

A Legal Update

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“THE SHORT SALE” What does it mean to you?

One of the results of poor lending practices and a slumping economy is the soaring rate of mortgage foreclosures. Briefly, the foreclosure process allows a lender (bank, mortgage broker, credit union, etc.) under the terms of the mortgage signed by the home owner, to acquire title to the home and sell it at public auction to a third party. Not only does this process hurt the home owner, it has become overwhelming to lenders who end up owning the property because no third party will bid high enough to pay off the mortgage balance.

Enter the “short sale”. The short sale, by definition is a process where a homeowner can sell his or her home for less money than they owe the lender and the lender agrees to accept the lesser amount, usually as payment in full. One of the most frequently asked questions we receive is “How does this effect me?” And the answer is “It depends, are you the seller or the buyer?”

Short Sale and the Seller

As a seller, the first thing you have to do is to get your lender to agree to a short sale. Generally this means you will have to be behind in your payments (or that the market value has fallen substantially) to even get their attention. Once you get the lender’s attention they will want to know why you fell behind and what are your chances of making payments in the future. The lender may ask you for bank statements, income and asset information, a market appraisal, and a hardship letter.

If (and when) you convince the lender you are no longer capable of making timely payments the lender will try to determine if it is more profitable for them to approve the short sale or foreclose on the property (their business is to make money, not bail you out). Assuming the lender is convinced that a short sale is in *their best interests*, they will want to review the Listing Agreement, the Purchase and Sale Agreement and an estimated net proceeds statement before giving final approval.

Unfortunately, this is not the end of the story. Many other issues may confront the seller, such as:

- Are there any other loans or liens that have to be addressed (junior lien holders)?

- Is the lender going to seek the deficiency (the difference between the amount owed and the amount accepted) from the home owner or, more importantly, a co-signer?
- Is the lender going to report the short sale adversely to the credit reporting agencies? (Practically speaking the home owner's credit has already been tarnished by several months of late payments reported prior to the short sale).
- Does the Mortgage Forgiveness Debt Relief Act of 2007 apply? If it doesn't, the IRS could consider the amount of debt forgiven as income and taxable.

Short Sale and the Buyer

One of the most important things the buyer of a short sale has to realize is the difference between a short sale and a foreclosure sale. If a buyer purchases the property at foreclosure, he buys it free and clear of all junior lien holders (second mortgages, home equity loans, mechanic lines). If a buyer purchases the property at a short sale, the lender will only release its lien and all other lien holders will have to cooperate for the buyer to get clear title to the property at the agreed upon price.

Next, remember that even though the seller has accepted your offer, you do not have a deal until the lender accepts it. Though it may seem like the lender is in the driver's seat, as a buyer you must protect yourself. First, do your research. Go to the Registry of Deeds and look for junior lien holders. Go to the town hall to check for passed or future assessments or compliance issues. Second, make sure you inspect the property thoroughly (home, pest, radon, lead paint, etc). Require that the property is in compliance with Title V if applicable (septic system services the property). And demand a realistic closing date. Lenders will say that have you close within a week or two to get this *great price* which is often unrealistic.

Lastly, just because it is a short sale doesn't mean it's a good deal. Maybe the seller paid too much for the property or maybe they borrowed too much to pay for college education. Maybe the market value has fallen so much that the short sale price is more than you can sell it for. Bottom line, do your homework and expect delays and last minute negotiations from all sides, including the real estate broker.

We, at Russell, McTernan, McTernan and Fruci, LLP, are well versed and experienced in short sales. If you have any questions please give us a call.