Short Sale Checklist – Information Gathering

Compile the following information when creating a short sale proposal packet.
Note: Always make copies of original documents and return originals to the homeowner.

Financial Information

Three most recent bank statements for all checking accounts for all borrowers

Three most recent bank statements for all savings accounts for all borrowers

W2s from the past two years for all borrowers

Income tax returns from the past two years for all borrowers

Past three paycheck stubs for all borrowers

Copies of all bills for all borrowers from the past two months. Will be used to compile a financial worksheet. Could include:

Automobile loans
Alimony/child support
Child care bills
All credit card bills
Electricity bills
Gas bills
Water/Sewage bills
Home telephone bills
Cell phone bills
Cable bills
Automobile insurance
Health insurance
Life insurance
Doctor bills
Dentist bills
Pharmaceutical drug bills
Food/Groceries
School lunches
Gasoline (auto)
Student loans
Other loans
Other bills

Yvette
985 640 5412

Hardship Information

Hardship letter that describes succinctly yet persuasively why the homeowner was unable to meet his or her loan payments. The homeowner must write the hardship letter.
Documentation of hardship. Documentation may include:

Hospital bills
Doctor bills
Home repair bills
Documentation of unemployment
Documentation of incarceration
Death certificate
Divorce decree
Other documentation

Property Information

Information about any additional liens on the home. The homeowner may have this information. Ask the homeowner if he or she has a recent credit report. Alternately, a present owner search would reveal whether there are any additional liens.
Recent Comparative Market Analysis (CMA)
Estimated HUD-1
Estimates for any necessary repairs to the home.
Most recent property tax bill and proof of payment status
Proof of homeowner's insurance coverage

Lender Information

Monthly statements from the first and second lenders
Name of supervisor in Loss Mitigation department
Direct phone number for Loss Mitigation department
Short sale application from the lender
Written authorization from the homeowner for the Realtor to speak on his or her behalf

Other

If homeowner filed for bankruptcy, name and number of bankruptcy attorney
If homeowner is in a law suit, name and number of attorneys

Lender Name
Lender Address

Today's Date

Re: Hardship Letter/Short Sale for 123 Main Street, City, State 12345

To Whom It May Concern:

I purchased the property at 123 Main Street in March 2006. At that time, I had just started my own antique resale business, which had great promise for generating profits capable of supporting my mortgage. Unfortunately, sales were slow, which I attribute to great declines in tourism after gas prices skyrocketed. I ran out of money, and began working as a waiter to make ends meet. At the same time I was redoubling my efforts in my own business, but to no avail. After struggling for months to make my expensive mortgage payments, I had no choice but to put my house on the market. In August of 2006 I put my home up for sale by owner at an original listing price of $210,000. The only people to look at the house ran when they saw the extensive damage to the pool and the severe water damage from a leaking roof that had long needed a replacement. I lowered the price, but still had no takers. Over the next couple of months I lowered the home price three times, finally settling at $170,000. This price was the lowest I could list the house at and still afford real estate agent commissions to be deducted, although it leaves me with no profit. The home still has no offers. I am working with a Real Estate agent now, who is listing my house and promises to push it to get it sold quickly. I believe that using an actual agent will ensure that the home sells promptly.

I love my home, but I also understand that at this point, I cannot afford it. I am a single parent, now working as a waiter to survive. My financial situation cannot sustain a home mortgage of nearly $2000.00 per month. I would like nothing more than to sell my home, avoid foreclosure, and salvage my credit. This is my main concern. I know that a foreclosure on my record will affect me for years to come. I would ask that you please assist me in avoiding this.

Please accept this offer as payment in full. My attorney has advised me to file bankruptcy, but I prefer to avoid further destruction of my credit. I just want to move on and start over.

I deeply appreciate your help and understanding in this matter. If you have any questions, or need anything further from me, please contact me personally.

Kindest regards,
Home Owner Name

Short Sale Proposal Packet Checklist

Include the loan number on the header of every page in the proposal checklist.

Title page
Executive summary that highlights the financial benefits to the lender for accepting the short sale
Table of contents
Written authorization from the homeowner for the Realtor to speak on his or her behalf
Lender's short sale application
Listing agreement
Buyer's contract
Estimated HUD-1
Information about any other liens on the home
Short sale disclosure signed by the seller and the buyer
Hardship letter. Note: The hardship letter must be written by the homeowner
Supporting documentation for the hardship, including financial documentation
Recent Comparative Market Analysis (CMA)
Documentation of any damage to the home and estimates for repairs
Detailed request for the short sale
Cost-benefit analysis that details the financial benefits to the lender of accepting the short sale
All relevant phone numbers and contact information

4 Reasons Lenders Want to Work With you on Short Sales

In steeply declining markets — particularly in states like Nevada, Arizona, Ohio, and Michigan — short sales are booming. Selling a home for less than the underlying mortgage often provides troubled home owners with their best chance of avoiding foreclosure and ruining their credit. A cottage industry of bankruptcy specialists and other self-described loan mitigators are trawling for clients, but lenders would often prefer to work with real estate professionals in negotiating short sales for clients.

Short sales expert Will Weaver of Royal Oak, Mich., explains why:

1. You're licensed by the state.

2. You adhere to a code of ethics.

3. You carry errors and omissions insurance.

4. You have too much at stake to cut corners. As a licensed professional, you aren't likely to commit fraud that could put your entire career at risk.

Sold up short

How to Succeed at Short Sales

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.

BY MARIWYN EVANS

You're so happy you got the listing — at least until the sellers inform you the price you're suggesting based on your careful CMA just isn't enough. Why? They owe more than that on their mortgage and home equity loans. Welcome to the world of short sales.

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: the short sale.

To help you gain a better understanding of short sales and what it takes to specialize in this growing area, we took a look at some of the most common questions on this topic that you and your customers likely will face today. Armed with this information, you can decide whether short sales are an avenue worth exploring for your business.

What is a short sale?

A short sale occurs when the net proceeds from the sale of a home are not enough to cover the sellers' mortgage obligations and closing costs, such as property taxes, transfer taxes, and the real estate practitioner's commission. The seller is unwilling or unable to cover the difference.

Some — although by no means all — short sellers may also be in default on their mortgage loans and be headed for foreclosure. However, home owners who bought at the top of the market or who took out large amounts of equity with a refinance and who now need to sell because of divorce or job transfer may also find themselves upside down, owing more than the home is currently worth when closing costs are factored in.

Tip: Losing your home can be very emotional and most people don't want to face up to the reality until foreclosure sets in. "You have to have to have a very soft sell approach, but still keep sellers focused on getting forms and paperwork complete," says Sheryl Thomson, associate broker, Exit Island and Beach Realty, Merritt Island, Fla.

Other sellers simply don't understand that if they have assets, such as stocks or a high-salaried job, a lender is not going to let them just walk away from a short sale without signing a note to repay what they owe, says Steve White, broker with Keller Williams VIP Properties, Santa Clarita, Calif.

How do I know it's short?

A CMA will be your first indicator, but you also need to ask the seller what their outstanding debt is and calculate the cost associated with a sale — from transfer taxes to your commission. This will give you an estimate of the net proceeds that will be realized, often called the net sheet. This information can then be entered into a HUD-1 Settlement Statement to calculate out the final, negative result at closing. Some lenders also have their own forms.

Check with the title company and the lender to get exact figures on closing costs and loan balances and to find out what procedures they have in place. If they can afford it, sellers should also consider getting a home inspection to determine what repairs are needed on a home and how this might affect its value, says White.

Tip: Get the seller to send a brief letter to all mortgage holders, giving them permission to speak with you. Otherwise, privacy laws will prevent them from talking to you about the loans, says Larry Hollingsworth, associate with HomeCity Realty, Dallas/Frisco, Texas, and a short-sale course instructor. It's also critical to build a relationship with the seller's lender. Once you have credibility, the entire process becomes easier, he says.

Who do I and the seller need to talk to about the problem?

If there are a first and second mortgage or a home equity line of credit, you may have to talk to more than one lender to get approval for a short sale. In addition, you may also need approval from the entity that holds the pool of loans if the mortgage has been securitized.

"The presence of two lenders 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," says White, who with Gina Covello, e-Pro®, broker associate at Keller Williams Realty, Studio City, Calif., teaches a course called "The Anatomy of the Short Sale."

Opinions differ, but most experts suggest that you let the lender involved know as soon as possible of the potential short sale. Others say you should wait until you have an offer because you'll get no action until then. "Without a viable purchase offer, your deal won't be considered by mortgagees," says Margot Cole-Murphy, broker with RE/MAX Equity Group, Portland, Ore.

Tip: Be sure you contact the bank's loss mitigation department, which will be the group to decide whether to accept a short sale, rather than the collection or customer service department, which is only interested in recouping past due loan payments. "Finding the decision maker is often one of the biggest initial challenges in a short sales," says Thomson.

What information will the bank need to decide whether to accept a short sale?

The sellers' submission package should include W-2 forms from employers (or a letter explaining the seller is unemployed), bank statements, two years of tax returns, and other financial documents outlining income and debt obligations. The bank will also need comps or a broker's price opinion showing your estimate of value.

In addition, the sellers should submit a "hardship letter," explaining the circumstances that make it impossible for them to pay the full amount of the loan. The seller needs to be able to show true financial hardship. Someone with the assets or the income to pay is unlikely to be considered, say most interviewees.

Tip: In preparing the package, be careful about discrepancies between the seller's income and the income used to obtain the loan, cautions Lance Churchill, an attorney and instructor on short sales and REOs with FrontLine Seminars. A big gap may indicate mortgage fraud, unless employment circumstances have drastically changed.

What are the options besides a short sale?

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. This option can extend the term of the loan, add on delinquent payments to the loan principal, and/or reduce the interest rate to make the loan more manageable for the home owner.

Another option is a repayment plan that requires home owners to increase their monthly payments until the loan is current, says Loni Parmelly, a real estate practitioner and consultant who specializes in short sales. Parmelly also is author of *Success in Short Sales* (2004), a book she sells on her Web site. It may be possible to refinance an adjustable rate loan with a Federal Housing Authority or conventional fixed loan. Note that lenders will not postpone a foreclosure just because a property is listed, although they may postpone if you have a reasonable offer in the works.

Tip: The ideal candidate for a short sale is still making loan payments and has a credit rating worth preserving. Otherwise, it may not be worth going through the complicated process, says Steve Pierce, broker and operating principal of Keller Williams Benchmark Properties, Fremont, Calif.

How should I price a short sale property?

In general, most short sale experts say to price the property at or near fair market value, although a few will begin with the total payoff amount owned by the seller. How frequently prices are dropped will depend in part on whether the property is in preforeclosure. Most banks have a formula for what percentage under market value they will accept, say interviewees. Figures cited vary from 8 percent under to almost 20 percent under.

"I always price the property 10 percent lower than comparable to peak buyer interest and initiate buyer activity," says Cole-Murphy, who's also founder and curriculum developer for Real Estate Pro Guides, a line of educational books for practitioners. However, it's important for buyers to understand that the bank will not give away the property, she says.

Tip: Most lenders will want to get a broker's price opinion or even an appraisal to see what the property is worth before you and seller set a list price. One way to help ensure that the bank's estimate of value is realistic is to offer comps of recent sales — both traditional and REO, says Churchill, who is also the author of *The Foreclosure Specialist: A Real Estate Agent's Complete Guide on Working in the Foreclosure Market* (Valco Press, 2007).

"Practitioners who do BPOs are rated in part on how close their estimates are to the final sale price, so they usually welcome information on legitimate comps," he says.

What and how should I disclose about the short-sale property to prospective buyers?

Opinions vary on this topic, although most experts favor disclosing that a property is a short sale in the comments section of the MLS listing. Others suggest waiting to disclose the need for lender approval of the sale until a buyer is ready to make an offer. Debra Allen, ABR®, e-Pro®, with Prudential Arizona Properties, Gilbert, Ariz., uses a disclosure form prepared by her brokerage just for short sales. She also had a special sign rider for the yard sign made indicating a property is a short sale.

Tip: Watch out for unethical investors who will try to convice an owner facing foreclosure to sign a quit-claim deed for the property, and then lease the property, warns Jim Cacioppo, broker/owner of Grand Realty Group. Grayslake, Ill. In such cases, the former owners will still be liable for the mortgage payments, even though they no longer own the house.

How long does it take to complete a short sale?

Although response times vary from lender to lender, it can take two weeks or as long as 60 days to receive an approval of a short sale from a lender. That's why it's critical that buyers and their representative understand and accept that time frame before they make an offer.

An addendum to the California Association of REALTORS® purchase contract includes a provision allowing either party to cancel a short-sale contract within a set period if the seller hasn't gotten the deal approved, says White. Properties with securitized loans (which are the majority these days) may require a longer time to get an approval of a short sale because of the possible need for approval from the entity holding the pool of securities, says Churchill.

Tip: Keep in mind that the purchase contract on a short-sale property is a legally binding agreement once the earnest money has been deposited. Without language in the contract stating that the lenders must approve the offer and release all liens on the property, the seller may face a legal problem for failing to execute the contract if the short sale is not approved, says Hollingsworth.

What can the seller and I do to make a short sale more attractive to a lender?

Getting a lender to approve a short sale is primarily a question of economics. You have to provide hard numbers to show that the amount of money a bank will realize on the short sale is better than the amount it may recoup from foreclosing on the property and selling the property as an REO, says Todd Ruckle, ABR, RE/MAX Associates Inc., Newark, Del.

A 2002 study by Craig Focardi of the Tower Group estimated that the entire cost of a foreclosure was $58,759 and took 18 months. Other factors that can influence a bank's decision include the liability risk it assumes by owning the property after foreclosures, the money tied up during the holding period for a foreclosure and REO resale, additional costs associated with an REO such as attorneys' fees, and the additional reserves it will need if REOs rise in the bank's portfolio.

Tip: A buyer that is willing to close in 30 days and who can make a substantial down payment may make the deal more attractive than a buyer who wants 95 percent financing, notes Michael Termine, GRI, CRB, associate broker, Prudential Rand Realty, New York City. All buyers should be preapproved for a mortgage before submitting the offer.

However, to avoid unnecessary costs, buyers should wait on having a home inspection and an appraisal for the loan until after the bank has accepted the short sale proposition, say Cole-Murphy. Genuine hardship, such as a lost job or high medical bills from an illness may also have an influence, says Covello.

What are the seller's options if a short sale is rejected by the lender?

There are a variety of reasons a bank will reject a short sale — from too low a price to too many files on the loss mitigator's desk. You can look for another buyer or even try resubmitting the same contract. "Banks don't want to take properties back in foreclosure, so they are going to do everything they can to make it work," says Pierce. You also need to prepare your seller in advance for the possibility of foreclosure if a short sale fails, says Parmelly.

Tip: A short sale might be rejected if the loan is less than a year old. In such cases, the servicer that's bought the loan can often require the original lender to buy it back, says Hollingsworth.

What financial or credit liabilities will a seller have as a result of a short sale?

Many lenders ask sellers to sign a promissory note for all or part of the difference between the proceeds of the short sale and the debt obligation as a condition to a short sale. In such cases, the note gives lenders the right to sue a seller and attach other assets if the note is not paid when due.

It's particularly important to understand this distinction if you work in states such as California that have a nonrecourse mortgage, says Churchill. In such states, the lender cannot pursue a deficiency judgment against a seller for any deficiencies after a property is foreclosed. Because of this distinction, sellers who are already in default on a mortgage and do not have the resources to pay off a separate promissory note after a short sale might be better off letting the lender foreclose, he says. If you are working in a state in which mortgage loans are nonrecourse, be sure and alert your seller-clients to this distinction.

Tip: Having a portion of a loan forgiven may have an adverse affect on the seller's credit. Encourage your client to try and sign a lease on an apartment before credit is further damaged, suggests Roberta Murphy, an associate broker with Windermere Exclusive Properties, San Diego.

What tax liabilities will a seller have as a result of a short sale?

One often overlooked aspect of short sales is that a seller must count any amount forgiven by the lender as income and pay taxes on that income, even if no actual money was received. The IRS requires lenders to submit a Form 1099 stating the forgiven amount. Sellers who meet the Internal Revenue Service definition of insolvency (either in bankruptcy or with debts exceeding assets) will not have to pay taxes on the forgiven amount.

Tip: The U.S. House of Representatives has introduced the Mortgage Cancellation Tax Relief Act (H.R. 1876), which would eliminate taxes on any debt forgiven on a principal residence through either short sale or foreclosure. The NATIONAL ASSOCIATION OF REALTORS® has been working to support this bill.

What compensation will I receive as the real estate salesperson or broker in a short sale?

Banks are going to want you to discount your commission. "It's the first place they'll look to save on closing costs," says Ruckle. Rates offered can vary, but are typically 1 percent to 2 percent below averages in the market, say interviewees. However, says Hollingsworth, more lenders now seem willing to pay a full commission on sales.

Tip: When you offer cooperative compensation through the MLS, be sure you also advise potential cooperating brokers that the gross commission established in your listing agreement is subject to court or lender approval and could potentially be reduced. You might also indicate in the remarks or comments field how you'll share the compensation you receive with the successful cooperating broker in the event the gross commission is reduced, instead of locking yourself to a specific percentage of compensation to the cooperating broker, says White.

Where can I find clients if I'm interested in specializing in short sales?

Word of mouth remains the biggest source of new business, experts say, but you can also promote your services to individuals attending credit counseling classes (now required prior to filing bankruptcy), to people who receive state notices of loan defaults, and to home owners named on lists of ARMs that will be resetting in the next few months. To find buyer clients, creativity is a plus. For example, Thomson is developing a monthly "Short Sale Hot Sheet" she e-mails to investors.

Tip: FSBOs are another good source since many upside-down sellers think they can't afford to pay a commission and so try to sell on their own. Many don't realize that in a short sale, the lender pays the broker's commissions, says Churchill.

Are short sales for me?

With many more adjustable rate mortgages ready to reset to higher loan amounts in the next couple of years, short sales represent a growing sector of the market. However, because sales are time consuming, they aren't for everyone. "I always say that if you're going to succeed in short sales, you need the 3 Ps — patience, persistence, and problem solving," says Cacioppo.

Published June 2007, REALTOR® Magazine Online

Loan forgiveness

After the Short Sale: Taxing What Isn't There

Too often, real estate practitioners are unaware of the tax liabilities arising from the cancellation of debt and fail to advise their clients accordingly.

BY LANCE CHURCHILL

You've just spent several stressful weeks helping your beleaguered seller negotiate a short sale. You've helped demonstrate to the lender that the home's price has fallen and that to close the deal with the new buyer, the lender will have to forgive $10,000 of the seller's outstanding mortgage loan not covered by the sale proceeds. But you did it, and now everyone is happy. The buyer gets a home, the lender avoids a messy foreclosure, and the seller walks away with no further financial burdens. Well, not quite.

Whenever real estate is sold, whether in a standard transaction, a short sale or a foreclosure auction, there are potential tax consequences for the seller. In this little scenario, the seller may still owe taxes to Uncle Sam — both in the form of capital gains on the home and on the unpaid portion of the mortgage. Yet, too often, real estate practitioners are unaware of the tax liabilities arising from the cancellation of debt and fail to advise their clients accordingly. Don't make that mistake with your clients.

How Debt Forgiveness Works

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. If the new note is for less than the balance of the original debt, the difference would be considered canceled, or forgiven, debt. Third, the lender may agree to cancel the entire deficiency balance.

On the surface, option three would be seem to be the best alternative for a seller. However, the IRS considers any canceled mortgage debt ordinary income. This means that the amount forgiven is taxed at the same rate — somewhere between 15 percent and 30 percent — as the sellers' 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 cancelled. A seller will also receive a copy of the 1099-C to use in filing income taxes. The seller's home state would also consider the cancelled debt as ordinary income.

4 Exceptions to the Rule

The IRS does recognize four situations in which cancellation of debt will not result in tax liability for the seller. A seller may avoid tax liability:

- When the borrower receives a bankruptcy discharge and the deficiency was included in the bankruptcy

- When the borrower is insolvent at the time of the cancellation of the debt. Insolvency would occur when a borrower's liabilities exceed assets. Note that seller would have to prove this insolvency to the IRS when filing a tax return.
- When the debt was 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 are do not fall into this category, purchase money loans on a person's residence are 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, a 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 is 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 also alert short sellers to the basic facts about the tax consequences of short sales. With the current foreclosure crisis in this country, many, including NAR, are working to reverse this law. However, until that time, real estate sales associates must be aware of the potential tax issues for a seller in a short sale.

Editor's note: The NATIONAL ASSOCIATION OF REALTORS® has long worked to change the tax laws and eliminate this "phantom tax" on income. Currently NAR is 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 residents as part of a short sale or foreclosure. Learn more about this topic at REALTOR.org.

About the Author: Lance Churchill is vice president of FrontLine Seminars, which educates and certifies real estate practitioners in foreclosure, preforeclosure, and short sales. Visit the company's Web site for information about courses on foreclosures and short sales. It's blog, FrontlineForeclosureForum.com, includes a discussion board for real estate practitioners working with foreclosures and short sales. Churchill can be reached at 208/846-9644 or lance@frontlinescompanies.com.