The Basics of “Short Sales”

by William Bronchick

You will likely come across dozens of properties in foreclosure with little or no equity, that is, the seller owes at close to or more than the property is worth. In these situations, lenders are sometimes willing to accept less than the full amount due, commonly referred to a “**short pay**” or “**short sale**.”

Negotiating a short sale with the lender is a difficult process, generally because it is a daunting task finding a bank officer who has the authority to accept a discount. You will have to call around to locate the lender’s “Loss Mitigation Department.” More than likely, each lender you deal with will have a separate name for this department, so be patient when calling. Much like getting your phone bill corrected, you can expect the process to involve a lot of waiting on hold and being bounced around an intricate maze of automated voice mail systems. Once you get in touch with the right person, then the negotiating begins.

From the lender’s perspective, a short sale saves many of the costs associated with the foreclosure process - attorney fee's, the eviction process, delays from borrower bankruptcy, damage to the property, costs associated with resale, etc. In a short sale scenario, the lender gets the property back faster, so it is able to cut its losses. Your job as the investor is to convince the lender that it will fare better by accepting less money now.

The lender will want some information about the property, the borrower and the deal he has made with you. Specifically, the lender wants to know what the property is worth. The lender will generally hire a local real estate broker or appraiser to evaluate the property (called a broker’s price opinion or “BPO”). You can also submit your own appraisal or comparable sales information. In addition you will want to offer as much specific negative information about the property as possible. Also, include some relevant information about the neighborhood and the local economy if things are bad (copies of newspaper articles with “bad news” may help). A contract’s bid for repair estimates should also be submitted, which, of course, should be the highest bid you can obtain!

The lender will also ask for financial information about the borrower. Sort of a backwards loan application, the borrower must prove that he is broke and unable to afford the payments. The borrower must show that he has no other source of income or assets to repay the loan. This process may involve as much, if not more paperwork than an original mortgage application! The borrower should submit a “hardship letter”, which is basically a sob story about how much financial trouble the borrower is in. This may require a little literary creativity, and some help on your part. Don’t lie, just paint a picture that doesn’t look good.

Finally, the lender generally wants to see a written contract between you and the seller. The lender wants to make sure the seller isn’t walking away with any cash from the deal. Generally, the contract must be written so that the buyer pays all costs associated with the transaction, so that the “net cash” to the seller is the exact amount of the short pay to the lender. A preliminary HUD-1 settlement statement is often requested, which can be difficult, since many title and escrow companies simple won’t prepare one in advance of closing. You can prepare your own HUD-1, and simply write “preliminary” on the top.

Don’t be surprised if your short sale bid is rejected. Lenders aren’t emotionally attached to their properties, so they aren’t as likely to give you “steal.” Many short sales fall through if the BPO comes in too high, which is often the case. You can’t pull the wool over a lender’s eyes - if the property isn’t is need of serious repair, it is unlikely you can convince the lender the property is worth a whole lot less than the appraised value.