



Everyone COULD win on home 'short sale'

By [Tamara E. Holmes](#) • Bankrate.com

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If you can no longer make your mortgage payments and your home is now worth less than you owe on it, foreclosure may not be your only option.

A **short sale** -- in which the lender allows the sale of a home for less than it is worth and forgives the rest of the note -- provides another alternative to homeowners.

While there are some significant negative consequences to a short sale, an ever-increasing number of properties are being advertised with that label, says Natalie Lohrenz, director of counseling for Consumer Credit Counseling Service of Orange County in Santa Ana, Calif.

"A lot of people in the last couple of years have just stretched themselves to the limit and you have people with mortgage payments where even when they got the mortgage, the payment was half their income or more," says Lohrenz. "Now that rates are adjusting, it's two-thirds or three-quarters of their income and it's just not possible."

Short sale: Win-win-win situation

The beauty of short sales is that they can be a win-win-win situation for seller, buyer and lender. Here's how:

- **The seller** gets out of the mortgage liability without facing bankruptcy.
- **The buyer** gets the home at a reduced price.
- **The lender** agrees to a loss it considers minimal without waiting through a foreclosure and being saddled with an unsalable property.

While it may seem surprising that lenders would agree to accept less than what they are owed, they benefit from the process, as well.


"The lender benefits by not having to go through the protracted process of foreclosing on the borrower and then having to put the property on the market and go through the whole marketing process," says Stuart Wilson, a real estate agent with Paragon Real Estate Group in San Francisco.

A market saturated with foreclosures can cost lenders billions -- as much as \$50,000 per foreclosure -- according to a study released earlier this year by the Joint Economic Committee.

A buyer's dream


For a buyer, a short sale is a boon since he or she is getting a property at a reduced price. However, the process of waiting for a lender to decide whether to agree to a short sale could make a lengthy home buying process even longer and more arduous.

Next: ["A lot of lenders aren't even going to consider a short sale ..."](#)

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Wilson, who has represented both buyers and sellers in short-sale deals, advises working with an agent who's familiar with short sales. He also suggests that buyers looking to negotiate a short-sale deal come armed with enough documentation to convince the lender that settling for the lower price is their best option.

"You'd better be armed with recent comparables that show unequivocally that the lender's price is out of line," says Wilson. "You can't do this with a cover letter or a conversation. It will need to be done with the kind of documentation that an appraiser would come up with.

"When you go into a short sale, you have an institutional lender and it is an anonymous entity," Wilson continues. "You don't get a chance to talk to these people, you don't know what their guidelines are, you don't know what their time frames are and you don't know if your contract will be approved in six weeks or six months. It's a real crapshoot."

Lenders are most concerned with the financial situations of the seller when they ultimately make their decisions. If a seller can handle the mortgage payment, there's no motivation for the lender to let the seller out of the mortgage at a lower price.

"A lot of lenders aren't even going to consider a short sale unless it seems like (the homeowner) is in financial distress," says Lohrenz.


Also, if the home has a second mortgage with another institution, a short sale is less likely to be approved since that second institution would have to agree to forfeit all or part of the money it's owed.

Last gasp only




While getting a lender to agree to a short sale may seem like an answer to the prayers of homeowners who want to unload a house, it's not a good move if you're merely looking to find a new place. It's generally a last-ditch effort when the only other option is foreclosure.

Should you go for a short sale? It depends on how deep a financial hole you're in and how likely it is you'll be able to overcome those financial difficulties.




[Next: Thinking about asking your lender to consider a short sale?](#)

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"If they're just having a short-term problem -- short-term disability or maternity leave or layoffs, but they have good prospects to find something soon and they can weather the storm and hold onto the profit through that -- obviously they wouldn't want to think about a short sale," says Lohrenz.

"But if the choice is foreclosure or short sale, generally a short sale is going to be a better idea."

Before you think about asking your lender to consider a short sale, it would be a good idea to get your paperwork lined up.

Be ready to document your need and to show the lender you are serious about your situation, including a hardship letter (an honest explanation of your financial situation and how it occurred), pay stubs, bank statements, tax returns, an appraisal and documentation of your debts.

3 critical safeguards

If you're considering a short sale, experts advise you to take the following steps to meet potential negative consequences head-on.

Get it in writing. Make sure the lender agrees in writing that the short sale will absolve all debts.

"If they owe \$300,000 on the house and the short sale is for \$280,000, is there any possible way that the lender's going to come after them for the \$20,000?" Lohrenz says. "Most lenders will put that in the agreement that they're not going to come after the deficiency."

3 critical safeguards:

1. Get it in writing.
2. Protect your credit.
3. Work with a tax pro.

Protect your credit rating. Ask the lender how it will report the short sale on your credit report.

"Most of the time, a short sale shows simply that a debt is satisfied," says Lohrenz. "But theoretically, a short sale could reflect on the credit report as 'settled for less than the full balance.'" Such a designation is a negative mark on your credit report, though it wouldn't hurt your credit as much as a foreclosure would.

Get professional tax advice. Short sales often have tax repercussions since lenders can claim the forgiven debt as income that they provided you.

That means if you agreed to a short sale for \$50,000 less than what you owed the lender, the lender could issue you a 1099 for \$50,000, which you would have to pay taxes on.

But there are two "outs," says Lohrenz. "If you meet the IRS's definition of insolvency at the

time the debt was forgiven, then you generally don't have to pay taxes on it."

Or, if your home loan is a non-recourse loan, you're also likely to escape this tax. With a recourse loan, whoever signed the note is personally liable for the debt, and in a short sale, the debtor would have to pay tax on the difference. A nonrecourse debt is one secured by the loan collateral -- such as the house itself -- and the debtor would not have to pay tax on the sale shortfall.

The most common case is that mortgages secured by the property -- especially for buyers who made a 20 percent or more down payment -- is a nonrecourse loan. But it is absolutely critical you consult a tax attorney before you make such a move to ensure that you don't dig a deeper financial hole as a result of the tax situation.

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