property is worth. If you have patience, persistence, and a knack for problem-solving, this niche could be for you. If you decide to work in the “Short Sale” market you will need to learn to help homeowners understand that it's a mistake for them to go into denial and do nothing. Pro-active

and preventive action is required to avoid foreclosure. Your role is to review their options with them

- ✚ First and foremost, sellers must decide if they absolutely must sell or if they might be better off riding out their financial crisis. Before raising red flags with lenders and potential buyers, make sure your seller will be “short”. Just because sellers are behind on their mortgage or are having financial difficulties doesn’t mean that the property is automatically eligible for a “Short Sale”. Your first clue is the market analysis vs. the mortgage amount. Perform a CMA, subtract the amount owed by your client. Then calculate and deduct costs associated with closing the transaction, including your commission. Only then can you determine if they are “upside down” with their mortgage.
- ✚ Thanks to programs such as those proposed by Fannie Mae and Freddie Mac to assist subprime borrowers, many lenders are more willing to offer loan modification options. One option is to extend the term of the loan and add on delinquent payments to the loan principal to make the loan more manageable for the home owner. Lenders are taking a more active approach to working out problems with property holders as an option that’s usually less costly for them than charging off a delinquent loan or foreclosing on the property. You should advise sellers to contact their lender as soon as possible to see if they have a program to help them stay in their home. In addition to offering a different payment plan, lenders may be willing to refinance at a lower interest rate, refinance an adjustable rate mortgage with a Federal Housing Authority or conventional fixed loan or provide a forbearance period if the seller’s situation is temporary. It’s important to note that lenders generally will not postpone a foreclosure just because a property is listed, though they may postpone if you have a reasonable offer in the works. The ideal candidate for a “Short Sale” is still making loan payments and has a credit rating worth preserving.
- ✚ When discussing a potential listing, try to assess the seller’s financial situation. People don’t generally tell you they can’t make their payments so you have to ask qualifying questions that will bring out the true motivation and situation. You could ask the seller what type of loan they have, what interest rate are they currently paying, whether there have been any recent changes. You could also ask the owner to estimate how much equity there is in the home. You should never assume you already know the answers to these types of questions.
- ✚ Calculate the carrying costs of the property. Get the sellers to think six months into the future. What price would they be happy about at that point? Let them know that by pricing at that level and moving it today, they can avoid the ongoing costs and get out of the property more quickly.
- ✚ Explain the “Short Sale” process. The seller has to know that they need to take the time to work with the lender. Some sellers don’t want to cooperate; others want to get things taken care of quickly, regain credit status and buy again.

- ✚ Next, you should encourage them to talk with a HUD-approved housing counseling agency that offers “default” counseling.
- ✚ Get them to talk with their lender. Ignoring letters or calls from lenders only enhances their state of denial. Typically, the lender has a “loss mitigation” department that handles these matters. Get in touch with the decision maker of the department. Ask them for a list of documents they will be required to submit to be considered for a “Short Sale”.
- ✚ If the seller wishes to authorize you (as their real estate agent) to act on their behalf, the lender will need a letter of authorization from the seller. This letter must include the seller’s name, agent’s name, property address and loan number. It’s critical for you to build a relationship with the seller’s lender. Once you have credibility, the entire process becomes somewhat easier. If there’s more than one lender involved, you may have to talk with each of them to get approval for a “Short Sale”. The presence of more than one lender makes a “Short Sale” more complicated since it’s often the lender holding the second, or junior, mortgage that has to absorb most of the loss.
- ✚ Suggest that they seek legal counsel. There are things attorneys can do that real estate professionals cannot do.



When a homeowner realizes his property is worth less than he owns and he’s finding it more and more difficult to continue making payments, his first reaction may be “I need to sell”. This is a tough situation for anyone. Not only is it painful, sometimes it’s heartbreaking. So, you get the call! You want to help, but you know there is little chance the owner can afford to pay your fee to list the property. You may even agree to reduce your fee, but even that may not be enough. And you still need to offer competitive compensation to the buyer’s agent.

As mentioned before, when considering a “short sale”, the lender will evaluate the owner’s financial condition. They will also consider the value of the property, the cost of foreclosure, and any offer to purchase the property that is less than the amount owed. If the lender decides to proceed with a “Short Sale”, the lender will agree to accept a reduced pay-off at closing in lieu of foreclosing on the property.

So how can you advise a seller who is seeking a “Short Sale” remedy? First you need to understand what a lender typically looks at when evaluating whether an owner qualifies for a “short sale”. Advise the seller that the lender will:

- ✚ Take the owner through an application and verification process, looking at W-2 forms from employers (or a letter explaining the seller is unemployed), tax returns, bank statements, financial documents outlining income and debt obligations, assets, etc. The seller will be required to prepare a comprehensive letter explaining why he is requesting the “Short Sale”. The seller will need to spell out his request in detail, being as specific as possible – what price is he asking the lender to approve; what percent commission will the real estate agent be allowed to accept, and what closing costs will be associated with

the settlement. The seller needs to show true financial hardship. Advise him to emphasize the hardship. Someone with the assets or the income to pay is unlikely to be considered. The seller's request should also include a request from the lender to provide an accurate accounting of the outstanding balance. The seller needs to review this to ensure there are no erroneous charges added. The more documentation a seller can provide the lender, the faster the decision will be. In preparing the package, sellers must be careful about discrepancies between the seller's income and the income used to obtain the loan. A big gap may indicate mortgage fraud, unless employment circumstances have drastically changed.

- ✚ You can assist them by preparing a market analysis or Broker Price Opinion which will show what houses in the area are currently selling for. In general, most "Short Sale" experts say to price the property at or near fair market value (although a few begin with the total payoff amount owned by the seller). Most banks have a formula for what percentage under market value they will accept which is why it's important to submit comps of recent sales.
- ✚ Have the property appraised by an appraiser other than any appraiser a potential buyer may intend to use. The cost of the appraisal will likely be passed on to the owner up front or at closing.
- ✚ Evaluate the adequacy of and negotiate any offer made by a potential buyer.
- ✚ Compare the likely cost of closing the sale with the potential buyer versus the likely cost of foreclosure.



PATIENCE – The Name of the Game

All of this takes time. Any contract the owner enters into with a potential buyer will most likely be subject to the owner being able to satisfy the lender's requirements under a "Short Sale." When a purchaser makes an offer it is important that the contract state that it is contingent on the lender's approval. When you send the contract to the lender, it would be helpful if you would include an accounting of all expenses which will have to be paid at settlement. Patience on the part of all parties involved will be essential as the review moves through its paces and the lender attempts to negotiate the sales price. This means you have to prepare both the buyer and seller for a lengthy waiting period.

A "Short Sale" is not for the impatient. Frustrations can emerge. For example, the owner may already be angry because he now believes he paid too much for the property – and he may blame a real estate agent for this. The owner may not have a realistic idea as to the current value of the property-especially if he borrowed money against the property to make improvements that have added little or no value. The buyer and homeowner may believe that the lender is under no incentive to hurry the review along. All of these pent up emotions may come down to you being asked to forego part of your fee. You are not the reason that the deal won't close though others

in the process may attempt to make you feel that way. Whether you decide to cut your commission or not is a personal decision. However, these transactions are difficult, time consuming, gut-wrenching, and ulcer-inducing. Why on earth would you accept a low fee?

Even if you're well organized and have all the documents in place, be prepared for a long process. Waiting for a lender's review can take several weeks to months. Some experts say:

- ✚ If the seller has only one mortgage to satisfy, the review can take up to 2 months
- ✚ If the seller has a 1st and 2nd mortgage with the same lender, the review can take up to 3 months
- ✚ And if the seller has two or more mortgages with different lenders, it may take 4 months or longer.

Obviously, if the lender counters or denies the "Short Sale", the process is lengthened.

Many real estate professionals will advise you to steer clear of "Short Sales" if you want to make a living. Why? Some feel lenders are not dealing in good faith and from experience they've decided not to waste their or their client's time. Some blame the "Short Sale" horror stories on uncertainty – over just how far prices will drop, whether the federal government will bail out more lenders, and the extent to which various foreclosure prevention programs actually will help homeowners stay in their homes.



That banks were ill-prepared to handle the sudden onslaught of loan defaults and foreclosures is an understatement. The combination of panicked homeowners, lack of a standardized process, short-staffed loss mitigation departments, inexperienced Realtors®, and falling home values resulted in chaos during 2008. "There was no curve—it was a big boom," says Kathy Jeffers-Volk of Coldwell Banker's Corporate REO division, who was with Countrywide in the early 1990s. "But back then it wasn't 400 one month and 4,000 the next as it was this time."

Most experts suggest that you let the lender know as soon as possible of the potential "Short Sale". The key is establishing direct communication between the agent, homeowner, and lender, quickly performing a property valuation, and identifying mortgage insurance or other issues, such as liens before any offers from buyers are entertained. With federal and state governments and regulators increasingly calling the shots, banks are scouring their portfolios looking for borrowers in trouble or on the verge of it. The hope is that lower interest rates will allow many homeowners to refinance or negotiate a loan modification.

Until 2008 there were taxable consequences in doing a "Short Sale" so many didn't consider this a good option. More about that later in this lesson.. "Short Sales" have also become a cheaper option in most cases than foreclosing. One of the primary issues for lenders regarding "Short

Sales” is understanding what the “real” value of the property is. Determining value (in some markets) is like playing in quicksand.

According to a Realtor® Magazine article “Short Sales: The New Wild West”, another issue when working “Short Sales” is that when you’re working with buyers, the lender who must approve the “Short Sale” may wish for the purchaser to be preapproved by them. Some companies extend this requirement by insisting that the purchaser finance the home using one of their lenders. The hard sell by lenders is just one of the many challenges sales associates face when working with distressed sales.



Other challenges



- ✚ **Aggressive investors** who try to make money through a “double close and flip” transaction that can leave sellers upset with their listing agent. This happens when an investor tells a listing agent they can help bring a “Short Sale” to a speedy close by using their experience to negotiate the deal with the lender. All the listing agent has to do to earn their commission is find a buyer. This is where trouble can emerge. Once the agent accepts the investors’ negotiating help, the investors talk the seller into turning over the deed to them and—in some cases—giving them power of attorney. Armed with that authority, they negotiate a deeply discounted sales price with the lender, often without the practitioner’s knowledge. Then, when the agent procures a buyer, the investors buy the property at the discount and flip it to the buyer at the original listed price, pocketing the spread. This leaves the sellers feeling that the listing agent didn’t do the job of getting the best price for their home. Can you spell Potential Lawsuit?

- ✚ **Our Own Worst Enemy** – As if pressures from lenders and investors weren’t enough, sometimes sales people create their own problems when they encourage buyers to make offers on several “short sale” properties in hopes of finding one that will make it to closing. This category of buyer lacks commitment and oftentimes commitment is the only glue that holds a deal together. These multiple offers can derail efforts of buyers who are committed to one property. Agents can also derail transactions simply by not preparing well. To save everyone time and effort, agents should carefully qualify sellers upfront to be sure they have a genuine hardship. Then they need to assist the seller in submitting a complete proposal. One way of accomplishing this may be to see whether there are junior liens. Helping the seller to submit a complete, well-organized proposal to the lender will help insure that the process survives the rigors of the process.

- ✚ **Using “Short Sale” Consultants** – “Short Sale” specialists seek out practitioners who have either little experience or little time to deal with these types of sales and offer their services as a way for practitioners to focus on obtaining listings and finding buyers while they handle communication with lenders. When a consultant company operates professionally, its services can make a difference in the success or failure of distressed sales. Effective third-party negotiators have been trained; they have relationships with

banks; they provide good follow-up; and they know who to talk to. Ineffective negotiators who misfile paperwork and consistently use excuses for inaccuracies or wrong dates do a disservice to all involved. So how do you tell the difference. The best way, is to get referrals from colleagues you trust.



YOUR ROLE – The Buyer's Agent

A “Short Sale” holds many potential pitfalls for buyers. It’s important for you to understand what to look for before you decide to represent them in a “Short Sale” purchase. Properly interviewing buyers to determine whether they are a good candidate for a “Short Sale” purchase is a must. It will help ensure they understand what it takes to go through this arduous process.

A good candidate for a “Short Sale” purchase is:

- ✚ Someone who is very patient. Even after you come to agreement with the seller to buy a “Short Sale” property, the seller’s lender (or lenders) has to approve the sale before you can close.
- ✚ Someone who has their financing in order. Lenders like cash offers. But even if the buyer can’t pay all cash, it’s important to show that your buyer is well qualified and their financing is set. If they’ve been preapproved, have a large down payment, and can close at any time, their offer will be viewed more favorably than that of a buyer whose financing is less secure.
- ✚ Someone who has no contingencies. If the buyers has to sell a home before they can close on the purchase of the “Short Sale” property, or the buyer needs to be in the new home by a certain time, a “Short Sale” may not be for them. Lenders like no-contingency offers and flexible closing terms.

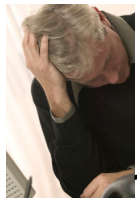
A buyer who is serious about purchasing a “Short Sale” property should have expert assistance from:

- ✚ An experienced real estate attorney - Only about two out of five “Short Sales” are approved by lenders. But a good real estate attorney who’s knowledgeable about the “Short Sale” process will increase your chances of getting an approved contract. If the buyer wants specialized language written into the purchase contract, a real estate attorney is essential.
- ✚ A qualified real estate professional. – If you wish to specialize in this niche, you must be prepared to let a buyer know how many people you’ve represented in a “Short Sale” and, of those, how many have successfully closed.

- ✚ A title officer – It's a good idea to have a title officer do an initial title search on a "Short Sale" property to see all the liens attached to the property. If there are multiple lien holders, it's much tougher to get that "Short Sale" contract to the closing table.

Other risks you may want to convey to buyers of "Short Sale" properties include:

- ✚ Potential for rejection – Lenders want to minimize their losses as much as possible. If the buyer makes an offer significantly lower than the fair market value of the home, chances are that the offer will be rejected and you'll have wasted your time and theirs. Or the lender could make a counteroffer, which will lengthen the process.
- ✚ Change of Terms – Even when a lender approves a "Short Sale", they may require the seller to sign a promissory note to repay the deficient amount of the loan and if the seller refuses to sign, it could kill the deal. Lenders can also change any of the terms of the contract that have already been negotiated, which may not be agreeable to the buyer.
- ✚ No repairs or repair credits – More than likely buyers will be asked to take the property "as is". Lenders are already taking a loss on the property and may not agree to requests for repair credits. It's important to ensure your buyers have an inspection so they know what they're getting into (even before they make an offer).



To Work "Short Sales" or not?

The risks of a "Short Sale" are considerable. If you have the time, patience, and iron will to see it through, a "Short Sale" can be a win-win for you, the buyers and the sellers.

Not all homeowners have the luxury of waiting out the recession in the comfort of their homes. As a real estate professional, you may be in an ideal position to assist sellers with their "Short Sale" needs. Most homeowners have no clue on where to start or how to effectively negotiate with their lenders. In addition, lenders are often skeptical when homeowners call, asking or demanding a "Short Sale". Your status and reputation as a real estate professional gives you more credibility in the lender's eyes. The lender is likely to be more willing to listen to someone who knows current market values and the price and timeframe for selling a property.

Negotiating "Short Sales" on behalf of your clients can benefit you in several ways, some direct and some indirect:

- ✚ The homeowners are more likely to contract with you to list their home when you have offered valuable advice and a viable solution to a serious problem.
- ✚ You generate positive word-of-mouth advertising by assisting homeowners in distress.
- ✚ You help prevent foreclosures that can further depress home values in your market.

- ✚ You establish valuable professional relationships with lenders that have the potential of generating additional business opportunities later.



Become Educated

Knowledge is power and the more you know about the “short sale” and foreclosure process, the more valuable you become. You should attend classes, find mentors and read up on the process online and in trade journals. “Short Sales” require a high level of knowledge about the inner workings of these types of deals. Learn about the different parameters that each loan must meet in order to qualify for this type of sale. An FHA loan, for example, may have different guidelines concerning the seller’s financials than a VA or a Freddie Mac loan. This is important so that you know how to advise sellers on how to put together packages that meet each of their criteria. Learning from mentors who have “successfully” navigated the torrential waters of “Short Sales” will prove beneficial also.

THE HIDDEN MONSTER – The Deficiency Balance



With a “Short Sale”, the lender has three possible ways to handle the deficiency balance, which is the portion of the mortgage debt not covered by the sale of the home.

- ✚ First, the lender can attempt to collect the deficiency balance from the seller after the property has closed.
- ✚ Second, the lender may require the seller to sign an unsecured promissory note for the deficiency balance as a condition of agreeing to the “Short Sale”. The note gives the lenders the right to sue a seller and attach other assets if the note is not paid when due. If the new note is for less than the balance of the original debt, the difference would be considered cancelled or forgiven debt.
- ✚ Third, the lender may agree to cancel the entire deficiency balance.

On the surface, option three would seem to be the best alternative for a seller. However, the IRS currently considers any canceled mortgage debt ordinary income. This means that the amount forgiven is taxed at the same rate – somewhere between 15-30% as the seller’s salaries. In addition, because the IRS requires the lender to file a 1099-C form stating the amount of the canceled debt, Uncle Sam will have a record of the exact amount of the debt that was canceled. A seller will also receive a copy of the 1099-C to use in filing income taxes. The seller’s home state may also consider the cancelled debt as ordinary income.

There are four exceptions. A seller may avoid tax liability:

- ✚ When he receives a bankruptcy discharge and the deficiency is included in the bankruptcy.
- ✚ When he is insolvent at the time of the cancellation of the debt. Insolvency would occur when his liabilities exceed assets. Note that the seller will have to prove this insolvency to the IRS when filing a tax return.
- ✚ When the debt is secured by a nonrecourse loan. Under a nonrecourse loan, the lender does not have the legal right to collect a deficiency judgment from any assets of the debtor not pledged to secure the loan. While most home mortgages do not fall into this category, purchase money loans on a person's residence is nonrecourse in some states.
- ✚ When the tax liability from the cancellation of debt on an investment property can be offset against other business liabilities and expenses. This exception does not apply to properties occupied as a residence by the mortgagor.

In many “Short Sales” the seller would be able to qualify under the first two of these exemptions, especially since it was almost certainly necessary to show financial hardship in order to convince the lender to agree to a “Short Sale”. However, it remains the seller's responsibility to notify the IRS why the amount in the 1099-C should not be counted as ordinary income. Otherwise, the IRS will consider the forgiven debt as income and penalize the seller for unpaid taxes.

What to Tell Clients

To ensure that your sellers don't run afoul of the IRS and blame you, you should notify all sellers in writing that they should seek professional tax advice regarding the possible tax consequences of selling their home.

While you certainly don't want to give specific tax advice, you should alert “short” sellers to the basics facts about the tax consequences of “Short Sales”. With the current foreclosure crisis in this country, many, including NAR, are working with Congress to reverse this law. However, until that time, real estate professionals must be aware of the potential tax issues for a seller in a “short sale”. The NAR is currently supporting the passage of S. 1394, the Mortgage Cancellation Tax Relief Act, which would repeal the law that requires home owners to pay taxes on forgiven debt for their principal residence as a part of a “Short Sale”. If you work “Short Sales”, you will want to keep abreast of changes to this law so you can properly counsel your sellers.



LEGAL PITFALLS

As home prices stagnate, real estate professionals are more likely to face the question of when, how, and how much to disclose about a financially distressed property. “Short Sale” properties

present two disclosure challenges – finding a reliable source of correct information about the physical condition of the property and deciding how and when to make disclosure about the owner’s financial distress.

In a “Short Sale”, sellers may feel desperate and be particularly reluctant to disclose property defects. In addition, a seller who is unable to pay a mortgage has often failed to maintain the property. In these situations, it’s critical to explain to the seller that withholding information will not improve their situation. Distressed sellers need to understand that they will still be vulnerable to a buyer’s lawsuit if known defects aren’t disclosed. Of course, buyer’s agents have an obligation to encourage buyers to have a thorough inspection of any property prior to purchase.

An agent for a distressed seller also faces the decision of when to disclose the owner’s situation and how much to disclose. In general, a salesperson representing the seller should advise prospective buyers about the property’s financial status before they sign a purchase contract because the need for the lender’s approval of such sales can affect the terms of the sale and the timing of the closing.

NAR’s MLS policy was amended early in 2009 to require multiple listing services to give their participants the ability to disclose any possibility of a “Short Sale” to other MLS participants. Participants may also communicate to other members how any lender-mandated reduction in the gross commission stated in the listing contract will be apportioned between the listing and cooperating brokers.

The policy also gives MLSs discretionary authority to require participants to disclose potential “Short Sales: when participants have reason to believe that the transaction may result in a “Short Sale”. The policy provides that “Short Sale” information should be included in the confidential remarks field of a listing as soon as the listing broker knows about the possibility of a “Short Sale”. (Because a “Short Sale” is considered a material fact, NWMLS Rule 11 a iii requires listing agents to disclose that the listing is a “Short Sale” in the Agent only remarks.)



And what of your liability? Customers will be turning to you for help. You will be asked about options available to them. They want advice and expect you to know the answers to their questions. Are you prepared to assist them? More importantly, are you protected against any issues that may arise from accepting such transactions? Have you taken actions to lessen your exposure to potential liabilities? The legal and financial ramifications of any mistakes made while guiding customers through a “Short Sale” process may be severe unless you take the necessary steps to guard your business. So what can you do to build a shield against accusations from customers who may feel they’ve been wronged.

The time to protect yourself should start at the time you meet your client for the first time. When you arrive at the conclusion that a transaction could be a “Short Sale”, you should immediately and in writing, advise your client to seek the assistance of an attorney and CPA.

Another possible pitfall is the language in a lender's pay-off statement. Take a look at these two statements:

1. We, the lender, accept \$400,000 to release lien on the subject property.
2. We, the lender, accept \$400,000 as full and final settlement of debt for the subject property.

There is a significant difference. The first sentence merely states that the customer is released from the property while financial liabilities may still remain. The second, clearly states that the lender accepts an amount as final settlement and that any future claims will not be made. That's why it's important that you remind your sellers (in writing) to seek legal counsel.

In addition to educating yourself on the ins and outs of these complex deals, you also need a good picture of legal risks that exist for you. Following are 7 legal pitfalls written in the Realtor® on-line magazine by Robert Freeman, senior editor of Realtor® magazine.

Misrepresenting tax consequences

Although it's true that the federal government passed a law in 2007 directing the IRS not to count mortgage debt forgiven by a lender as income, the provision is limited. It applies only to purchase money; it doesn't apply to debt on a cash-out refinancing, and it doesn't apply to second homes. There's also a dollar limitation, albeit a generous one (\$1 million for married couples filing separately, twice that for joint filers).

Misrepresenting how secondary debt is treated

"Practitioners might mistakenly tell sellers that all the house debt is forgiven once the primary lender approves a short sale. But that might not be the case", says Lance Churchill, a short sales specialist and trainer who operates in Boise, ID and San Diego. Holders on second deeds of trust don't typically forgive the debt. More commonly, they accept a partial payment, like \$2,000; and rather than write off the balance, they sell the balance to a collection agency for another few thousand dollars. In many states, these second loans are recourse, so sellers can be caught by surprise when the collection agency contacts them a year later seeking payment of the debt.

Acting on inappropriate lender request for seller contributions

It's not uncommon for lenders to go after money that the sellers have in the bank or in a retirement account before they approve a "Short Sale" request. They'll sometimes seek to put the onus on the real estate practitioner to get sellers to sign over a note for the amount they have in the bank as a condition of sale. But in states where mortgage debt is nonrecourse (no right to demand), lenders have no right to the money, and associates that suggest otherwise to the sellers might be later sued for negligence.

Breaching fiduciary duty

Investors are increasingly executing what's known as a "double close and flip", which was described earlier in this lesson. This practice can leave practitioners exposed to irate sellers who say they got a raw deal.

Providing poor oversight of a loss mitigation company

Companies that specialize in managing “Short Sales” promise to focus on the complicated details of the “Short Sale”, freeing up practitioners’ time to find buyers. But if you take a hands-off approach, you can be charged with negligence if a deal falls apart. According to Churchill “Practitioners are coming back a month later to find no one’s even opened the file.”

Lacking the required license to undertake loss mitigation

It often makes sense for practitioners to take a two-pronged approach with clients facing a difficult time paying their mortgage – first trying to help them accomplish a loan modification (for a fee), and then finding a buyer if a modification doesn’t work. Are you licensed to earn a fee for helping owners modify mortgage terms? Without having the right credentials, taking a fee for loan modification assistance could be a criminal offense.

Facilitating transactions not listed on the HUD-1 form

It’s not uncommon for investors to offer incentives to sellers to move a deal forward, but lenders typically frown upon sellers who walk away with money when they’re supposedly taking a loss. Investors sometimes work around this limitation by offering to buy something from the sellers at an attractive price, such as a couch for \$5,000. Associates who communicate these offers to sellers can get tied into charges of lender fraud because the deals may be deceptive.

NWMLS LEGAL BULLETIN #181

Effective March 25, 2009, the Washington legislature has amended Distressed Homes Law (RCW 61.34)(The “Law”)

In June 2008, the Law created new duties for real estate licensees in order to protect owners of “Distressed Homes.” Under certain circumstances, real estate licenses could have been considered “Distressed Home Consultants” for sellers and were required to comply with the various provisions of the Law. The 2009 amendment to the Law generally exempt a real estate licensee from the definition of a “Distressed Home Consultant” when the licensee is providing routine real estate brokerage services.

Sales associates are encouraged to review the legal bulletin on the NWMLS Discover site and to review the revised forms and manual instructions. This bulletin describes what the “exempt” status means, exceptions to the exemption, revised listing agreements, revised buyer agency agreements, discontinuance of forms, the modification of the “20 day rule” and the “delayed possession” provisions; revisions to the For Sale By Owner Addendum, delayed possession – 20 day limit and other amendments to the Law.

Foreclosures are UP but according to sources in the mortgage industry, people who agree to a “Short Sale” with the lender do far less damage to their credit rating than those who go through foreclosure. While in both cases credit will be negatively affected, at least “Short” sellers avoid having a “debt discharged due to foreclosure” which can reduce their credit score by over 250 points. “Short Sales” show up on a credit report as a “pre-foreclosure in redemption” status and can result in a credit score reduction of 100 points or less. People who successfully complete a “Short Sale” may also qualify for a mortgage at a reasonable interest rate in as little as 18 months.

As mentioned early on in this lesson, to work successfully in this niche requires patience, persistence, and a keen knack for problem-solving. This course is a basic introduction to the life of “Short Sales”. If you should decide to specialize in this niche market, you are encouraged to seek additional guidance from your Broker, attend advanced classes relating to the subject and seek assistance from practitioners who have successfully worked the “Short Sale” market.

Resources: N.A.R. Realtor’s On-Line Magazine articles

Short Sales

Shorts & REO, Circa 2009

Short Sales: The New Wild West

Realtor Advantage

Loan Forgiveness – After the Short Sale: Taxing What Isn’t There

Housing Counsel: What’s a Short Sale

Short Sales Set Sail Again

Don’t Sell Yourself Short

Rescue Sellers with Short Sales

Short Sales: Disclosing Distress

Are You Sidestepping Short Sales?

What to do When the Sale Price Leaves You Short?

Are You Protected?

Short Sales: 7 Legal Pitfalls

Assisting Clients with Short Sales

Dual Upside to Foreclosure Alternative

Making an Offer on a Short Sale? What you Need to Know

How to Succeed at Short Sales

NWMLS Legal Bulletin #181

**LOAN FORGIVENESS – A Primer on Short Sales
EXAM**

Complete and attain a minimum of 70% on the following exam consisting of multiple choice and true or false questions. Please circle the correct response to each question.

1. A short sale is described as
 - a. A means for buyers to offer low-ball offers
 - b. A process whereby the lender agrees to accept less than what is owed on a mortgage
 - c. A HUD-approved financial alternative for sellers to avoid foreclosure
 - d. Sales that take a short time to close

2. A lender's loan modification may include:
 - a. Refinancing at a lower interest rate
 - b. Providing a different payment plan
 - c. Providing a forbearance period if the seller's situation is temporary
 - d. All of the above

3. If a seller has 2 or more mortgages with different lenders, it may take up to how many months to close
 - a. 3
 - b. 2
 - c. 1
 - d. 4

4. You should recommend sellers seek housing default counseling from
 - a. Department of Finance
 - b. HUD-approved agencies
 - c. Department of Economic Development
 - d. None of the above

5. When considering a short sale, the lender will evaluate
 - a. The seller's financial situation
 - b. The property value
 - c. Foreclosure costs
 - d. All of the above

6. Factors a lender will consider when determining whether to allow a short sale include
 - a. What loss the seller will suffer
 - b. Where the house is located
 - c. How the short sale will affect the seller's future credit worthiness
 - d. None of the above

7. Short sale disclosure issues include
 - a. The property's physical condition
 - b. The owner's financial distress status
 - c. Agency representation
 - d. A&B
8. T or F Your role in the Short Sale process is to review a distressed seller's options with them
9. T or F All sellers who are behind in their mortgage are eligible for short sale status
10. T or F Preparing a market analysis will not benefit the seller who is applying for a short sale because the lender will have it appraised anyway.
11. T or F Lenders are more concerned with the time and cost involved with foreclosing on a property than the cost of closing a short sale.
12. T or F Short sale offers must have language indicating that the offer is contingent on the lender's approval.
13. T or F Understanding the "real" value of a property is a primary issue for lenders
14. T or F Working with aggressive investors who wish to do "double closes and flips" is encouraged in order to facilitate a quick sale of distressed properties.
15. T or F It is an acceptable practice to encourage buyers to make offers on several short sale properties.
16. T or F Using third party negotiators who have been trained, have relationships with banks, provide good follow-up can be effective to helping you close short sales.
17. T or F Lenders can not collect deficiency balances from a seller after the sale has closed.
18. T or F Preventing foreclosures is an indirect benefit to you when you negotiate short sales on behalf of clients.
19. T or F Cancelled debt is currently viewed as ordinary income by the IRS.
20. T or F A seller may avoid tax liability only if they receive a bankruptcy discharge and the deficiency is included in the bankruptcy.
21. T or F It is the seller's responsibility to notify the IRS why the amount on a 1099-C they receive should not be counted as ordinary income.

22. T or F When you realize that you may be working with a short sale seller, you should immediately, and in writing, advise your client to seek the assistance of an attorney and CPA.
23. T or F In all cases, all of the house debt is forgiven once the primary lender approves a short sale.
24. T or F Once you employ a third party to oversee a short sale negotiation process, you can take a hands-off approach.
25. T or F The lender may require the seller to sign an unsecured promissory note for the deficiency balance as a condition to agreeing to doing a short sale.

Mandatory Course Evaluation

Name: _____ Date: _____

Course Title: Loan Forgiveness – A Primer on Short Sales

School: Basics and Beyond Real Estate Institute

Instructor: Loraine Du Paul

Delivery Method: Distance Education

Please check your answer to each question	Yes	No
Did you receive a copy of the course curriculum/objectives?		
Did the course content conform with the published description?		
Did you read the material in the booklet on the date indicated above?		
Did you complete the quiz for the course & use the enclosed answer sheet?		
Did you complete this course evaluation & sign the form below?		

Why did you choose to take this course? Circle all that apply: Topic Time Cost Ease or Other (Specify) _____

Course (5 being excellent, 1 being poor)	Exc				Poor
How useful was the information acquired from this course?					
How current was the information presented?					
How would you rate the organization of the information?					
How would you rate the quality of the materials used?					
What is your overall evaluation of this course?					

Delivery Method (Distance Education)	Answers
How many hours did it take you to finish the course?	
Was your assessment of your clock hours inclusive a homework assignments? If yes, then break down the seat time.	
Did the course have periodic measures of time spent and progression towards completion?	
Did the delivery method allow interactivity with an instructor? Was the instructor available?	
Additional comments about the course, instructor or delivery method	

Would you take another correspondence course from Basics & Beyond Real Estate Institute?

Yes No Why? _____

Thank you for taking this course

Your Signature _____ Date: _____

To file a complaint regarding any education issues, you can download the Education Complaint Form from www.dol.wa.gov/forms/610013.htm

DISCLAIMER: No denial of full continuing education credit for the subject course may occur as a result of completing this evaluation form.