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## **THE SHORT SALE**

There is very little documentation about short sales to support what has been heard through the media and of course, the grapevine. The following is an attempt to give an overview of just what a short sale is, if it is a solution and the steps necessary to make this type of sale happen.

### **What is a short sale?**

The definition is simple. A Short sale occurs when a lender adjusts the loan payoff to accommodate the sale of a property. For example: Loan balance is actually \$100,000.00 and Seller gets an offer from a new Buyer who is only willing to pay \$80,000.00. If the lender accepts the offer, the lender has agreed to "Short-Sell" the payoff down \$20,000.00.

There are many other terms describing the short sale which include: Short Pay Sale; Compromise Sale; Negotiable Sale and Pre Foreclosure Sale. All of these terms describe the same principal for the same transaction. The term varies from lender to lender, however, the most common name is the Short Sale.

### **Why would a lender accept a payoff for less than the loan balance?**

Lenders must manage and mitigate their losses. The short sale option is usually a prelude and/or alternative to foreclosure. Because banks are required to maintain reserves on all properties in foreclosure, it can be financially advantageous to accept a payoff for less than the loan balance. Remember- there must be a willingness by the lender to negotiate this type of agreement.

### **Who and what situation qualifies for a short sale?**

There is mainly one requirement for qualification and that is proof of hardship. Hardships are not necessarily financial. The most common hardship situations are:

Impending divorce – a situation where both spouses may be able to meet the payment before the divorce, neither party alone can afford the payment after the divorce.

Illness – Illnesses where the person (s) is unable to work and continue to make the loan payment.

Unemployment – a situation where an individual has inadequate income to meet the loan obligation.

Hardball – for lack of any other term, hardball refers to anyone who no longer wants the property for whatever reason and will accept the consequences whatever they may be.

### **What are the consequences of implementing a short sale?**

In the vast majority of short sale situations, the Seller maintains a satisfactory credit rating, however, derogatory credit is a possibility depending upon status of the existing loan(s) at the time of sale and close of escrow.

The IRS law will require the issuance of a 1099C (Cancellation of Debt) for the difference between the loan amount and the actual payoff amount. Using the example shown above, the lender can issue the seller a 1099C for \$20,000.00 with applicable taxes due to the IRS.

In reality, only a portion of the banks/lenders issue a 1099C because there are usually several parties involved ( lender/bank, Fannie Mae, Freddie Mac, Mortgage Insurance) and none of those parties involved are willing to accept the responsibility issue the 1099C.

There are several advantages to the short sale. The seller can reduce debt, avoid foreclosure, maintain creditworthiness and most importantly, get out from under the mortgage/real estate loan.

However, there are also some disadvantages. Bad credit and tax liabilities can occur. In addition, any short sale from a VA guaranteed loan requires payment in full (for the entire amount due) or the Veteran/Seller loses all veteran benefits including death, educational and medical until the balance is paid in full.

The key decision makers in the short sale process include the lender, investor and the mortgage insurer, if applicable (MI/PMI). The lender (sometimes also the investor) typically gathers all the information required to consider a short sale package. The lender will then calculate what the actual loss is and either approve or disapprove the package. The final decision maker, if the loan carried mortgage insurance, is the mortgage insurer. MI/PMI will only approve a short sale package that has been signed off by the investor and requires the most comprehensive support information.

### **How to avoid pitfalls and information necessary in the short sale transaction:**

1. Seller should consult an attorney or their accountant to confirm ramifications and all legal issues.

2. Seller needs to gather applicable documentation which is similar to the data required when completing the original loan package with the additional proof of hardship, including: tax returns ( 2 yrs); paycheck stubs ( most current- at least 6 months) bank statements ( 2 years ) copies of debt balances and payment schedules.

**ALL OF THIS INFORMATION GATHERING SHOULD BE ACCOMPLISHED, INCLUDING THE LENDER'S VERBAL ACCEPTANCE OF THE SHORT SALE, PRIOR TO OPENING AN ESCROW.**

3. Real Estate Agent should have a written and signed statement from the seller authorizing said agent to communicate with the lender on the seller's behalf.