Short Sale

In order to hand over ownership of a property to you, your seller must first clear all debts secured to the property. So what happens when a seller accepts an offer that isn't high enough cover all selling costs and pay off their debts? Assuming they have the money, the seller could write a check for the shortage at closing. But what if they don't?
Then you're involved in a short sale.

A short sale is a transaction where the seller will not clear enough to pay off the mortgages and other debts secured to the property. The seller can only sell by convincing their lender to accept a short payoff, releasing all liens even though the debts are not fully paid.

What's the Process?

If you write an offer on a short sale, you'll quickly learn that the "short" in short sale refers to the bank's money, not time. Things start like a normal transaction—you write an offer and negotiate with the seller. The difference starts once you and seller agree on terms. Before you can close, your offer must go to the seller's lender to review and approve.

The bank needs to assess two things: 1) is the seller eligible for a short sale? and 2) is accepting this offer in the bank's best interest?

Financial Hardship

To qualify for a short sale the seller is almost always required to demonstrate a financial hardship and an inability to pay. Job loss, death in the family, illness, medical emergency, bankruptcy and divorce are considered acceptable hardships. A desire to move, financial mismanagement, having a child or buying another home is not generally considered an acceptable hardship. The seller must also turn out their pockets and prove they do not have the cash to pay the shortage. If a seller has the ability to pay, the bank will likely refuse the short sale.

What's Best for the Bank?

Before the bank will sign off on losing money, it needs to be sure there are no better alternatives. For starters, this means the loan must be delinquent. After all, why would the bank approve a short sale if payments keep rolling in each month? Once a loan is in default, the bank has just two options: 1) approve the short sale or 2) foreclose. Neither is good, but the bank wants to pick the one that's less bad.

Time is Money (But Money is Money too)

For the bank, a foreclosure is a lengthy and expensive process. The fastest a foreclosure can legally go through is about 4 months but many take a year or more. A short sale offers the bank quicker path to getting a defaulted loan paid off. If your offer is at market value—even in the ballpark—the bank is probably better off approving the short sale. If your offer is too low, however, the bank may clear more cash through a foreclosure and resale. Before approving your offer, the bank will assess the value of the property using an appraisal or (more often) broker price opinions (BPOs).

Complications and Irrationality

All of this assumes that, when assessing short sales, banks are rational actors, following a logical process. From the outside looking in, this doesn't always appear to be the case. Lots of factors come into play.

For one thing, the bank is more of a middleman than the decision-maker. Most banks are merely a loan

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servicer, acting on behalf of whoever actually owns the loan. Odds are whoever owns the loan sold securities to fund it, often to hundreds of different investors. Untangling this web of interested parties to secure a decision can be, well, complicated.

Although servicers have gotten much more organized about processing short sale requests things are still far from perfect. Each short sale is assigned to a "negotiator" at the bank. Negotiators are often over-worked (handling many, many cases at a time) and under-paid. Bound by arbitrary rules established by each servicer and investor, even a negotiator with the best intentions can only do so much. Further complicating matters, virtually all communication with the negotiator goes through a web portal (most often one called Equator).

Finally, some short sales involve more than one loan. After selling costs and Realtors are paid, there is only so much cash to go around. If there are multiple banks, they have to work out who gets how much amongst themselves.

Third Party Negotiators

The mortgage crisis and subsequent falling home values made for a large number of short sales—enough to spawn a mini-industry in managing them. Some real estate agents even specialize in processing short sales. Others outsource management to third-party short sale negotiators. For a fee, these negotiators handle communication with the bank(s), managing the flow of information and documents. Having a skilled Realtor or negotiator on the case can make all the difference in whether or not and how quickly a short sale closes.

Logistics – Write, Wait… Then Hurry Up

Timing for short sales can vary widely. We've seen a few offers written, submitted to the bank and approved in matter of weeks. At least one we worked on took over a year to go through. As of this writing, the average bank response time seems to be about 6 weeks. But of course, not every short sale offer gets approved.

Once your short sale approval comes in, be prepared to move quickly. The bank approval will contain a deadline for closing—generally 30 days or less. Yup, after waiting perhaps months to hear back from the bank, they'll give us just barely enough time to close. Take their deadline seriously, though. Extensions can be hard to come by and often carry a cost. And of course the seller has no money, so guess who's going to pay any extension fees?

Why Bother?

Although it's hard to call a short sale a good thing, everybody can benefit.

As a buyer, you may have less competition for short sale properties and may be able to buy them at slightly less than their full market value.

The bank gets a defaulted loan off of its books without the cost and delays of a foreclosure.

The seller maintains some control, gets a relatively speedy resolution to a difficult financial situation and avoids further damaging their credit with a foreclosure. Although it is important to note that a short sale does not automatically relieve the seller from responsibility for their debt and can have tax consequences. Sellers contemplating a short sale should seek legal and tax advice from qualified professionals.

Nothing Ventured, Nothing Gained

Your offer on a short sale will almost always include the right to withdraw your offer at any time prior to bank approval. Timelines (for deposit of earnest money, inspections, etc.) usually only begin upon bank approval. So if a short sale catches your eye, maybe just write an offer (see what your Realtor thinks, but why not?). But try not to leave your heart with it—keep shopping. If you find another property you like better, you can always cancel your short sale offer (generally with no consequence or cost). If you've kept shopping and nothing else has caught your eye? You can be that much more confident that short sale is meant to be yours.

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